



**carbonenergy**

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Carbon Energy Limited

ABN 56 057 552 137

Carbon Energy (Operations) Pty Ltd

ABN 61 105 176 967

## **ASX / Media Announcement**

1 August 2014

# **Carbon Energy 2014 Annual Report**

Carbon Energy (ASX: CNX, OTCQX: CNXAY) is pleased to lodge its Annual Report for the 2014 financial year, a copy of which is attached to this notice.

The 2014 Annual General Meeting of Carbon Energy will be held on **Thursday 20 November 2014** at:

Queensland Art Gallery  
Gallery of Modern Art (GOMA)  
Cinema B  
Stanley Place  
Southbank QLD 4101

Security holders who have elected to receive a hard copy of the 2014 Annual Report will do so with the Notice of Meeting for the AGM that will be distributed in due course.

## **ENDS**

For and on behalf of the Board

Tracy Bragg  
General Counsel & Company Secretary

**For more information please contact Marina Cid on +61 3156 7777.**

## About Carbon Energy

Carbon Energy is an energy innovator, and leading coal-to-gas company.

Our unique proprietary underground coal gasification technology keyseam, delivers low cost and environmentally responsible energy which can be used for power generation, chemical production and pipeline quality gas.

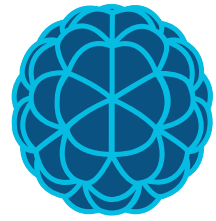
Initially developed by the CSIRO, Carbon Energy's keyseam has the capacity to deliver a new generation of energy following over \$100 million investment and five years of research and development. Our proven high quality and consistent syngas production has been developed at our Bloodwood Creek demonstration site in South East Queensland.

keyseam unlocks new energy sources by converting deep, previously inaccessible or uneconomical coal into a high-value gas, while it is still underground. The result is more sustainable, affordable, and safer, energy.

Carbon Energy is based in Brisbane, Australia.

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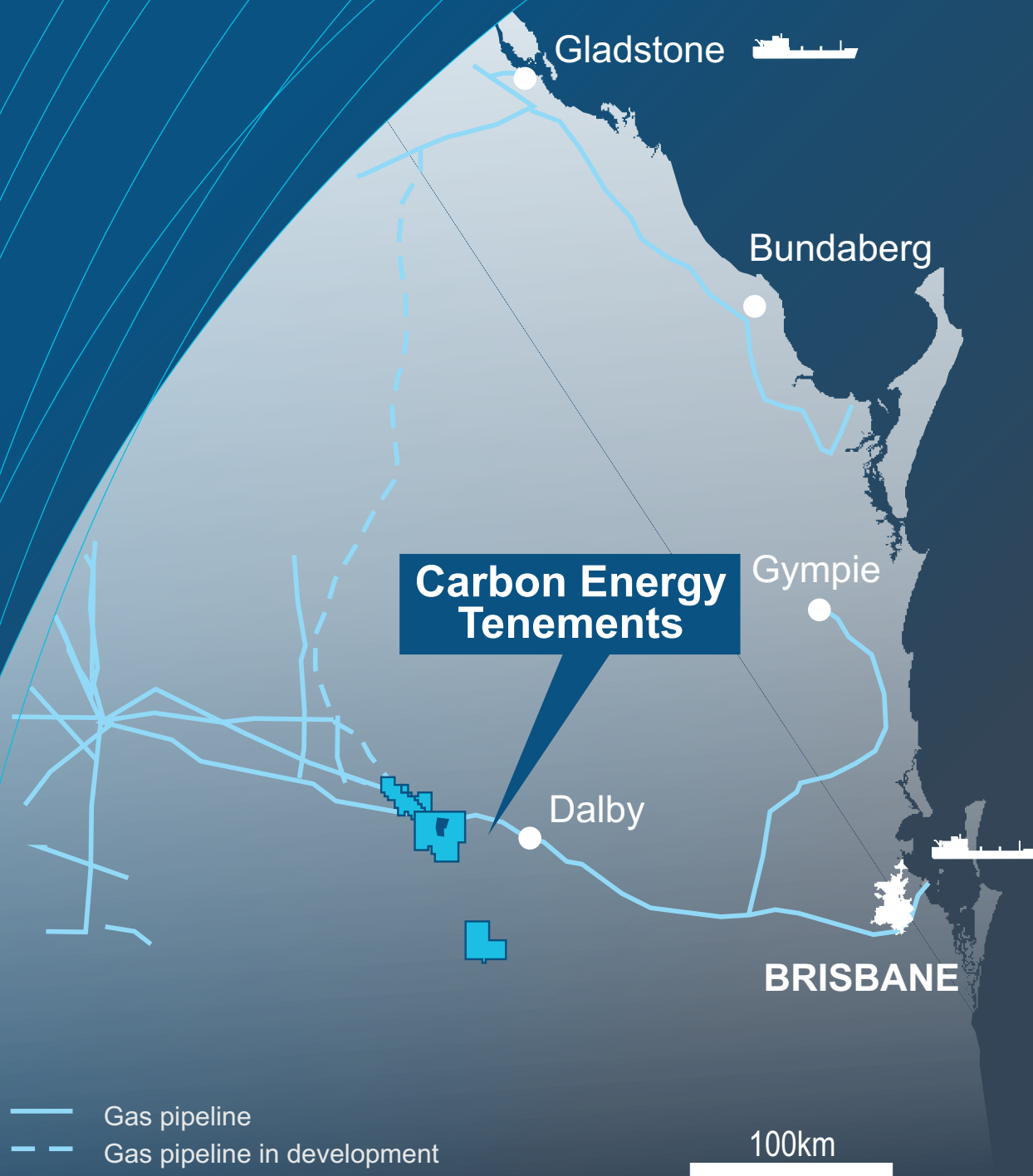
keyseam® is a registered Trademark of Carbon Energy Ltd



**carbonenergy**  
resource. technology. markets.

# ANNUAL REPORT 2014





## Carbon Energy Tenements

keyseam● is a registered trade mark of Carbon Energy Ltd.

Front cover: Drilling for environmental sample collection at Bloodwood Creek

# Carbon Energy

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Carbon Energy is based in Brisbane, Australia.





“ We are committed to unlocking the significant value of our first commercial project for our shareholders and to making an important contribution to the Queensland economy ”

Morné Engelbrecht  
*Managing Director & CEO*



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# Carbon Energy, Adding Value

## Commercial Project Economic Benefits

### ENERGY COMPARISON **keyseam** vs **CSG**

**keyseam BWC**

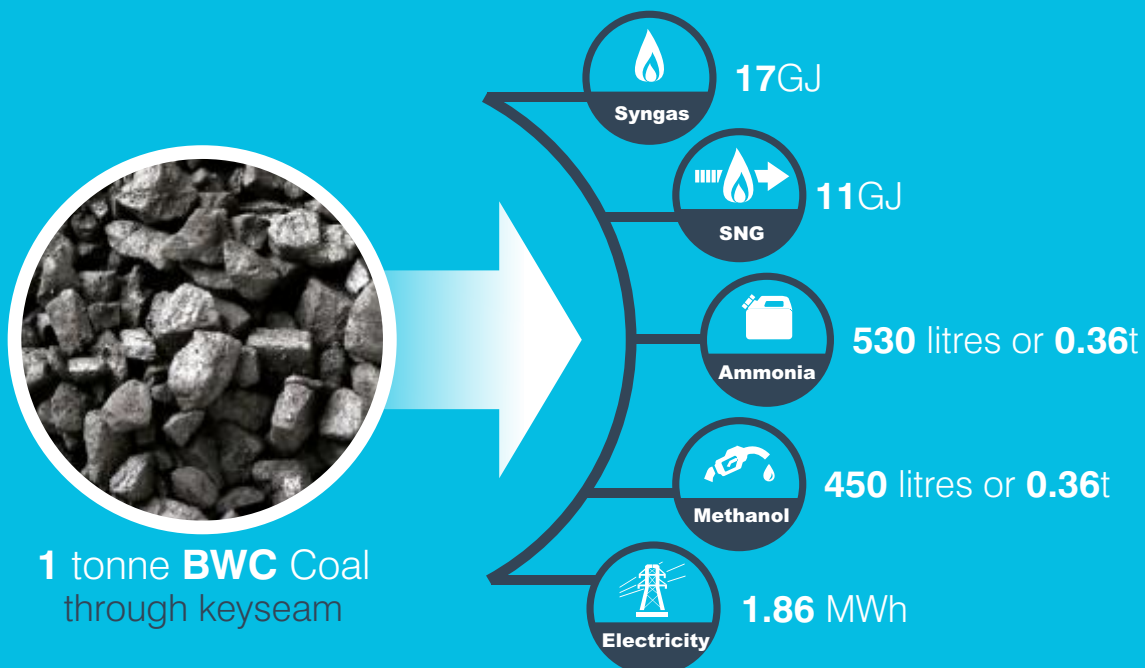
138 GJ<sup>2</sup>

CSG - 2.1 GJ<sup>1</sup>



1. Data from <http://mines.industry.qld.gov.au/mining/production-reserves-statistics.htm>

2. Data from CNX ASX Release 7 November 2013



BWC = Bloodwood Creek



QLD **GAS**  
CONSUMPTION



= **209PJ**<sup>1</sup>

  
carbon**energy**  
10 x 10 km  
**COAL** AREA

would  
produce  
equivalent  
**GAS**



TO  
SUPPLY  
QLD

**25**  
YEARS<sup>2</sup>



1. AMEO (2013)

2. Conceptual study results based on BWC trials

## 1<sup>st</sup> QUEENSLAND PROJECT COMMERCIAL VISION

**25PJ** pa **SNG** Plant

**\$4.6** billion

=

**25 YEARS**  
REVENUE

**\$187** million

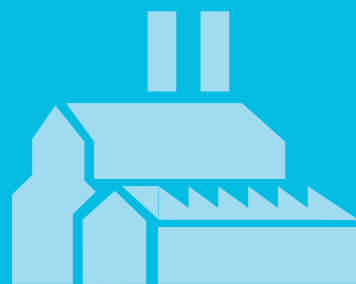
=

**ANNUAL**  
REVENUE

**\$9.15** million

=

QLD STATE  
**ROYALTIES**  
ANNUALLY



OVER

**1000** JOBS

DURING

**150**

NEW SUSTAINED  
LOCAL JOBS



CONSTRUCTION

# Chairman & Managing Director's Report

---

“ WITH GAS PRICES SKYROCKETING AND SUPPLY UNCERTAIN, CARBON ENERGY'S KEYSEAM TECHNOLOGY HAS NEVER BEEN MORE VIABLE. WE ARE LOOKING FORWARD TO DEVELOPING THIS VITAL NEW INDUSTRY HERE IN SOUTH EAST QUEENSLAND. ”

Dr Chris Rawlings  
Chairman

We are pleased to provide Carbon Energy shareholders with a review of the 2014 financial year.

2014 was a year of considerable progress. Following on from proving our technology, in the past year we have gone on to demonstrate keyseam's environmental credentials. We are now in the final stages of progressing commercial approval to operate in our head-quartered State of Queensland. Pending this approval, our Surat Basin gas project is poised for rapid development.

While the east coast of Australia faces the prospect of steeply rising gas prices, Carbon Energy is uniquely poised to capitalise on the market opportunity this has created. Our proposed gas project will provide Queensland industry with a reliable new source of low cost gas and help to bridge the gap of gas shortages predicted from 2017, when LNG exports are predicted to start.<sup>1</sup> Developing our gas project will be the Company's primary focus in the year ahead, with a goal of producing gas within three years of project commencement.

In preparation for the pending Government approval, Carbon Energy is negotiating off-take agreements with foundation customers for the project which will provide a solid project funding framework, as well as offer customers lower cost gas supplies.

Commercially our Surat Basin gas project will deliver the Company substantial revenue. Based on developing a 25 PJ synthetic natural gas processing plant, earnings over 25 years are estimated at \$4 billion, including \$9.15 million in State revenues annually. At a more local level the project requires a \$1 billion capital investment at our Bloodwood Creek site. The project will require over a 1000 jobs during construction and generate 150 new sustained employees on site. Additionally it is anticipated that the project could also save upwards of 500 manufacturing jobs as the new local and low cost gas supply secures the future of industry in Queensland.

Looking beyond our imminent gas project the potential for our keyseam technology to unlock untapped sources of deep coal reserves is enormous. Based on our own projections, keyseam has the potential to produce more than 135,000 PJ of energy, if applied to the estimated total of 6.75 billion tonnes of suitable coal in Queensland.<sup>2</sup> To provide some comparison, current economic demonstrated resources (EDR) of coal seam gas (CSG) in Queensland total 33,001 PJ.<sup>3</sup> However given that the coal suitable for keyseam would not be recovered by other means of mainstream mining, Carbon Energy could make an additional and sizeable contribution to the State.

<sup>1</sup> 2012 Gas Market Review: Queensland, State of Queensland. 2012

<sup>2</sup> World Energy Council. 2007 Survey of Energy Resources. 2007

<sup>3</sup> Department of Resources, Energy and Tourism. Australian Gas Resources 2012. 2012.



*Dr Chris Rawlings, Chairman and Morné Engelbrecht, Managing Director*

If we then cast our mind beyond Queensland or Australia, the potential for keyseam to unlock global deep coal resources is immense. keyseam could be part of the solution in developing continents such as India, Asia and South America where the need for energy is growing at an exponential rate.

## Year in Review

The 2014 financial year was a milestone year for the business, thanks to the Queensland government-appointed Independent Scientific Panel's (ISP) positive review of our technology. The ISP's report stated underground coal gasification (UCG) has a commercial future and can be managed in an environmentally and socially acceptable manner.

During the 2014 financial year our primary focus has been achieving the recommendations of the ISP to demonstrate our technology's environmental credentials. We have invested almost \$1 million to validate that our unique keyseam technology is environmentally robust and has a low and controlled impact on the environment.

This has included a comprehensive drilling and sampling program, drilling over 800 metres and collecting more than 150 samples for analysis by three of the world's foremost laboratories. Importantly, our environmental monitoring and reporting results acknowledge the Company is setting a new standard for world's best practice.

“GAINING GOVERNMENT APPROVAL TO COMMERCIALISE OUR GAS ASSET IS KEY TO THE RAPID DEVELOPMENT OF OUR SURAT BASIN GAS PROJECT AND THE WORLDWIDE RECOGNITION OF OUR TECHNOLOGY.”

**Morné Engelbrecht**  
Managing Director &  
Chief Executive Officer

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During the year we also began receiving revenue from our project in Inner Mongolia. Establishing the project in China, and receiving local and central government endorsement, will afford Carbon Energy an opportunity for further growth across the region, eventually extending throughout China.

We also completed a substantial capital raising in an extremely tough market, securing two new Hong Kong-based cornerstone investors who recognise the value of using our keyseam technology for clean energy demands not only in China but across Asia.

Reducing costs and managing cash flow were also priorities during the year.

## Other Assets

Carbon Energy wholly owns approximately 1,076 square kilometres of coal resources in the Surat Basin. This asset was chosen for its superior coal content and suitability for keyseam technology. This coal has the potential to contain large quantities of gas the Company is looking to access.

## Outstanding Safety, Environmental and Social Performance


The safety of our employees, contractors and all those involved in our business is of paramount importance. We continuously monitor our site to ensure compliance with our Safety Policy and all relevant laws and regulations. During the year, Carbon Energy experienced no lost-time injuries or reportable incidents.

We are also committed to the protection of the environment and we adhere strictly to our Environmental Policy, as well as to relevant laws and regulations. We recorded no environmental incidents.

The significant progress made in FY2014 across the business is testament to the quality and dedication of our team, which has worked tirelessly and skilfully to deliver the exceptional results we have produced during the year. On behalf of the Board and Management Team, we would like to sincerely thank all our employees and contractors for their hard work.

Finally, the Board and Management team would also like to recognise our shareholders for their ongoing support. As a result, Carbon Energy is poised to realise the immense value of our assets. We are confident that the combination of our assets, our team and our strategy will result in long term shareholder value.





. . . the Surat Basin gas project will be a key focus in the forthcoming year, with an aim for first commercial gas production three years from commencement.

*C.D. Rawlings*

Dr Chris Rawlings  
Chairman

*Morné Engelbrecht*

Morné Engelbrecht  
Managing Director &  
Chief Executive Officer



# Strategic Focus

**As we stand on the threshold of realising the significant value of our gas assets in the Surat Basin, the 2015 financial year will be critical for the Company in many ways.**

Carbon Energy has reprioritised its strategic objectives to focus on achieving Queensland Government approval to plan for a commercial scale project in Queensland. This change in focus aligns with current trends of the Australian gas industry with domestic gas supply shortages, particularly on the East Coast, tipped to drive domestic prices higher. Carbon Energy is strategically poised to capitalise on this opportunity once the necessary building blocks for commercialisation of our gas project at Bloodwood Creek, in the Surat Basin, are in place.

Governments around the world and industry peers are closely watching the outcomes and decisions the Queensland Government is expected to make regarding the commercialisation of keyseam. The process thus far has been extremely rigorous. The recommendations of the Queensland Government appointed Independent Scientific Panel (ISP) have lead to the development of the world's best environmental standards for UCG.

In light of the progress made so far in Queensland and market conditions, Carbon Energy remains committed to growth, maximising shareholder value and generating cash flow to be self funding. Our long term vision is to be recognised internationally as a leading, gas producer and to achieve this we have identified the following strategic priorities:

Priority

1



## State Government approval to proceed commercially

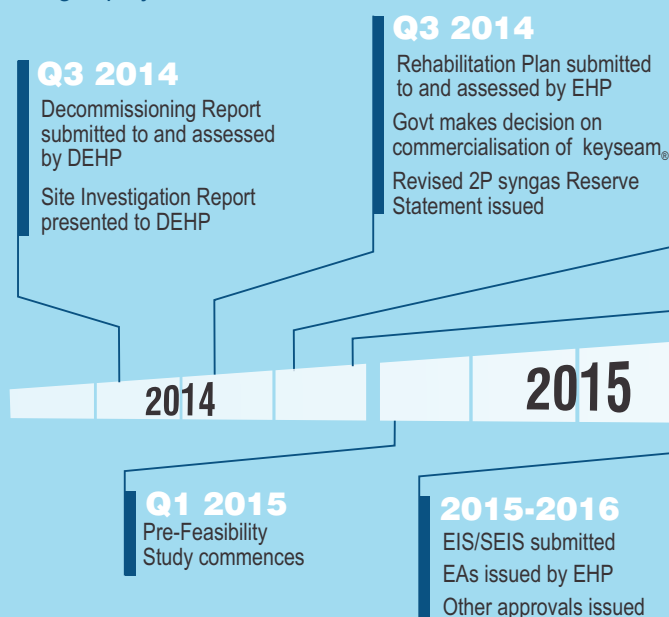
Key environmental and scientific questions have been addressed by the Queensland Government ISP's conclusion that Carbon Energy's technology can be operated safely in Queensland.

The completion of a decommissioning report and rehabilitation plan is the final step in the process recommended by the ISP and we are working co-operatively with the State Government to create a safe, new and vibrant industry for Queensland.

Carbon Energy is confident it will be able to meet the Government's requirements given keyseam's ability to continuously self-clean the cavity during production, and steam clean during de-commissioning. This is a key differentiator of our technology.

Carbon Energy has taken this process extremely seriously, having invested heavily during 2014 financial year in sampling and environmental studies to comprehensively demonstrate the environmental credentials of our technology. We await completion of laboratory tests to provide the QLD government with conclusive results.

A defined approval path to proceed to a commercial project will be the final step in the regulatory process and will lead the way for the rapid development of our Surat Basin gas project.



Priority

2



## Rapid Development of Surat Basin gas project

To ensure the company is well placed to capitalise on the current east coast of Australia gas supply shortages, preparation for the commencement of commercialising our gas project will begin prior to the Priority One Milestone being reached.

Approximately 700PJs of gas are consumed on the East Coast of Australia each year, this is forecast to exceed 2,500 PJs per annum by 2020.

Major industrial customers are already expressing widespread concerns about their ability to source future supplies of gas and at the same time those that are able to source new supply contracts are doing so at historically high pricing levels.

Carbon Energy is uniquely placed to contribute to a solution to this market imbalance with our substantial gas asset at Bloodwood Creek. To place the size of this asset in context, Bloodwood Creek's 1362 PJ is enough gas to meet the gas needs of Brisbane for the next 25 years.

Our asset is ideally in close proximity to distribution infrastructure. This gives the business a competitive advantage and we expect to be producing gas within 3 years of commencement of a commercial project.

Importantly, our project has the confidence of major Australian manufacturing and power generation companies, which once we are able to commercialise will allow us to monetise one of the most significant gas assets on the eastern seaboard.

### Q4 2014

Initial Advice Statement for EIS being drafted  
Gas Sales Agreements (GSA) being negotiated

### Q4 2014

Gas Sales and/or  
pre-funding agreements  
execution

2016

### 2015-2016

Drilling program  
Planned FID

### 2015-2016

Completion of Design  
Procurement  
Construction commences

Priority

3



## Further licensing of projects across Australia and internationally

The establishment of a commercially viable gas project at our first UCG site supports our third strategic focus to license our technology to other projects in Australia and internationally. The progression and success in delivering on our priorities underpins this strategic priority and our ongoing aim to be the preferred partner of choice for UCG technology projects worldwide.

Expansion across Australia  
and the world

2017 & beyond

### 2017

Commissioning  
First gas production

# Executive Management



**Mr Morné Engelbrecht**  
Managing Director &  
Chief Executive Officer  
BCom (Hons), CA(SA), MAICD

Morné Engelbrecht was appointed to the role of Chief Executive Officer on 18 June 2013 and was appointed to the Board on 23 July 2013. Morné joined the team at Carbon Energy in October 2011 as the Company's Chief Financial Officer and Company Secretary and was appointed Acting CEO on 22 December 2012.

Offering over 14 years' Australian and international oil & gas and resources industry experience, Morné provides leadership across all facets of the business as well as executing the strategic direction and managing the rapid expansion plans of the company including setting the base for the commercialisation of keyseam in Queensland, Australia and the rest of the world.

Prior to his career in Carbon Energy, he held several senior management roles including senior management positions at InterOil, Lihir Gold (now part of Newcrest Mining), Harmony Gold Mining Company and PricewaterhouseCoopers. Morné has a Bachelor of Commerce Honours Degree from the University of Pretoria and is a member of the South African Institute of Chartered Accountants and the Australian Institute of Company Directors.



**Ms Catherine Costello**  
Chief Financial Officer  
BCom, MSc, CA

Catherine Costello joined Carbon Energy in April 2014 as the Company's Chief Financial Officer. Catherine has more than 18 years of international experience in the mining and engineering sectors. Her experience extends to global listed entities undergoing significant growth and she brings extensive financial and corporate governance skills. Prior to accepting the position with Carbon Energy, Catherine held several senior management roles including senior financial positions in Ausenco, Lihir Gold (now Newcrest Mining) and Placer Dome (now Barrick Gold).

Catherine has a Bachelor of Commerce Degree from the University of Queensland, a Master of Science (Mineral Economics) from Curtin University and is a member of the Australian Institute of Chartered Accountants.



**Dr Cliff Mallett**  
Technical Director  
MSc, PhD

Cliff Mallett is responsible for the ongoing development of Carbon Energy's world-leading technology. Additionally, Cliff undertakes assessment of potential coal deposits that may be suitable for the Company's expanding portfolio of Australian and international projects. He is also heavily involved with the evaluation of emerging carbon capture and storage opportunities. Cliff has been associated with advancing the development of UCG process technology for more than 15 years and has degrees in geology from the University of Queensland and the University of Melbourne. He has almost 30 years experience in mining research at CSIRO culminating in him acting as Chief of CSIRO Exploration and Mining Division, interim Director of the Centre for Low Emission Technology, and Executive Manager, Queensland Centre of Advanced Technologies. In June 2013 Cliff was appointed Chairman of the International Association for Underground Coal Gasification (UCGA).



**Ms Tracy Bragg**  
General Counsel and  
Company Secretary  
LLB (Hons), BA, GDLP, AGIA

Tracy Bragg commenced with Carbon Energy in January 2013 bringing nearly 15 years experience in contract and commercial law, specialising in the delivery of major projects with long term operations, both in the UK and in Australia. Tracy's experience extends to over 10 years managing the delivery of in-house legal, company secretarial and corporate governance services. Prior to joining Carbon Energy, Tracy also held an executive appointment on the Board of Trility Pty Ltd, the Australian water business of Mitsubishi Corporation.

Tracy has an Honours Degree in the Bachelor of Laws from the University of Adelaide and is an Associate member of the Governance Institute of Australia, having completed the Graduate Diploma in Applied Corporate Governance in 2007.



**Mr Justin Haines**  
General Manager Technical  
Services  
B.App.Sc, Grad Dip Sc (Hons),  
M.Min.Eng., M.AusIMM, M.AIG, RPEQ

Justin Haines has 24 years experience as geologist, project manager, and contract geological services provider for exploration and mining operations. His expertise extends to geological and resource modelling and valuation, geophysics, and mine development, and appraisal. Justin joined Carbon Energy in 2011 as a member of the Carbon Energy management team and is responsible for the implementation of our proprietary technology across our global projects and management of the Technical Services Group within the Company. This group delivers engineering, modelling, geological, hydrogeological, and project management services.



**Mr Terry Moore**  
General Manager  
Operations

Terry Moore is responsible for the development and ongoing operations of Carbon Energy's global projects. Terry has over 30 years engineering experience in both the resources and energy sectors and more than 15 years experience in senior management roles, including roles with Ausenco Operations and Downer EDI Mining. His experience covers extensive electrical, mechanical and civil engineering disciplines, as well as maintenance engineering and design and constructions projects from concept to commissioning and operational readiness.

Terry's solid track record incorporates optimisation of projects based on best practises including plant utilisation, cost control and business process, as well as managing regulatory compliance. Terry leads a growing team of project, environment and safety professionals.







# Directors' Report

# Directors' Report

## Board Information

Your Directors present their Report on the Company and its controlled entities for the financial year ended 30 June 2014.

### Directors

The names of Directors in office at any time during or since the end of the year are:

Dr Chris Rawlings - Chairman and Non-Executive Director  
Mr Morné Engelbrecht – Managing Director (appointed 23 July 2013)  
Mr Max Cozijn - Non-Executive Director  
Dr Helen Garnett - Non-Executive Director  
Mr Peter Hogan - Non-Executive Director  
Mr Louis Rozman - Non-Executive Director

Directors have been in office since the start of the financial year to the date of this Annual Report unless otherwise stated.

### Company Secretary

Ms Tracy Bragg was appointed General Counsel and Company Secretary on 15 October 2013. Ms Bragg replaced Mr Morné Engelbrecht who held the position of Company Secretary as part of his broader responsibilities prior to his appointment as Chief Executive Officer and Managing Director. Ms Bragg's experience and qualifications are set out in the information on Directors and Company Secretary in the Directors' Report.

### Other Key Management Personnel

Mr Morné Engelbrecht – Chief Executive Officer  
Ms Catherine Costello – Chief Financial Officer (appointed 1 April 2014)  
Ms Tracy Bragg – General Counsel and Company Secretary (appointed 15 October 2013)  
Mr Justin Haines – General Manager Technical Services  
Dr Clifford Mallett – Technical Director  
Mr Terry Moore – General Manager Operations

## Principal Activities

The principal activities of the Consolidated Group during the financial year were:

- To successfully prove its world leading, proprietary underground coal gasification (UCG) technology, keyseam®, at its UCG site in Queensland;
- To establish keyseam as the UCG technology of choice for UCG projects worldwide; and
- To prove keyseam's environmental credentials as part of responding to the findings of the Independent Scientific Panel (ISP) in its report on UCG issued by the Queensland Government.

## Operating Results

The loss of the Consolidated Group after providing for income tax amounted to \$9,119,601 (2013: loss \$35,584,327).

## Dividends Paid or Recommended

No dividend was paid or declared during the year and the Directors do not recommend the payment of a dividend in respect of the year ended 30 June 2014 (2013: nil).

## Review of Operations

Carbon Energy's operations are based around its established UCG projects and business development opportunities.

### Projects

#### Bloodwood Creek, Queensland, Australia

The Queensland Government's UCG Policy, announced in February 2009, provided for a trial period to assess the technical, environmental and commercial performance of UCG, after which the Government would set essential policy decisions about this technology.

The Company's main focus for the year has been working towards achieving approval to commence a commercial scale UCG operation in

# Directors' Report

Queensland. Early in the financial year, the Queensland Government released the final report and findings of the Independent Scientific Panel (ISP) on UCG and confirmed its acceptance of the overarching recommendations set out by the ISP in the report. Carbon Energy welcomed the defined pathway to commercialisation for the UCG industry in Queensland and the local commercialisation of its keyseam technology.

In order to satisfy the recommendations of the ISP the Company is required to submit a report to demonstrate that it has successfully decommissioned its pilot UCG activities at Bloodwood Creek, and a plan which sets out the process for rehabilitation of the pilot site to the extent that rehabilitation is required. The Company embarked on a comprehensive drilling and environmental sampling collection program which was completed in May 2014. The samples obtained from the drilling program will provide the key inputs to the development of the documentation to be submitted to Government.

The Company is planning to submit the Decommissioning Report to Government in early August 2014 and the Rehabilitation Plan will follow in September 2014.

In June 2013 Carbon Energy announced the results of a comprehensive concept study based on independent data which identified economically viable, commercial scale UCG opportunities at the Company's Bloodwood Creek site. This study was completed to advance commercialisation of the Company's syngas project at Bloodwood Creek which is facilitating discussions in securing a joint venture development partner.

Ammonia and Synthetic Natural Gas (SNG) production were identified as the most economically attractive downstream products. The Company's wholly owned substantial syngas assets in Queensland offer the potential for over 25 years of continuous production of SNG or Ammonia, with the potential to provide long term returns for the Company and its shareholders.

With the Queensland Government's announcement on the way ahead for the UCG industry, Carbon Energy is moving forward with

the next steps in the pathway to commercialisation and is working constructively with the Government to achieve these plans.

Additionally during the reporting period MHA Petroleum Consultants independently certified an 83% increase in Carbon Energy's 2P UCG syngas Reserve to 1,362PJ<sup>1</sup>, at Bloodwood Creek. This increase reinforces the potential for the Company to become a major gas producer in the Queensland market.

## Inner Mongolia, China

Carbon Energy achieved a first for the Company when it received the first instalment payment for the Inner Mongolia UCG Project during the reporting period. This major milestone represents the first ever commercialisation of Carbon Energy's keyseam UCG technology.

The project remained a focus for the Company throughout the year and substantial completion of 4 out of 8 work packages for Stage 1 of the project was achieved on schedule prior to the end of the reporting period.

The Company received another milestone payment of \$1.1 million (before withholding taxes) in March 2014 triggering commencement of packages 4, 5 and 6.

## Business Development Opportunities Mulpun, Chile

Carbon Energy has been working with Antofagasta Minerals S.A. (AMSA) to develop a UCG project in Mulpun, Chile. The project will have the potential to supply syngas to a minimum

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<sup>1</sup> These reserve estimates are based on, and fairly represent, information and supporting documentation prepared by Timothy Hower of MHA Petroleum Consultants of Denver, USA. Mr Hower is a member of the Society of Petroleum Engineers and has consented to the use of the reserve estimates and supporting information contained herein, in the form and context in which it appears. Further, Carbon Energy is not aware of any new information or data that materially affects the reserve information and confirms that all material assumptions and technical parameters underpinning the estimates continue to apply and have not materially changed since reporting that information to the market on 7 November 2013.

# Directors' Report

250MW power station to in turn provide the country with its own domestic supply of energy.

Carbon Energy has been focusing its efforts on securing debt funding and equity partners for the project. The Company is continuing its dialogue with AMSA and potential funding and project partners. At this stage the Company aims to be a technology partner to the project once project partners have been identified and funding is secured.

## Argentina

Carbon Energy has a Memorandum of Understanding (MOU) with Delmo Group Pty Limited (Delmo) to become the UCG technology partner for a commercial UCG project in Argentina. The project is proposed to initially generate 300MW of electricity from UCG syngas to help meet the country's rising electricity demands.

Discussions between Delmo and the Argentinean Government regarding an MOU for an off-take agreement are continuing. It is expected that the signing of the off-take MOU will trigger the commencement of the feasibility assessment for the project and therefore the commencement of technical services by Carbon Energy.

## Queensland Surat Basin Coal Assets

It is Carbon Energy's goal to monetise these coal assets and utilise funds to further develop the core business of providing UCG technology and services. On 6 August 2013, the Company announced the appointment of PCF Capital Group as marketing agents for the sale of the asset. Carbon Energy is seeking a partner to acquire or invest in the Company's thermal coal assets. Carbon Energy plans to utilise the funds generated from the monetisation of its Surat Basin resource to further develop its core business of licensing its keyseam UCG technology and providing associated technical services.

Indicative offers to acquire these assets to date have not been reflective of the Company's view of the long term value of the assets and the

Company intends to retain ownership until such time as their true value can be achieved.

## Financial Position

The net assets of the Consolidated Group increased by \$585,944 to \$135,605,591 during the financial year.

As at 30 June 2014 the Consolidated Group had \$2.4 million in cash and cash equivalents.

During the reporting period, management initiated a number of measures to build a stronger balance sheet to position the Company to take advantage of the growing global opportunities for UCG. The Company:

- Successfully completed a fully subscribed \$7.8 million rights issue of which \$3.4 million in shares were subscribed for by new cornerstone investor Kam Lung Investment Development Company Limited from the rights issue shortfall;
- Secured a private placement of \$1.0 million to cornerstone investor Holder East Capital Limited;
- Received \$3.8 million R&D tax incentive from the ATO;
- Received instalment payments of \$1.8 million (before withholding taxes of \$0.2 million) from the Company's first commercial UCG project; and
- Repaid the \$3.0 million balance outstanding and fully extinguished the \$10 million Credit Suisse debt facility.

Subsequent to 30 June 2014, the Company secured a \$1.5 million loan facility with Macquarie Bank. The facility will provide the Consolidated Group with the ability to drawdown up to \$1.5 million to assist in funding its working capital requirements prior to the receipt of the 2014 Research and Development tax incentive rebate.

## Strategic Review and Prospects

The Company's overarching strategy remains to obtain approval to commercialise keyseam in Queensland while building on and expanding the Company's interests internationally. The

# Directors' Report

Company has tightly focused its operations in accordance with the strategic direction, making significant achievements during the reporting period and is on track to deliver real shareholder value. These included:

- Initiating a process for implementing the ISP recommendations;
- Reaching in-principle agreement with the Queensland Government on the process and timetable for obtaining a decision on the commercialisation of keyseam in Queensland;
- Further developing its core business of licensing keyseam and associated services worldwide; and
- Adding further value to the Company's extensive thermal coal assets in the Surat Basin in preparation for monetising those assets.

## Impact of Carbon Tax

The Clean Energy Legislation (Carbon Tax Repeal) Bill 2013 received Royal Assent on 17 July 2014. The Bill abolishes the carbon tax from 1 July 2014. There is no impact on the Company.

## Impact of Minerals Resource Rent Tax (MRRT)

The Minerals Resource Rent Tax Act 2012 (MRRT) was enacted on 19 March 2012 and applies from 1 July 2012. On 17 July 2014 the *Minerals Resource Rent Tax Repeal and Other Measures Bill 2013* (Bill) containing the repeal of MRRT was approved by the Senate, with amendments. On 18 July 2014 the amended Bill was rejected by the House of Representatives. The next sitting of Parliament is scheduled for August 2014 at which time a bill containing the repeal of MRRT is expected to be re-presented.

The MRRT seeks to tax the profits from the upstream operations of all new and existing coal and iron ore projects in Australia, which constitute mining project interests (MPIs) for MRRT purposes. Carbon Energy does not hold any MPIs and currently only holds pre-mining project interests (pre-MPIs) being the relevant EPCs and MDL. As Carbon Energy has not derived any pre-mining revenue, it is not liable to pay MRRT in the

year ended 30 June 2014. Furthermore, as these pre-MPIs are currently being held for sale, management has determined that it is not appropriate to recognise any deferred tax consequences relating to these pre-MPIs as Carbon Energy is unlikely to be liable to pay MRRT in the foreseeable future.

Any resources subject to MRRT are not taxable under the Petroleum Resource Rent Tax Assessment Act 1987 (PRRT). The repeal of MRRT would mean that PRRT may now apply to the Consolidated Group if the coal is ultimately used to generate syngas, which is subject to PRRT. In order to qualify for a starting base under PRRT, the Company lodged a PRRT starting base return during the year in the event that the MRRT was repealed. Under PRRT, once the coal is in the production phase and is making assessable profits; the starting base allowance reduces the 40% tax liability incurred under PRRT, as a tax deduction.

## Environmental Performance & Approvals

The Consolidated Group's operations are subject to significant environmental regulation under the Laws of the Commonwealth and State.

Carbon Energy operate the Bloodwood Creek site under a Level 2 Environmental Authority, where the Company's focus has moved to submission of the Decommissioning Report and Rehabilitation Plan to the Queensland Government after completion of a comprehensive drilling and sampling program in May 2014.

Carbon Energy continues to provide monthly groundwater quality reports to the Department of Environment and Heritage Protection and no issues relating to water quality have been raised by the Department in relation to the water quality reports.

In Queensland, the Company has lodged financial assurance bonds for Environmental Authority Permits and associated security bonds of \$20,640 (2013: \$55,640).



# Directors' Report

## Significant Changes in State of Affairs

The following significant changes in the state of affairs of the Consolidated Group occurred during the financial year:

- On 5 July 2013 Carbon Energy announced that, following an assessment of the technical and commercial feasibility, the Company had elected not to enter into any further contractual commitments in relation to projects in Wyoming (USA) and North Dakota/Montana (USA), thereby relinquishing the rights to explore or lease those tenements.
- On 8 July 2013 Carbon Energy welcomed the Queensland Government releasing the final report and findings of the ISP including the acceptance of the overarching recommendations by the ISP.
- On 23 July 2013 an MOU was signed for Carbon Energy to become the exclusive UCG technology partner to the Delmo Group for a commercial scale UCG project in Argentina.
- On 23 July 2013 an agreed outcome was reached over the outstanding legal matter with the Department of Environment and Heritage Protection.
- Mr Morné Engelbrecht was appointed to the position of Managing Director on 23 July 2013.
- On 24 July 2013 the Company sold its investment in Energia Minerals Limited.
- On 25 July 2013 the Company announced a non-renounceable pro rata rights issue to Eligible Shareholders and a new cornerstone investor, Holder East Capital Ltd (HEC). HEC invested \$1,000,000 through a private placement after the Company successfully raised \$2,000,000 from the rights issue by 31 August 2013. HEC also became Carbon Energy's UCG business development agent for the Chinese market.
- On 6 August 2013 the Company announced the appointment of PCF Capital Group as marketing agents to monetise the Company's coal assets.
- On 9 October 2013 the Company signed an MOU to potentially acquire the Mulpun UCG Project in Chile from Antofagasta Minerals S.A. (AMSA). This MOU subsequently expired on 28 February 2014.
- On 11 October 2013 the Company announced it had secured a cornerstone investor, Kam Lung Investment Development Company, who invested \$3.4 million in Carbon Energy.
- Ms Tracy Bragg was appointed to the position of General Counsel and Company Secretary on 15 October 2013.
- On 5 November 2013 the Company announced a commercial settlement had been reached in the matter of Carbon Energy Limited and Carbon Energy (Operations) Pty Ltd v John Wedgwood, Alexware Consulting Pty Ltd trading as Pangea Partners International and Laura Fett.
- On 7 November 2013 the Company announced an 83% increase in its 2P UCG gas Reserves at Bloodwood Creek to 1,362 PJ.
- On 11 November 2013 the Company announced it had received the first milestone payment of \$725,000 from its UCG project in Inner Mongolia, China.
- On 16 January 2014 the Company announced it had commenced drilling into Panel 2 at its Bloodwood Creek UCG site to fulfil the final recommendations set out in the report of the ISP and endorsed by the Queensland Government.
- On 20 January 2014 the Company announced that it had agreed to discharge the mortgage held in relation to mining tenements in the Laverton area in Western Australia that were transferred to Focus Minerals Limited (formerly Crescent Gold Limited) pursuant to an Asset Sale Agreement executed on 7 November 2009, in return for a payment of \$600,000.
- On 18 February 2014 the Company announced it had achieved substantial completion of the first two engineering work packages for Stage 1 of the Inner Mongolia UCG Project and was ready to commence delivery of staged deliverables for package 3.

# Directors' Report

- On 13 March 2014 the Company announced the receipt of the second milestone payment of \$1.1 million (before withholding taxes) for its UCG Project in Inner Mongolia.
- On 19 March 2014 the Company announced it had successfully recovered core samples from alongside the Panel 2 cavity at its Bloodwood Creek site and further drilling was scheduled to recover baseline samples from the boundary of the site, along with samples from above and within the UCG cavity.
- Ms Catherine Costello was appointed to the position of Chief Financial Officer on 1 April 2014.
- On 23 May 2014 the Company announced the commencement of the Decommissioning Report and Rehabilitation Plan for submission to the Queensland Government after completion of a comprehensive drilling and sampling program at its Bloodwood Creek UCG pilot site.

## After Balance Date Events

- On 1 July 2014 the Company secured a \$1.5 million loan facility with Macquarie Bank Limited. The facility will provide the Company with the ability to drawdown up to \$1.5 million to assist in funding its working capital requirements prior to receipt of the 2014 Research and Development tax incentive rebate.

## Non-audit Services

The Board of Directors, in accordance with advice from the Audit and Risk Committee, is satisfied that the provision of non-audit services during the year is compatible with the general standard of independence for auditors imposed by the Corporations Act 2001. The Directors are satisfied that the services disclosed in Note 35 did not compromise the external auditor's independence for the following reasons:

- All non-audit services are reviewed and approved by the Executive Director prior to commencement to ensure they do not adversely affect the integrity and objectivity of the auditor; and

- The nature of the services provided do not compromise the general principles relating to auditor independence in accordance with APES 110: Code of Ethics for Professional Accountants set by the Accounting Professional and Ethical Standards Board.

Fees for non-audit services were paid to the external auditors, Deloitte Touche Tohmatsu, during the year ended 30 June 2014 (refer Note 35).

## Indemnifying Officers

The Company has continued an insurance policy insuring Directors and Officers of the Company against any liability arising from a claim brought by a third party against the Company or its Directors and Officers, and against liabilities for costs and expenses incurred by them in defending any legal proceedings arising from their conduct while acting in their capacity as a Director or Officer of the Company, other than conduct involving a wilful breach of duty in relation to the Company.

In accordance with a confidentiality clause under the insurance policy, the amount of the premium paid to insurers has not been disclosed. This is permitted under s.300 (9) of the Corporations Act 2001.

## Proceedings on behalf of the Company

On 12 June 2012, the Department of Environment and Heritage Protection advised Carbon Energy of charges laid against the Company in relation to the transportation of process water by a contractor that occurred during June 2011. On 22 July 2013, a court-approved settlement was reached with the Department in relation to these proceedings without conviction.

As announced on 5 November 2013, the Company reached a commercial settlement in the matter of Carbon Energy Limited and Carbon Energy (Operations) Pty Ltd v John Wedgwood, Alexware Consulting Pty Ltd trading as Pangea Partners International and Laura Fett.

# Board of Directors & Company Secretary



**Dr Chris Rawlings**  
Chairman and  
Non-Executive Director  
BSc (Hons), PhD, FAICD, FAusIMM

Dr Rawlings was appointed to the Board on 1 July 2011 and elected as Chairman on 26 July 2011.

Dr Chris Rawlings graduated from the University of Newcastle in 1976 with a Bachelor of Science (Honours) in Geology; he then went on to complete a PhD in Structural Geology and Rock Mechanics in 1983. Dr Rawlings has extensive experience managing and operating mining operations and mining companies. He has been a Non Executive Director of ASX-listed and non-listed public companies for over 10 years. His strong industry knowledge backed by a pragmatic, results-driven approach is a great advantage to the Company. Dr Rawlings is a Fellow of the Australasian Institute of Mining and Metallurgy, the Geological Society of Australia and the Institute of Company Directors. Dr Rawlings is also Chairman of Queensland Energy Resources.

During the past three years Dr Rawlings has held no other listed company Directorships.

Dr Rawlings is also the Chairman of the Nomination Committee and a member of both the Audit & Risk and Remuneration Committees.



**Mr Morné Engelbrecht**  
Managing Director &  
Chief Executive Officer  
BCom (Hons), CA(SA), MAICD

Mr Engelbrecht was appointed to the role of Chief Executive Officer on 18 June 2013 and was appointed to the Board on 23 July 2013. Mr Engelbrecht joined the team at Carbon Energy in October 2011 as the Company's Chief Financial Officer and Company Secretary and was appointed Acting CEO on 22 December 2012.

Offering over 14 years' Australian and international oil & gas and resources industry experience, Mr Engelbrecht provides leadership across all facets of the business as well as executing the strategic direction and managing the rapid expansion plans of the company including setting the base for the commercialisation of keyseam in Queensland, Australia and the rest of the world.

Prior to his career in Carbon Energy, he held several senior management roles including senior management positions at InterOil, Lihir Gold (now part of Newcrest Mining), Harmony Gold Mining Company and PricewaterhouseCoopers. Mr Engelbrecht has a Bachelor of Commerce Honours Degree from the University of Pretoria and is a member of the South African Institute of Chartered Accountants and the Australian Institute of Company Directors.

During the past three years Mr Engelbrecht has held no other listed company Directorships.



**Mr Max Cozijn**  
Non-Executive Director  
BCom, CPA, MAICD

Mr Cozijn was appointed to the Board in September 1992.

Mr Cozijn has a Bachelor of Commerce Degree from the University of Western Australia, having graduated in 1972.

Mr Cozijn is an Associate of the Australian Society of Certified Practising Accountants and is a member of the Australian Institute of Company Directors. Mr Cozijn has over 30 years experience in the administration of listed mining and industrial companies, as well as various private operating companies. Mr Cozijn was the Company's Finance Director between 1993 and 2008, and is now a Non-Executive Director. During the past three years Mr Cozijn has held the following listed company Directorships:

- Oilex Ltd (from September 1997) Non-Executive Chairman
- Energia Minerals Limited (from May 1997) Non-Executive Director
- Jacka Resources Ltd (from May 2014) Non-Executive Chairman
- Magma Metals Ltd (from June 2005 to June 2012) Non-Executive Chairman
- Malagasy Minerals Limited (from September 2006 to August 2013) Non-Executive Chairman

Mr Cozijn is also the Chairman of the Remuneration Committee and a member of the Nomination Committee.



**Dr Helen Garnett**  
Non-Executive Director  
BSc (Hons), PhD, FTSE, FAICD

Dr Garnett was appointed to the Board on 6 September 2010.

Dr Helen Garnett has 30 years experience in transforming technical innovation into practical commercial outcomes. She has 15 years experience as a Chief Executive and over 20 years as a Non-Executive Director having been closely associated with the resource and energy sectors throughout this time. She is a Fellow of the Australian Institute of Company Directors and the Academy of Technical Sciences and Engineering. Dr Garnett is currently chair of Delta Electricity and a Non-Executive Director of a number of other non-listed entities. During the past three years Dr Garnett has held the following other listed company Directorships:

- Energy Resources of Australia Limited (from January 2005) Non-Executive Director

Dr Garnett is also the Chair of the Audit & Risk Committee and a member of the Nomination Committee.



**Mr Peter Hogan**  
Non-Executive Director  
BBus, ACA

Mr Hogan was appointed to the Board on 29 August 2008.

Mr Hogan is a Chartered Accountant, and has been engaged as a consultant to Incitec Pivot Ltd since early 2008. Prior to this engagement, Mr Hogan worked with PricewaterhouseCoopers for 23 years, including 17 years as Partner. He has extensive experience in providing business advisory services to Australian and overseas listed public companies and large private companies. He has particular experience with companies in the consumer and industrial product sectors and the mining sector.

During the past three years Mr Hogan has held the following other listed company Directorships:

- SGX listed Fabchem China Ltd (from July 2008 to November 2013) Non-Executive Director

Mr Hogan is a member of the Audit and Risk, Remuneration and Nomination Committees.



**Mr Louis Rozman**  
Non-Executive Director  
BEng, MGeos,  
FAusIMM CP (Man), FAICD

Mr Rozman was appointed to the Board on 7 April 2010.

Mr Rozman is a founding partner of Pacific Road Capital, a private equity mining investment fund. He has over 30 years' experience in mining operations, joint ventures and corporate management.

During the past three years Mr Rozman has held the following other listed company Directorships:

- Pacific Energy Limited (from May 2009) Non-Executive Director
- Kula Gold Limited (from November 2007) Non-Executive Director
- ABM Resources Limited (from May 2014) Non-Executive Director, and
- TSX listed Mawson West Limited (from February 2009 to April 2014) Non-Executive Director

Mr Rozman is a member of the Nomination Committee.



**Ms Tracy Bragg**  
General Counsel and  
Company Secretary  
LLB (Hons), BA, GDLP, AGIA

Ms Bragg commenced with Carbon Energy in January 2013 bringing nearly 15 years experience in contract and commercial law, specialising in the delivery of major projects with long term operations, both in the UK and in Australia. Ms Bragg's experience extends to over 10 years managing the delivery of in-house legal, company secretarial and corporate governance services. Prior to joining Carbon Energy, Ms Bragg also held an executive appointment on the Board of Trility Pty Ltd, the Australian water business of Mitsubishi Corporation.

Ms Bragg has an Honours Degree in the Bachelor of Laws from the University of Adelaide and is an Associate member of the Governance Institute of Australia, having completed the Graduate Diploma in Applied Corporate Governance in 2007.



# Directors' Report

## Information on Directors and Company Secretary

### Meeting Attendance

| Director          | Board Meeting             |                 | Audit and Risk Committee Meeting |                 | Remuneration Committee Meeting |                 | Nomination Committee Meeting |                 |
|-------------------|---------------------------|-----------------|----------------------------------|-----------------|--------------------------------|-----------------|------------------------------|-----------------|
|                   | Number eligible to attend | Number attended | Number eligible to attend        | Number attended | Number eligible to attend      | Number attended | Number eligible to attend    | Number attended |
| Chris Rawlings    | 17                        | 15              | 3                                | 3               | 3                              | 3               | 1                            | 1               |
| Morné Engelbrecht | 17                        | 17              | NM                               | NM              | NM                             | NM              | 1                            | 1               |
| Max Cozijn        | 17                        | 17              | NM                               | NM              | 3                              | 3               | 1                            | 1               |
| Helen Garnett     | 17                        | 14              | 3                                | 3               | NM                             | NM              | 1                            | 1               |
| Peter Hogan       | 17                        | 16              | 3                                | 3               | 3                              | 3               | 1                            | 0               |
| Louis Rozman      | 17                        | 15              | NM                               | NM              | NM                             | NM              | 1                            | 1               |

NM – Not a member of the Committee.

### Director's Interests

As at 17 July 2014, the interests of the Directors in shares and unlisted options of the Company are:

|                           | No. Shares Held  |                    | Listed Options |                  | Unlisted Options |                   |
|---------------------------|------------------|--------------------|----------------|------------------|------------------|-------------------|
|                           | Direct           | Indirect (i)       | Direct (iii)   | Indirect (iii)   | Direct           | Indirect (ii)     |
| Chris Rawlings            | -                | 6,850,000          | -              | 3,950,000        | -                | -                 |
| Morné Engelbrecht (iv)(v) | 4,506,109        | -                  | 355,093        | -                | 5,187,877        | -                 |
| Max Cozijn                | 18,816           | 1,898,695          | 6,272          | 632,899          | -                | -                 |
| Helen Garnett             | 188,551          | 377,101            | 188,151        | -                | -                | -                 |
| Peter Hogan               | -                | 500,000            | -              | 220,000          | -                | -                 |
| Louis Rozman (vi)         | 75,000           | 105,746,535        | 75,000         | -                | -                | 35,779,180        |
| <b>Total</b>              | <b>4,788,476</b> | <b>115,372,331</b> | <b>624,516</b> | <b>4,802,899</b> | <b>5,187,877</b> | <b>35,779,180</b> |

(i) Indirect Shares refer to Note 32 and section on shareholder information.

(ii) Indirect Options refer to Notes 32 and 36.

(iii) Listed Options were issued subsequent to the AGM held on 21 November 2013.

(iv) Morné Engelbrecht was appointed Managing Director on 23 July 2013.

(v) An additional 99,999,999 unlisted options were issued to Morné Engelbrecht on 6 December 2013 to vest only upon achievement of share price performance hurdles. 33,333,333 of those options were forfeited on 30 June 2014 as a result of failure to achieve the relevant share price performance hurdles for the year.

(vi) Indirect Holding represents Pacific Road Resources Funds of which Louis Rozman is an employee and Director of some Pacific Road Capital entities.

# Directors' Report

## Remuneration Report (Audited)

The Directors are pleased to present Carbon Energy Limited's 2014 remuneration report which sets out information about the remuneration of the Company's Non-Executive Directors, Executive Director and other Key Management Personnel.

### Key Management Personnel

Key Management Personnel are divided into three separate groups for ease of reference:

#### Non-Executive Directors

(refer to pages 22 to 24 for details about each Director):

|                       |                                     |
|-----------------------|-------------------------------------|
| <b>Chris Rawlings</b> | Chairman and Non-Executive Director |
| <b>Max Cozijn</b>     | Non-Executive Director              |
| <b>Helen Garnett</b>  | Non-Executive Director              |
| <b>Peter Hogan</b>    | Non-Executive Director              |
| <b>Louis Rozman</b>   | Non-Executive Director              |

#### Executive Director

|                          |   |
|--------------------------|---|
| <b>Morné Engelbrecht</b> | Chief Executive Officer (from 18 June 2013) and Managing Director (from 23 July 2013) |
|--------------------------|---|

#### Other Key Management Personnel

|                           |   |
|---------------------------|---|
| <b>Tracy Bragg</b>        | General Counsel and Company Secretary<br>(from 15 October 2013) |
| <b>Catherine Costello</b> | Chief Financial Officer<br>(from 1 April 2014)                  |
| <b>Justin Haines</b>      | General Manager, Technical Services                             |
| <b>Cliff Mallett</b>      | Technical Director  |
| <b>Terry Moore</b>        | General Manager, Operations                                     |

### Remuneration Governance

The Remuneration Committee is a committee of the Board. It is primarily responsible for making recommendations to the Board on:

- the over-arching executive remuneration framework;
- operation of the incentive arrangements which apply to Executive Directors and senior executives (the executive team), including key performance indicators and performance hurdles;
- remuneration levels of executives, and
- Non-Executive Director fees.

Their objective is to ensure that remuneration policies and structures are fair and competitive and aligned with the long-term interests of the Company.

The Corporate Governance Statement provides further information on the role of this committee and the Remuneration Committee Charter is set out on the Company's website:

[www.carbonenergy.com](http://www.carbonenergy.com)

### Voting and Comments made at the Company's 2013 Annual General Meeting

The Company received more than 89% of "yes" votes on its remuneration report for the 2013 financial year. The Company did not receive any specific feedback at the AGM or throughout the year on its remuneration practices.

### Non-Executive Director Remuneration Policy

The remuneration and terms of employment for the Non-Executive Directors are subject to annual review with no fixed term, with one third of the Directors being subject to re-election at each Annual General Meeting of Shareholders. The aggregate amount of remuneration payable to all Non-Executive Directors was set by shareholders at \$500,000 per annum. The total amount currently paid is a maximum of \$40,000 per

# Directors' Report

## Remuneration Report (Audited)

annum plus statutory superannuation to each Non-Executive Director and \$120,000 per annum plus statutory superannuation to the Chairman of the Board. The Chair of the Audit and Risk Committee is paid an additional \$10,000 per annum plus superannuation. On 10 July 2013, the Board resolved to suspend 100% of the fees for the nominee Non-Executive Directors and 50% of fees for other Non-Executive Directors pending business improvement. Fees were reinstated from 1 October 2013.

No termination payment provisions are currently in place for Non-Executive Directors.

### Executive Remuneration Policy

The remuneration policy, which sets the terms and conditions for the Managing Director and other Key Management Personnel, was developed by the Remuneration Committee after seeking professional advice from independent consultants and was approved by the Board. All Key Management Personnel receive a base salary, superannuation, car park and performance incentives.

The Remuneration Committee reviews Key Management Personnel packages annually by reference to group performance, Executive performance, comparable information from industry sectors and other listed companies and independent advice. The performance of Key Management Personnel is reviewed annually by the Managing Director and his performance is reviewed by the Remuneration Committee, with revised remuneration packages generally taking effect from the 1st of July of the new financial year.

The payment of bonuses, stock options and other incentive payments are reviewed by the Remuneration Committee annually as part of the review of Key Management Personnel remuneration and a recommendation is put to the Board for approval. All bonuses, options and incentives must be linked to predetermined performance criteria. The Board can exercise its discretion in relation to approving incentives, bonuses and options and can recommend

changes to the Remuneration Committee recommendations. Any changes must be justified by reference to measurable performance criteria. On 10 July 2013, the Board resolved to reduce the base salary of Key Management Personnel by 40% for a period of six weeks pending business improvement.

### Executive Remuneration Framework

There are three general components of remuneration used to reward employees, including Key Management Personnel, depending on their role and responsibility within the Consolidated Group:

1. Total Fixed Remuneration;
2. Short Term Incentive; and
3. Long Term Incentive.

The STI and LTI components paid to Key Management Personnel range between 15% and 30% of their fixed remuneration package and are payable in shares and/ or options in Carbon Energy Limited.

The Board expects that the remuneration structure implemented will result in the Company being able to attract and retain the best Key Management Personnel to run the Consolidated Group. It will also provide Key Management Personnel with the necessary incentives to work to grow long-term shareholder value.

### Total Fixed Remuneration

Total Fixed Remuneration comprises base salary, any relevant allowances and Carbon Energy's statutory superannuation guarantee contribution. Total Fixed Remuneration is set with reference to market data, reflecting the scope of the role and the performance of the employee in the role.

Total Fixed Remuneration also reflects any market premium required for roles that are in short supply or with a unique skill set. Remuneration is reviewed annually using market surveys, external remuneration consultants, and internal feedback as to market conditions, as considered

# Directors' Report

## Remuneration Report (Audited)

appropriate to provide analysis and advice to ensure competitive remuneration is set to reflect the market for comparable roles. Due to the nature of the business, fixed remuneration of Key Management Personnel is not linked to the performance of the Company due to the requirement to retain these employees to develop the Company and meet its current strategic objectives.

### Short Term Incentive (STI)

Carbon Energy offers a Short Term Incentive (STI) to the Executive Director and other Key Management Personnel to achieve the following objectives:

- Focus Key Management Personnel on the achievement of key targets as well as individual contribution that the Board believes will lead to sustained and improved business performance; and
- Reward and recognise superior performance.

The metrics, weightings and performance measures are reviewed annually to ensure business needs are met and the overall STI is consistent with general market practices.

The STI scheme involves establishing the STI value for the financial year, subject to satisfactorily meeting Key Performance Indicators. At the end of each financial year, the Key Management Personnel would be allocated a number of shares equivalent to the cash value of the STI, based on the 90 day VWAP prior to the allocation date, which are redeemable immediately. The Executive Director has the option to receive payment of the STI in cash or shares.

### Long Term Incentive (LTI)

The scheme involves establishing an LTI value for each financial year, subject to satisfactorily meeting Key Performance Indicators.

At the end of each financial year the Key Management Personnel will be allocated a number of shares or options equivalent to the cash value of the LTI, based on the 90 day VWAP prior to the allocation date, which would be redeemable immediately provided the Key Management Personnel remained employed with the Company at that time.

The Executive Director LTI arrangements as approved at the annual general meeting on 21 November 2013 comprise the following:

- 33,333,333 options with an exercise price of \$0.06 each and a vesting date of 30 June 2014 with vesting subject to the (subject to the market price of the shares as at 30 June 2014 being no less than 4.5 cents (\$0.045) per share expiring 30 June 2017 (these options were forfeited on 30 June 2014 as a result of failure to achieve the share price performance hurdle);
- 33,333,333 options with an exercise price of \$0.06 each and a vesting date of 30 June 2015 (subject to the market price of the shares as at 30 June 2015 being no less than 7.5 cents (\$0.075) per share) expiring 30 June 2018; and
- 33,333,333, options with an exercise price of \$0.06 each and a vesting date of 30 June 2016 (subject to the market price of the shares as at 30 June 2016 being no less than 10.5 cents (\$0.105) per share) expiring 30 June 2019.

### Relationship between Remuneration and the Company's Performance

As the Company is in its exploration and early stage development phase, key performance indicators for Key Management Personnel are not currently directly linked to the Company's financial performance.



# Directors' Report

## Remuneration Report (Audited)

### Details of Remuneration

The remuneration for each Director of the Consolidated Group during the year is noted as follows:

| 2014                        | Cash                         |                   |       |                     |                          | Non-cash            |                              |                   |                     |
|-----------------------------|------------------------------|-------------------|-------|---------------------|--------------------------|---------------------|------------------------------|-------------------|---------------------|
|                             | Short term employee benefits |                   |       |                     | Post employment benefits | Total Cash Payments | Share-based Payments Expense | Forfeited Options | Performance Related |
|                             | Cash Salary                  | Directors Fee (v) | Other | Super Contributions | Options (vi)             |                     | Shares                       |                   |                     |
|                             | \$                           | \$                | \$    | \$                  | \$                       | \$                  | \$                           | \$                | %                   |
| NON-EXECUTIVE DIRECTOR      |                              |                   |       |                     |                          |                     |                              |                   |                     |
| Chris Rawlings              | -                            | 105,000           | -     | 9,713               | 114,713                  | -                   | -                            | -                 | -                   |
| Max Cozijn                  | -                            | 35,000            | -     | 3,238               | 38,238                   | -                   | -                            | -                 | -                   |
| Helen Garnett               | -                            | 43,750            | -     | 4,047               | 47,797                   | -                   | -                            | -                 | -                   |
| Peter Hogan(i)              | -                            | 30,000            | -     | -                   | 30,000                   | -                   | -                            | -                 | -                   |
| Louis Rozman(ii)            | -                            | 30,000            | -     | -                   | 30,000                   | -                   | -                            | -                 | -                   |
| SUB-TOTAL \$                | -                            | 243,750           | -     | 16,998              | 260,748                  | -                   | -                            | -                 |                     |
| EXECUTIVE DIRECTOR          |                              |                   |       |                     |                          |                     |                              |                   |                     |
| Morné Engelbrecht (iii)(iv) | 360,988                      | -                 | 3,128 | 20,509              | 384,625                  | 125,869             | 105,008                      | (56,433)          | 38%                 |
| SUB-TOTAL \$                | 360,988                      | -                 | 3,128 | 20,509              | 384,625                  | 125,869             | 105,008                      | (56,433)          |                     |
| GRAND TOTALS                | 360,988                      | 243,750           | 3,128 | 37,507              | 645,373                  | 125,869             | 105,008                      | (56,433)          |                     |

(i) Peter Hogan's fees are paid directly to Incitec Pivot Limited.

(ii) Louis Rozman's fees are paid directly to Pacific Road Capital Management Holdings Pty Limited.

(iii) Morné Engelbrecht was appointed Chief Executive Officer on 18 June 2013 and Managing Director on 23 July 2013.

(iv) Morné Engelbrecht salary was reduced by 50% during the period 1 July to 30 August in recognition of the prevailing business performance during that period.

(v) Nominee Non-Executive Director fees were reduced by 100% and other Non-Executive director fees were reduced by 50% during the period 1 July 2013 to 30 September 13 in recognition of the prevailing business performance during that period.

(vi) Morné Engelbrecht was granted 99,999,999 options with share price performance hurdles. As at 30 June 2014 66,666,666 have not yet vested and 33,333,333 were forfeited as a result of failure to meet the share price performance hurdles for the year.

# Directors' Report

## Remuneration Report (Audited)

The remuneration for each Director of the Consolidated Group during the year is noted as follows:

| 2013                   | Cash                         |                  |        |                             |                           | Non-cash                        |                      |    | Performance<br>Related |
|------------------------|------------------------------|------------------|--------|-----------------------------|---------------------------|---------------------------------|----------------------|----|------------------------|
|                        | Short term employee benefits |                  |        | Post employment<br>benefits | Total<br>cash<br>payments | Share-based<br>Payments Expense | Forfeited<br>Options |    |                        |
|                        | Cash<br>Salary               | Directors<br>Fee | Other  | Super<br>Contributions      |                           | Options                         | Shares               |    |                        |
|                        | \$                           | \$               | \$     | \$                          |                           | \$                              | \$                   | \$ |                        |
| NON-EXECUTIVE DIRECTOR |                              |                  |        |                             |                           |                                 |                      |    |                        |
| Chris Rawlings         | -                            | 120,000          | -      | 10,800                      | 130,800                   | -                               | -                    | -  | -                      |
| Max Cozijn             | -                            | 40,000           | -      | 3,600                       | 43,600                    | -                               | -                    | -  | -                      |
| Helen Garnett          | -                            | 50,000           | -      | 4,500                       | 54,500                    | -                               | -                    | -  | -                      |
| Peter Hogan(i)         | -                            | 40,000           | -      | -                           | 40,000                    | -                               | -                    | -  | -                      |
| Louis Rozman(ii)       | -                            | 40,000           | -      | -                           | 40,000                    | -                               | -                    | -  | -                      |
| SUB-TOTAL \$           | -                            | 290,000          | -      | 18,900                      | 308,900                   | -                               | -                    | -  |                        |
| EXECUTIVE DIRECTOR     |                              |                  |        |                             |                           |                                 |                      |    |                        |
| Andrew Dash (iii)      | 231,284                      | -                | 93,298 | 12,500                      | 337,082                   | -                               | -                    | -  | -                      |
| SUB-TOTAL \$           | 231,284                      | -                | 93,298 | 12,500                      | 337,082                   | -                               | -                    | -  |                        |
| GRAND TOTALS           | 231,284                      | 290,000          | 93,298 | 31,400                      | 645,982                   | -                               | -                    | -  |                        |

(i) Amounts paid to Incitec Pivot Limited for Mr Hogan's service.

(ii) Amounts paid to Pacific Road Capital Management Holdings Pty Limited for Mr Rozman's services.

(iii) Resigned as Managing Director and Chief Executive Officer on 21 December 2012.

# Directors' Report

## Remuneration Report (Audited)

The remuneration for each Key Management Personnel of the Consolidated Group during the year is noted as follows:

| 2014                    | Cash                            |             |                                 |                          |         | Non-cash                  |                         |                      |    | Performance<br>Related<br><br>% |
|-------------------------|---------------------------------|-------------|---------------------------------|--------------------------|---------|---------------------------|-------------------------|----------------------|----|---------------------------------|
|                         | Short term employee<br>benefits |             | Post-<br>employment<br>benefits | Termination<br>Costs     | Total   | Long-<br>term<br>benefits | Share-based<br>Payments |                      |    |                                 |
|                         | Cash<br>Salary                  | Other (iii) | Super<br>Contributions          | Long<br>Service<br>Leave |         | Options<br>(iv)           | Shares<br>(v)           | Forfeited<br>options |    |                                 |
|                         | \$                              | \$          | \$                              | \$                       |         | \$                        | \$                      | \$                   | \$ |                                 |
| Tracy Bragg(i)          | 150,000                         | 3,871       | 13,875                          | -                        | 167,746 | -                         | 12,591                  | 37,773               | -  | 23%                             |
| Catherine Costello (ii) | 43,096                          | -           | 3,986                           | -                        | 47,082  | -                         | 2,769                   | 8,309                | -  | 19%                             |
| Justin Haines           | 262,019                         | 2,560       | 17,775                          | -                        | 282,354 | -                         | 13,707                  | 39,220               | -  | 16%                             |
| Cliff Mallett           | 174,562                         | 2,199       | 16,147                          | -                        | 192,908 | 26,315                    | 21,399                  | 37,800               | -  | 22%                             |
| Terry Moore             | 229,590                         | 2,137       | 21,237                          | -                        | 252,964 | -                         | 10,674                  | 32,761               | -  | 15%                             |
| TOTALS                  | 859,267                         | 10,767      | 73,020                          | -                        | 943,054 | 26,315                    | 61,140                  | 155,863              | -  |                                 |

(i) Tracy Bragg was appointed General Counsel and Company Secretary on 15 October 2013.

(ii) Catherine Costello was appointed Chief Financial Officer on 1 April 2014.

(iii) Car parking benefits.

(iv) Options have vested/accrued but not yet exercised (out of the money).

(v) Shares issued/accrued on settlement of STI and LTI payments.

| 2013                  | Cash                            |                        |                                 |                          |           | Non-cash                  |                         |                      |    | Performance<br>Related<br><br>% |
|-----------------------|---------------------------------|------------------------|---------------------------------|--------------------------|-----------|---------------------------|-------------------------|----------------------|----|---------------------------------|
|                       | Short term employee<br>benefits |                        | Post-<br>employment<br>benefits | Termination<br>Costs     | Total     | Long-<br>term<br>benefits | Share-based<br>Payments |                      |    |                                 |
|                       |                                 |                        |                                 |                          |           |                           |                         |                      |    |                                 |
|                       | Cash<br>Salary                  | Super<br>Contributions | Other<br>(iii)                  | Long<br>Service<br>Leave |           | Options<br>(iv)           | Shares<br>(v)           | Forfeited<br>Options |    |                                 |
|                       | \$                              | \$                     | \$                              | \$                       | \$        | \$                        | \$                      | \$                   | \$ |                                 |
| Morné Engelbrecht (i) | 371,690                         | 21,083                 | 3,376                           | -                        | 396,149   | -                         | 28,386                  | 107,957              | -  | 26%                             |
| Justin Haines         | 263,530                         | 16,470                 | 1,838                           | -                        | 281,838   | -                         | 15,125                  | 62,083               | -  | 22%                             |
| Cliff Mallett         | 175,000                         | 15,750                 | 1,838                           | -                        | 192,588   | 20,014                    | -                       | -                    | -  | -                               |
| Terry Moore           | 235,780                         | 21,220                 | 2,599                           | -                        | 259,599   | -                         | 10,728                  | 59,462               | -  | 21%                             |
| Peter Swaddle (ii)    | 19,549                          | 1,759                  | 607                             | 120,393                  | 142,308   | -                         | -                       | -                    | -  | -                               |
| TOTALS                | 1,065,549                       | 76,282                 | 10,258                          | 120,393                  | 1,272,482 | 20,014                    | 54,239                  | 229,502              | -  |                                 |

(i) Morné Engelbrecht was appointed Chief Executive Officer on 18 June 2013 and Managing Director on 23 July 2013, he appears here as Chief Financial Officer and Company Secretary.

(ii) Peter Swaddle resigned as Senior Vice President Strategy Business Development on 31 July 2012.

(iii) Car parking benefits.

(iv) Options have vested/accrued but not yet exercised (out of the money).

(v) Shares issued/accrued on settlement of STI/LTI payments.

# Directors' Report

## Remuneration Report (Audited)

### Service Agreements of Executive Directors and Key Management Personnel

Remuneration and other terms of employment for the executives are formalised in service agreements. The service agreements specify the components of remuneration, benefits and notice periods. Participation in the STI and LTI arrangements is subject to the Board's discretion. Other major provisions of the agreements relating to remuneration are set out below.

Termination benefits are within the limits set by the Corporations Act 2001 such that they do not require shareholder approval.

| Name                                      | Term of agreement and Notice Period                     | Base salary including Superannuation | Termination Payments <sup>(ii)(iii)</sup> |
|---|---|--------------------------------------|---|
| Morné Engelbrecht (i)                     | 3 years fixed term contract to 18 June 2016<br>6 months | \$398,940                            | 6 months                                  |
| Catherine Costello<br>(from 1 April 2014) | No fixed term<br>(permanent part-time)<br>3 months      | \$176,985                            | 3 months                                  |
| Tracy Bragg<br>(from 15 October 2013)     | No fixed term<br>3 months                               | \$218,500                            | 3 months                                  |
| Justin Haines                             | No fixed term<br>3 months                               | \$295,104                            | 3 months                                  |
| Cliff Mallett                             | 3 years fixed term contract to 30 June 2016<br>3 months | \$200,747                            | 12 months                                 |
| Terry Moore                               | No fixed term<br>3 months                               | \$264,029                            | 3 months                                  |

(i) Morné Engelbrecht was promoted to Chief Executive Officer on 18 June 2013 and his appointment to the Board became effective on 23 July 2013. Morné Engelbrecht's term of appointment was announced by the Company on 18 June 2013 and he is entitled to a maximum STI of 30% on meeting performance targets and LTI options for the next 3 years subject to Shareholder approval.

(ii) Base salary payable if the company terminates employees with notice, and without cause (e.g for reasons other than unsatisfactory performance).

(iii) Current termination payments for Key Management Personnel are currently under review for application in FY2015.

Required early termination notice period for the Executive Director is six months, and required notice period for Key Management Personnel employed under Executive Service Agreements is three months from either party. A payment for termination benefit on early termination by the employer is payable, other than for gross misconduct as set out in the table above.



# Directors' Report

## Remuneration Report (Audited)

### Details of Share Based Compensation and Bonuses

#### Options

Options were provided to Key Management Personnel in 2014.

|               | Options Granted as<br>Remuneration<br>2014 (i) | Options Granted as<br>Remuneration<br>2013 (ii) |
|---------------|--|---|
| Justin Haines | 1,851,408                                      | 860,000   |
| Cliff Mallett | 1,092,843                                      | -   |
| Terry Moore   | 1,656,453                                      | 610,000   |
| <b>TOTALS</b> | <b>4,600,704</b>                               | <b>1,470,000</b>                                |

(i) These options were granted as part of the LTI for the 2013 financial year.

(ii) These options were granted as part of the LTI for the 2012 financial year.

No options were exercised during the 2014 year (2013: Nil) that were granted as compensation in prior periods to current Key Management Personnel.

Options expensed during the 2014 year that were accrued or granted as compensation are as follows:

|                    | Options<br>Expensed (i) | Total<br>Remuneration<br>Represented by | Options<br>Exercised | Options Forfeited |
|--------------------|-------------------------|---|----------------------|-------------------|
| 2014               | \$                      | %                                       | \$                   | \$                |
| Morné Engelbrecht  | 125,869                 | 20%                                     | -                    | -(ii)             |
| Tracy Bragg        | 12,591                  | 6%                                      | -                    | -                 |
| Catherine Costello | 2,769                   | 5%                                      | -                    | -                 |
| Justin Haines      | 13,707                  | 4%                                      | -                    | -                 |
| Cliff Mallett      | 21,399                  | 8%                                      | -                    | -                 |
| Terry Moore        | 10,674                  | 4%                                      | -                    | -                 |
| <b>TOTALS</b>      | <b>187,009</b>          |   | -                    | -                 |

(i) Options have vested but not exercised (out of the money).

(ii) 33,333,333 were forfeited as a result of failure to meet share price performance hurdles.

Key Management Personnel were also eligible to earn 12,873,550 options upon achievement of 2014 Key Performance Indicators at a strike price of 30% premium to the 5 day VWAP. At 30 June 2014 only 80% (10,727,959) of these options have been accrued.

# Directors' Report

## Remuneration Report (Audited)

Options expensed during the 2013 year that were accrued or granted as compensation are as follows:

|                   | Options<br>Expensed (i) | Total<br>Remuneration<br>Represented by | Options<br>Exercised | Options Forfeited |
|-------------------|-------------------------|---|----------------------|-------------------|
| 2013              | \$                      | %                                       | \$                   | \$                |
| Morné Engelbrecht | 28,386                  | 5%                                      | -                    | -                 |
| Justin Haines     | 15,125                  | 4%                                      | -                    | -                 |
| Terry Moore       | 10,728                  | 3%                                      | -                    | -                 |
| <b>TOTALS</b>     | <b>54,239</b>           |   | <b>-</b>             | <b>-</b>          |

(i) Options have vested but not yet been exercised (out of the money).

## Shares

Shares were provided to Key Management Personnel in 2014.

|                   | Shares Granted as<br>Remuneration | Shares Granted<br>as Remuneration |
|-------------------|-----------------------------------|-----------------------------------|
|                   | 2014 (i)                          | 2013 (ii)                         |
| Morné Engelbrecht | 3,440,831                         | 710,185                           |
| Justin Haines     | 1,781,449                         | 377,592                           |
| Terry Moore       | 1,593,861                         | 267,591                           |
| <b>TOTALS</b>     | <b>6,816,141</b>                  | <b>1,355,368</b>                  |

(i) These shares were granted as part of the STI for the 2013 financial year.

(ii) These shares were granted as part of the STI for the 2012 financial year.

# Directors' Report

## Remuneration Report (Audited)

Shares expensed during the 2014 year that were accrued or granted as compensation are as follows:

|                    | Shares<br>Expensed | Total<br>Remuneration<br>Represented by<br>Shares | Total          |
|--------------------|--------------------|---|----------------|
| 2014               | \$                 | %   | \$             |
| Morné Engelbrecht  | 105,008            | 17%   | 105,088        |
| Tracy Bragg        | 37,773             | 17%   | 37,773         |
| Catherine Costello | 8,309              | 14%   | 8,309          |
| Justin Haines      | 39,220             | 12%   | 39,220         |
| Cliff Mallett      | 37,800             | 14%   | 37,800         |
| Terry Moore        | 32,761             | 11%   | 32,761         |
| <b>TOTALS</b>      | <b>260,871</b>     | <b>-</b>  | <b>260,871</b> |

Key Management Personnel were also eligible to earn 23,709,742 shares upon achievement of 2014 Key Performance Indicators. At 30 June 2014 only 80% (18,967,794) of these shares have been accrued.

Shares expensed during the 2013 year that were accrued or granted as compensation are as follows:

|                   | Shares<br>Expensed | Total<br>Remuneration<br>Represented by<br>Shares | Total          |
|-------------------|--------------------|---|----------------|
| 2013              | \$                 | %   | \$             |
| Morné Engelbrecht | 107,957            | 20%   | 107,957        |
| Justin Haines     | 62,083             | 17%   | 62,083         |
| Cliff Mallett     | -                  | -   | -              |
| Terry Moore       | 59,462             | 18%   | 59,462         |
| Peter Swaddle     | -                  | -   | -              |
| <b>TOTALS</b>     | <b>229,502</b>     | <b>-</b>  | <b>229,502</b> |

# Directors' Report

## Remuneration Report (Audited)

### Equity instruments held by Key Management Personnel

The tables on the following page show the number of:

- options over ordinary shares in the Company; and
- shares in the Company,

that were held during the financial year by Key Management Personnel of the Consolidated Group, including their close family members and entities related to them.

#### (a) Option Holdings held directly and indirectly by Directors

| 2014 Directors         | Balance at 1 Jul 2013 | Granted as Remuneration | Options Forfeited | Net Change Other (i) | Balance at 30 Jun 14 | Total Vested 30 Jun 14 | Total Exercisable 30 Jun 14 | Total Unexercisable 30 Jun 14 |
|------------------------|-----------------------|-------------------------|-------------------|----------------------|----------------------|------------------------|-----------------------------|-------------------------------|
| Chris Rawlings         | -                     | -                       | -                 | 3,950,000            | 3,950,000            | 3,950,000              | 3,950,000                   | -                             |
| Morné Engelbrecht (ii) | 1,614,000             | 103,573,876             | 33,333,333        | 355,093              | 72,209,636           | 72,209,636             | 5,542,970                   | 66,666,666                    |
| Max Cozijn             | -                     | -                       | -                 | 639,171              | 639,171              | 639,171                | 639,171                     | -                             |
| Helen Garnett          | -                     | -                       | -                 | 188,551              | 188,551              | 188,551                | 188,551                     | -                             |
| Peter Hogan            | -                     | -                       | -                 | 220,000              | 220,000              | 220,000                | 220,000                     | -                             |
| Louis Rozman (iii)     | 44,645,845            | -                       | -                 | 75,000               | 44,720,845           | 44,720,845             | 44,720,845                  | -                             |
| <b>TOTAL</b>           | <b>46,259,845</b>     | <b>103,573,876</b>      | <b>33,333,333</b> | <b>5,427,815</b>     | <b>121,928,203</b>   | <b>121,928,203</b>     | <b>55,261,537</b>           | <b>66,666,666</b>             |

(i) Acquired through 2013 rights issue either directly or indirectly through a self managed superannuation fund.

(ii) Morné Engelbrecht was appointed Managing Director on 23 July 2013.

(iii) Indirect Holding (44,645,845) represents Pacific Road Resources Funds; Louis Rozman is an employee and Director of some Pacific Road Capital entities.

| 2013 Directors    | Balance at 1 Jul 2012 | Granted as Remuneration | Options Forfeited | Net Change Other | Balance at 30 Jun 13 | Total Vested 30 Jun 13 | Total Exercisable 30 Jun 13 | Total Unexercisable 30 Jun 13 |
|-------------------|-----------------------|-------------------------|-------------------|------------------|----------------------|------------------------|-----------------------------|-------------------------------|
| Chris Rawlings    | -                     | -                       | -                 | -                | -                    | -                      | -                           | -                             |
| Andrew Dash (i)   | 22,000,000            | -                       | -                 | -                | 22,000,000           | 22,000,000             | 22,000,000                  | -                             |
| Max Cozijn        | -                     | -                       | -                 | -                | -                    | -                      | -                           | -                             |
| Helen Garnett     | -                     | -                       | -                 | -                | -                    | -                      | -                           | -                             |
| Peter Hogan       | -                     | -                       | -                 | -                | -                    | -                      | -                           | -                             |
| Kim Robinson      | -                     | -                       | -                 | -                | -                    | -                      | -                           | -                             |
| Louis Rozman (ii) | 35,000,000            | -                       | -                 | 9,645,845        | 44,645,845           | 44,645,845             | 44,645,845                  | -                             |
| <b>TOTAL</b>      | <b>57,000,000</b>     | <b>-</b>                | <b>-</b>          | <b>9,645,845</b> | <b>66,645,845</b>    | <b>66,645,845</b>      | <b>66,645,845</b>           | <b>-</b>                      |

(i) Andrew Dash resigned 21 December 2012.

(ii) Indirect Holding (44,645,845) represents Pacific Road Resources Funds; Louis Rozman is an employee and Director of some Pacific Road Capital entities.



# Directors' Report

## Remuneration Report (Audited)

### (b) Option Holdings held directly and indirectly by Key Management Personnel

| 2014               | Balance at<br>1 Jul 2013 | Granted as<br>Remuneration<br>(i) | Options<br>Forfeited | Net<br>Change<br>Other (ii) | Balance at<br>30 Jun 14 | Total Vested<br>30 Jun 14 | Total<br>Exercisable<br>30 Jun 14 | Total<br>Unexercisable<br>30 Jun 14 |
|--------------------|--------------------------|-----------------------------------|----------------------|-----------------------------|-------------------------|---------------------------|-----------------------------------|-------------------------------------|
| Cliff Mallett      | 4,375,000                | 1,092,843                         | 4,375,000            | 3,175,487                   | 4,268,330               | 4,268,330                 | 4,268,330                         | -                                   |
| Justin Haines      | 860,000                  | 1,851,408                         | -                    | -                           | 2,711,408               | 2,711,408                 | 2,711,408                         | -                                   |
| Terry Moore        | 610,000                  | 1,656,453                         | -                    | 133,796                     | 2,400,249               | 2,400,249                 | 2,400,249                         | -                                   |
| Tracy Bragg        | -                        | -                                 | -                    | -                           | -                       | -                         | -                                 | -                                   |
| Catherine Costello | -                        | -                                 | -                    | -                           | -                       | -                         | -                                 | -                                   |
| <b>TOTAL</b>       | <b>5,845,000</b>         | <b>4,600,704</b>                  | <b>4,375,000</b>     | <b>3,309,283</b>            | <b>9,379,987</b>        | <b>9,379,987</b>          | <b>9,379,987</b>                  | <b>-</b>                            |

(i) These options were granted as part of the LTI.

(ii) These options were acquired either directly or indirectly through the 2013 Rights issue and some are held by a Self Managed Super Fund.

| 2013                   | Balance at<br>1 Jul 2012 | Granted as<br>Remuneration (i) | Options<br>Forfeited | Net<br>Change<br>Other | Balance at<br>30 Jun 13 | Total Vested<br>30 Jun 13 | Total<br>Exercisable<br>30 Jun 13 | Total<br>Unexercisable<br>30 Jun 13 |
|------------------------|--------------------------|--------------------------------|----------------------|------------------------|-------------------------|---------------------------|-----------------------------------|-------------------------------------|
| Morné Engelbrecht (ii) | -                        | 1,614,000                      | -                    | -                      | 1,614,000               | 1,614,000                 | 1,614,000                         | -                                   |
| Cliff Mallett          | 4,375,000                | -                              | -                    | -                      | 4,375,000               | 4,375,000                 | 4,375,000                         | -                                   |
| Justin Haines          | -                        | 860,000                        | -                    | -                      | 860,000                 | 860,000                   | 860,000                           | -                                   |
| Terry Moore            | -                        | 610,000                        | -                    | -                      | 610,000                 | 610,000                   | 610,000                           | -                                   |
| Peter Swaddle (iii)    | 1,000,000                | -                              | -                    | -                      | 1,000,000               | 1,000,000                 | 1,000,000                         | -                                   |
| <b>TOTAL</b>           | <b>5,375,000</b>         | <b>3,084,000</b>               | <b>-</b>             | <b>-</b>               | <b>8,459,000</b>        | <b>8,459,000</b>          | <b>8,459,000</b>                  | <b>-</b>                            |

(i) These options were granted as part of the LTI.

(ii) Morné Engelbrecht appointed as Chief Executive Officer on 18 June 2013.

(iii) Peter Swaddle resigned as Senior Vice President Strategy and Business Development on 31 July 2012.

# Directors' Report

## Remuneration Report (Audited)

### (c) Share Holdings held directly and indirectly by Directors

| 2014                    | Balance at 1 Jul 2013 | Options Exercised | Net Change Other  | Balance at 30 Jun 14 |
|-------------------------|-----------------------|-------------------|-------------------|----------------------|
| Chris Rawlings          | 2,900,000             | -                 | 3,950,000 (i)     | 6,850,000            |
| Morné Engelbrecht (iii) | 710,185               | -                 | 3,795,924 (i)(ii) | 4,506,109            |
| Max Cozijn              | 1,278,340             | -                 | 639,171 (i)       | 1,917,511            |
| Helen Garnett           | 377,101               | -                 | 188,551 (i)       | 565,652              |
| Peter Hogan             | 280,000               | -                 | 220,000 (i)       | 500,000              |
| Louis Rozman (iv)       | 77,750,238            | -                 | 28,071,297 (v)    | 105,821,535          |
| <b>TOTAL</b>            | <b>83,295,864</b>     | <b>-</b>          | <b>36,864,943</b> | <b>120,160,807</b>   |

(i) Acquired through 2013 rights issue, held directly or indirectly through a self managed superannuation fund.

(ii) These shares were granted as part of the STI/LTI.

(iii) Morné Engelbrecht was appointed Managing Director 23 July 2013.

(iv) Indirect Holding (105,746,535) represents Pacific Road Resources Funds; Louis Rozman is an employee and Director of some of Pacific Road Capital entities.

(v) 75,000 shares were acquired through the 2013 rights issue.

| 2013              | Balance at 1 Jul 2012 | Options Exercised | Net Change Other  | Balance at 30 Jun 13 |
|-------------------|-----------------------|-------------------|-------------------|----------------------|
| Chris Rawlings    | 750,000               | -                 | 2,150,000         | 2,900,000            |
| Andrew Dash (i)   | 480,000               | -                 | -                 | 480,000              |
| Max Cozijn        | 2,278,340             | -                 | (1,000,000)       | 1,278,340            |
| Helen Garnett     | 27,101                | -                 | 350,000           | 377,101              |
| Peter Hogan       | 250,000               | -                 | 30,000            | 280,000              |
| Louis Rozman (ii) | 65,123,353            | -                 | 12,626,885        | 77,750,238           |
| <b>TOTAL</b>      | <b>68,908,794</b>     | <b>-</b>          | <b>14,156,885</b> | <b>83,065,679</b>    |

(i) Andrew Dash resigned 21 December 2012.

(ii) Indirect Holding (77,750,238) represents Pacific Road Resources Funds; Louis Rozman is an employee and Director of some Pacific Road Capital entities.

# Directors' Report

## Remuneration Report (Audited)

### (d) Share Holdings held directly and indirectly by Key Management Personnel

| 2014               | Balance at 1 Jul 2013 | Options Exercised | Net Change Other(i)           | Balance at 30 Jun 14 |
|--------------------|-----------------------|-------------------|-------------------------------|----------------------|
| Cliff Mallett      | 12,824,513            | -                 | 3,175,487 <sup>(i)(iii)</sup> | 16,000,000           |
| Justin Haines      | 377,592               | -                 | 1,781,450 <sup>(i)</sup>      | 2,159,042            |
| Terry Moore        | 267,591               | -                 | 1,727,657 <sup>(i)(iii)</sup> | 1,995,248            |
| Tracy Bragg        | -                     | -                 | -                             | -                    |
| Catherine Costello | -                     | -                 | -                             | -                    |
| <b>TOTAL</b>       | <b>13,469,696</b>     | <b>-</b>          | <b>6,684,594</b>              | <b>20,154,290</b>    |

(i) These shares were granted as part of the STI/LTI.

(ii) These shares are held indirectly through a self managed superannuation fund.

(iii) 133,796 shares were acquired through the 2013 rights issue.

| 2013                  | Balance at 1 Jul 2012 | Options Exercised | Net Change Other | Balance at 30 Jun 13 |
|-----------------------|-----------------------|-------------------|------------------|----------------------|
| Morné Engelbrecht (i) | -                     | -                 | 710,185          | 710,185              |
| Cliff Mallett         | 11,766,952            | -                 | 1,057,561        | 12,824,513           |
| Justin Haines         | -                     | -                 | 377,592          | 377,592              |
| Peter Swaddle (ii)    | -                     | -                 | 94,924           | 94,924               |
| Terry Moore           | -                     | -                 | 267,591          | 267,591              |
| <b>TOTAL</b>          | <b>11,766,952</b>     | <b>-</b>          | <b>2,507,853</b> | <b>14,274,805</b>    |

(i) Morné Engelbrecht appointed Chief Executive Officer on 18 June 2013.

(ii) Peter Swaddle resigned as Senior Vice President Strategy and Business Development on 31 July 2012.

# Directors' Report

## Remuneration Report (Audited)

### Loans to Key Management Personnel

In 2014 and 2013 there were no loans to Key Management Personnel.

### Other Transactions with Key Management Personnel

Louis Rozman (Non-Executive Director) holds Directorships in other companies which are shareholders of Carbon Energy Limited. Amounts paid to Pacific Road Capital Management Holdings Pty Limited for Mr Rozman's services as a Director amount to \$30,000 for the year ended 30 June 2014.

Parent Entity with significant influence over associated entity where Max Cozijn is a Director:

- On 24 July 2013 Carbon Energy sold its investment in Energia Minerals Limited for \$449,999. Refer to Note 12 for further details.

Other related party transactions:

- On 22 December 2011 Carbon Energy executed a Convertible Note Facility Agreement with Pacific Road Capital Management Pty Ltd (PRCM).

The Convertible Note Facility Agreement requires Carbon Energy to pay interest of 5% per annum on the Facility amount. The interest is payable quarterly in arrears and is payable through the issuance of shares in Carbon Energy at the 5 day VWAP for the Shares on the Australian Stock Exchange (ASX) prior to the day a payment is due. PRCM may convert all or part of the Facility amount to shares in the Company at any time during the term at a conversion price of \$0.14. If the share price exceeds \$0.40 for continuous 60 day VWAP period the Company can request the conversion of the Facility in full. The Facility repayment date is 18 January 2017 and any part of the Facility amount not converted into shares on that date is repayable in cash by the Company on that date. A total of 44,645,845 options have vested in connection with the Facility with varying expiry dates as follows:

| Options    | Grant Date | Price    | Expiry Date       |
|------------|------------|----------|-------------------|
| 7,000,000  | 25-Jan-12  | \$0.1678 | January 18, 2017  |
| 28,000,000 | 29-Feb-12  | \$0.1678 | February 25, 2017 |
| 9,645,845  | 16-Nov-12  | \$0.061  | November 15, 2015 |

# Directors' Report

## Unlisted Options

### Shares Under Option

At the date of this report, the unissued ordinary shares of Carbon Energy Limited under option are as follows:

| Grant Date       | No. of Options | Exercise Price | Vesting Date | Expiry Date |
|------------------|----------------|----------------|--------------|-------------|
| 13/11/2008       | 10,000,000     | \$1.00         | 30/06/2012   | 10/12/2014  |
| 25/01/2012 (ii)  | 7,000,000      | \$0.1678       | 25/01/2012   | 18/01/2017  |
| 25/01/2012 (ii)  | 28,000,000     | \$0.1678       | 25/01/2012   | 25/02/2017  |
| 16/11/2012 (i)   | 61,728,395     | \$0.061        | 16/11/2012   | 15/11/2015  |
| 16/11/2012 (ii)  | 9,645,845      | \$0.061        | 16/11/2012   | 15/11/2015  |
| 02/01/2013 (iii) | 3,084,000      | \$0.120        | 02/01/2013   | 31/12/2015  |
| 15/10/2013 (iii) | 4,600,704      | \$0.026        | 15/10/2013   | 15/10/2016  |
| 6/12/2013 (iii)  | 3,573,877      | \$0.026        | 6/12/2013    | 15/10/2016  |
| 6/12/2013 (iii)  | 33,333,333     | \$0.060        | 30/06/2014   | 30/06/2017  |
| 6/12/2013 (iii)  | 33,333,333     | \$0.060        | 30/06/2015   | 30/06/2018  |
| 6/12/2013 (iii)  | 33,333,333     | \$0.060        | 30/03/2016   | 30/06/2019  |

(i) 61,728,395 Options have been issued to Credit Suisse as part of the \$10,000,000 bridging loan secured facility (refer Note 20).

(ii) 44,645,845 Options have been issued to Pacific Road Capital Management as part of the \$10,000,000 Convertible Note Facility (refer Note 23).

(iii) Included in these options were options granted as remuneration to the Directors and Key Management Personnel during the year. Details of options granted to Key Management Personnel are disclosed on pages 35 and 36 above.



# Directors' report

## Auditor's Independence Declaration

The lead auditor's independence declaration for the year ended 30 June 2014 has been received and can be found on page 42 of the Annual Report.

Deloitte continues in office in accordance with s. 327 of the Corporations Act 2001.

Signed in accordance with a resolution of the Board of Directors made pursuant to s.298 (2) of the Corporations Act 2001.

On behalf of the Directors

A handwritten signature in black ink, appearing to read 'C.D. Rawlings'.

Dr Chris Rawlings  
Chairman

A handwritten signature in black ink, appearing to read 'M. Engelbrecht'.

Morné Engelbrecht  
Managing Director

Brisbane, Queensland  
1 August 2014

Board of Directors  
Carbon Energy Limited  
Level 9, 301 Coronation Drive  
Milton QLD 4064

1 August 2014

Dear Board Members

## Independence Declaration

In accordance with section 307C of the Corporations Act 2001, I am pleased to provide the following declaration of independence to the directors of Carbon Energy Limited.

As lead audit partner for the audit of the financial statements of Carbon Energy Limited for the financial year ended 30 June 2014, I declare that to the best of my knowledge and belief, there have been no contraventions of:

- (i) the auditor independence requirements of the Corporations Act 2001 in relation to the audit; and
- (ii) any applicable code of professional conduct in relation to the audit .

Yours sincerely



DELOITTE TOUCHE TOHMATSU



**Stephen Stavrou**  
Partner  
Chartered Accountants

# Corporate Governance Statement

## Carbon Energy Limited

### Approach to Corporate Governance

The Company has adopted systems of control and accountability as the basis for the administration of corporate governance. Commensurate with the spirit of the ASX Corporate Governance Council's Corporate Governance Principles and Recommendations 2nd edition (Principles and Recommendations), the Company has followed each recommendation where the Board has considered the recommendation to be an appropriate benchmark for its corporate governance practices. Where the Company's corporate governance practices follow a recommendation, the Board has made appropriate statements reporting on the adoption of the recommendation. In compliance with the "if not, why not" reporting regime, where, after due consideration, the Company's corporate governance practices depart from a recommendation, the Board has offered full disclosure and an explanation for the adoption of its own practice.

The following governance-related documents can be found on the Company's website at [www.carbonenergy.com.au](http://www.carbonenergy.com.au), under the "Corporate Governance" section of "About Us".

#### *Charters*

- Board
- Audit and Risk Committee
- Nomination Committee
- Remuneration Committee

#### *Policies*

- Assessing the Independence of Directors Policy
- Securities Trading Policy
- Code of Conduct (summary)
- Continuous Disclosure Policy (summary)
- Shareholder Communications Policy
- Diversity Policy
- Whistleblower Policy
- Remuneration Policy

Set out below are the fundamental corporate governance practices of Carbon Energy. The

information in this statement is current at 30 June 2014.

### Board

#### **Roles and responsibilities of the Board and Senior Executives**

(Recommendations: 1.1, 1.3)

The Company has established the functions reserved to the Board, and those delegated to senior executives and has set out these functions in its Board Charter. The Board Charter can be found on the Company's website at [www.carbonenergy.com.au](http://www.carbonenergy.com.au), under the "Corporate Governance" section of "About Us".

In carrying out its governance role, the main task of the Board is to guide Carbon Energy by setting the overall strategy for the business and oversee the performance of the Company. The Board is committed to Carbon Energy's compliance with all of its contractual, statutory, ethical and any other legal obligations, including the requirements of any regulatory body. The Board is collectively responsible for promoting the success of the Company through its key functions of overseeing the management of the Company, providing overall corporate governance of the Company, monitoring the financial performance of the Company, engaging appropriate management commensurate with the Company's structure and objectives, involvement in the development of corporate strategy and performance objectives, and reviewing, ratifying and monitoring systems of risk management and internal control, codes of conduct and legal compliance.

The Board has established the following committees to assist it in discharging its functions:

- Audit and Risk Committee
- Remuneration Committee
- Nomination Committee

The Board holds regular scheduled meetings and, if necessary, ad hoc meetings will be called to deal with any urgent matters which may arise between the scheduled meetings. Directors'

# Corporate Governance Statement

## Carbon Energy Limited

attendance at Board Meetings during this reporting period is set out on page 24.

Each Director is provided with a formal appointment letter setting out the key terms and conditions of their appointment. Any new Directors appointed are also provided with an induction programme, which includes distribution of key documents, pertaining to their role and to Carbon Energy, and discussions with key persons. It is the role of senior management to manage Carbon Energy in accordance with the direction and delegations of the Board and the responsibility of the Board to oversee the activities of management in carrying out these delegated duties.

Senior executives are also responsible for supporting the Managing Director and assisting the Managing Director in implementing the running of the general operations and financial business of the Company in accordance with the delegated authority of the Board. Senior executives are responsible for reporting all matters which fall within the Company's materiality thresholds at first instance to the Managing Director or, if the matter concerns the Managing Director, directly to the Chairman or the lead independent Director, as appropriate. All senior executives are provided with formal appointment letters, which include expectations of their role, term of appointment, termination entitlements and rights and responsibilities.

### Skills, Experience, Expertise and Period of Office of Each Director

(Recommendation: 2.6)

A profile of each Director setting out their skills, experience, expertise and period of office is set out in the Directors' Report.

The Company encourages diversity in the composition of its Board, as a means of ensuring the Company has an appropriate mix of skills and talent to achieve the Company's goals. The Company has established a Diversity Policy which is available on the Company's website at [www.carbonenergy.com.au](http://www.carbonenergy.com.au), under the "Corporate Governance" section of "About Us". The

Nomination Committee is responsible for ensuring that the Board has the appropriate blend of Directors with the necessary skills, expertise and relevant industry experience. The Nomination Committee has determined that the Directors have the necessary skills and experience, which are as follows: financial expertise, industry knowledge and experience, mining operations and corporate management experience, as well as geological and engineering expertise.

### Director Independence

(Recommendations: 2.1, 2.2, 2.3, 2.6)

The Board comprises a total of 6 Directors. There were three independent Directors of the Company during the reporting period, being Chris Rawlings, Helen Garnett and Max Cozijn. These Directors are independent as they are Non-Executive Directors who are not members of management and they are free of any business or other relationship that could materially interfere with, or could reasonably be perceived to materially interfere with, the independent exercise of their judgement.

The Board did not have a majority of independent Directors during the reporting period. The Board considers that its current composition and the composition during the year is appropriate for the Company's size and operations, and includes an appropriate mix of skills and expertise relevant to the Company's business.

The Board considers the independence of Directors having regard to the relationships (listed below) of the Principles and Recommendations and the Company's materiality thresholds.

The Board has agreed on the following guidelines, as set out in the Company's Board Charter for assessing the materiality of matters:

- Balance sheet items are material if they have a value of more than 10% of pro-forma net assets.
- Profit and loss items are material if they will have an impact on the current year operating result of 10% or more.

# Corporate Governance Statement

## Carbon Energy Limited

Items are also material if they impact on the reputation of the Company, involve a breach of legislation, are outside the ordinary course of business, could affect the Company's rights to its assets, if accumulated would trigger the quantitative tests, involve a contingent liability that would have a probable effect of 10% or more on balance sheet or profit and loss items, or will have an effect on operations which is likely to result in an increase or decrease in net income or dividend distribution of more than 10%.

Contracts will be considered material if they are outside the ordinary course of business, contain exceptionally onerous provisions in the opinion of the Board, impact on income or distribution in excess of the quantitative tests, there is a likelihood that either party will default, and the default may trigger any of the quantitative or qualitative tests, are essential to the activities of the Company and cannot be replaced, or cannot be replaced without an increase in cost which triggers any of the quantitative tests, contain or trigger change of control provisions, are between or for the benefit of related parties, or otherwise trigger the quantitative tests.

The Non-Executive Directors for the reporting period that were not independent were Peter Hogan and Louis Rozman.

The independent Chairman of the Board, Chris Rawlings, was appointed on 26 July 2011 as a Non-Executive Independent Director. The roles of Chairman and Managing Director are clearly separated.

### Independent Professional Advice

(Recommendation: 2.6)

It is the Board's policy that if a Director considers it necessary to obtain independent professional advice to properly discharge the responsibilities of their office as a Director then, provided the Director first obtains approval from the Chairman for incurring such expense, the Company will pay the reasonable expenses associated with obtaining such advice.

### Selection and (Re) Appointment of Directors

(Recommendation: 2.6)

In determining candidates for the Board, the Nomination Committee (which comprises the full Board) follows a prescribed process whereby it evaluates the range of skills, experience and expertise of the existing Board. In particular, the Nomination Committee is to identify the particular skills that will best increase the Board's effectiveness. Consideration is also given to the balance of independent Directors. Potential candidates are identified and, if relevant, the Nomination Committee recommends an appropriate candidate for appointment to the Board. Any Director appointed to the Board is subject to ratification by shareholders at the next general meeting.

The Board recognises that Board renewal is critical to performance and the impact of Board tenure on succession planning. Each Director other than the Managing Director, must not hold office (without re-election) past the third annual general meeting of the Company following the Director's appointment or three years following that Director's last election or appointment (whichever is the longer). However, a Director appointed to fill a casual vacancy or as an addition to the Board must not hold office (without re-election) past the next annual general meeting of the Company. At each annual general meeting a minimum of one Director or one third of the total number of Directors must resign. A Director who retires at an annual general meeting is eligible for re-election at that meeting. Re-appointment of Directors is not automatic.

Directors are appointed in accordance with the Constitution of the Company and the Corporations Act 2001.

Details of the Directors' skills, experience, expertise and the term of office held by each Director are set out on pages 22 and 23 under 'Information on Directors and Company Secretary'.



# Corporate Governance Statement

## Carbon Energy Limited

### Board committees

#### Nomination Committee

(Recommendations: 2.4, 2.6)

The Company has adopted a Nomination Committee Charter which describes the role, composition, functions and responsibilities of the Nomination Committee. This charter is available on the Company's website at [www.carbonenergy.com.au](http://www.carbonenergy.com.au), under the "Corporate Governance" section of "About Us".

The Nomination Committee functions are currently performed by the full Board. Nomination Committee meetings are held separate from Board meetings. When the Board convenes as the Nomination Committee it carries out those functions which are delegated to it in the Company's Nomination Committee Charter. The Board deals with any conflicts of interest that may occur when convening in the capacity of the Nomination Committee by ensuring that the Director with conflicting interests is not party to the relevant discussions.

The full Board, in its capacity as the Nomination Committee, held one meeting during the reporting period. Details of the Directors' attendance at the Nomination Committee meeting are set out in the following table:

| Name                   | No. eligible to attend | No. of meetings attended |
|------------------------|------------------------|--------------------------|
| Chris Rawlings (Chair) | 1                      | 1                        |
| Morne Engelbrecht      | 1                      | 1                        |
| Max Cozijn             | 1                      | 1                        |
| Helen Garnett          | 1                      | 1                        |
| Peter Hogan            | 1                      | 0                        |
| Louis Rozman           | 1                      | 1                        |

#### Audit and Risk Committee

(Recommendations: 4.1, 4.2, 4.3, 4.4)

The role of the Audit and Risk Committee is set out in a formal charter approved by the Board. The Audit and Risk Committee Charter describes its role, composition, functions and responsibilities. This charter is available on the Company's website at [www.carbonenergy.com.au](http://www.carbonenergy.com.au), under the "Corporate Governance" section of "About Us".

The Audit and Risk Committee is structured in compliance with Recommendation 4.2, with three Non-Executive Directors as members, a majority of independent members and an Independent Chair. The members of the Audit and Risk Committee and details of their attendance at Audit and Risk Committee meetings (a total of three meetings were held during the reporting period) are set out in the following table:

| Name  | No. eligible to attend | No. of meetings attended |
|---|------------------------|--------------------------|
| Helen Garnett (independent Non-Executive and Chair) | 3                      | 3                        |
| Peter Hogan (non-independent Non-Executive)         | 3                      | 3                        |
| Chris Rawlings (independent Non-Executive)          | 3                      | 3                        |

Details of each of the Director's qualifications are set out in the Directors' Report. All members of the Audit and Risk Committee are financially literate and have sufficient industry knowledge to participate in and contribute to the Audit and Risk Committee. Further, Morné Engelbrecht, the Company's Managing Director during the reporting period (following his appointment on 23 July 2013 and having the role of Chief Financial Officer of the Company prior to that appointment), attended the Audit and Risk Committee meetings, and the Audit and Risk Committee has the

# Corporate Governance Statement

## Carbon Energy Limited

opportunity to meet with the external auditor, if necessary.

The Company has established procedures for the selection, appointment and rotation of its external auditor. The Board is responsible for the initial appointment of the external auditor and the appointment of a new external auditor when any vacancy arises, as recommended by the Audit and Risk Committee. Candidates for the position of external auditor must demonstrate complete independence from the Company through the engagement period. The Board may otherwise select an external auditor based on criteria relevant to the Company's business and circumstances. The performance of the external auditor is reviewed on an annual basis by the Audit and Risk Committee and any recommendations are made to the Board.

### Remuneration Committee

(Recommendations: 8.1, 8.2, 8.3, 8.4)

The role of the Remuneration Committee is set out in a formal charter approved by the Board. The Remuneration Committee Charter describes the role, composition, functions and responsibilities of the Remuneration Committee. This charter is available on the Company's website at [www.carbonenergy.com.au](http://www.carbonenergy.com.au), under the "Corporate Governance" section of "About Us".

The Remuneration Committee is structured in accordance with Recommendation 8.2 and ASX Listing Rule 12.8, consisting of three Non-Executive Directors as members, a majority of independent members and an Independent Chair.

The three members of the Remuneration Committee, and details of their attendance at Remuneration Committee meetings (three meetings were held during the reporting period) are set out in the following table:

| Name   | No. eligible to attend | No. of meetings attended |
|--|------------------------|--------------------------|
| Max Cozijn<br>(independent Non-Executive and Chairman) | 3                      | 3                        |
| Peter Hogan (non-independent Non-Executive)            | 3                      | 3                        |
| Chris Rawlings<br>(independent Non-Executive)          | 3                      | 3                        |

Details of remuneration, including the Company's policy on remuneration, are contained in the "Remuneration Report" which forms part of the Directors' Report. Non-executive Directors are remunerated at a fixed fee for time, commitment and responsibilities. Fees for Non-Executive Directors are not linked to the performance of the Company.

Pay and rewards for executive Directors and senior executives consists of a base salary, superannuation, fringe benefits and performance incentives. The Remuneration Committee reviews executive packages annually by reference to company performance, executive performance, comparable information from industry sectors and other listed companies and independent advice.

There are no termination or retirement benefits for Non-Executive Directors (other than superannuation).

### Performance Evaluation

#### Senior Executives

(Recommendations: 1.2, 1.3)

The performance of Executives is reviewed annually, in July, by the Managing Director and in the case of the Managing Director, by the Remuneration Committee, with revised remuneration packages generally taking effect from 1 July of the new financial year. Executives

# Corporate Governance Statement

## Carbon Energy Limited

are also entitled to participate in a Short Term Incentive (STI) and Long Term Incentive (LTI) scheme as determined by the Board. Key performance indicators are established for each executive and relate to specific outcomes agreed between the executive and the Company for the period involved. Further, the Executive needs to be in the employment of the Consolidated Group for the period to successfully meet the performance criterion for any granted options to vest.

During the reporting period an evaluation of senior executives took place in accordance with the process disclosed.

### Board, its Committees and Individual Directors

(Recommendations: 2.5, 2.6)

The Chair has the overall responsibility for evaluating the Board and, when deemed appropriate, Board committees and individual Directors. The process for evaluating the performance of the Board, individual Directors and any applicable committees is:

- questionnaires are prepared by the Company Secretary and circulated to each Director for completion;
- the Chairman, with support from the Company Secretary, then summarises and collates the responses to the questionnaires and reports back to the Board; and
- the Chairman and Directors then review and discuss the report and address any issues as required.

During the reporting period an evaluation of the Board, its committees and individual Directors commenced in accordance with the process disclosed above.

## Ethical and Responsible Decision Making

### Code of Conduct

(Recommendations: 3.1, 3.5)

### Company Code of Conduct

Carbon Energy is committed to operating with honesty, fairness and integrity in all its business dealings, and to observe the rule and spirit of the legal and regulatory environment in which the Company operates. Accordingly, Carbon Energy requires employees to act in Carbon Energy's best interests in a professional, honest and ethical manner, and in full compliance with the law, both within and on behalf of Carbon Energy. Directors, management and employees are required to respect the confidentiality of all information of a confidential nature acquired in the course of the Company's business.

Carbon Energy has an established Code of Conduct, a summary of which is available on the Company's website at [www.carbonenergy.com.au](http://www.carbonenergy.com.au), under the "Corporate Governance" section of "About Us". The Code governs all Carbon Energy commercial operations and the conduct of Directors, senior executives and employees when they represent Carbon Energy.

### Whistleblower and Speak Out Policy

Carbon Energy has established a Whistleblower Policy which outlines the process for any Director, officer or employee of Carbon Energy or member of the public, who makes or wishes to make a report regarding a violation or suspected violation of the Company's Code of Conduct. The policy is intended to encourage reporting of violations (or suspected violations) and to provide protection to whistleblowers from victimisation or dismissal by implementing systems for confidentiality and report handling.

### Diversity

(Recommendations: 3.2, 3.3, 3.4, 3.5)

The Company has established a Diversity Policy which is available on the Company's website at

# Corporate Governance Statement

## Carbon Energy Limited

www.carbonenergy.com.au, under the "Corporate Governance" section of "About Us". The Diversity Policy does not include a requirement for the Board to establish measurable objectives for achieving diversity, or for the Board to assess annually both the objectives and progress in achieving them. The Company aims to achieve an appropriate mix of diversity on its Board, in senior executive management and throughout the organisation. However, the Board has determined that no specific measurable objectives will be established until the number of employees and level of activities of the Company increases to a level sufficient to enable meaningful and achievable objectives to be developed.

The proportion of women employees in the whole organisation, women in senior executive positions and women on the Board are set out in the following table:

|                            | Proportion of women  |
|----------------------------|----------------------|
| Whole organisation         | 10 out of 23 (43.5%) |
| Senior Executive positions | 2 out of 6 (33.3%)   |
| Board                      | 1 out of 6 (16.7%)   |

### Continuous Disclosure

(Recommendations: 5.1, 5.2)

The Board has designated the Carbon Energy Company Secretary as the person responsible for overseeing and co-ordinating disclosure of information to the ASX as well as communicating with the ASX.

The Board has established a written policy for ensuring compliance with ASX Listing Rule disclosure requirements, in particular the management of the Company's continuous disclosure obligations. A summary of the Carbon Energy Continuous Disclosure Policy can be found on the Company's website at www.carbonenergy.com.au, under the "Corporate Governance" section of "About Us".

### Shareholder Communication

(Recommendations: 6.1, 6.2)

The Company has designed a communications policy for promoting effective communication with shareholders and encouraging shareholder participation at general meetings. The policy describes the methods the Company uses to communicate with its shareholders. The Carbon Energy policy on Shareholder Communication can be found on the Company's website at www.carbonenergy.com.au, under the "Corporate Governance" section of "About Us".

### Risk Management

(Recommendations: 7.1, 7.2, 7.3, 7.4)

The Board is committed to the establishment and maintenance of adequate risk management systems. A Risk Management Policy has been adopted by the Board, which sets out the Company's risk profile and a framework upon which the Company meets its risk management obligations. Under the policy, the Board has delegated responsibilities to the Audit and Risk Committee.

The Risk Management Policy applies to Carbon Energy, in its capacity as a listed company, and its subsidiaries. Key components of the Policy which bring together a number of procedures and controls within the Company are as follows:

- confirmation of the Company's risk appetite and tolerance;
- identification and assessment of risks;
- monitoring and, wherever possible, mitigation of identified risks;
- periodic reporting; and
- assessment of effectiveness of the risk management framework.

Management is responsible for designing and implementing the risk management framework. Management identifies and reviews the major risks impacting each area of the business and develops strategies to effectively mitigate those risks. All identified risks are recorded on the Risk Register which is regularly reviewed by the Audit and Risk Committee who then recommend it to

# Corporate Governance Statement

## Carbon Energy Limited

the Board for approval on an annual basis. Any changes to, or newly identified, extreme or high risks are reported to the Board promptly, as and when they occur. The Board has received a report from management as to the effectiveness of the Company's management of its material business risks for the reporting period.

Key risks that the Company review and monitor include: operations; environmental; human capital; technology; commercial; political; financial reporting; legal and compliance.

The Chief Executive Officer and Chief Financial Officer have provided declarations to the Board in accordance with section 295A of the Corporations Act and have assured the Board that such declarations are founded on a sound system of risk management and internal control and that the system is operating effectively in all material respects in relation to financial reporting risks.



# 2014

## Financial Report



# Financial Report

## Consolidated Statement of Profit and Loss and Other Comprehensive Income

FOR THE YEAR ENDED 30 JUNE 2014

|   |       | CONSOLIDATED GROUP |                     |
|---|-------|--------------------|---------------------|
|   | Notes | 2014 \$            | 2013 \$             |
| <b>Revenue and other income</b>   |       |                    |                     |
| Technology service fee revenue  |       | 2,332,029          | -                   |
| Other income  | 3     | 4,125,561          | 816,084             |
| <b>Total revenue and other income</b>   |       | <b>6,457,590</b>   | <b>816,084</b>      |
| Employee benefits expense   |       | (5,702,661)        | (5,647,912)         |
| Administration, legal and corporate costs                                       |       | (2,357,484)        | (3,181,724)         |
| Consultancy costs   |       | (1,048,943)        | (1,877,449)         |
| Operating expenditure   |       | (1,624,864)        | (1,869,786)         |
| Share-based payments  | 36    | (478,393)          | (280,056)           |
| Depreciation expense  | 4(a)  | (145,253)          | (97,389)            |
| Finance costs   |       | (2,270,742)        | (4,561,259)         |
| Movement in fair value of derivatives   | 21    | 255,252            | 1,051,581           |
| Impairment expense  | 4(b)  | (1,970,900)        | (18,790,669)        |
| Loss on disposal of assets  | 4(a)  | -                  | (404,360)           |
| Loss on disposal of investment in associate                                     | 11    | -                  | (176,710)           |
| Net loss from equity accounted investment in associate                          | 11    | -                  | (564,678)           |
| <b>Loss before income tax expense</b>   |       | <b>(8,886,398)</b> | <b>(35,584,327)</b> |
| Income Tax Expense  | 6     | (233,203)          | -                   |
| <b>Loss of the Year</b>   | 26    | <b>(9,119,601)</b> | <b>(35,584,327)</b> |
| <b>Other comprehensive income for the year (net of tax)</b>                     |       |                    |                     |
| <b>Items that will not be reclassified subsequently to profit or loss</b>       |       | -                  | -                   |
|   |       | -                  | -                   |
| <b>Items that may be reclassified subsequently to profit or loss</b>            |       |                    |                     |
| Exchange differences on translation of foreign operations                       |       | -                  | 3,510               |
|   |       | -                  | <b>3,510</b>        |
| <b>Total Loss including comprehensive income for the year</b>                   |       | <b>(9,119,601)</b> | <b>(35,580,817)</b> |
| <b>Loss attributable to Owners of the Parent</b>                                |       | (9,119,601)        | (35,580,817)        |
| <b>Total Loss and comprehensive income attributable to Owners of the Parent</b> |       | (9,119,601)        | (35,580,817)        |
| <b>Overall Operations</b>   |       |                    |                     |
| Basic loss per share (cents per share)  | 5     | (0.81)             | (4.56)              |
| Diluted loss per share (cents per share)  | 5     | (0.81)             | (4.56)              |

The above consolidated statement of profit and loss and other comprehensive income should be read in conjunction with the accompanying notes.

# Financial Report

## Consolidated Statement of Financial Position

FOR THE YEAR ENDED 30 JUNE 2014

|   |       | CONSOLIDATED GROUP |                    |
|---|-------|--------------------|--------------------|
|   | Notes | 2014 \$            | 2013 \$            |
| <b>Assets</b>                             |       |                    |                    |
| <b>Current Assets</b>                     |       |                    |                    |
| Cash and cash equivalents                 | 8     | 2,387,114          | 1,772,562          |
| Trade and other receivables               | 9     | 1,460,432          | 109,140            |
| Other current assets                      | 10    | 39,461             | 83,552             |
| <b>Total Current Assets</b>               |       | <b>3,887,007</b>   | <b>1,965,254</b>   |
| <b>Non-Current Assets</b>                 |       |                    |                    |
| Trade and other receivables               | 9     | 267,553            | 1,702,893          |
| Available for sale financial assets       | 12    | -                  | 449,999            |
| Construction work in progress             | 13    | 2,555,334          | 2,555,334          |
| UCG panel assets                          | 14    | 1,774,901          | 1,776,106          |
| Property, plant & equipment               | 15    | 1,043,282          | 1,083,224          |
| Other non-current asset                   | 16    | 860,326            | 1,722,723          |
| Deferred exploration and evaluation costs | 17    | 90,180,110         | 90,322,819         |
| Intangible assets                         | 18    | 47,598,834         | 47,623,940         |
| <b>Total Non-Current Assets</b>           |       | <b>144,280,340</b> | <b>147,237,038</b> |
| <b>Total Assets</b>                       |       | <b>148,167,347</b> | <b>149,202,292</b> |
| <b>Liabilities</b>                        |       |                    |                    |
| <b>Current Liabilities</b>                |       |                    |                    |
| Trade and other payables                  | 19    | 952,372            | 1,089,873          |
| Deferred revenue                          | 7     | 873,106            | -                  |
| Loans and borrowings                      | 20    | -                  | 2,997,233          |
| Derivative financial liability            | 21    | 10,904             | 266,156            |
| Provisions                                | 22    | 829,337            | 1,334,350          |
| <b>Total Current Liabilities</b>          |       | <b>2,665,719</b>   | <b>5,687,612</b>   |
| <b>Non Current Liabilities</b>            |       |                    |                    |
| Provisions                                | 22    | 2,923,595          | 2,315,729          |
| Financial Liabilities                     | 23    | 6,972,442          | 6,179,304          |
| <b>Total Non Current Liabilities</b>      |       | <b>9,896,037</b>   | <b>8,495,033</b>   |
| <b>Total Liabilities</b>                  |       | <b>12,561,756</b>  | <b>14,182,645</b>  |
| <b>Net Assets</b>                         |       | <b>135,605,591</b> | <b>135,019,647</b> |
| <b>Equity</b>                             |       |                    |                    |
| Issued Capital                            | 24    | 235,606,127        | 227,727,927        |
| Reserves                                  | 25    | 19,735,710         | 17,908,365         |
| Accumulated losses                        | 26    | (119,736,246)      | (110,616,645)      |
| <b>Total Equity</b>                       |       | <b>135,605,591</b> | <b>135,019,647</b> |

The above consolidated statement of financial position should be read in conjunction with the accompanying notes.

# Financial Report

## Consolidated Statement of Changes in Equity

FOR THE YEAR ENDED 30 JUNE 2014

|  | Notes | Issued<br>Capital  | Options<br>Reserve | Share-<br>Based<br>Payments<br>Reserve | Other<br>Reserve | Foreign<br>Currency<br>Reserve | Accumulated<br>Losses | Total              |
|--|-------|--------------------|--------------------|--|------------------|--------------------------------|-----------------------|--------------------|
|  |       | \$                 |                    | \$                                     | \$               | \$                             | \$                    | \$                 |
| Balance at 1 July 2012   |       | 227,174,129        | -                  | 15,718,230                             | 2,101,590        | 37,816                         | (75,032,318)          | 169,999,447        |
| Shares issued during the year  | 24    | 559,990            | -                  | -                                      | --               | -                              | -                     | 559,990            |
| Transaction Costs  | 24    | (6,192)            | -                  | -                                      | -                | -                              | -                     | (6,192)            |
| Movement in share option reserve on recognition of share passed payments | 25    | -                  | -                  | 54,239                                 | -                | -                              | -                     | 54,239             |
| Translation of Foreign Operations  | 25    | -                  | -                  | -                                      | -                | (3,510)                        | -                     | (3,510)            |
| Losses attributable to member of parent entity                           | 26    | -                  | -                  | -                                      | -                | -                              | (35,584,327)          | (35,584,327)       |
| <b>Balance at 30 June 2013</b>   |       | <b>227,727,927</b> | <b>-</b>           | <b>15,772,469</b>                      | <b>2,101,590</b> | <b>34,306</b>                  | <b>(110,616,645)</b>  | <b>135,019,647</b> |
| Balance at 1 July 2013   |       | 227,727,927        | -                  | 15,772,469                             | 2,101,590        | 34,306                         | (110,616,645)         | 135,019,647        |
| Shares issued during the year  | 24    | 7,927,522          | -                  | -                                      | -                | -                              | -                     | 7,927,522          |
| Transaction Costs  | 24    | (49,322)           | -                  | -                                      | -                | -                              | -                     | (49,322)           |
| Options issued during the year   | 25    | -                  | 1,650,453          | -                                      | -                | -                              | -                     | 1,650,453          |
| Movement in share option reserve on recognition of share based payments  | 25    | -                  | -                  | 211,198                                | -                | -                              | -                     | 211,198            |
| Translation of Foreign Operations  | 25    | -                  | -                  | -                                      | -                | (34,306)                       | -                     | (34,306)           |
| Losses attributable to member of parent entity                           | 26    | -                  | -                  | -                                      | -                | -                              | (9,119,601)           | (9,119,601)        |
| <b>Balance at 30 June 2014</b>   |       | <b>235,606,127</b> | <b>1,650,453</b>   | <b>15,983,667</b>                      | <b>2,101,590</b> | <b>-</b>                       | <b>(119,736,246)</b>  | <b>135,605,591</b> |

The above consolidated statement of changes in equity should be read in conjunction with the accompanying notes.

# Financial Report

## Cash Flow Statement

FOR THE YEAR ENDED 30 JUNE 2014

| CONSOLIDATED GROUP  |                  |                    |
|---|------------------|--------------------|
| Notes   | 2014 \$          | 2013 \$            |
| <b>Cash flows from operating activities</b>                       |                  |                    |
| Receipts from customers   | 1,810,818        | -                  |
| Payments to suppliers and employees                               | (11,759,977)     | (13,376,874)       |
| Receipt of Research & Development rebate                          | 3,865,463        | 7,002,767          |
| Interest received   | 166,946          | 187,752            |
| Taxes paid  | (181,082)        | -                  |
| Other receipts  | 85,390           | 606,365            |
| <b>Net cash flows used in operating activities</b>                | <b>31</b>        | <b>(5,579,990)</b> |
| <b>Cash flows from Investing Activities</b>                       |                  |                    |
| Payments for property, plant and equipment                        | (105,311)        | (589,511)          |
| Proceeds from disposal of property, plant and equipment           | -                | 350,000            |
| Proceeds on sale of AFS asset                                     | 449,999          | -                  |
| Proceeds from sale of tenements                                   | 600,000          | -                  |
| Payments for Exploration & Evaluation costs                       | (120,857)        | (461,913)          |
| Payments for Intangible Assets                                    | (24,452)         | (33,023)           |
| Payments for Chile Project  | -                | (115,061)          |
| Net Payments for return of security bonds                         | -                | (49,627)           |
| <b>Net cash flows generated/ (used) in investing activities</b>   | <b>799,379</b>   | <b>(899,135)</b>   |
| <b>Cash flows from Financing Activities</b>                       |                  |                    |
| Proceeds from issues of shares                                    | 8,874,169        | -                  |
| Proceeds from short term loan facility                            | -                | 10,000,000         |
| Repayment of short term loan facility                             | (2,997,233)      | (7,002,767)        |
| Term facility costs   | -                | (1,010,000)        |
| Capital raising and financing costs                               | (49,321)         | (6,192)            |
| <b>Net cash flows provided by financing activities</b>            | <b>5,827,615</b> | <b>1,981,041</b>   |
| <b>Net increase/ (decrease) in cash and cash equivalents held</b> | <b>614,552</b>   | <b>(4,498,084)</b> |
| Cash and cash equivalents at the beginning of the financial year  | 1,772,562        | 6,270,646          |
| <b>Cash and cash equivalents at the end of the financial year</b> | <b>8</b>         | <b>1,772,562</b>   |

The above consolidated cash flow statement should be read in conjunction with the accompanying notes.



# Financial Report

## Notes to the Financial Statements

FOR THE YEAR ENDED 30 JUNE 2014

### Note 1 - Statement of Significant Accounting Policies

The financial report covers the Consolidated Group of Carbon Energy Limited and its controlled entities. Carbon Energy Limited is a listed public company, incorporated and domiciled in Australia. The addresses of its registered office and principal place of business are disclosed in the introduction to the annual report. The principal activities of the Company and its subsidiaries (the Consolidated Group) are described in Note 34.

#### 1.1 Statement of Compliance

These financial statements are general purpose financial statements which have been prepared in accordance with the Corporations Act 2001, Accounting Standards and Interpretations, and comply with other requirements of the law.

Accounting Standards include Australian Accounting Standards. Compliance with Australian Accounting Standards ensures that the financial statements and notes of the Company and the Consolidated Group comply with International Financial Reporting Standards ('IFRS').

The financial statements were authorised for issue by the Directors on 1 August 2014.

Material accounting policies adopted in the preparation of this financial report are presented below. They have been consistently applied unless otherwise stated.

#### 1.2 Basis of Preparation

The consolidated financial statements have been prepared on the basis of historical cost, except for certain non-current assets and financial instruments that are measured at re-valued amounts or fair values, as explained in the accounting policies below. Historical cost is generally based on the fair values of the consideration given in exchange for assets. All amounts are presented in Australian dollars, unless otherwise stated.

#### 1.2.1 Going Concern

The financial report has been prepared on a going concern basis, which assumes the continuity of normal business activities and the realisation of assets and the settlement of liabilities in the ordinary course of business.

In concluding that the going concern basis is appropriate, a cash flow forecast for twelve months from the signing of the financial report was considered.

The ability of the Company and the Consolidated Group to continue as going concerns and fund the development and commercialisation of its keyseam UCG technology is dependent upon the receipt of agreed technology and service fees, the receipt of the R&D cash incentive to be lodged with the ATO and the ability to secure additional funds from a range of opportunities. These opportunities include the further licensing and services arising from the Company's keyseam UCG technology, progress towards the utilisation of its gas reserves and issuing new equity and/or entering into debt facilities. Factors which can influence these opportunities include, but are not limited to, approval of the utilisation of the Company's keyseam technology in Queensland by the Queensland Government and general market sentiment.

Notwithstanding this, as a technology development and exploration company with start-up projects and a dependency upon continuing support from current shareholders and financiers and on securing additional sources of funds, should the Company and the Consolidated Group not receive the forecast cash inflows and additional funding referred to above there are material uncertainties as to whether the Company and the Consolidated Group will be able to continue as going concerns and therefore, whether they will realise their assets and extinguish their liabilities in the normal course of business and at the amounts stated in the financial report.

# Financial Report

## Notes to the Financial Statements

FOR THE YEAR ENDED 30 JUNE 2014

### Note 1 - Statement of Significant Accounting Policies (continued)

The financial report does not include adjustments relating to the recoverability and classification of recorded asset amounts nor to the amounts and classification of liabilities that might be necessary should the Company and the Consolidated Group not continue as going concerns.

#### 1.3 Principles of Consolidation

A controlled entity is any entity over which Carbon Energy Limited has the power to govern the financial and operating policies so as to obtain benefits from its activities. In assessing the power to govern, the existence and effect of holdings of actual and potential voting rights are considered.

A list of controlled entities is contained in Note 34 to the financial statements.

As at reporting date, the assets and liabilities of all controlled entities have been incorporated into the consolidated financial statements as well as their results for the year then ended. Where controlled entities have entered (left) the Consolidated Group during the year, their operating results have been included (excluded) from the date control was obtained (ceased).

All inter-group balances and transactions between entities in the Consolidated Group, including any unrealised profits or losses, have been eliminated on consolidation. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with those adopted by the parent entity.

#### 1.4 Business Combinations

The acquisition method of accounting is used to account for all business combinations, regardless of whether equity instruments or other assets are acquired. The consideration transferred for the acquisition of a subsidiary comprises the fair values of the assets transferred, the liabilities incurred and the equity interests issued by the Consolidated Group. The consideration

transferred also includes the fair value of any asset or liability resulting from a contingent consideration arrangement and the fair value of any pre-existing equity interest in the subsidiary. Acquisition-related costs are expensed as incurred. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are, with limited exceptions, measured initially at their fair values at the acquisition date.

The excess of the consideration transferred, the amount of any non-controlling interest in the subsidiary acquired 'acquiree' and the acquisition-date fair value of any previous equity interest in the acquiree over the fair value of the Consolidated Group's share of the net identifiable assets acquired is recorded as goodwill. If those amounts are less than the fair value of the net identifiable assets of the subsidiary acquired and the measurement of all amounts has been reviewed, the difference is recognised directly in profit or loss as a bargain purchase.

Where settlement of any part of cash consideration is deferred, the amounts payable in the future are discounted to their present value as at the date of exchange.

#### 1.5 Investments in Associates

Investments in associate companies are recognised in the financial statements by applying the equity method of accounting. The equity method of accounting recognises the Consolidated Group's share of post acquisition reserves of its associates. Significant influence is defined as the power to participate in the financial and operating policy decisions of the investee but is not control or joint control over those policies. Such investments are tested for impairment in accordance with the policy stated in Note 1.16.

Where the Consolidated Group loses significant influence upon disposal or dilution via a rights issue the retained investment is measured at fair value on its initial recognition as a financial asset in accordance with AASB 139. The difference between the previous carrying amount and the fair

# Financial Report

## Notes to the Financial Statements

FOR THE YEAR ENDED 30 JUNE 2014

### Note 1 - Statement of Significant Accounting Policies (continued)

value is treated as the gain or loss. Any gain or loss previously recognised in other comprehensive income is to be reclassified from equity to profit or loss.

#### 1.6 Revenue Recognition

Revenue is measured at the fair value of the consideration received or receivable and represents amounts receivable for goods supplied stated net of discounts, returns and GST.

The Consolidated Group's transactions may comprise multiple deliverables over a period of time and in these instances revenue recognition criteria are applied to each separately identifiable component in order to reflect the substance. The Consolidated Group recognises revenue when the amount of revenue can be reliably measured, when it is probable that future economic benefits will flow to the entity and when specific criteria have been met for each of the Consolidated Group's activities, as described below.

##### 1.6.1 Technology Licence Fees

Technology license revenue is generated from granting third parties the right to use Keyseam UCG technology in accordance with the terms of the relevant agreement. Technology licence fees are recognised as revenue as contractual milestones are fulfilled.

##### 1.6.2 Technology Service Fees

The Consolidated Group provides technology services to customers on a fixed price basis. For the delivery of services the related revenue is recognised in the accounting period in which the services are rendered, by reference to the stage of completion and assessed on the basis of the actual service provided as a proportion of the total services to be provided unless the outcome of the contract cannot be reliably estimated. Where it is probable that a loss will arise from a contract, the

excess of total costs over revenue is recognised as an expense immediately.

##### 1.6.3 Royalty Revenue

Royalty revenue is recognised on an accrual basis in accordance with the substance of the relevant agreements.

##### 1.6.4 Interest and Other Revenue

Interest revenue is recognised using the effective interest rate method. Gains from the sale of investments or other assets are recognised when the risks and rewards have been transferred to the purchaser which is on the date of the contract for sale or delivery.

##### 1.6.5 Unbilled and Deferred Revenue

Unbilled revenue is stated at the aggregate of contract costs incurred to date plus recognised profits less recognised losses and progress billings. If there are contracts where progress billings exceed the aggregate costs incurred plus profits less losses, the net amounts are presented as deferred revenue.

#### 1.7 Leases

Lease payments for operating leases, where substantially all the risks and benefits remain with the lessor, are charged as expenses and accounted for on a straight line basis in the periods in which they are incurred.

#### 1.8 Foreign Currencies

For the purpose of the consolidated financial statements, the results and financial position of each group entity are expressed in Australian dollars ('\$'), which is the functional currency of the Company and the presentation currency for the consolidated financial statements.

For the purpose of presenting consolidated financial statements, the assets and liabilities of the Consolidated Group's foreign operations are translated into Australian dollars using exchange rates prevailing at the end of the reporting period,

# Financial Report

## Notes to the Financial Statements

FOR THE YEAR ENDED 30 JUNE 2014

### Note 1 - Statement of Significant Accounting Policies (continued)

income and expense items are translated at the average exchange rates for the period. Exchange differences arising, if any, are recognised in other comprehensive income and accumulated in equity.

#### 1.9 Borrowing Costs

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use or sale.

Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs eligible for capitalisation.

All other borrowing costs are recognised in profit or loss in the period in which they are incurred.

#### 1.10 Government Grants

Grants from the government are recognised at their fair value where the amount of the grant can be reliably measured and when it is probable that future economic benefits will flow to the entity. The Consolidated Group recognises grants when the government body has confirmed that a submitted claim is payable.

Where the grants are in recognition of expenses, the grant is presented as other income. Grants related to assets are presented in the balance income as a deduction against the assets carrying value.

#### 1.11 Employee Benefits

A liability is recognised for benefits accruing to employees in respect of wages and salaries, annual leave, long service leave, and sick leave when it is probable that settlement will be required and they are capable of being measured reliably.

Liabilities recognised in respect of employee benefits expected to be settled wholly within 12 months after the end of the period in which the employees render the related service are recognised in respect of employees' services up to the end of the reporting period and are measured at the amounts expected to be paid when the liabilities are settled.

Liabilities recognised in respect of employee benefits not expected to be settled wholly within 12 months after the end of the period in which the employees render the related service are measured as the present value of the estimated future cash outflows to be made by the Consolidated Group in respect of services provided by employees up to reporting date. Consideration is given to expected future wage and salary levels, experience of employee departures and periods of service. Expected future payments are discounted using market yields at the end of the reporting period of government bonds with terms and currencies that match, as closely as possible, the estimated future cash outflows.

#### 1.12 Equity Settled Compensation

The Consolidated Group operates equity-settled share-based payment employee share and option schemes. The fair value of the equity to which employees become entitled is measured at grant date and recognised as an expense over the vesting period, with a corresponding increase to an equity account. The number of shares and options expected to vest is reviewed and adjusted at each reporting date such that the amount recognised for services received as consideration for the equity instruments granted shall be based on the number of equity instruments that eventually vest.

##### 1.12.1 Share-based Payments Transactions of the Company

Equity-settled share-based payments to employees and others providing similar services are measured at the fair value of the equity

# Financial Report

## Notes to the Financial Statements

FOR THE YEAR ENDED 30 JUNE 2014

### Note 1 - Statement of Significant Accounting Policies (continued)

instruments at the grant date. Details regarding the determination of the fair value of employee equity-settled share-based transactions are set out in note 36.

The fair value determined at the grant date of the equity-settled share-based payments is expensed on a straight-line basis over the vesting period, based on the Consolidated Group's estimate of equity instruments that will eventually vest, with a corresponding increase in equity. At the end of each reporting period, the Consolidated Group revises its estimate of the number of equity instruments expected to vest. The impact of the revision of the original estimates, if any, is recognised in profit or loss such that the cumulative expense reflects the revised estimate, with a corresponding adjustment to the equity-settled employee benefits reserve.

Equity-settled share-based payment transactions with parties other than employees are measured at the fair value of the goods or services received, except where that fair value cannot be estimated reliably, in which case they are measured at the fair value of the equity instruments granted, measured at the date the entity obtains the goods or the counterparty renders the service.

For cash-settled share-based payments, a liability is recognised for the goods or services acquired, measured initially at the fair value of the liability. At the end of each reporting period until the liability is settled and at the date of settlement, the fair value of the liability is re-measured, with any changes in fair value recognised in profit or loss for the year.

#### 1.13 Income Tax

The charge for current income tax expenses is based on the profit for the year adjusted for any non-assessable or disallowed items. It is calculated using tax rates that have been enacted or are substantially enacted by the balance sheet date.

Deferred tax is accounted for using the balance sheet liability method in respect of temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. No deferred income tax will be recognised from the initial recognition of an asset or liability, excluding a business combination, where there is no effect on accounting or taxable profit or loss. Deferred tax is calculated at the tax rates that are expected to apply to the period when the asset is realised or liability is settled. Deferred tax is credited in the Statement of Comprehensive Income except where it relates to items that may be credited directly to equity, in which case the deferred tax is adjusted directly against equity.

Deferred income tax assets relating to temporary differences and unused tax losses are recognised only to the extent that it is probable that future tax profits will be available against which the benefits of the deferred tax asset can be utilised.

Where temporary differences exist in relation to investments in subsidiaries and joint ventures, deferred tax assets and liabilities are not recognised where the timing of the reversal of the temporary difference can be controlled and it is not probable that the reversal will occur in the foreseeable future.

Current tax assets and liabilities are offset where a legally enforceable right of set-off exists and it is intended that net settlement or simultaneous realisation and settlement of the respective asset and liability will occur. Deferred tax assets and liabilities are offset where a legally enforceable right of set-off exists, the deferred tax assets and liabilities relate to income taxes levied by the same taxation authority on either the same taxable entity or different taxable entities where it is intended that net settlement or simultaneous realisation and settlement of the respective asset and liability will occur in future periods in which significant amounts of deferred tax assets or liabilities are expected to be recovered or settled.

The amount of benefits brought to account or which may be realised in the future is based on



# Financial Report

## Notes to the Financial Statements

FOR THE YEAR ENDED 30 JUNE 2014

### Note 1 - Statement of Significant Accounting Policies (continued)

the assumption that no adverse change will occur in income taxation legislation and the anticipation that the Consolidated Group will derive sufficient future assessable income to enable the benefit to be realised and comply with the conditions of deductibility imposed by the law.

#### 1.14 Property, Plant and Equipment

Each class of property, plant and equipment is carried at cost less, where applicable, any accumulated depreciation and impairment losses.

##### 1.14.1 Plant and Equipment

Plant and equipment are measured on the cost basis less depreciation and impairment losses.

The cost of plant and equipment constructed within the Consolidated Group includes the cost of materials, direct labour, borrowing costs and an appropriate proportion of fixed and variable overheads.

The carrying amount of plant and equipment is reviewed for indicators of impairment bi-annually to ensure it is not in excess of the recoverable amount from these assets. The recoverable amount is assessed on the basis of the expected net cash flows which will be received from the assets employment and subsequent disposal. The expected net cash flows have been discounted to their present values in determining recoverable amounts.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Consolidated Group and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the Statement of Comprehensive Income during the financial period in which they are incurred.

##### 1.14.2 Depreciation

The cost of all plant and equipment is depreciated on a straight line basis over their useful lives to the Consolidated Group commencing from the time the asset is held ready for use.

The depreciation rates used for each class of depreciable assets are:

| Class of Fixed Asset                                      | Depreciation Rate<br>(Prime Cost) |
|---|-----------------------------------|
| Motor Vehicles  | 22.5%                             |
| Plant and Equipment<br>(includes Furniture &<br>Fittings) | 7.5-50%                           |
| Water Monitoring assets                                   | 4%                                |
| Site Infrastructure                                       | 4%                                |
| Bloodwood Creek Trial<br>Plant and Equipment              | 4%                                |

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount.

Gains and losses on disposals are determined by comparing proceeds with the carrying amount. These gains and losses are included in the profit and loss component of the statement of comprehensive income.

##### 1.14.3 UCG Panel Assets

UCG Panel Assets include costs transferred from Construction work-in-progress once technical feasibility and commercial viability for a particular Panel can be demonstrated. When production commences, the accumulated costs for the relevant area of interest (for each Panel) are amortised over the life of the area according to the rate of coal depletion.



# Financial Report

## Notes to the Financial Statements

FOR THE YEAR ENDED 30 JUNE 2014

### Note 1 - Statement of Significant Accounting Policies (continued)

#### 1.14.4 Exploration and Evaluation Expenditure

Exploration and evaluation expenditure incurred is either written off as incurred or accumulated in respect of each identifiable area of interest. Costs are only carried forward to the extent that they are expected to be recouped through the successful development of the area, sale of the respective areas of interest or where activities in the area have not yet reached a stage, which permits reasonable assessment of the existence of economically recoverable gas assets.

Accumulated costs in relation to an abandoned area are written off in full against profit in the year in which the decision to abandon the area is made.

When production commences, the accumulated costs for the relevant area of interest are amortised over the life of the area according to the rate of depletion of the economically recoverable gas assets.

A regular review is undertaken of each area of interest to determine the appropriateness of continuing to carry forward costs in relation to that area of interest.

#### 1.15 Intangibles

##### 1.15.1 Research and Development

Expenditure on research activities is recognised as an expense in the period in which it is incurred.

An internally-generated intangible asset arising from development (or from the development phase of an internal project) is recognised if, and only if, all of the following have been demonstrated:

- the technical feasibility of completing the intangible asset so that it will be available for use or sale;

- the intention to complete the intangible asset and use or sell it;
- the ability to use or sell the intangible asset;
- how the intangible asset will generate probable future economic benefits;
- the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset; and
- the ability to measure reliably the expenditure attributable to the intangible asset during its development.

The amount initially recognised for internally-generated intangible assets is the sum of the expenditure incurred from the date when the intangible asset first meets the recognition criteria listed above. Where no internally-generated intangible asset can be recognised, development expenditure is recognised in profit or loss in the period in which it is incurred.

Subsequent to initial recognition, internally-generated intangible assets are reported at cost less accumulated impairment losses, on the same basis as intangible assets that are acquired separately.

Internally generated UCG intangible assets recognised by the Company have an indefinite life and are not amortised. A number of asset categories have been identified as operating assets used in the development of the Company's keyseam technology and accordingly are amortised into the Intangible asset over the life of the respective asset/s or transferred to the Intangible asset in their entirety on meeting certain criteria.

Each period, the useful life of the intangible asset is reviewed to determine whether events and circumstances continue to support an indefinite useful life assessment for the asset. Such assets

# Financial Report

## Notes to the Financial Statements

FOR THE YEAR ENDED 30 JUNE 2014

### Note 1 - Statement of Significant Accounting Policies (continued)

are tested for impairment in accordance with the policy stated in note 1.16.

#### 1.15.2 De-recognition of Intangible Assets

An intangible asset is derecognised on disposal, or when no future economic benefits are expected from use or disposal. Gains or losses arising from de-recognition of an intangible asset, measured as the difference between the net disposal proceeds and the carrying amount of the asset are recognised in profit or loss when the asset is derecognised.

#### 1.16 Impairment of Tangible and Intangible Assets other than Goodwill

At the end of each reporting period, the Consolidated Group reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any).

Intangible assets that have an indefinite useful life are not subject to amortisation and are tested annually for impairment, or more frequently if events or changes in circumstances indicate that they might be impaired. Other assets are tested for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use.

For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash inflows which are largely independent of the cash inflows from other

assets or groups of assets (cash-generating units).

Non-financial assets other than goodwill that suffered impairment are reviewed for possible reversal of the impairment at the end of each reporting period. A reversal of an impairment loss is recognised immediately in profit or loss, unless the relevant asset is carried at a revalued amount, in which case the reversal of the impairment loss is treated as a revaluation increase.

#### 1.17 Provision for Restoration and Rehabilitation

##### 1.17.1 Site Rehabilitation

A provision for restoration and rehabilitation is recognised when there is a present obligation as a result of exploration and development activities undertaken, it is probable that an outflow of benefits will be required to settle the obligation and the provision can be measured reliably. The estimated future obligations will include (but are not limited to) the costs of site restoration, investigative bore holes, cavity process water clean-up and removal/transfer of surface infrastructure (if applicable).

The provision for future restoration is the best estimate of the present value of the expenditure required to settle the restoration obligation at the reporting date. Future restoration costs will be reviewed where appropriate and any changes in the estimate are reflected in the present value of the restoration provision at each reporting date.

The initial estimate of restoration and rehabilitation relating to the construction or installation of site assets is capitalised into the cost of the related asset and amortised on the same basis as the related asset.

Changes in the estimate of the provision for restoration and rehabilitation are treated in the same way, except that the unwinding of the effect of discounting on the provision is recognised as a finance cost rather than being capitalised into the cost of the related asset.

# Financial Report

## Notes to the Financial Statements

FOR THE YEAR ENDED 30 JUNE 2014

### Note 1 - Statement of Significant Accounting Policies (continued)

#### 1.17.2 Panel Rehabilitation

The amount recognised as a provision will be the best estimate of the consideration required to settle the present obligation at the reporting date, taking into account the risks and uncertainties surrounding the obligation. The provision will be measured using the cashflows estimated to settle the present obligation, therefore the carrying amount will be the present value of those cashflows. Essentially management will take the present value of the estimated panel rehabilitation costs, calculated over the estimated life of the panel and recognise the rehabilitation expense based on the percentage of coal utilisation for the period.

#### 1.18 Financial Instruments

Trade dated accounting is adopted for financial assets that are delivered within timeframes established by marketplace convention.

Financial instruments, incorporating financial assets and liabilities are recognised when the entity becomes a party to the contractual provisions of the instrument. Financial instruments are initially measured at fair value plus transactions costs where the instrument is not classified as at fair value through profit or loss. Transaction costs related to instruments classified as at fair value through profit or loss are expensed to profit or loss immediately. Financial instruments are classified and measured as set out below.

##### 1.18.1 Financial Assets

##### 1.18.1.1 Financial Assets at Fair Value through Profit and Loss

A financial asset is classified in this category if acquired principally for the purpose of selling in the short term or if so designated by management and within the requirements of AASB 139: Recognition and Measurement of Financial Instruments. Derivatives are also categorised as

held for trading unless they are designated as hedges. Realised and unrealised gains and losses arising from changes in the fair value of these assets are included in the profit and loss component of the statement of comprehensive income in the period in which they arise.

##### 1.18.1.2 Available – for- Sale (AFS) Financial Asset

Listed shares held by the Consolidated Group that are traded in an active market are classified as AFS and are stated at fair value.

Fair value measurements are derived from quoted prices (unadjusted) in active markets.

Gains or losses arising from change in fair value are recognised in other comprehensive income and accumulated in the investment revaluation reserve except for impairment losses.

##### 1.18.3 Loans and Receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and are stated at amortised cost using the effective interest rate method.

##### 1.18.1.4 Impairment of Financial Instruments

At each reporting date, the Group assess whether there is objective evidence that a financial instrument has been impaired. Impairment losses are recognised in the profit and loss component of the statement of comprehensive income.

AFS assets are assessed for impairment at the end of each reporting period based on market changes of non- recovery through a prolonged decline in fair value below cost.

##### 1.18.1.5 De-recognition of Financial Assets

Financial assets are derecognised where the contractual rights to receipt of cash flows expires

# Financial Report

## Notes to the Financial Statements

FOR THE YEAR ENDED 30 JUNE 2014

### Note 1 - Statement of Significant Accounting Policies (continued)

or the asset is transferred to another party whereby the entity no longer has any significant continuing involvement in the risks and benefits associated with the asset. Financial liabilities are derecognised where the related obligations are either discharged, cancelled or expire. The difference between the carrying value of the financial liability extinguished or transferred to another party and the fair value of consideration paid, including the transfer of non-cash assets or liabilities assumed, is recognised in profit or loss.

Financial instruments incorporating financial assets and financial liabilities are recognised when the entity becomes a party to the contractual provisions of the instrument.

#### 1.18.1.6 Fair Value

Fair value is determined based on current bid prices for all quoted investments. Valuation techniques are applied to determine the fair value for all unlisted securities, including recent arms length transactions, reference to similar instruments and option pricing models.

### 1.18.2 Financial Liabilities and Equity Instruments

#### 1.18.2.1 Financial Liabilities

Non-derivative financial liabilities are recognised at amortised cost, comprising original debt less principal payments and amortisation.

Short-term liability includes secured loan facility to assist short term working capital.

The liability is initially measured at fair value, net of transaction costs and subsequently re-measured at amortised cost using the effective interest method, with interest expense recognised on an effective yield basis.

The effective interest method calculates the amortised cost of the financial liability and allocates interest expense over the relevant

period based on the discount rate of estimated future cash payments through the expected life of the financial liability to the net carrying amount on initial recognition.

#### 1.18.2.2 Compound Instruments

The component parts of compound instruments (convertible bonds) issued by the Consolidated Group are classified separately as financial liabilities and equity in accordance with the substance of the contractual arrangements and the definitions of a financial liability and an equity instrument. Conversion options that will be settled by the exchange of a fixed amount of cash or another financial asset for a fixed number of the Company's own equity instruments is an equity instrument.

At the date of issue, the fair value of the liability component is estimated using the prevailing market interest rate for similar non-convertible instruments. This amount is recognised as a liability on an amortised cost basis using the effective interest method until extinguished upon conversion or at the instrument's maturity date.

The conversion option classified as equity is determined by deducting the amount of the liability component from the fair value of the compound instrument as a whole. This is recognised and included in equity, net of income tax effects, and is not subsequently remeasured. In addition, the conversion option classified as equity will remain in equity until the conversion option is exercised.

No gain or loss is recognised in profit or loss upon conversion or expiration of the conversion option.

Transaction costs that relate to the issue of the convertible notes are allocated to the liability and equity components in proportion to the allocation of the gross proceeds. Transaction costs relating to the equity component are recognised directly in equity. Transaction costs relating to the liability component are included in the carrying amount of the liability component and are amortised over the lives of the convertible notes using the effective interest method.

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## Notes to the Financial Statements

FOR THE YEAR ENDED 30 JUNE 2014

### Note 1 - Statement of Significant Accounting Policies (continued)

#### 1.18.2.3 De-recognition of Financial Liability

The Consolidated Group derecognises financial liabilities when, and only when the Consolidated Group's obligations are discharged, cancelled or they expire. The difference between the carrying amount of the financial liability derecognised and the consideration paid and payable is recognised in profit and loss.

#### 1.19 Derivative Financial Instrument

The issue of options for the short-term loan is treated as an embedded derivative, initially recognised at cost using Black Scholes option valuation, the date the contract is entered into and is treated as transaction cost over the loan period and subsequently measured at fair value at the end of the reporting period. The resulting gain or loss is recognised in the profit or loss immediately.

#### 1.20 Goods and Services Tax (GST)

Revenues, expenses and assets are recognised net of the amount of GST, except where the amount of GST incurred is not recoverable from the Australian Tax Office. In these circumstances the GST is recognised as part of the cost of acquisition of the asset or as part of an item of the expense. Receivables and payables in the Statement of Financial Position are shown inclusive of GST.

Cash flows are presented in the cash flow statement on a gross basis, except for the GST component of investing and financing activities, which are disclosed as operating cash flows.

#### 1.21 Cash and Cash Equivalents

Cash and cash equivalents includes cash on hand, deposits held at call with banks, other short-term highly liquid investments with original maturities of three months or less.

#### 1.22 Contributed Equity

Issued and paid up capital is recognised at the fair value of the consideration received by the Company. Any transaction costs arising on the issue of ordinary shares are recognised directly in equity as a reduction of the share proceeds received.

#### 1.23 Contingent Asset

A contingent asset is a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity. Contingent assets are not recognised in financial statements since this may result in the recognition of income that may never be realised. However, when the realisation of income is virtually certain, then the related asset is not a contingent asset and its recognition is appropriate. Where an inflow of economic benefits is probable, the Consolidated Group will disclose a brief description of the nature of the contingent assets at the end of the reporting period, and, where practicable, an estimate of their financial effect.

#### 1.24 Critical Accounting Estimates and Judgements

The Directors evaluate estimates and judgments incorporated into the financial report based on historical knowledge and best available current information. Estimates assume a reasonable expectation of future events, including expectations of future events that may have a financial impact on the entity and that are believed to be reasonable under the circumstances. Estimates are based on current trends and economic data, obtained both externally and within the Consolidated Group.

This note provides an overview of the areas that involved a higher degree of judgement or complexity, and of items which are more likely to be materially adjusted due to estimates and assumptions turning out to be wrong.



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## Notes to the Financial Statements

FOR THE YEAR ENDED 30 JUNE 2014

### Note 1 - Statement of Significant Accounting Policies (continued)

#### 1.24.1 Estimated Impairment of Assets

The Consolidated Group assess impairment at each reporting date by evaluating conditions specific to the Consolidated Group that may lead to impairment of assets. Where an impairment trigger exists, the recoverable amount of the asset is determined. Value-in-use calculations performed in assessing recoverable amounts incorporate a number of key estimates.

The recoverable amount of the deferred exploration and evaluation asset has been calculated by modelling the value of a future gas project for the Bloodwood Creek site and placing a value on the other coal assets. The success of a future gas project is dependent on receiving a positive decision on the commercial future of keyseam® from the Queensland government.

An impairment test is completed annually for carried forward indefinite life intangibles (Underground coal gasification technology asset).

The value in use cash flows have been estimated based on the technology, licence and service fees and ongoing royalty contractual arrangements entered into to date. Growth in projects is based on known and potential projects expected to progress to a commercial scale.

Detailed information about each of these estimates and judgements is included in Note 17 and 18 respectively.

#### 1.24.2 Recognition of Revenue

The provision of technology service fee services to customers requires judgement in assessing both the components of contracted services and an assessment on the stage of completion of each component.

An determination has been made that the Inner Mongolia UCG project contains a number of work packages and these have been assessed individually. Stage of completion is assessed by

Management on the basis of the actual service provided as a proportion of the total services to be provided. For the purposes of recognising revenue, the stage of completion for individual packages is capped at 90% as the final milestone payment is due on the successful ignition and testing of the process characterisation panel.

#### 1.24.3 Provision for Rehabilitation

The provision for rehabilitation is based on the best estimate of the current obligations to rehabilitate the Bloodwood Creek.

The Consolidated Group is working on a rehabilitation plan for the site as required by the Queensland Government, with lodgement of the plan expected by the end of September 2014.

Once the decommissioning and rehabilitation has been agreed with the Queensland Government the Consolidated Group will review the current estimate on the basis of the approved rehabilitation plan and update the provision, if required. The current estimate uses valuations provided by external consultants.

To calculate the present value of the provision for rehabilitation, the Consolidated Group has taken the value of the estimated rehabilitation liability provided by the external consultants and inflated the liability to a future value using forecast inflation rates and applied an appropriate discount rate based on the expected timing for the rehabilitation expenditure.

#### 1.24.4 Share-based Payment Transactions

The Consolidated Group measures the cost of equity-settled transactions with employees and non-employees by reference to the fair value of the equity instruments at the date at which they are granted. Fair value is determined by using the Black-Scholes options pricing model or Monte Carlo, depending on the conditions attached to the options. As employee share based payment transactions can be granted at a future date for past services rendered, a fair value estimate has



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## Notes to the Financial Statements

FOR THE YEAR ENDED 30 JUNE 2014

### Note 1 - Statement of Significant Accounting Policies (continued)

been determined based on the best estimate of the number of shares or options to be granted.

The fair value is most sensitive to the volatility input. Equity instrument volatilities to match the life of the equity instrument have been provided by independent consultants.

#### 1.24.4.1 Estimate of the Useful Life of Property, Plant & Equipment

The estimation of the useful lives of assets has been based on historical experience. In addition, the condition of the assets is assessed at least once per year and considered against the remaining useful life. Details of the useful lives of property, plant and equipment are set out in Note 1.14.2.

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## Notes to the Financial Statements

FOR THE YEAR ENDED 30 JUNE 2014

### Note 2 – Application of new and revised Accounting Standards

At the date of authorisation of the financial statements, the Standards and Interpretations listed below were in issue but not yet effective

| Standard/Interpretation  | Effective for annual reporting periods beginning on or after   | Expected to be initially applied in the financial year ending | Impact  |
|--|--|---|---|
| AASB 9 'Financial Instruments', and the relevant amending standards  | 1 January 2017   | 30 June 2018  | Still to be assessed  |
| AASB 119 Defined Benefit Plans: Employee Contributions   | 1 January 2014   | Not applicable  | Not applicable  |
| AASB 1031 Materiality  | 1 January 2014   | 30 June 2015  | No impact   |
| AASB 1048 Interpretation of Standards  | Annual reporting periods ending on or after 20 December 2013   | 30 June 2015  | Still to be assessed  |
| AASB 1055 <i>Budgetary Reporting</i> , and the relevant amending standards   | 1 July 2014  | Not applicable  | Not applicable  |
| AASB 14 Regulatory Deferral Accounts   | Applicable to an entity's first annual IFRS financial statements for a period beginning on or after 1 January 2016 | Not applicable  | Not applicable  |
| IFRS 15 Revenue from contracts with customers  | 1 January 2017   | 30 June 2018  | Still to be assessed, however initial review suggests there will be no impact |
| AASB 2012-3 'Amendments to Australian Accounting Standards – Offsetting Financial Assets and Financial Liabilities   | 1 January 2014   | 30 June 2015  | No impact   |
| AASB 2013-3 <i>Amendments to AASB 136 – Recoverable Amount Disclosures for Non-Financial Assets</i>  | 1 January 2014   | 30 June 2014  | Early adopted   |
| AASB 2013-4 <i>Amendments to Australian Accounting Standards – Novation of Derivatives and Continuation of Hedge Accounting</i>                                    | 1 January 2014   | 30 June 2015  | No impact   |
| AASB 2013-5 <i>Amendments to Australian Accounting Standards – Investment Entities</i>   | 1 January 2014   | Not applicable  | Not applicable  |
| AASB 2013-7 <i>Amendments to AASB 1038 arising from AASB 10 in relation to Consolidation and Interests of Policyholders</i>  | 1 January 2014   | Not applicable  | Not applicable  |
| AASB 2013-8 <i>Amendments to Australian Accounting Standards – Australian Implementation Guidance for Not-for-Profit Entities – Control and Structure Entities</i> | 1 January 2014   | Not applicable  | Not applicable  |

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## Notes to the Financial Statements

FOR THE YEAR ENDED 30 JUNE 2014

### Note 2 – Application of new and revised Accounting Standards (continued)

At the date of authorisation of the financial statements, the Standards and Interpretations listed below were in issue but not yet effective

| Standard/Interpretation   | Effective for annual reporting periods beginning on or after | Expected to be initially applied in the financial year ending | Impact               |
|---|--|---|----------------------|
| AASB CF 2013-1 Amendments to the Australian Conceptual Framework,<br>AASB 2013-9 Amendments to Australian Accounting Standards – Conceptual Framework, Materiality and Financial Instruments<br>Part A – Conceptual Framework | Annual reporting periods ending on or after 20 December 2013 | 30 June 2015  | No impact            |
| AASB 2013-9 Amendments to Australian Accounting Standards – Conceptual Framework, Materiality and Financial Instruments<br>Part B – Materiality   | 1 January 2014   | 30 June 2015  | No impact            |
| AASB 2013-9 Amendments to Australian Accounting Standards – Conceptual Framework, Materiality and Financial Instruments<br>Part A – Financial Instruments   | 1 January 2015   | 30 June 2016  | Still to be assessed |
| Interpretation 21 <i>Accounting for Levies</i>  | 1 January 2014   | 30 June 2015  | No impact            |
| Annual improvements 2010-2012 cycle   | 1 July 2014  | 30 June 2015  | No impact            |
| Annual improvements 2011-2013 cycle   | 1 July 2014  | 30 June 2015  | No impact            |
| AASB 2014-1 'Amendments to Australian Accounting Standards'   |  |   |                      |
| - Part A: 'Annual Improvements 2010–2012 and 2011–2013 Cycles'  | 1 July 2014  | 30 June 2015  | Still to be assessed |
| - Part B: 'Defined Benefit Plans: Employee Contributions (Amendments to AASB 119)'  |  |   |                      |
| - Part C: 'Materiality'   |  |   |                      |
| AASB 2014-1 'Amendments to Australian Accounting Standards' – Part D: 'Consequential Amendments arising from AASB 14'   | 1 July 2016  | 30 June 2017  | Still to be assessed |
| AASB 2014-1 'Amendments to Australian Accounting Standards' – Part E: 'Financial Instruments'   | 1 July 2015  | 30 June 2016  | Still to be assessed |
| Accounting for Acquisitions of Interests in Joint Operations (Amendments to IFRS 11)  | 1 July 2016  | 30 June 2017  | No impact            |
| Clarification of Acceptable Methods of Depreciation and Amortisation (Amendments to IAS 16 and IAS 38)  | 1 July 2016  | 30 June 2017  | Still to be assessed |
| Agriculture: Bearer Plants (Amendments to IAS 16 and IAS 41)  | 1 July 2016  | 30 June 2017  | Not applicable       |

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## Notes to the Financial Statements

FOR THE YEAR ENDED 30 JUNE 2014

### Note 3 – Other Income

|                                 | CONSOLIDATED GROUP |                |
|---------------------------------|--------------------|----------------|
|                                 | 2014 \$            | 2013 \$        |
| <b>Operating Activities</b>     |                    |                |
| Government grants <sup>1</sup>  | 3,865,463          | 150,000        |
| Interest received               | 174,708            | 219,749        |
| <b>Non-operating activities</b> |                    |                |
| Other income                    | 85,390             | 446,335        |
| <b>TOTAL</b>                    | <b>4,125,561</b>   | <b>816,084</b> |

<sup>1</sup> The Consolidated Group receives a research and development tax incentive (R&D) rebate from the Australian Taxation Office and an export market development grant (EMDG) from Austrade. The R&D grant is equivalent to 45% of eligible research and development expenditure while the EMDG scheme reimburses up to 50% of eligible export promotion expenses. As the Consolidated Group recognises rebates upon receipt, this income relates to expenditure incurred in the 2013 financial year. On 13 May 2014 the government announced a proposal to reduce the research and development tax incentive to 43.5% for expenditure incurred after 30 June 2014.

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## Notes to the Financial Statements

FOR THE YEAR ENDED 30 JUNE 2014

### Note 4 - Loss From Ordinary Activities

|   | CONSOLIDATED GROUP |                   |
|---|--------------------|-------------------|
|   | 2014 \$            | 2013 \$           |
| Loss from ordinary activities before income tax has been determined after:  |                    |                   |
| (a) Expenses  |                    |                   |
| Depreciation of Non-current assets  |                    |                   |
| Motor Vehicles  | 5,752              | 15,221            |
| Plant & Equipment (includes Furniture & Fittings)   | 139,501            | 82,168            |
| <b>Total Depreciation</b>   | <b>145,253</b>     | <b>97,389</b>     |
| Superannuation expense  | 235,692            | 331,844           |
| Operating lease expense   | 373,453            | 133,456           |
| Loss on disposal of assets  | -                  | 404,360           |
| Loss on disposal of investment in associate (refer to Note 11)  | -                  | 176,710           |
| Loss on equity accounted investment in associate (refer to Note 11)   | -                  | 564,678           |
| (b) Significant Transactions  |                    |                   |
| Impairment  |                    |                   |
| US Coal assets (refer to Note 17)   | 263,564            | 18,254,668        |
| Chile Project asset (refer to Note 16).   | 860,327            | -                 |
| On 21 December 2013 a Deed of Termination and Release was entered into which released Focus Minerals Limited from its contingent consideration obligation to Carbon Energy Ltd and secured the release/discharge of the Mortgage for a cash settlement of \$600,000 which resulted in a write down of the receivable. | 847,009            | -                 |
| The Available-For-Sale Asset was impaired by \$536,001 due to the sustained decline in the share price of the equity instrument.  | -                  | 536,001           |
| <b>Total Impairment</b>   | <b>1,970,900</b>   | <b>18,790,669</b> |

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## Notes to the Financial Statements

FOR THE YEAR ENDED 30 JUNE 2014

### Note 5 - Earnings per share (EPS)

#### CONSOLIDATED GROUP

|   | 2014 \$              | 2013 \$            |
|---|----------------------|--------------------|
| Net loss for the year attributable to members of the parent entity  | (9,119,601)          | (35,584,327)       |
| Basic loss per share (cents per share)  | (0.81)               | (4.56)             |
| Weighted average number of ordinary shares outstanding during the year used in calculation of basic EPS   | <b>1,132,612,426</b> | <b>779,453,295</b> |
| Diluted loss per share (cents per share)  | (0.81)               | (4.56)             |
| Weighted average number of ordinary shares outstanding during the year used in calculation of diluted EPS | <b>1,132,612,426</b> | <b>779,453,295</b> |

Options outstanding at 30 June 2014, totalling 638,007,891 are not considered to be dilutive potential ordinary shares as the effect is anti-dilutive due to the nature of vesting conditions.



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## Notes to the Financial Statements

FOR THE YEAR ENDED 30 JUNE 2014

### Note 6 - Income Tax Expense

|  | CONSOLIDATED GROUP |                   |
|--|--------------------|-------------------|
|  | 2014 \$            | 2013 \$           |
| (a) The components of tax expense comprise   |                    |                   |
| Current year tax   | 233,203            | -                 |
| Deferred tax   | -                  | -                 |
|  | <b>233,203</b>     | <b>-</b>          |
|  | 2014 \$            | 2013 \$           |
| (b) The prima facie tax/ (benefit) on Profit/ (Loss) for ordinary activities is reconciled to the income tax expense as follows: |                    |                   |
| Operating income/ (loss)   |                    |                   |
| Prima facie tax/ (benefit) on Profit/ (loss) from ordinary   | (8,886,398)        | (35,584,327)      |
| Activities before income tax at 30%  |                    |                   |
| 2014:30% (2013:30%) tax  | (2,665,919)        | (10,675,298)      |
| Add tax effect of:   |                    |                   |
| Non-deductible items   | 3,477,228          | 8,062,773         |
| Other deductible items   | (84,534)           | (146,074)         |
| Revaluation and gain on disposal of investments not subject to income tax  |                    | 169,403           |
| Net exempt income  | (1,132,599)        |                   |
| Other tax credit not recognised (i)  | 233,203            |                   |
| Deferred tax assets not brought to account   | 405,824            | 2,589,196         |
| <b>Income tax attributable to entity</b>   | <b>233,203</b>     | <b>-</b>          |
|  | 2014 \$            | 2013 \$           |
| (c) Deferred tax assets  |                    |                   |
| An income tax Consolidated Group was formed from 1 July 2008   |                    |                   |
| Balance at the beginning of the year   | 69,678,022         | 70,919,471        |
| Adjustment to Prior year carry forward losses for Research & Development (R&D)   | (351,825)          | (3,367,453)       |
| Temporary differences  | (36,670)           | (463,192)         |
| Tax losses (after income tax at 30%)   | 405,824            | 2,589,196         |
| <b>TOTAL DEFERRED TAX ASSETS NOT BROUGHT TO ACCOUNT</b>  | <b>69,695,351</b>  | <b>69,678,022</b> |

(i) Other tax credits not recognised relate to withholding tax paid in China not able to be claimed against Australian Taxable Income.

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## Notes to the Financial Statements

FOR THE YEAR ENDED 30 JUNE 2014

### Note 6 - Income Tax Expense (continued)

#### Impact of Minerals Resource Rent Tax (MRRT)

The Minerals Resource Rent Tax Act 2012 (MRRT) was enacted on 19 March 2012 and applies from 1 July 2012. On 17 July 2014 the *Minerals Resource Rent Tax Repeal and Other Measures Bill 2013* (Bill) containing the repeal of MRRT was approved by the Senate, with amendments. On 18 July 2014 the amended Bill was rejected by the House of Representatives. The next sitting of Parliament is scheduled for August 2014 at which time a bill containing the repeal of MRRT is expected to be re-presented.

The MRRT seeks to tax the profits from the upstream operations of all new and existing coal and iron ore projects in Australia, which constitute mining project interests (MPIs) for MRRT purposes. Carbon Energy does not hold any MPIs and currently only holds pre-mining project interests (pre-MPIs) being the relevant EPCs and MDL. As Carbon Energy has not derived any pre-mining revenue, it is not liable to pay MRRT in the year ended 30 June 2014. Furthermore, as these pre-MPIs are currently being held for sale, management has determined that it is not appropriate to recognise any deferred tax consequences relating to these pre-MPIs as Carbon Energy is unlikely to be liable to pay MRRT in the foreseeable future.

Any resources subject to MRRT are not taxable under the Petroleum Resource Rent Tax Assessment Act 1987 (PRRT). The repeal of MRRT would mean that PRRT may now apply to the Consolidated Group if the coal is ultimately used to generate syngas, which is subject to PRRT. In order to qualify for a starting base under PRRT, the Company lodged a PRRT starting base return during the year in the event that the MRRT was repealed. Under PRRT, once the coal is in the production phase and is making assessable profits, the starting base allowance reduces the 40% tax liability incurred under PRRT, as a tax deduction.

### Note 7 – Deferred Revenue

|                        | CONSOLIDATED GROUP |          |
|------------------------|--------------------|----------|
|                        | 2014 \$            | 2013 \$  |
| Opening Balance        | -                  | -        |
| Additions              | 873,106            | -        |
| <b>Closing Balance</b> | <b>873,106</b>     | <b>-</b> |

Deferral of technical services revenue arises due to invoicing for services in advance of service delivery on the Inner Mongolia project.

### Note 8 – Cash at Bank

|  | CONSOLIDATED GROUP |                  |
|--|--------------------|------------------|
|  | 2014 \$            | 2013 \$          |
| Cash at bank                           | 387,114            | 1,772,562        |
| Short term deposits                    | 2,000,000          | -                |
| <b>TOTAL CASH AND CASH EQUIVALENTS</b> | <b>2,387,114</b>   | <b>1,772,562</b> |

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## Notes to the Financial Statements

FOR THE YEAR ENDED 30 JUNE 2014

### Note 9 – Trade and Other Receivables

|  | CONSOLIDATED GROUP     |                  |
|--|------------------------|------------------|
|  | 2014 \$                | 2013 \$          |
| <b>Current</b>   |                        |                  |
| Trade receivables  | 1,394,394 <sup>1</sup> | -                |
| Other receivables  | 66,038                 | 109,140          |
| <b>TOTAL CURRENT TRADE &amp; OTHER RECEIVABLES</b>                       | <b>1,460,432</b>       | <b>109,140</b>   |
| <b>Non Current</b>   |                        |                  |
| Deposits   | 267,553                | 270,053          |
| Receivable from Focus Minerals Ltd (previously Crescent Gold Limited)(i) | -                      | 1,432,840        |
| <b>TOTAL NON CURRENT TRADE &amp; OTHER RECEIVABLES</b>                   | <b>267,553</b>         | <b>1,702,893</b> |

<sup>1</sup> Due from Haoqin Mining in relation to the Inner Mongolia project

On 21 December 2013 a Deed of Termination and Release was entered into which released Focus Minerals Limited from its contingent consideration obligation to Carbon Energy Ltd and secured the release/discharge of the Mortgage for a cash settlement of \$600,000 which resulted in a write down of the receivable by \$847,009.

### Note 10 – Other Current Assets

|                                   | CONSOLIDATED GROUP |               |
|-----------------------------------|--------------------|---------------|
|                                   | 2014 \$            | 2013 \$       |
| <b>Current</b>                    |                    |               |
| Prepayments                       | 39,461             | 83,552        |
| <b>TOTAL OTHER CURRENT ASSETS</b> | <b>39,461</b>      | <b>83,552</b> |

### Note 11 – Investment in Associate

|  | CONSOLIDATED GROUP |                  |
|--|--------------------|------------------|
|  | 2014 \$            | 2013 \$          |
| <b>Opening Balance</b>                         | -                  | 1,727,388        |
| Share of associate's loss after income tax     | -                  | (564,678)        |
| <b>Closing Balance prior to disposal</b>       | -                  | <b>1,162,710</b> |
| Fair Value at date of disposal                 | -                  | 986,000          |
| Loss on deemed disposal of associate           | -                  | (176,710)        |
| Transfer to Available for Sale Financial Asset | -                  | (986,000)        |
| <b>Closing Balance</b>                         | -                  | -                |

On 11 December 2012 Energia Minerals Limited completed a rights issue reducing Carbon Energy's % holding from 26.48% to 16.45%. Accordingly Carbon Energy's investment in Energia Minerals Limited was reclassified from an Investment in Associate to an Available-for-Sale Financial Asset as of 11 December 2012 (refer Note 12). The loss on disposal at 11 December 2012 arising from the difference between the fair value and carrying value at 11 December 2012 amounts to \$176,710. On 24 July 2013 the available for sale financial asset was disposed of for \$449,999 (refer to Note 12).

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## Notes to the Financial Statements

FOR THE YEAR ENDED 30 JUNE 2014

### Note 12 – Available-For-Sale Financial Asset

|                                       | CONSOLIDATED GROUP |           |
|---------------------------------------|--------------------|-----------|
|                                       | 2014 \$            | 2013 \$   |
| <b>Listed securities</b>              |                    |           |
| Energia Minerals Limited              | -                  | 449,999   |
| <b>Opening Balance</b>                | 449,999            | -         |
| Transfer from investment in Associate |                    | 986,000   |
| Impairment Loss (see note 4b)         |                    | (536,001) |
| Disposal of investment                | (449,999)          |           |
| <b>Closing Balance</b>                | -                  | 449,999   |

On 24 July 2013, the Company sold its investment in Energia Minerals Limited (29,000,005 shares) for \$449,999.

### Note 13 – Construction Work-In-Progress

|                                | CONSOLIDATED GROUP |           |
|--------------------------------|--------------------|-----------|
|                                | 2014 \$            | 2013 \$   |
| <b>Opening Balance</b>         | 2,555,334          | 2,715,768 |
| Cost written off during period | -                  | (160,434) |
| <b>Closing Balance</b>         | 2,555,334          | 2,555,334 |

This relates to Panel 3 at Bloodwood Creek, Dalby in Queensland.

### Note 14 – UCG Panel Assets

|   | CONSOLIDATED GROUP |           |
|---|--------------------|-----------|
|   | 2014 \$            | 2013 \$   |
| <b>Opening Balance</b>                  | 1,776,106          | 1,733,640 |
| Adjustment for Rehabilitation Provision | (1,205)            | 42,466    |
| <b>Closing Balance</b>                  | 1,774,901          | 1,776,106 |

# Financial Report

## Notes to the Financial Statements

FOR THE YEAR ENDED 30 JUNE 2014

### Note 15 - Property, Plant and Equipment

(a) Carrying amounts:

|                          | Freehold Land  | Motor Vehicles | Property, Plant<br>& Equipment | Total            |
|--------------------------|----------------|----------------|--------------------------------|------------------|
|                          | \$             | \$             | \$                             | \$               |
| <b>30 June 2014</b>      |                |                |                                |                  |
| Cost                     | 408,016        | 87,287         | 1,196,586                      | 1,691,889        |
| Accumulated Depreciation | -              | (67,473)       | (581,134)                      | (648,607)        |
| <b>Net Book Value</b>    | <b>408,016</b> | <b>19,814</b>  | <b>615,452</b>                 | <b>1,043,282</b> |

|                          |                |               |                |                  |
|--------------------------|----------------|---------------|----------------|------------------|
| <b>30 June 2013</b>      |                |               |                |                  |
| Cost                     | 408,016        | 87,287        | 1,091,275      | 1,586,578        |
| Accumulated Depreciation | -              | (61,721)      | (441,633)      | (503,354)        |
| <b>Net Book Value</b>    | <b>408,016</b> | <b>25,566</b> | <b>649,642</b> | <b>1,083,224</b> |

(b) Movements in carrying amount:

|  | Freehold Land  | Motor Vehicles | Property, Plant<br>& Equipment | Total            |
|--|----------------|----------------|--------------------------------|------------------|
|  | \$             | \$             | \$                             | \$               |
| Carrying amount at 1 July 2012         | 408,016        | 40,787         | 898,130                        | 1,346,933        |
| Additions                              | -              | -              | 590,490                        | 590,490          |
| Disposals                              | -              | -              | (756,810)                      | (756,810)        |
| Depreciation expense                   | -              | (15,221)       | (82,168)                       | (97,389)         |
| Carrying Amount at 30 June 2013        | 408,016        | 25,566         | 649,642                        | 1,083,224        |
| Carrying amount at 1 July 2013         | 408,016        | 25,566         | 649,642                        | 1,083,224        |
| Additions                              | -              | -              | 105,311                        | 105,311          |
| Disposals                              | -              | -              | -                              | -                |
| Depreciation expense                   | -              | (5,752)        | (139,501)                      | (145,253)        |
| <b>Carrying Amount at 30 June 2014</b> | <b>408,016</b> | <b>19,814</b>  | <b>615,452</b>                 | <b>1,043,282</b> |

### Note 16 – Other Non-Current Asset

CONSOLIDATED GROUP

# Financial Report

## Notes to the Financial Statements

FOR THE YEAR ENDED 30 JUNE 2014

|   | 2014 \$          | 2013 \$          |
|---|------------------|------------------|
| <b>Opening Balance</b>                  | <b>1,722,723</b> | 1,607,662        |
| Additions                               | -                | 115,061          |
| Adjustments                             | (2,070)          | -                |
| Impairment write-down (Refer Note 4(b)) | (860,327)        | -                |
| <b>Closing Balance</b>                  | <b>860,326</b>   | <b>1,722,723</b> |

Carbon Energy has been working with Antofagasta Minerals S.A. (AMSA) to develop a UCG project in Mulpun, Chile. The project will have the potential to supply syngas to a minimum 250MW power station to in turn provide the country with its own domestic supply of energy.

Carbon Energy has been focussing its efforts on securing debt funding and equity partners for the project. The Company is continuing its dialogue with AMSA and potential funding and project partners. At this stage the Company aims to be a technology partner to the project once project partners have been identified and funding is secured.

### Note 17 – Deferred Exploration and Evaluation Costs

|   | CONSOLIDATED GROUP |                   |
|---|--------------------|-------------------|
|   | 2014 \$            | 2013 \$           |
| <b>Opening Balance</b>                  | <b>90,322,819</b>  | 108,128,765       |
| Additions                               | 120,857            | 454,660           |
| Impairment write-down (refer note 4(b)) | (263,566)          | (18,254,668)      |
| Costs written off                       | -                  | (5,938)           |
| <b>Closing Balance</b>                  | <b>90,180,110</b>  | <b>90,322,819</b> |

The US coal assets were written down by \$263,566 (2013: \$18,254,668) during that year following a decision not to proceed with commercialising the resource. Intangible assets with indefinite useful lives and intangible assets not yet available for use are tested for impairment annually, and whenever there is an indication that the asset may be impaired, the recoverable amount (the higher of fair value less costs to sell and value to use) of the asset is estimated in order to determine the extent of the impairment loss.



# Financial Report

## Notes to the Financial Statements

FOR THE YEAR ENDED 30 JUNE 2014

### Note 18 – Intangible Assets

| CONSOLIDATED GROUP                                       |                   |                   |
|--|-------------------|-------------------|
|  | 2014 \$           | 2013 \$           |
| <b>Opening Balance</b>                                   | 47,623,940        | 54,815,481        |
| Additions  | 24,452            | 33,023            |
| Decrease in Rehabilitation provision                     | (49,558)          | (221,797)         |
| Carrying value reduction following receipt of R&D rebate | -                 | (7,002,767)       |
| <b>Closing Balance</b>                                   | <b>47,598,834</b> | <b>47,623,940</b> |

#### UCG intangible asset

A 'know how' intangible asset was recognised for the first time in the 2011 financial year and relates to transfers from Mine Development costs and Property, Plant and Equipment from the Bloodwood Creek trial. This balance also includes design and engineering costs in relation to the modification of carburettors and other associated work to enable the engines to run on syngas which resulted in significant technological know-how gains.

A further \$24,452 (2013: \$33,023) was added to the 'know how' intangible asset during the 2014 financial year for ongoing patent costs following achievement of 'Proof of Concept' of the Company's keyseam UCG Technology. The asset has been adjusted with the decrease in rehabilitation provision.

A reduction of \$7,002,767 in the 'know-how' intangible asset occurred in 2013 upon the receipt of the 2011/12 R&D rebate.

#### Impairment test for indefinite life intangible assets

The recoverable amount of the UCG intangible asset has been determined based on a value in use calculation using a discount rate of 14.50%. The value in use cash flows have been estimated by management based on the technology, license and service contractual arrangements entered into to date and the estimated cash inflows expected to be generated over the life such agreements. The expected life of the underlying projects is estimated to be 25 years which is consistent with the expected scale of commercial projects of this nature. Growth in the cash flows is represented by the estimation that at least seven projects will be progressed to commercial scale. These projects have been allocated probability weightings ranging from 15% to 50%. Management also believes that any reasonably possible change in the key assumptions on which the UCG intangible asset's recoverable amount is based would not cause the carrying amount to exceed its recoverable amount.

### Note 19 - Trade and Other Payables

| CONSOLIDATED GROUP                    |                |                  |
|---------------------------------------|----------------|------------------|
|                                       | 2014 \$        | 2013 \$          |
| Trade payables                        | 443,887        | 591,659          |
| Other payables                        | 508,485        | 498,214          |
| <b>TOTAL TRADE AND OTHER PAYABLES</b> | <b>952,372</b> | <b>1,089,873</b> |

# Financial Report

## Notes to the Financial Statements

FOR THE YEAR ENDED 30 JUNE 2014

### Note 20 – Loans and Borrowings

|                         | CONSOLIDATED GROUP |                  |
|-------------------------|--------------------|------------------|
|                         | 2014 \$            | 2013 \$          |
| <b>Current</b>          |                    |                  |
| Term Facility (Secured) | -                  | 2,997,233        |
| <b>Closing Balance</b>  | -                  | <b>2,997,233</b> |

The Company entered into a \$10,000,000 bridging loan facility with Credit Suisse on 15 November 2012 to assist in funding the Company's short term working capital requirements. The loan was a 12 month secured loan facility at an interest rate of 8% per annum. The Company repaid the loan in full during the current period.

As per the facility agreement, 61,728,395 Options were issued at a strike price of \$0.081 to Credit Suisse. The 2013 rights issue resulted in a recalculation of the strike price which has reduced to \$0.061. Refer to Note 21 below for further disclosure on the share options.

As part of finalisation of the Credit Suisse Short Term Facility, Carbon Energy, along with some of its subsidiaries, entered into a general security agreement which charged all of its assets except for the intellectual property and software relating to the UCG technology acquired from CSIRO and any money deposited with a bank who has pledged support to environmental bonds, guarantees or similar undertakings. This charge was removed at the time of repayment of the loan.

|  | CONSOLIDATED GROUP |                  |
|--|--------------------|------------------|
|  | 2014 \$            | 2013 \$          |
| Opening balance                                      | 2,997,233          |                  |
| Loan proceeds  | -                  | 10,000,000       |
| Less: Repayment                                      | (2,997,233)        | (7,002,767)      |
| <b>Secured Loan Debt outstanding at balance date</b> | -                  | <b>2,997,233</b> |
| <i>Accounting Adjustments</i>                        |                    |                  |
| Less: transaction costs                              |                    |                  |
| Facility fee, upfront interest, legal fees           | -                  | (1,080,053)      |
| Options issued                                       | -                  | (1,317,737)      |
| Financial Liability Unwinding at 30 June 2013        | -                  | 2,397,790        |
| <b>Closing Loan Facility Balance</b>                 |                    | <b>2,997,233</b> |

# Financial Report

## Notes to the Financial Statements

FOR THE YEAR ENDED 30 JUNE 2014

### Note 21 – Derivative Financial Liability

|   | CONSOLIDATED GROUP |                |
|---|--------------------|----------------|
|   | 2014 \$            | 2013 \$        |
| <b>Current</b>                                |                    |                |
| Derivative out of Credit Suisse loan facility | 10,904             | 266,156        |
| <b>Closing Balance</b>                        | <b>10,904</b>      | <b>266,156</b> |

As part of the finalisation of the Credit Suisse loan facility, 61,728,395 options were issued to Credit Suisse at a strike price of \$0.081. The 2013 rights issue resulted in a recalculation of the strike price which has reduced to \$0.061. The Company has the discretion to settle the net gain (per market/share price) either in cash or equity at the time that Credit Suisse exercises the options. The issue of these options has been treated as an embedded derivative and accordingly the value has been classified as a derivative financial liability.

The derivative financial liability is measured at fair value at the period end. Refer to Note 29 (e) for further details.

The reconciliation of the derivative financial liability is as follows:

|   | CONSOLIDATED GROUP |                |
|---|--------------------|----------------|
|   | 2014 \$            | 2013 \$        |
| Opening Balance   | 266,156            | -              |
| Additions   | -                  | 1,317,737      |
| Fair value adjustment recognised in the profit and loss | (255,252)          | (1,051,581)    |
| <b>Closing Balance</b>                                  | <b>10,904</b>      | <b>266,156</b> |

# Financial Report

## Notes to the Financial Statements

FOR THE YEAR ENDED 30 JUNE 2014

### Note 22 – Provisions

|                         | CONSOLIDATED GROUP |                  |
|-------------------------|--------------------|------------------|
|                         | 2014 \$            | 2013 \$          |
| <b>Current</b>          |                    |                  |
| Employee Benefits       | 320,234            | 256,000          |
| Rehabilitation          | 509,103            | 1,078,350        |
|                         | <b>829,337</b>     | <b>1,334,350</b> |
| <b>Non-Current</b>      |                    |                  |
| Employee Benefits       | 30,863             | 25,785           |
| Rehabilitation          | 2,892,732          | 2,289,944        |
|                         | <b>2,923,595</b>   | <b>2,315,729</b> |
| <b>TOTAL PROVISIONS</b> | <b>3,752,932</b>   | <b>3,650,079</b> |

a) *Information about individual provisions and significant estimates*

*Employee provisions*

The provision for employee benefits relates to the Consolidated Groups liability for annual leave and long service leave.

*Rehabilitation provision*

The Consolidated Group recognises that it has an obligation to restore and rehabilitate the area disturbed as a result of its exploration and development activities. A provision has been recognised for the present value of expected expenditure required to rehabilitate the areas in the future. Although the ultimate cost to be incurred is uncertain the Consolidated Group has considered its provisions based on valuations provided by independent consultants. When this liability is recognised, a corresponding asset is also recognised and is amortised on the same basis as the underlying asset. Refer to Note 1.17 for further information in relation to the group's accounting policy relevant to this provision.

b) *Employee benefit amounts not expected to be settled within the next 12 months*

The group has assessed its annual leave provision and determined that the entire amount of the provision be presented as current, since the group does not have an unconditional right to defer settlement for any of these obligations. Based on past experience employees are taking their annual entitlement to leave within 12 months.

The following amounts reflect long service leave that is not expected to be taken or paid in the next 12 months.

|   | CONSOLIDATED GROUP |         |
|---|--------------------|---------|
|   | 2014 \$            | 2013 \$ |
| Amounts not expected to be settled within 12 Months | 30,863             | 25,785  |

# Financial Report

## Notes to the Financial Statements

FOR THE YEAR ENDED 30 JUNE 2014

### Note 22 – Provisions (continued)

c) *Movement in provisions*

Movements in each class of provision during the financial year, other than employee benefits, are set out below:

CONSOLIDATED GROUP

2014 \$

|  | Rehabilitation<br>provision |
|--|-----------------------------|
| Carrying amount at 1 July 2013         | 3,368,294                   |
| Movements in discount rates            | (50,763)                    |
| Unwinding of discount                  | 84,304                      |
| <b>Carrying amount at 30 June 2014</b> | <b>3,401,835</b>            |
| <b>Split between:</b>                  |                             |
| Current                                | 509,103                     |
| Non-Current                            | 2,892,732                   |
|  | <b>3,401,835</b>            |

# Financial Report

## Notes to the Financial Statements

FOR THE YEAR ENDED 30 JUNE 2014

### Note 23 – Financial Liabilities

|                                     | CONSOLIDATED GROUP |                  |
|-------------------------------------|--------------------|------------------|
|                                     | 2014 \$            | 2013 \$          |
| <b>Non-Current</b>                  |                    |                  |
| Convertible note facility (secured) | 6,972,442          | 6,179,304        |
| <b>TOTAL FINANCIAL LIABILITIES</b>  | <b>6,972,442</b>   | <b>6,179,304</b> |

|                                 | 2014 \$          | 2013 \$          |
|---------------------------------|------------------|------------------|
| Opening balance                 | 6,179,304        | 5,375,340        |
| Accretion                       | 793,138          | 803,964          |
| <b>Closing facility balance</b> | <b>6,972,442</b> | <b>6,179,304</b> |

The total secured Pacific Road Capital “Pacific Road” convertible note outstanding at 30 June 2014 is \$10,000,000. A reconciliation of the financial liability to the convertible note is as follows:

|  | 2014 \$    |
|--|------------|
| Financial liability as at 30 June 2014               | 6,972,442  |
| Fair value discount to unwind in future periods      | 3,027,550  |
| Convertible note outstanding as at 30 June 2014      | 10,000,000 |
| Future interest payments at 5% (refer to Note 29(c)) | 1,322,192  |

The Equity component of \$2,101,590 has been credited to equity (Other Reserve). 35,000,000 options were issued with a strike price at a 25% premium over the term of the Facility Agreement which expires on 18 January 2017.

An additional 9,645,845 unlisted options were issued to Pacific Road Capital Management Pty Ltd (Pacific Road) on 16 November 2012 with an exercise price of \$0.081 and an expiry date of 15 November 2015. These options were issued in accordance with the non-dilution clause in the Pacific Road Facility Agreement whereby the convertible note has provision to prevent any further capital raising from diluting Pacific Road’s share holding in Carbon Energy. This increases Pacific Road’s unlisted options from 35,000,000 in 2012 to 44,645,845 in 2013. The 2013 rights issue resulted in a recalculation of the exercise price of these options which has reduced to \$0.061.

PRCM may convert all or part of the Facility amount to shares in the Company at any time during the term at a conversion price of \$0.14. If the share price exceeds \$0.40 for continuous 60 day VWAP period the Company can request the conversion of the Facility in full. The Facility repayment date is 18 January 2017 and any part of the Facility amount not converted into shares on that date is repayable in cash by the Company on that date. The Pacific Convertible Note Facility is secured by a mortgage over the UCG technology and software transferred from CSIRO to Carbon Energy.

The fair value of the financial liability approximates its carrying value. Interest on the convertible note facility is paid through the issue of shares. Refer to Note 24.



# Financial Report

## Notes to the Financial Statements

FOR THE YEAR ENDED 30 JUNE 2014

### Note 24 - Issued Capital

|   | CONSOLIDATED GROUP |             |
|---|--------------------|-------------|
|   | 2014               | 2013        |
| <b>1,265,979,607</b> (2013: 786,889,705) Fully paid ordinary shares | <b>235,606,127</b> | 227,727,927 |

#### Movement in issued ordinary shares for the year:

|   | 2014 \$              | 2013 \$            |
|---|----------------------|--------------------|
|   | No. of Shares        | No. of Shares      |
| Opening number of shares  | 786,889,705          | 773,999,771        |
| Shares issued during the year:  |                      |                    |
| • 29 August 2012 interest costs in relation to drawdown of Tranche A and Tranche B (Pacific Road Convertible Note Facility)   |                      | 2,306,795          |
| • 29 November 2012 interest costs in relation to drawdown of Tranche A and Tranche B (Pacific Road Convertible Note Facility) |                      | 2,145,388          |
| • 2 January 2013 Issue of Ordinary Shares under the Company's Short and Long Term Executive Incentive Plan                    |                      | 1,355,368          |
| • 7 March 2013 interest costs in relation to drawdown of Tranche A and Tranche B (Pacific Road Convertible Note Facility)     |                      | 2,877,033          |
| • 30 April 2013 interest costs in relation to drawdown of Tranche A and Tranche B (Pacific Road Convertible Note Facility)    |                      | 4,205,350          |
| • 26 August 2013 Non-renounceable rights issue @ \$0.02   | 131,999,245          | -                  |
| • 27 August 2013 Share Subscription Agreement with Holder East Capital @ \$0.02 per share                                     | 50,000,000           | -                  |
| • 30 August 2013 interest costs in relation to drawdown of Tranche A and Tranche B (Pacific Road Convertible Note Facility)   | 6,279,353            | -                  |
| • 15 October 2013 Rights Issue shortfall @ Kam Lung Investment Development Co. Under Rights Issue Shortfall                   | 171,818,615          | -                  |
| • 31 October 2013 Short Term Incentive/ Long Term Incentive Shares allotted for Executives                                    | 3,944,370            | -                  |
| • 20 November 2013 Rights Issue shortfall   | 89,626,993           | -                  |
| • 6 December 2013 Rights Issue shortfall to Directors   | 263,551              | -                  |
| • 6 December 2013 interest costs in relation to drawdown of Tranche A and Tranche B (Pacific Road Convertible Note Facility)  | 5,834,861            | -                  |
| • 6 December 2013 Short Term Incentive/ Long Term Incentive Shares allotted for Executives                                    | 3,440,831            | -                  |
| • 11 March 2014 interest costs in relation to drawdown of Tranche A and Tranche B (Pacific Road Convertible Note Facility)    | 7,047,459            | -                  |
| • 29 May 2014 interest costs in relation to drawdown of Tranche A and Tranche B (Pacific Road Convertible Note Facility)      | 8,834,624            | -                  |
| <b>Closing number of shares</b>   | <b>1,265,979,607</b> | <b>786,889,705</b> |

# Financial Report

## Notes to the Financial Statements

FOR THE YEAR ENDED 30 JUNE 2014

### Note 24 - Issued Capital (continued)

|   | No. Shares           | \$                 |
|---|----------------------|--------------------|
| <b>BALANCE AT 1 JULY 2012</b>   | <b>773,999,771</b>   | <b>227,174,129</b> |
| 29 August 2012 interest costs in relation to drawdown of Tranche A and Tranche B (Pacific Road Convertible Note Facility)   | 2,306,795            | 124,567            |
| 29 November 2012 interest costs in relation to drawdown of Tranche A and Tranche B (Pacific Road Convertible Note Facility) | 2,145,388            | 126,578            |
| 2 January 2013 Issue of Ordinary Shares under the Company's Short and Long Term Executive Incentive Plan                    | 1,355,368            | 63,702             |
| 7 March 2013 interest costs in relation to drawdown of Tranche A and Tranche B (Pacific Road Convertible Note Facility)     | 2,877,033            | 124,576            |
| 30 May 2013 interest costs in relation to drawdown of Tranche A and Tranche B (Pacific Road Convertible Note Facility)      | 4,205,350            | 120,567            |
| Share Issue Costs   | -                    | (6,192)            |
| <b>BALANCE AT 30 JUNE 2013</b>  | <b>786,889,705</b>   | <b>227,727,927</b> |
| <b>BALANCE AT 1 JULY 2013</b>   | <b>786,889,705</b>   | <b>227,727,927</b> |
| 26 August 2013 Non-renounceable rights issue @ \$0.02   | 131,999,245          | 2,123,588          |
| 27 August 2013 Share Subscription Agreement with Holder East Capital @ \$0.02 per share                                     | 50,000,000           | 804,624            |
| 30 August 2013 interest costs in relation to drawdown of Tranche A and Tranche B (Pacific Road Convertible Note Facility)   | 6,279,353            | 125,587            |
| 15 October 2013 Rights Issue shortfall  | 171,818,615          | 2,815,913          |
| 31 October 2013 Short Term Incentive/ Long Term Incentive Shares allotted for Executives                                    | 3,944,370            | 114,895            |
| 20 November 2013 Rights Issue shortfall   | 89,626,993           | 1,475,234          |
| 6 December 2013 Rights Issue shortfall to Directors   | 263,551              | 4,358              |
| 6 December 2013 interest costs in relation to drawdown of Tranche A and Tranche B (Pacific Road Convertible Note Facility)  | 5,834,861            | 128,360            |
| 6 December 2013 Short Term Incentive/ Long Term Incentive Shares allotted for Executives                                    | 3,440,831            | 86,191             |
| 11 March 2014 interest costs in relation to drawdown of Tranche A and Tranche B (Pacific Road Convertible Note Facility)    | 7,047,459            | 126,854            |
| 29 May 2014 interest costs in relation to drawdown of Tranche A and Tranche B (Pacific Road Convertible Note Facility)      | 8,834,624            | 121,918            |
| Share Issue Costs   | -                    | (49,322)           |
| <b>BALANCE AT 30 JUNE 2014</b>  | <b>1,265,979,607</b> | <b>235,606,127</b> |

The Company has no maximum authorised share capital. Ordinary shares are of no par value.

- (a) Ordinary shares participate in dividends and the proceeds on winding up of the parent entity in proportion to the number of shares held.
- (b) At shareholders' meetings each ordinary share is entitled to one vote when a poll is called, otherwise each shareholder has one vote on a show of hands.

# Financial Report

## Notes to the Financial Statements

FOR THE YEAR ENDED 30 JUNE 2014

### Note 24 - Issued Capital (continued)

#### Capital Risk Management

When managing capital, management's objective is to ensure the entity continues as a going concern as well as to maintain optimal returns to shareholders and benefits for other stakeholders. Management also aims to maintain a capital structure that ensures the lowest cost of capital available to the entity.

In order to maintain or adjust the capital structure, the entity may adjust the amount of dividends paid to shareholders, return capital to shareholders, issue new shares, enter into joint ventures or sell assets.

The entity does not have a defined share buy-back plan. No dividends were paid in 2014 (2013: Nil) and no dividends are expected to be paid in 2015.

#### Stock Exchange Listing

Quotation has been granted for 1,265,979,607 (2012: 786,889,705) of the Company's ordinary shares on all Member exchanges of the Australian Stock Exchange Limited ("ASX").

Carbon Energy is quoted on the US securities market, the International OTCQX in New York. Merriman Capital is providing Principal American Liaison (PAL) services for the Company's quotation on the OTCQX.

#### Options

As at year end the Company has on issue 194,299,487 unlisted options. 127,632,821 have vested and are exercisable. Exercise prices for unlisted options range from \$0.026 to \$1.00.

As at year end the Company has on issue 443,708,404 6c listed options expiring on 21 July 2016

### Note 25 – Reserves

|                                      |      | CONSOLIDATED GROUP |            |
|--------------------------------------|------|--------------------|------------|
|                                      | Note | 2014 \$            | 2013 \$    |
| Share based payments reserve         | (a)  | 15,983,667         | 15,772,469 |
| Options reserve                      | (b)  | 1,650,453          | -          |
| Foreign currency translation reserve | (c)  | -                  | 34,306     |
| Other reserve                        | (d)  | 2,101,590          | 2,101,590  |
| <b>TOTAL RESERVES</b>                |      | <b>19,735,710</b>  | 17,908,365 |

- (a) The share based payments reserve is used to recognise the fair value of options issued to employees, including Key Management Personnel in relation to equity-settled share based payments.
- (b) The options reserve records the value of listed options on issue.
- (c) The foreign currency translation reserve is used to record exchange differences arising from the translation of the financial statements of foreign subsidiaries. During the year the Consolidated Group dissolved Carbon Energy USA Inc and Clean Coal Amasra Limited. Foreign exchange gains and losses accumulated in equity have been transferred to the Statement of profit and loss upon disposal.
- (d) The Other reserve records the conversion option attached to the convertible note. The conversion option remains deferred in the reserve until the conversion option is exercised. Refer to Note 1.18.2.2 for additional information.

# Financial Report

## Notes to the Financial Statements

FOR THE YEAR ENDED 30 JUNE 2014

### Note 25 – Reserves (continued)

#### CONSOLIDATED GROUP

##### SHARE BASED PAYMENTS RESERVE

|   |
|---|
| Balance at beginning of the year                    |
| Employee share schemes – value of employee services |
| <b>Balance at end of the year</b>                   |

| 2014 \$           | 2013 \$           |
|-------------------|-------------------|
| 15,772,469        | 15,718,230        |
| 211,198           | 54,239            |
| <b>15,983,667</b> | <b>15,772,469</b> |

##### OPTIONS RESERVE

|                                   |
|-----------------------------------|
| Balance at beginning of the year  |
| Issue of options                  |
| <b>Balance at end of the year</b> |

| 2014 \$          | 2013 \$  |
|------------------|----------|
| -                | -        |
| 1,650,453        | -        |
| <b>1,650,453</b> | <b>-</b> |

##### FOREIGN CURRENCY RESERVE

|  |
|--|
| Balance at beginning of the year         |
| Currency translation differences         |
| Dissolution of foreign controlled entity |
| <b>Balance at end of the year</b>        |

| 2014 \$  | 2013 \$       |
|----------|---------------|
| 34,306   | 37,816        |
| 16,481   | (3,510)       |
| (50,787) | -             |
| <b>-</b> | <b>34,306</b> |

##### OTHER RESERVE

|                                   |
|-----------------------------------|
| Balance at beginning of the year  |
| <b>Balance at end of the year</b> |

| 2014 \$          | 2013 \$          |
|------------------|------------------|
| 2,101,590        | 2,101,590        |
| <b>2,101,590</b> | <b>2,101,590</b> |

# Financial Report

## Notes to the Financial Statements

FOR THE YEAR ENDED 30 JUNE 2014

### Note 26 – Accumulated Losses

|   | CONSOLIDATED GROUP   |                      |
|---|----------------------|----------------------|
|   | 2014 \$              | 2013 \$              |
| Balance at beginning of the year            | (110,616,645)        | (75,032,318)         |
| Loss attributable to the Consolidated Group | (9,119,601)          | (35,584,327)         |
| <b>BALANCE AT END OF THE YEAR</b>           | <b>(119,736,246)</b> | <b>(110,616,645)</b> |

### Note 27 - Statement of Operations by Segment

The Consolidated Group operates in one segment, being development of clean energy and chemical feedstock from UCG syngas and reports to the chief operating decision-maker on this basis. As such one reportable segment has been identified and this basis is consistent with the current reporting structure.

The Consolidated Group accounted for revenue of \$2,332,029, deferred revenue of \$873,106 and at the period end \$1,394,318 is included in current trade receivables. All amounts relate to technology services performed in Australia and delivered to a Chinese project.

# Financial Report

## Notes to the Financial Statements

FOR THE YEAR ENDED 30 JUNE 2014

### Note 28 – Parent Entity Disclosures

|                                 | PARENT ENTITY      |                    |
|---------------------------------|--------------------|--------------------|
|                                 | 2014 \$            | 2013 \$            |
| <i>Financial Position</i>       |                    |                    |
| <b>Assets</b>                   |                    |                    |
| Current assets                  | 2,153,688          | 1,595,071          |
| Non-current assets              | 140,968,021        | 143,340,348        |
| <b>Total Assets</b>             | <b>143,121,708</b> | <b>144,935,419</b> |
| <b>Liabilities</b>              |                    |                    |
| Current liabilities             | 543,675            | 473,080            |
| Non-current liabilities         | 6,972,442          | 9,442,692          |
| <b>Total Liabilities</b>        | <b>7,516,117</b>   | <b>9,915,772</b>   |
| <b>Equity</b>                   |                    |                    |
| Issued capital                  | 235,606,127        | 227,727,927        |
| Accumulated losses              | (119,736,246)      | (110,582,339)      |
| <b>Reserves</b>                 |                    |                    |
| Share based payments reserve    | 15,983,668         | 15,772,469         |
| Options reserve                 | 1,650,453          | -                  |
| Other reserve                   | 2,101,590          | 2,101,590          |
| <b>Total Equity</b>             | <b>135,605,591</b> | <b>135,019,647</b> |
| <i>Financial Performance</i>    |                    |                    |
| Loss for the year               | 9,153,907          | 85,849,322         |
| Other Comprehensive Income      | -                  | -                  |
| <b>Total Comprehensive Loss</b> | <b>9,153,907</b>   | <b>85,849,322</b>  |

Carbon Energy Limited had nil material contingent liabilities at 30 June 2014 (2013: nil) refer Note 30 (e).

The Pacific Road Convertible Note Facility is secured by a first ranking registered fixed and floating charge over the initial technology transferred from CSIRO to Carbon Energy.

The Inter Company Receivable has been written down to its recoverable amount. A loan forgiveness of \$1,033,828 was expensed on dissolution of Carbon Energy USA Inc and an impairment of \$2,714,430 was recognised on other intercompany receivables for the year ended 30 June 2014 (2013:\$60,530,456).



# Financial Report

## Notes to the Financial Statements

FOR THE YEAR ENDED 30 JUNE 2014

### Note 28 – Parent Entity Disclosures (continued)

#### *Operating Lease Commitment*

|   | PARENT ENTITY    |                  |
|---|------------------|------------------|
|   | 2014 \$          | 2013 \$          |
| Non-cancellable operating leases contracted for but not capitalised in the financial statements |                  |                  |
| • not later than one year   | 384,023          | 369,253          |
| • later than one year but not later than five years   | 1,504,487        | 1,888,510        |
| <b>TOTAL OPERATING LEASE COMMITMENTS</b>  | <b>1,883,510</b> | <b>2,257,763</b> |

The Company has a property lease for the Brisbane office which commenced on 1 February 2013 for a term of 6 years. The lease agreement expires on 31 January 2019 with a further 5 year option. Rent increases are set at a 4% increase per annum.

# Financial Report

## Notes to the Financial Statements

FOR THE YEAR ENDED 30 JUNE 2014

### Note 29 - Financial Risk Management

#### *(a) Financial Risk Management Objectives*

The Consolidated Group's management of financial risk is aimed at ensuring net cash flows are sufficient to:

- meet all its financial commitments; and
- maintain the capacity to fund the consolidated group's growth activities.

Market, liquidity and credit risk (including interest rate and foreign exchange risk) arise in the normal course of the Consolidated Group's business. These risks are managed under Board approved directives which underpin Carbon Energy finance practices and processes.

The Consolidated Group's principal financial instruments comprise interest bearing debt, cash and short-term deposits. Other financial instruments include trade receivables and trade payables, which arise directly from operations.

Other minor risks are either summarised below or disclosed at Note 24 in the case of capital risk management.

#### *(b) Liquidity Risk*

The liquidity position of the Consolidated Group is managed to ensure sufficient liquid funds are available to meet the Consolidated Group's financial commitments in a timely and cost effective manner.

Management continually reviews the Consolidated Group's liquidity position including cash flow forecasts to determine the forecast liquidity position and maintain appropriate liquidity levels.

The following tables detail the Consolidated Group's remaining contractual maturity for its non-derivative financial liabilities with agreed repayment periods. The tables have been drawn up based on the undiscounted cash flows of financial liabilities based on the earliest date on which the Consolidated Group can be required to pay.

The maturity analysis of contracted payables at the reporting date is as follows:

# Financial Report

## Notes to the Financial Statements

FOR THE YEAR ENDED 30 JUNE 2014

### Note 29 - Financial Risk Management (continued)

CONSOLIDATED GROUP

| 2014                          | TOTAL             | payables maturity analysis |                |                   |                   |
|-------------------------------|-------------------|----------------------------|----------------|-------------------|-------------------|
|                               |                   | <1 year                    | 1-2 years      | 2-3 years         | >3 years          |
| Trade and other payables      | 952,372           | 952,372                    | -              | -                 | -                 |
| Pacific Road Convertible Note | 10,000,000        | -                          | -              | 10,000,000        | -                 |
| Credit Suisse                 | -                 | -                          | -              | -                 | -                 |
| Interest payable              | 1,322,192         | 500,000                    | 500,000        | 322,192           | -                 |
| <b>TOTAL PAYABLES</b>         | <b>12,274,564</b> | <b>1,452,372</b>           | <b>500,000</b> | <b>10,322,192</b> | <b>-</b>          |
| <b>2013</b>                   |                   |                            |                |                   |                   |
| Trade and other payables      | 1,089,873         | 1,089,873                  | -              | -                 | -                 |
| Pacific Road Convertible Note | 10,000,000        | -                          | -              | -                 | 10,000,000        |
| Credit Suisse                 | 2,997,233         | 2,997,233                  | -              | -                 | -                 |
| Interest payable              | 1,912,848         | 590,656                    | 500,000        | 500,000           | 322,192           |
| <b>TOTAL PAYABLES</b>         | <b>15,999,954</b> | <b>4,677,762</b>           | <b>500,000</b> | <b>500,000</b>    | <b>10,322,192</b> |

#### (c) Market Risk

##### (i) Interest Rate Risk

The Consolidated Group's exposure to the risks of changes in market interest rates relates largely to the Consolidated Group's cash deposits with a floating interest rate and its short term deposits and bonds with fixed interest rates (these are predominantly 30, 60 and 90 day revolving term deposits). These financial assets expose the Consolidated Group to cash flow interest rate risk.

The Pacific Road Convertible Note Facility is a fixed rate debt which exposes the Consolidated Group to fair value interest rate risk. The Pacific Road Convertible Note Facility is secured by a mortgage over the UCG technology and software transferred from CSIRO to Carbon Energy.

The Consolidated Group entered into a \$10m bridging loan facility with Credit Suisse on 15 November 2012 to assist in funding the Company's short term working capital requirements. The loan was a 12 month secured loan facility at an interest rate of 8% per annum. The Company repaid the loan in full during the period.

In regard to its interest rate risk, the Consolidated Group continuously analyses its exposure. Within this analysis consideration is given to potential renewals of existing positions, alternative investments and the mix of fixed and variable interest rates. The Consolidated Group does not engage in any hedging or derivative transactions to manage interest rate risk.

The following table sets out the carrying amount by maturity of the Parent Entity and Consolidated Group's exposure to interest rate risk and the effective weighted average interest rate for each class of these financial instruments.

# Financial Report

## Notes to the Financial Statements

FOR THE YEAR ENDED 30 JUNE 2014

### Note 29 - Financial Risk Management (continued)

#### (c) Market Risk (continued)

|   | Weighted Ave |      | Floating Interest |                  | Fixed Interest Rate |                    | Non-Interest     |                    | Total              |                     |
|---|--------------|------|-------------------|------------------|---------------------|--------------------|------------------|--------------------|--------------------|---------------------|
|   | 2014         | 2013 | 2014              | 2013             | 2014                | 2013               | 2014             | 2013               | 2014               | 2013                |
|   | %            | %    | \$                | \$               | \$                  | \$                 | \$               | \$                 | \$                 | \$                  |
| Cash                                      | 3.03         | 3.65 | 385,836           | 1,721,809        | 2,000,000           | -                  | 1,278            | 753                | 2,387,114          | 1,722,562           |
| Receivables                               | 3.61         | -    | -                 | -                | 267,553             | -                  | 1,460,432        | 1,812,033          | 1,727,985          | 1,812,033           |
| <b>TOTAL FINANCIAL ASSETS</b>             |              |      | <b>385,836</b>    | <b>1,721,809</b> | <b>2,267,553</b>    | <b>-</b>           | <b>1,461,710</b> | <b>1,812,786</b>   | <b>4,115,099</b>   | <b>3,534,595</b>    |
| Trade and other payables                  | -            | -    | -                 | -                | -                   | -                  | (952,372)        | (1,089,873)        | (952,372)          | (1,089,873)         |
| Financial liability – Credit Suisse       | -            | 8.00 | -                 | -                | -                   | (2,997,233)        | -                | (266,156)          | -                  | (3,263,389)         |
| Financial liability – Pacific Road        | 5.00         | 5.00 | -                 | -                | (6,972,442)         | (6,179,304)        | -                | -                  | (6,972,442)        | (6,179,304)         |
| <b>TOTAL FINANCIAL LIABILITIES</b>        |              |      | <b>-</b>          | <b>-</b>         | <b>(6,972,442)</b>  | <b>(9,176,537)</b> | <b>(952,372)</b> | <b>(1,356,029)</b> | <b>(7,924,814)</b> | <b>(10,532,566)</b> |
| <b>NET FINANCIAL ASSETS (LIABILITIES)</b> |              |      | <b>385,836</b>    | <b>1,721,809</b> | <b>(4,704,889)</b>  | <b>(9,176,537)</b> | <b>509,338</b>   | <b>456,757</b>     | <b>(3,809,715)</b> | <b>(6,997,971)</b>  |

The following table provides a sensitivity analysis on profit and equity after tax if interest rates at that date had been 10% higher or lower with all other variables held constant.

|   | Interest Rate Risk Sensitivity 2014 |                | Interest Rate Risk Sensitivity 2013 |                |
|---|-------------------------------------|----------------|-------------------------------------|----------------|
|   | +10% Profit \$                      | -10% Profit \$ | +10% Profit \$                      | -10% Profit \$ |
| Cash                                      | 1,168                               | (1,168)        | 6,285                               | (6,285)        |
| Receivables                               | -                                   | -              | -                                   | -              |
| <b>TOTAL FINANCIAL ASSETS</b>             | <b>1,168</b>                        | <b>(1,168)</b> | <b>6,285</b>                        | <b>(6,285)</b> |
| Trade and other payables                  | -                                   | -              | -                                   | -              |
| Financial liability – Credit Suisse       | -                                   | -              | -                                   | -              |
| Financial liability – Pacific Road        | -                                   | -              | -                                   | -              |
| <b>TOTAL FINANCIAL LIABILITIES</b>        | <b>-</b>                            | <b>-</b>       | <b>-</b>                            | <b>-</b>       |
| <b>NET FINANCIAL ASSETS (LIABILITIES)</b> | <b>1,168</b>                        | <b>(1,168)</b> | <b>6,285</b>                        | <b>(6,285)</b> |

A sensitivity of 10% has been selected as this is considered reasonable given the current level of both short term and long term Australian dollar interest rates. A 10% sensitivity would increase/(decrease) short term interest rates at 30 June 2014 by approximately 30 basis points. This would represent approximately one RBA interest rate increases/(decreases) which is reasonably possible in the current environment.

# Financial Report

## Notes to the Financial Statements

FOR THE YEAR ENDED 30 JUNE 2014

### Note 29 - Financial Risk Management (continued)

#### (c) *Market Risk (continued)*

Based on the sensitivity analysis only interest revenue from cash and cash equivalents are impacted resulting in a decrease or increase in overall income.

#### (ii) *Market Price Risk*

Price risk is the risk that the Consolidated Group's financial position will be adversely affected by movements in the market value of its financial assets arising from investments in equity securities. To manage its price risk arising from investments in equity securities, the Consolidated Group only invests in equity securities approved by the Board of Directors and where the investment provides a strategic advantage to the Consolidated Group. Equity investments held by the Consolidated Group are classified in the balance sheets as either as available-for-sale or at fair value through profit or loss. During the year the Consolidated Group disposed of its investment in Energia Minerals Limited and currently has no investments in equity instruments. Accordingly, a sensitivity analysis has not been performed.

#### (iii) *Foreign Currency Risk*

Foreign exchange risk arises when future commercial transactions and recognised assets and liabilities are denominated in a currency that is not the entity's functional currency. The establishment and settlement of foreign exchange transactions require senior and financial management approval to minimise exposures to currency fluctuations. To date the Consolidated Group's foreign transactions have not been material however this will be monitored going forward to ensure foreign currency risk is managed effectively.

# Financial Report

## Notes to the Financial Statements

FOR THE YEAR ENDED 30 JUNE 2014

### Note 29 - Financial Risk Management (continued)

#### (d) Credit Risk

Credit risk arises mainly from cash and cash equivalents and deposits with banks and financial institutions. Receivables primarily include interest and amounts on deposit.

The maximum exposure to credit risk at balance date to recognised financial assets, is the carrying amount, net of any provision for impairment of those assets, as disclosed in note 1 to the financial statements.

The credit risk for counterparties in trade and other receivables at 30 June 2014 are not credit rated by the Company. Their maturities are detailed below:

|   | CONSOLIDATED GROUP |                  |
|---|--------------------|------------------|
|   | 2014 \$            | 2013 \$          |
| Contracted maturities of receivable for year ended 30 June 2014 |                    |                  |
| RECEIVABLE  |                    |                  |
| Less than 6 months  | 1,394,394          | 61,066           |
| 6 to 12 months  | -                  | -                |
| 1 to 5 years  | -                  | 1,432,850        |
| Later than 5 years  | -                  | -                |
| <b>TOTAL</b>  | <b>1,394,394</b>   | <b>1,493,916</b> |



# Financial Report

## Notes to the Financial Statements

FOR THE YEAR ENDED 30 JUNE 2014

### Note 29 - Financial Risk Management (continued)

(e) *Net Fair Values of Financial Instruments Carried at Amortised Cost*

#### Fair Value Technique Utilised

The fair value of the financial liability is determined by unwinding over the loan period the transaction costs including prepaid interest and 61,728,395 options issued to Credit Suisse at a strike price of \$0.081. The 2013 rights issue resulted in a recalculation of the strike price which has reduced to \$0.061. The issue of these options has been treated as an embedded derivative and the value has been classified as a derivative financial liability.

The derivative financial liability is measured at fair value at the period end. The following table gives information about how the fair value of this financial liability is determined and provides qualitative information about the significant unobservable inputs.

| Financial liability             | Fair value as at |            | Fair value hierarchy | Valuation technique and key input                | Significant unobservable input | Relationship of unobservable input to fair value  |
|---------------------------------|------------------|------------|----------------------|--|--------------------------------|---|
|                                 | 30 June 14       | 30 June 13 |                      |  |                                |   |
| Derivative financial instrument | <b>\$10,904</b>  | \$266,156  | Level 3              | Black-Scholes model.<br>Company share volatility | Company Share volatility = 67% | The higher the volatility the greater the fair value. A volatility of 2x would increase the fair value by \$200,000 |

# Financial Report

## Notes to the Financial Statements

FOR THE YEAR ENDED 30 JUNE 2014

### Note 30 – Commitments, Claims, Guarantees, Contingent Asset, Contingent Liabilities & Credit Facilities

#### (a) Exploration Commitments

The Consolidated Group is required to perform ongoing exploration expenditure and has certain statutory obligations to perform minimum exploration work on its tenements and to earn an interest in joint venture mining prospects. No provision has been made in the financial statements for these amounts as the amounts are expected to be fulfilled in the normal course of the operations of the Consolidated Group.

The statutory exploration commitments are deferred and awaiting decision from the Department of Natural Resources & Mines. The Statutory expenditure requirement may be renegotiated with the State's Mineral and Energy Departments and expenditure commitments may be varied between tenements, reduced subject to exploration area or relinquished for non- prospective tenements.

|   | CONSOLIDATED GROUP |                  |
|---|--------------------|------------------|
|   | 2014 \$            | 2013 \$          |
| These obligations which are not provided for in the financial statements and are payable: |                    |                  |
| • not later than one year   | 385,002            | 870,564          |
| • later than one year but not later than five years                                       | 370,448            | 400,718          |
| <b>TOTAL EXPLORATION COMMITMENTS</b>  | <b>755,450</b>     | <b>1,271,282</b> |

#### (b) Operating Lease Commitment

|   | CONSOLIDATED GROUP |                  |
|---|--------------------|------------------|
|   | 2014 \$            | 2013 \$          |
| Non-cancellable operating leases contracted for but not capitalised in the financial statements |                    |                  |
| • not later than one year   | 388,223            | 369,253          |
| • later than one year but not later than five years   | 1,511,978          | 1,888,510        |
| <b>TOTAL OPERATING LEASE COMMITMENTS</b>  | <b>1,900,201</b>   | <b>2,257,763</b> |

The Consolidated Group leases assets for operations including equipment and office premises. The leases have a life of between 3 and 5 years.

The lease for the Brisbane office commenced on 1 February 2013 for a term of 6 years and expires on 31 January 2019 with a further 5 year option. Rent increases are set at a 4% increase per annum.

# Financial Report

## Notes to the Financial Statements

FOR THE YEAR ENDED 30 JUNE 2014

### Note 30 – Commitments, Claims, Guarantees, Contingent Asset, Contingent Liabilities & Credit Facilities (continued)

#### (c) Claims of Native Title and Cultural Heritage

##### Mineral exploration

The Company is aware of native title claims made in accordance with the Native Title Act 1993 (NTA) that was enacted to accommodate the decision of the High Court in *Mabo v Queensland (No2)* (1992) 175 CLR 1, which recognised the rights and interests of the Aboriginal and Torres Strait Islanders as a form of common law native title.

The main objectives of the NTA are to:

- provide for the recognition and protection of native title;
- establish ways in which future dealings affecting native title may proceed and to set standards for those dealings; and
- establish a mechanism for determining claims to native title; and provide for, or permit, the validation of past acts invalidated because of the existence of native title.

##### Coal Exploration and UCG

A Cultural Heritage Management Plan (CHMP) has been developed in partnership with the Aboriginal traditional owners of the lands the subject of the UCG demonstration trial. The CHMP is registered under the provisions of the Aboriginal Cultural Heritage Act and ensures that there is minimal impact or damage caused to Aboriginal cultural heritage items, materials or values during the exploration and UCG activities on mining and petroleum tenements owned by Carbon Energy.

#### (d) Bank Guarantees

|   | CONSOLIDATED GROUP |          |
|---|--------------------|----------|
|   | 2014 \$            | 2013 \$  |
| Standby arrangements with banks to provide funds and support facilities for bank guarantees relating to rehabilitation bonds. |                    |          |
| These facilities are secured by fixed term cash deposits  |                    |          |
| Bank Credit Facility – Deposit (Note 9)   | 32,500             | 32,500   |
| Amount Utilised   | (32,500)           | (32,500) |
| <b>Unused Bank Credit Facility</b>  | <b>-</b>           | <b>-</b> |
| Interest rates on these credit facilities are variable and subject to adjustment.   |                    |          |
| Bank Guarantee in relation to Environmental bonds   | 53,140             | 55,640   |
| Bank Guarantee in relation to the entity's share of guarantee for Lease of office premises                                    | 181,913            | 181,913  |

# Financial Report

## Notes to the Financial Statements

FOR THE YEAR ENDED 30 JUNE 2014

### Note 30 – Commitments, Claims, Guarantees, Contingent Asset, Contingent Liabilities & Credit Facilities (continued)

#### (e) Contingent Liabilities

There are a number of matters of a commercial nature which are in progress:

- **Summa Resources Holdings LLC (Summa)**

As announced to the market on 30 May 2013, the Company maintains its position that project milestones under the Agreement with Summa Resources LLC (Summa) were not able to be achieved and that it is not obliged to issue further tranches of shares to Summa nor is it required to reserve those shares. Without prejudice discussions between representatives from both parties to resolve this dispute continue, but have to date failed to bring the matter to a close.

The Company is not engaged in any litigation which has or would be likely to have a material adverse effect on either the Company or its business.

#### (f) Other Credit Facilities

|   | CONSOLIDATED GROUP |                   |
|---|--------------------|-------------------|
|   | 2014 \$            | 2013 \$           |
| Pacific Road Convertible note Facility <sup>1</sup> | 10,000,000         | 10,000,000        |
| Credit Suisse Term Facility <sup>2</sup>            | -                  | 2,997,233         |
| <b>TOTAL</b>  | <b>10,000,000</b>  | <b>12,997,233</b> |
| Unused Credit Facility                              | -                  | -                 |

<sup>1</sup> The Pacific Road Convertible Note Facility is secured by a first ranking registered fixed and floating charge over the initial technology transferred from CSIRO to Carbon Energy.

<sup>2</sup> The Credit Suisse facility was fully repaid during the period.

# Financial Report

## Notes to the Financial Statements

FOR THE YEAR ENDED 30 JUNE 2014

### Note 31 – Cash flow Information

|  | CONSOLIDATED GROUP |                    |
|--|--------------------|--------------------|
|  | 2014 \$            | 2013 \$            |
| (a) Reconciliation of cash flow from operations with loss after income tax |                    |                    |
| Loss after income tax  | (9,119,601)        | (35,584,327)       |
| <b>Non-Cash flows in loss</b>  |                    |                    |
| Depreciation   | 145,253            | 97,389             |
| Interest expense <sup>1</sup>  | 500,000            | 3,691,077          |
| Interest expense (FV discount)   | 837,022            | -                  |
| Share Options expensed   | 412,285            | 280,056            |
| Loss on disposal of asset  | -                  | 404,360            |
| Translation of foreign operations  | (34,306)           | -                  |
| Equity accounted loss in associate   | -                  | 564,678            |
| Loss on disposal of investment in associate                                | -                  | 176,710            |
| Movement in fair value of derivative                                       | (255,252)          | (1,051,581)        |
| Impairment   | 1,970,900          | 18,790,669         |
| <b>Changes in assets and liabilities:</b>                                  |                    |                    |
| (Increase)/ Decrease in trade receivables and other current assets         | (1,307,201)        | 305,261            |
| R&D rebate received  | -                  | 7,002,767          |
| Decrease in trade creditors and accruals                                   | 137,501            | (223,447)          |
| Increase in deferred revenue   | 873,106            | -                  |
| Increase/ (Decrease) in provisions   | 102,853            | (33,602)           |
| <b>Cash out flow from operations</b>                                       | <b>(6,012,442)</b> | <b>(5,579,990)</b> |

#### Non-cash transactions

<sup>1</sup> Interest costs payable 3 months in arrears, in relation to Tranche A and Tranche B utilised under the \$10 million Pacific Road Convertible Note Facility Agreement.

# Financial Report

## Notes to the Financial Statements

FOR THE YEAR ENDED 30 JUNE 2014

### Note 32 - Related Party Transactions

#### Transactions with related parties

Transactions between related parties are on normal commercial terms and conditions no more favourable than those available to other parties unless otherwise stated.

##### (a) Key Management Personnel Compensation

|                              | CONSOLIDATED GROUP |                  |
|------------------------------|--------------------|------------------|
|                              | 2014 \$            | 2013 \$          |
| Short-term employee benefits | 1,477,900          | 1,680,131        |
| Post-employment benefits     | 110,527            | 107,682          |
| Long-term benefits           | 26,315             | -                |
| Termination benefits         | -                  | 120,393          |
| Share-based payments (i)     | 447,880            | 283,741          |
| <b>TOTAL</b>                 | <b>2,062,622</b>   | <b>2,191,947</b> |

(i) Detailed remuneration disclosures are provided in the remuneration report.

|  | CONSOLIDATED GROUP |             |
|--|--------------------|-------------|
|  | 2014 Shares        | 2013 Shares |
| <b>(b) Key Management Personnel share transactions:</b>  |                    |             |
| Subscription for new ordinary shares and options by key management personnel as a result of:                 |                    |             |
| Rights issue - Ordinary Shares*  | 120,160,807        | 82,585,679  |
| Rights issue - 6 cent vested listed options expiring 31/07/16  | 5,427,815          | -           |
| Pacific Road Convertible Note Facility - Interest costs in relation to drawdown of Tranche A and Tranche B** | 27,996,297         | 11,534,566  |

\* Includes Indirect holdings of 105,746,535 (2013: 77,750,238) shares which represents Pacific Road Resources Funds; Louis Rozman is an employee and Director of some Pacific Road Capital entities.

\*\* Indirect holdings which represent unlisted options held by Pacific Road Resources Funds; Louis Rozman is an employee and Director of some Pacific Road Capital Entities

Options granted as remuneration during the period:

|   |            |   |
|---|------------|---|
| 2.6 cent vested unlisted options expiring 15/10/16  | 3,573,877  | - |
| 6 cent unvested unlisted options expiring 30/06/17* | 33,333,333 | - |
| 6 cent unvested unlisted options expiring 30/06/18  | 33,333,333 | - |
| 6 cent unvested unlisted options expiring 30/06/19  | 33,333,333 | - |

\*Forfeited as a result of failure to meet share price performance hurdles



# Financial Report

## Notes to the Financial Statements

FOR THE YEAR ENDED 30 JUNE 2014

### Note 32 - Related Party Transactions (continued)

#### CONSOLIDATED GROUP

|   | 2014 \$ | 2013 \$ |
|---|---------|---------|
| <i>(c) Director – Related Entities:</i>   |         |         |
| Other service fees charged to Carbon Energy Limited of which Peter Hogan was both a Director of Carbon Energy Limited and Incitec Pivot Limited at that time.                                 | 30,000  | 40,000  |
| Other service fees charged to Carbon Energy Limited of which Louis Rozman was both a Director of Carbon Energy Limited and Pacific Road Capital Management Holdings Pty Limited at that time. | 30,000  | 40,000  |

Louis Rozman (Non-Executive Director) holds Directorships in other companies which are shareholders of Carbon Energy Limited.

Amounts paid to Pacific Road Capital Management Holdings Pty Limited for Mr Rozman's services as a Director amount to \$30,000 for the year ended 30 June 2014.

#### *(d) Parent Entity with significant influence over associated entity where Max Cozijn is a Director:*

On 24 July 2013 Carbon Energy sold its investment in Energia Minerals Limited for \$449,999. Refer to Note 12 for further details.

#### *(e) Other Related Party Transactions*

On 22 December 2011 Carbon Energy executed a Convertible Note Facility Agreement with Pacific Road Capital Management Pty Ltd (PRCM).

The Convertible Note Facility Agreement requires Carbon Energy to pay interest of 5% per annum on the Facility amount. The interest is payable quarterly in arrears and is payable through the issuance of shares in Carbon Energy at the 5 day VWAP for the Shares on the ASX prior to the day a payment is due. PRCM may convert all or part of the Facility amount to shares in the Company at any time during the term at a conversion price of \$0.14. If the share price exceeds \$0.40 for continuous 60 day VWAP period the Company can request the conversion of the Facility in full. The Facility repayment date is 18 January 2017 and any part of the Facility amount not converted into shares on that date is repayable in cash by the Company on that date. A total of 44,645,845 options have vested with varying expiry dates as follows:

| Options    | Grant Date | Price    | Expiry Date       |
|------------|------------|----------|-------------------|
| 7,000,000  | 25-Jan-12  | \$0.1678 | January 18, 2017  |
| 28,000,000 | 29-Feb-12  | \$0.1678 | February 25, 2017 |
| 9,645,845  | 16-Nov-12  | \$0.061  | November 15, 2015 |

Further information on this transaction is included under Note 23.

### Note 33 - Events Subsequent to Balance Date

On 1 July 2014 the Company secured a \$1.5 million loan facility with Macquarie Bank Limited. The facility will provide the Company with the ability to drawdown up to \$1.5 million to assist in funding its working capital requirements prior to receipt of the 2014 Research and Development tax incentive rebate. As at the date of signing this report the facility is undrawn.

# Financial Report

## Notes to the Financial Statements

FOR THE YEAR ENDED 30 JUNE 2014

### Note 34 - Controlled Entities

|  | Country of Incorporation | Principal Activity   | Percentage Owned |        |
|--|--------------------------|--|------------------|--------|
|  |                          |  | 2014 %           | 2013 % |
| Carbon Energy Ltd (CEL)  | Australia                | Parent entity of Carbon Energy group   | -                | -      |
| Carbon Energy (Holdings) Pty Ltd (CEH)                         | Australia                | Holding company for Carbon Energy Operations   | 100              | 100    |
| Carbon Energy (Operations) Pty Ltd (CEOPL)                     | Australia                | Facilitate the construction and commissioning of the Underground Coal Gasification project in Queensland | 100              | 100    |
| Coronation Drive (Energy) Pty Ltd                              | Australia                | Holding company for the investment in Carbon Energy USA Inc  | 100              | 100    |
| Carbon Energy (Galilee) Pty Ltd                                | Australia                | Holding company for the investment in Clean Coal Amasra Limited  | 100              | 100    |
| Carbon Energy (Latin America) Pty Ltd                          | Australia                | Holding company for the investment in Mulpun, Chile  | 100              | 100    |
| Carbon Energy USA Inc (previously Clean Coal Inc) <sup>1</sup> | USA                      | Coal exploration company targeting USA   | 100              | 100    |
| Clean Coal Amasra Limited <sup>2</sup>                         | UK                       | Coal exploration company targeting Turkey  | 100              | 100    |
| Carbon Energy Chile Limitada                                   | Chile                    | To jointly assess and develop an Underground Coal Gasification project at Mulpun, Chile                  | 100              | 100    |

<sup>1</sup> On 28 March 2014 the member Board approved the dissolution of Carbon Energy USA Inc.

<sup>2</sup> On 28 March 2014 the member Board approved the dissolution of Clean Coal Amasra Limited.

The subsidiaries noted above are all controlled entities and are in the early stage of establishment and are dependent on the parent entity for financial support. At year end, total loans to these subsidiaries amount to \$47,633,553 (2013: \$43,759,475).

### Note 35 - Remuneration of Auditors

|  | CONSOLIDATED GROUP |                |
|--|--------------------|----------------|
|  | 2014 \$            | 2013 \$        |
| Auditor of the parent entity:                  |                    |                |
| • auditing or reviewing the financial report   | 122,000            | 122,000        |
| • other non audit services – advisory services | 31,650             | 93,653         |
|  | <b>153,650</b>     | <b>215,653</b> |

# Financial Report

## Notes to the Financial Statements

FOR THE YEAR ENDED 30 JUNE 2014

### Note 36 - Share-Based Payments

#### *(a) Short Term Executive Incentive (STI)*

Carbon Energy offers a Short Term Incentive (STI) to the Executive Director and other Key Management Personnel to achieve the following objectives:

- Focus Key Management Personnel on the achievement of key targets as well as individual contribution that the Board believes will lead to sustained and improved business performance; and
- Reward and recognise superior performance.

The metrics, weightings and performance measures are reviewed annually to ensure business needs are met and the overall STI is consistent with general market practices.

The STI scheme involves establishing the STI value for the financial year, subject to satisfactorily meeting Key Performance Indicators. At the end of each financial year, the Key Management Personnel would be allocated a number of shares equivalent to the cash value of the STI, based on the 90 day VWAP prior to the allocation date, which are redeemable immediately. The Executive Director has the option to receive payment of the STI in cash or shares.

#### *(b) Long Term Executive Incentive (LTI)*

The scheme involves establishing an LTI value for each financial year, subject to satisfactorily meeting Key Performance Indicators.

- At the end of each financial year the Key Management Personnel will be allocated a number of shares or options equivalent to the cash value of the LTI, based on the 90 day VWAP prior to the allocation date, which would be redeemable immediately provided the Key Management Personnel remained employed with the Company at that time.
- If the Company terminates the Key Management Personnel employment, other than for cause, the LTI tranches that have been allocated but not yet redeemed will be issued to the Key Management Personnel.

The Executive Director LTI arrangements as approved at the annual general meeting on 21 November 2013 comprise the following:

- 33,333,333 options with an exercise price of \$0.06 each and a vesting date of 30 June 2014 (subject to the market price of the shares as at 30 June 2014 being no less than 4.5 cents (\$0.045) per share) expiring 30 June 2017. These options were forfeited on 30 June 2014 as a result of failure to achieve the share price performance hurdle; and
- 33,333,333 options with an exercise price of \$0.06 each and a vesting date of 30 June 2015 (subject to the market price of the shares as at 30 June 2015 being no less than 7.5 cents (\$0.075) per share) expiring 30 June 2018; and
- 33,333,333, options with an exercise price of \$0.06 each and a vesting date of 30 June 2016 (subject to the market price of the shares as at 30 June 2016 being no less than 10.5 cents (\$0.105) per share) expiring 30 June 2019.

# Financial Report

## Notes to the Financial Statements

### FOR THE YEAR ENDED 30 JUNE 2014

#### (c) Convertible Note

The Convertible Note Facility Agreement requires Carbon Energy to pay interest of 5% per annum on the Facility amount. The interest is payable quarterly in arrears and is payable through the issuance of shares in Carbon Energy at the 5 day VWAP for the shares on the ASX prior to the day a payment is due.

#### (d) Expenses arising from share-based payment transactions

A total expense arising from the share based payment transactions of \$500,000 was recognised during the year and included in finance costs (2013: \$500,000).

Total expenses arising from share based payment transactions recognised during the year as part of the employee benefit expenses were as follows:

|   | CONSOLIDATED GROUP |                |
|---|--------------------|----------------|
|   | 2014 \$            | 2013 \$        |
| Shares issued under the short term incentive scheme | 239,073            | 120,851        |
| Shares issued under the long term incentive scheme  | 52,310             | 30,180         |
| Options issued under the long term incentive scheme | 187,010            | 132,710        |
| <b>Closing Balance</b>                              | <b>478,393</b>     | <b>283,741</b> |

At 30 June 2014, 10,727,959 of options were accrued for Key Management Personnel (being 80% of the 12,873,550 eligible options to be earned upon achievement of 2014 Key Performance Indicators at a strike price of 30% premium to the 5 day VWAP) and in line with the executives short term incentive agreement for the 2014 year, 4,266,338 shares (being 80% performance of the maximum STI valued at the 90 day VWAP) valued at \$187,048 was also accrued (2013: 120,851).

# Financial Report

## Notes to the Financial Statements

FOR THE YEAR ENDED 30 JUNE 2014

### Note 36 - Share-Based Payments (continued)

#### (e) Employee Options

| Grant date                             | Expiry date | Exercise price | Balance at start of year | Granted during the year | Exercised during the year | Expired/ Forfeited during the year | Balance at the end of the year | Exercisable at the end of the year |
|--|-------------|----------------|--------------------------|-------------------------|---------------------------|------------------------------------|--------------------------------|------------------------------------|
|  |             |                | Number                   | Number                  | Number                    | Number                             | Number                         | Number                             |
| <b>2014</b>                            |             |                |                          |                         |                           |                                    |                                |                                    |
| 13/11/2008                             | 10/12/2013  | \$0.25         | 5,000,000                | -                       | -                         | 5,000,000                          | -                              | -                                  |
| 13/11/2008                             | 10/12/2013  | \$0.70         | 5,600,000                | -                       | -                         | 5,600,000                          | -                              | -                                  |
| 13/11/2008                             | 10/12/2014  | \$1.00         | 10,000,000               | -                       | -                         | -                                  | 10,000,000                     | 10,000,000                         |
| 13/11/2008                             | 10/12/2013  | \$0.35         | 1,400,000                | -                       | -                         | 1,400,000                          | -                              | -                                  |
| 13/11/2008                             | 10/12/2013  | \$0.80         | 1,750,000                | -                       | -                         | 1,750,000                          | -                              | -                                  |
| 13/11/2008                             | 10/12/2013  | \$1.20         | 875,000                  | -                       | -                         | 875,000                            | -                              | -                                  |
| 13/11/2008                             | 10/12/2013  | \$1.60         | 1,750,000                | -                       | -                         | 1,750,000                          | -                              | -                                  |
| 16/09/2008                             | 10/12/2013  | \$0.80         | 2,500,000                | -                       | -                         | 2,500,000                          | -                              | -                                  |
| 16/09/2008                             | 10/12/2013  | \$0.80         | 1,000,000                | -                       | -                         | 1,000,000                          | -                              | -                                  |
| 17/10/2008                             | 10/12/2013  | \$0.80         | 1,000,000                | -                       | -                         | 1,000,000                          | -                              | -                                  |
| 17/10/2008                             | 10/12/2013  | \$0.80         | 1,000,000                | -                       | -                         | 1,000,000                          | -                              | -                                  |
| 25/01/2012                             | 18/01/2017  | \$0.1678       | 7,000,000                | -                       | -                         | -                                  | 7,000,000                      | 7,000,000                          |
| 25/01/2012                             | 25/02/2017  | \$0.1678       | 28,000,000               | -                       | -                         | -                                  | 28,000,000                     | 28,000,000                         |
| 16/11/2012                             | 15/11/2014  | \$0.061        | 61,728,395               | -                       | -                         | -                                  | 61,728,395                     | 61,728,395                         |
| 16/11/2012                             | 15/11/2014  | \$0.061        | 9,645,845                | -                       | -                         | -                                  | 9,645,845                      | 9,645,845                          |
| 2/01/2013                              | 31/12/2015  | \$0.12         | 3,084,000                | -                       | -                         | -                                  | 3,084,000                      | 3,084,000                          |
| 15/10/2013                             | 15/10/2016  | \$0.026        | -                        | 4,600,704               | -                         | -                                  | 4,600,704                      | 4,600,704                          |
| 6/12/2013                              | 15/10/2016  | \$0.026        | -                        | 3,573,877               | -                         | -                                  | 3,573,877                      | 3,573,877                          |
| 6/12/2013                              | 30/06/2017  | \$0.06         | -                        | 33,333,333              | -                         | 33,333,333                         | -                              | -                                  |
| 6/12/2013                              | 30/06/2018  | \$0.06         | -                        | 33,333,333              | -                         | -                                  | 33,333,333                     | -                                  |
| 6/12/2013                              | 30/06/2019  | \$0.06         | -                        | 33,333,333              | -                         | -                                  | 33,333,333                     | -                                  |
|  |             |                | <b>141,333,240</b>       | <b>108,174,580</b>      | <b>-</b>                  | <b>55,208,333</b>                  | <b>194,299,487</b>             | <b>127,632,821</b>                 |
| <b>Weighted average exercise price</b> |             |                | <b>\$0.27</b>            | <b>\$0.06</b>           | <b>-</b>                  | <b>\$0.31</b>                      | <b>\$0.14</b>                  | <b>\$0.18</b>                      |

# Financial Report

## Notes to the Financial Statements

FOR THE YEAR ENDED 30 JUNE 2014

### Note 36 - Share-Based Payments (continued)

#### (e) Employee Options (continued)

| Grant date                             | Expiry date | Exercise price | Balance at start of year | Granted during the year | Exercised during the year | Expired/ Forfeited during the year | Balance at the end of the year | Exercisable at the end of the year |
|--|-------------|----------------|--------------------------|-------------------------|---------------------------|------------------------------------|--------------------------------|------------------------------------|
|  |             |                | Number                   | Number                  | Number                    | Number                             | Number                         | Number                             |
| <b>2013</b>                            |             |                |                          |                         |                           |                                    |                                |                                    |
| 13/11/2008                             | 10/12/2013  | \$0.25         | 5,000,000                | -                       | -                         | -                                  | 5,000,000                      | 5,000,000                          |
| 13/11/2008                             | 10/12/2013  | \$0.70         | 5,600,000                | -                       | -                         | -                                  | 5,600,000                      | 5,600,000                          |
| 13/11/2008                             | 10/12/2014  | \$1.00         | 10,000,000               | -                       | -                         | -                                  | 10,000,000                     | 10,000,000                         |
| 13/11/2008                             | 10/12/2013  | \$0.35         | 1,400,000                | -                       | -                         | -                                  | 1,400,000                      | 1,400,000                          |
| 13/11/2008                             | 10/12/2013  | \$0.80         | 1,750,000                | -                       | -                         | -                                  | 1,750,000                      | 1,750,000                          |
| 13/11/2008                             | 10/12/2013  | \$1.20         | 875,000                  | -                       | -                         | -                                  | 875,000                        | 875,000                            |
| 13/11/2008                             | 10/12/2013  | \$1.60         | 1,750,000                | -                       | -                         | -                                  | 1,750,000                      | 1,750,000                          |
| 16/09/2008                             | 10/12/2013  | \$0.80         | 2,500,000                | -                       | -                         | -                                  | 2,500,000                      | 2,500,000                          |
| 16/09/2008                             | 10/12/2013  | \$0.80         | 1,000,000                | -                       | -                         | -                                  | 1,000,000                      | 1,000,000                          |
| 17/10/2008                             | 10/12/2013  | \$0.80         | 1,000,000                | -                       | -                         | -                                  | 1,000,000                      | 1,000,000                          |
| 17/10/2008                             | 10/12/2013  | \$0.80         | 1,000,000                | -                       | -                         | -                                  | 1,000,000                      | 1,000,000                          |
| 25/01/2012                             | 18/01/2017  | \$0.1875       | 7,000,000                | -                       | -                         | -                                  | 7,000,000                      | 7,000,000                          |
| 25/01/2012                             | 25/02/2017  | \$0.1875       | 28,000,000               | -                       | -                         | -                                  | 28,000,000                     | 28,000,000                         |
| 16/11/2012                             | 15/11/2014  | \$0.081        | -                        | 61,728,395              | -                         | -                                  | 61,728,395                     | 61,728,395                         |
| 16/11/2012                             | 15/11/2014  | \$0.081        | -                        | 9,645,845               | -                         | -                                  | 9,645,845                      | 9,645,845                          |
| 2/01/2013                              | 31/12/2015  | \$0.12         | -                        | 3,084,000               | -                         | -                                  | 3,084,000                      | 3,084,000                          |
|  |             |                | <b>66,875,000</b>        | <b>74,458,240</b>       | -                         | -                                  | <b>141,333,240</b>             | <b>141,333,240</b>                 |
| <b>Weighted average exercise price</b> |             |                | <b>\$0.48</b>            | <b>\$0.08</b>           | -                         | -                                  | <b>\$0.27</b>                  | <b>\$0.27</b>                      |

There were nil options exercised during the year (2013: nil).

The Options outstanding at 30 June 2014 had a weighted average exercise price of \$0.14 (2013: \$0.27) and a weighted average remaining contractual life of 2.30 years (2013: 1.82 years). Exercise prices range from \$0.026 to \$1.00 in respect of options outstanding at 30 June 2014 (2013: \$0.081 to \$1.60).

On 21 November 2013 shareholders approved the grant 99,999,999 unlisted options with an exercise price of \$0.06. These options vest in 3 tranches of 33,333,333 each and have share price performance conditions attached. The first tranche, due to vest at 30 June 2014 were forfeited as the share price performance condition was not achieved.

# Financial Report

## Notes to the Financial Statements

FOR THE YEAR ENDED 30 JUNE 2014

### Note 36 - Share-Based Payments (continued)

(e) *Employee Options (continued)*

#### Fair value of options granted

The assessed fair value of the options granted during the year ended 30 June 2014 was \$0.003 per option (2013: \$0.08). The fair value at grant date is independently determined using a Black Scholes or Monte Carlo option pricing model that takes into account the exercise price, term of the option, the share price at grant date and expected volatility of the underlying share and the risk free interest rate for the term of the option.

The model inputs for options granted during the year ended 30 June 2014 included:

| 2014                            |                 |                 |                 |
|---------------------------------|-----------------|-----------------|-----------------|
| Grant Date                      | 15 October 2013 | 6 December 2013 | 6 December 2013 |
| Number of Options               | 4,600,704       | 3,573,877       | 99,999, 999     |
| Valuation methodology           | Black Scholes   | Black Scholes   | Monte Carlo     |
| Weighted average exercise price | \$0.0257        | \$0.0260        | \$0.06          |
| Weighted average life of option | 3.00 years      | 2.86 years      | 4.61 years      |
| Underlying share price          | \$0.0198        | \$0.02          | \$0.022         |
| Expected share price volatility | 70%             | 70%             | 70%             |
| Risk free interest rate         | 2.75%           | 2.75%           | 3.41% - 3.92%   |

| 2013                            |                  |                  |                |
|---------------------------------|------------------|------------------|----------------|
| Grant Date                      | 16 November 2012 | 16 November 2012 | 2 January 2013 |
| Number of Options               | 61,728,395       | 9,645,845        | 3,084,000      |
| Valuation methodology           | Black Scholes    | Black Scholes    | Black Scholes  |
| Weighted average exercise price | \$0.081          | \$0.081          | \$0.12         |
| Weighted average life of option | 2 years          | 2 years          | 3 years        |
| Underlying share price          | \$0.029          | \$0.055          | \$0.047        |
| Expected share price volatility | 90%              | 90%              | 90%            |
| Risk free interest rate         | 2.52%            | 2.52%            | 2.75%          |



# Financial Report

## Notes to the Financial Statements

FOR THE YEAR ENDED 30 JUNE 2014

### Note 36 - Share-Based Payments (continued)

#### (f) Shares

The Company issues shares to employees as part of the STI plan. The Convertible Note Facility Agreement also requires the Company to pay interest of 5% per annum on the \$10,000,000 facility. The interest is payable quarterly in arrears and is payable through the issuance of shares in Carbon Energy at the 5 day VWAP for the shares on the ASX prior to the day a payment is due.

The following table summarises the share based payment shares issued during the year ended 30 June 2014.

| Issue Date | No. of Shares | Description   | Deemed Value |
|------------|---------------|---|--------------|
| 30/08/2013 | 6,279,353     | Interest costs in relation to drawdown of Tranche A and Tranche B (Pacific Road Convertible Note Facility)                | \$0.020      |
| 15/10/2013 | 3,944,370     | Issue of Ordinary Share under the Company's Short and Long Term Executive Incentive Plan for the 2012-2013 financial year | \$0.020      |
| 6/12/2013  | 3,440,831     | Issue of Ordinary Share under the Company's Short and Long Term Executive Incentive Plan for the 2012-2013 financial year | \$0.020      |
| 6/12/2013  | 5,834,561     | Interest costs in relation to drawdown of Tranche A and Tranche B (Pacific Road Convertible Note Facility)                | \$0.022      |
| 11/03/2014 | 7,047,459     | Interest costs in relation to drawdown of Tranche A and Tranche B (Pacific Road Convertible Note Facility)                | \$0.018      |
| 29/05/2014 | 8,834,624     | Interest costs in relation to drawdown of Tranche A and Tranche B (Pacific Road Convertible Note Facility)                | \$0.0138     |

The following table summarises the share based payment shares issued during the year ended 30 June 2013.

| Issue Date | No. of Shares | Description  | Deemed Value |
|------------|---------------|--|--------------|
| 29/08/2012 | 2,306,795     | Interest costs in relation to drawdown of Tranche A and Tranche B (Pacific Road Convertible Note Facility) | \$0.054      |
| 29/11/2012 | 2,145,388     | Interest costs in relation to drawdown of Tranche A and Tranche B (Pacific Road Convertible Note Facility) | \$0.059      |
| 02/01/2013 | 1,355,368     | Issue of Ordinary Shares under the Company's Short and Long Term Executive Incentive Plan                  | \$0.047      |
| 07/03/2013 | 2,877,033     | Interest costs in relation to drawdown of Tranche A and Tranche B (Pacific Road Convertible Note Facility) | \$0.043      |
| 30/05/2013 | 4,205,350     | Interest costs in relation to drawdown of Tranche A and Tranche B (Pacific Road Convertible Note Facility) | \$0.029      |

# Financial report

## Directors' Declaration

The Directors of the Company declare that:

1. The financial statements and notes, as set out on pages 51 to 111, are in accordance with the Corporations Act 2001 and:
  - (a) there are reasonable grounds to believe that the Company will be able to pay its debts as and when they become due and payable;
  - (b) the attached financial statements are in compliance with International Financial Reporting Standards, as stated in Note 1 to the financial statements;
  - (c) in the Directors' opinion, the attached financial statements and notes thereto are in accordance with the Corporations Act 2001, including compliance with accounting standards and giving a true and fair view of the financial position and performance of the Consolidated Group; and
  - (d) the Directors have been given the declarations required by section 295A of the Corporations Act 2001.
2. The Managing Director and Finance Director have each declared that:
  - (a) the financial records of the Company for the financial year have been properly maintained in accordance with section 286 of the Corporations Act 2001;
  - (b) the financial statements and notes referred to in section 295 (3)(b) of the Corporations Act 2001 for the financial year comply with the Accounting Standards; and
  - (c) the financial statements and notes for the financial year give a true and fair view in accordance with section 297 of the Corporations Act 2001.

This declaration is made in accordance with a resolution of the Board of Directors and is signed for and on behalf of the Directors by:



Dr Chris Rawlings  
Chairman



Morné Engelbrecht  
Managing Director

Brisbane, Queensland

(1 August 2014)

# Independent Auditor's Report to the Members of Carbon Energy Limited

## Report on the Financial Report

We have audited the accompanying financial report of Carbon Energy Limited, which comprises the statement of financial position as at 30 June 2014, the statement of profit and loss and other comprehensive income, the cash flow statement and the statement of changes in equity for the year ended on that date, notes comprising a summary of significant accounting policies and other explanatory information, and the directors' declaration of the consolidated entity, comprising the company and the entities it controlled at the year's end or from time to time during the financial year as set out on pages 51 to 112.

### *Directors' Responsibility for the Financial Report*

The directors of the company are responsible for the preparation of the financial report that gives a true and fair view in accordance with Australian Accounting Standards and the *Corporations Act 2001* and for such internal control as the directors determine is necessary to enable the preparation of the financial report that gives a true and fair view and is free from material misstatement, whether due to fraud or error. In Note 1, the directors also state, in accordance with Accounting Standard AASB 101 Presentation of Financial Statements, that the consolidated financial statements comply with International Financial Reporting Standards.

### *Auditor's Responsibility*

Our responsibility is to express an opinion on the financial report based on our audit. We conducted our audit in accordance with Australian Auditing Standards. Those standards require that we comply with relevant ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance whether the financial report is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial report. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial report, whether due to fraud or error. In making those risk assessments, the auditor considers internal control, relevant to the company's preparation of the financial report that gives a true and fair view, in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the company's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### *Auditor's Independence Declaration*

In conducting our audit, we have complied with the independence requirements of the *Corporations Act 2001*. We confirm that the independence declaration required by the *Corporations Act 2001*, which has been given to the directors of Carbon Energy Limited, would be in the same terms if given to the directors as at the time of this auditor's report.

## *Opinion*

In our opinion:

- (a) the financial report of Carbon Energy Limited is in accordance with the *Corporations Act 2001*, including:
  - (i) giving a true and fair view of the consolidated entity's financial position as at 30 June 2014 and of its performance for the year ended on that date; and
  - (ii) complying with Australian Accounting Standards and the *Corporations Regulations 2001*; and
- (b) the consolidated financial statements also comply with International Financial Reporting Standards as disclosed in Note 1.

## *Material Uncertainty Regarding Continuation as a Going Concern*

Without modifying our opinion, we draw attention to Note 1.2.1 in the financial report which indicates that the ability of the Company and the Consolidated Group to be able to continue as going concerns is dependent upon securing additional funds.

The matters set out in Note 1.2.1 indicate the existence of a material uncertainty that may cast significant doubt about the Company and Consolidated Group's ability to continue as going concerns and therefore, the Company and the Consolidated Group may be unable to realise their assets and discharge their liabilities in the normal course of business.

## **Report on the Remuneration Report**

We have audited the Remuneration Report included in pages 25 to 39 of the directors' report for the the year ended 30 June 2014. The directors of the company are responsible for the preparation and presentation of the Remuneration Report in accordance with section 300A of the *Corporations Act 2001*. Our responsibility is to express an opinion on the Remuneration Report, based on our audit conducted in accordance with Australian Auditing Standards.

## *Opinion*

In our opinion the Remuneration Report of Carbon Energy Limited for the year ended 30 June 2014, complies with section 300A of the *Corporations Act 2001*.



DELOITTE TOUCHE TOHMATSU



Stephen Stavrou  
Partner  
Chartered Accountants  
Brisbane, 1 August 2014

# Tenement Schedule

As at 30 June 2014

| Tenement Number | Grant date  | Expiry Date | Holder                             | % of interest held | Sub-blocks as at 30 June 2014 |
|-----------------|-------------|-------------|------------------------------------|--------------------|-------------------------------|
| EPC 867         | 18/02/2005  | 17/02/2015  | Carbon Energy (Operations) Pty Ltd | 100%               | 167                           |
| EPC 868         | 18/02/2005  | 17/02/2015  | Carbon Energy (Operations) Pty Ltd | 100%               | 96                            |
| EPC 869         | 14/10/2004  | 13/10/2017  | Carbon Energy (Operations) Pty Ltd | 100%               | 63                            |
| EPC 1132        | 21/07/2007  | 20/06/2019  | Carbon Energy (Operations) Pty Ltd | 100%               | 23                            |
| MLa50253        | Application | -           | Carbon Energy (Operations) Pty Ltd | 100%               | 1,342 ha                      |
| MDL374 +        | 01/02/2008  | 31/01/2013  | Carbon Energy (Operations) Pty Ltd | 100%               | 2,868 ha                      |
| PFL6            |             |             | Carbon Energy (Operations) Pty Ltd | 100%               | 3 ha                          |

+ MDL 374 renewal was submitted on time and has been received by the Department and they are in the process of reviewing it.

## Reserve Statement

The Company's syngas Reserves, reported in accordance with Society of Petroleum Engineers (SPE) guidelines, are:

| Area                    | Category                                  | Gross Gas Volumes (PJ) |
|-------------------------|---|------------------------|
|                         | 1P Reserve (Proven)                       | 11                     |
| Bloodwood Creek MDL 374 | 2P Reserve (Proven + Probable)            | 1,362                  |
|                         | 3P Reserve (Proven + Probable + Possible) | 3,285                  |

These reserve estimates are based on, and fairly represent, information and supporting documentation prepared by Timothy Hower of MHA Petroleum Consultants of Denver, USA. Mr Hower is a member of the Society of Petroleum Engineers and has consented to the use of the reserve estimates and supporting information contained herein, in the form and context in which it appears.

Further, Carbon Energy is not aware of any new information or data that materially affects the reserve information and confirms that all material assumptions and technical parameters underpinning the estimates continue to apply and have not materially changed since reporting that information to the market on 7 November 2013.

# Tenement Schedule

As at 30 June 2014

## Conventional Coal Resources

The Company's Inferred Coal Resources, reported in accordance with Joint Ore Reserves Committee (JORC) guidelines, are:

| Tenure        | Formation                             | Resource (Mt) <sup>22</sup> |
|---------------|---------------------------------------|-----------------------------|
| EPC867*       | Macalister Seam                       | 1448                        |
| EPC868        | Not assessed due to insufficient data | -                           |
| EPC869        | Macalister Seam                       | 449                         |
| EPC1132       | Macalister Seam                       | 132                         |
| <b>Total:</b> |                                       | <b>2,029</b>                |

\*EPC867 excludes resources contained within MDL374

Note: Inferred Resources are conceptual in nature.

Constraints on the Inferred Resources are as follows:

1. Points of observation less than 4km apart and not exceeding 1km past the last data point.
2. Minimum seam thickness of 2m (in aggregate of plys)
3. Maximum stone parting thickness of 0.5m
4. Maximum raw ash of 50%
5. Drill holes classed as valid points of observations were defined as holes where;
  - a. The entire coal seam was cored or, the drillhole contained slimline geophysics,
  - b. Drillhole seam intersection has reasonable stratigraphic correlation

The information in this statement that relates to in situ coal resources potential is based on information compiled by GeoConsult Pty Ltd and Adrian Buck and reviewed by Warwick Smyth, who is a member of the Australasian Institute of Mining and Metallurgy (CP) Geology; and the Australian Institute of Geoscientists. Warwick Smyth is a qualified geologist (BSc Geol, Grad Dip AF&I, MAusIMM (CP), MGSA, MAIG), and a Principal Consultant for GeoConsult Pty Ltd. And has over 20 years experience which is relevant to the style of mineralisation, the type of deposit under consideration and to the activity which has been undertaken to qualify as a Competent Person as defined by the 2012 edition of the Australasian Code for Reporting of Exploration Results, Minerals Resources and Ore Reserves. Warwick Smyth of GeoConsult Pty Ltd has no material interest or entitlement, direct or indirect, in the securities of Carbon Energy or the Projects. GeoConsult has been commissioned to provide geological services to Carbon Energy since late 2012. Fees for the preparation of this report are on a time and materials basis. Warwick Smyth and GeoConsult Pty Ltd consent to the use of this statement and references to it and extracts from it, in the form and context in which they are included. Apart from the above, neither the whole nor any part of the statement document, nor references thereto, may be included in, or with, or attached to any document, circular, resolution, letter or statement without the prior written consent of Warwick Smyth or GeoConsult Pty Ltd.

<sup>22</sup> See announcement 2 April 2013. The Company is not aware of any new information or data that materially affects the included information and all material assumptions and technical parameters underpinning the estimates have not materially changed.

# Shareholder Information

As at 17 July 2014

The shareholder information set out below was applicable as at 17 July 2014.

(a) *Distribution of Share Holdings as at 17 July 2014.*

| Size of Share Holdings    | Number of Shareholders | Shares               | % of issued Capital |
|---------------------------|------------------------|----------------------|---------------------|
| 1 - 1,000                 | 341                    | 165,622              | 0.01%               |
| 1,001 - 5,000             | 1,059                  | 3,192,608            | 0.25%               |
| 5,001 - 10,000            | 802                    | 6,540,161            | 0.52%               |
| 10001 – 50,000            | 1,626                  | 41,666,939           | 3.29%               |
| 50,001 - 100,000          | 554                    | 42,643,404           | 3.37%               |
| 100,001 and over          | 985                    | 1,171,770,873        | 92.56%              |
| <b>Total Shareholders</b> | <b>5,367</b>           | <b>1,265,979,607</b> | <b>100.00%</b>      |

(b) *Of the above total 3,175 Ordinary Shareholders hold less than a marketable parcel.*

(c) *Shareholders in excess of 5% holding are:*

- Kam Lung Investment Development Company Limited holds 171,818,615 ordinary shares.
- Pacific Road Group holds 105,746,535 ordinary shares.
- Citicorp Nominees Pty Limited holds 80,830,929 ordinary shares.
- Incitec Pivot Limited holds 75,556,040 ordinary shares.



# Shareholder Information

As at 17 July 2014

*(d) Distribution of Option Holdings as at 17 July 2014. Listed 6c options expiring 21 July 2016.*

| Size of Option Holdings     | Number of Option Holders | Options            | % of issued Capital |
|-----------------------------|--------------------------|--------------------|---------------------|
| 1 - 1,000                   | 69                       | 42,156             | 0.01%               |
| 1,001 - 5,000               | 258                      | 809,996            | 0.18%               |
| 5,001 - 10,000              | 168                      | 1,319,315          | 0.30%               |
| 10001 – 50,000              | 405                      | 11,470,146         | 2.59%               |
| 50,001 - 100,000            | 143                      | 11,103,153         | 2.50%               |
| 100,001 and over            | 246                      | 418,963,638        | 94.42%              |
| <b>Total Option Holders</b> | <b>1,289</b>             | <b>443,708,404</b> | <b>100.00%</b>      |

*(e) Of the above total, 1,113 Option holders hold less than a marketable parcel.*

*(f) Option holders in excess of 5% holding are:*

- Kam Lung Investment Development Company Limited holds 171,818,615 options.
- Citicorp Nominees Pty Limited holds 50,714,991 options.

*(g) Voting Rights*

The voting rights attached to the ordinary shares are governed by the Constitution. On a show of hand every person present who is a Member or representative of a Member shall have one vote and on a poll, every member present in person or by proxy or by attorney or duly authorized representative shall have one vote for each share held. None of the options have any voting rights.

*(h) Other Information*

1. The name of the Company Secretary is Ms Tracy Bragg.
2. The address of the principal registered office in Australia is Level 9, 301 Coronation Drive, Milton, Brisbane, Queensland 4064, Telephone +61 7 3156 7777.
3. The register of securities is held at; Link Market Services Limited, Level 12, 680 George Street, Sydney NSW 2000, Telephone +61 2 8280 7001.
4. Stock Exchange Listing Quotation has been granted for all the ordinary share of the Company on all Member Exchanges of the Australian Stock Exchange Limited, and trade under the symbol CNX.
5. Quotation has also been granted for all the ordinary shares of the Company on the Berlin and Frankfurt Stock Exchange (Third Market).
6. Detailed schedules of exploration and mining tenements held are included in the tenement schedule.
7. Directors' interest in share capital are disclosed in the Directors Report.
8. Unquoted Securities – Details of the 194,299,487 unlisted options on issue are detailed in Note 36.
  - 8.1 Credit Suisse holds options of 61,728,395 representing 32% of the unlisted options on issue.
  - 8.2 Pacific Road Group holds options of 44,645,845 representing 23% of the unlisted options on issue.
  - 8.3 Mr Morné Engelbrecht, Managing Director holds options of 71,854,543 representing 37% of unlisted options on issue.

# Shareholder Information

As at 17 July 2014

## Twenty Largest Shareholders

| Shareholders (Fully Paid Ordinary)                     | Number of Shares     | %              |
|--|----------------------|----------------|
| Kam Lung Investment Development Company Limited        | 171,818,615          | 13.57%         |
| Pacific Road   | 105,746,535          | 8.35%          |
| Citicorp Nominees Pty Limited                          | 80,830,929           | 6.38%          |
| Incitec Pivot Limited                                  | 75,556,040           | 5.97%          |
| Lujeta Pty Ltd   | 40,426,874           | 3.19%          |
| CSIRO  | 28,346,389           | 2.24%          |
| Lomacott Pty Ltd                                       | 24,000,000           | 1.90%          |
| Mr Ross Francis Stanley                                | 22,875,000           | 1.81%          |
| Twynam Agricultural Group Pty Ltd                      | 19,594,023           | 1.55%          |
| JP Morgan Nominees Australia Limited                   | 15,130,718           | 1.20%          |
| Mr Clifford William Mallett + Mrs Wendy Justin Mallett | 11,204,975           | 0.89%          |
| Mr Anthony James George                                | 10,000,000           | 0.79%          |
| Pebet Pty Limited                                      | 10,000,000           | 0.79%          |
| Bridgelane Capital Pty Ltd                             | 9,500,000            | 0.75%          |
| National Nominees Limited                              | 9,118,620            | 0.72%          |
| Computer Visions Pty Ltd                               | 8,950,000            | 0.71%          |
| Mr Anthony Robert Davison                              | 7,832,000            | 0.62%          |
| Mitchell Family Investments (QLD) Pty Ltd              | 7,760,000            | 0.61%          |
| Mr Kaushik Biyani                                      | 7,298,919            | 0.58%          |
| Jurrah Investments Pty Ltd                             | 6,949,870            | 0.55%          |
| Invia Custodian Pty Limited                            | 6,850,000            | 0.54%          |
| <b>Top 20 Shareholders</b>                             | <b>679,789,507</b>   | <b>53.70%</b>  |
| <b>TOTAL ISSUED SHARES as at 17 July 2014</b>          | <b>1,265,979,607</b> | <b>100.00%</b> |

# Shareholder Information

As at 17 July 2014

## Twenty Largest Listed Option Holders (expiring 21 July 2016)

| Option Holders (Fully Paid Ordinary)                    | Number of Options  | %              |
|---|--------------------|----------------|
| Kam Lung Investment Development Company Limited         | 171,818,615        | 38.72%         |
| Citicorp Nominees Pty Limited                           | 50,714,991         | 11.43%         |
| Lomacott Pty Ltd  | 15,000,000         | 3.38%          |
| Archerfield Holdings                                    | 11,563,649         | 2.61%          |
| J P Morgan Nominees Australia Limited                   | 9,002,630          | 2.03%          |
| Mr Peter Andrew Proksa                                  | 8,700,000          | 1.96%          |
| Jetosea Pty Ltd   | 5,709,500          | 1.29%          |
| Mr Fuat Goksen Yurugor                                  | 5,020,000          | 1.13%          |
| P K Plan A Pty Ltd                                      | 4,000,000          | 0.90%          |
| Invia Custodian Pty Limited                             | 3,950,000          | 0.89%          |
| Mr Ross Francis Stanley                                 | 3,750,000          | 0.85%          |
| Mrs Kristin Eileen Franco                               | 3,450,000          | 0.78%          |
| Patocoa Nominees Pty Ltd                                | 3,241,000          | 0.73%          |
| Mr Clifford William Mallett + Mrs Wendy Justine Mallett | 3,175,487          | 0.72%          |
| North Of The River Investments Pty Ltd                  | 3,000,000          | 0.68%          |
| Computer Visions Pty Ltd                                | 2,650,000          | 0.60%          |
| Mr John William Evans                                   | 2,400,000          | 0.54%          |
| Dr Louis Xavier Whitehead                               | 2,343,255          | 0.53%          |
| Mr Mark John Turner                                     | 2,333,332          | 0.53%          |
| C & I Smith Pty Ltd                                     | 2,200,000          | 0.50%          |
| <b>Top 20 Option Holders</b>                            | <b>314,022,459</b> | <b>70.77%</b>  |
| <b>TOTAL LISTED OPTIONS as at 17 July 2014</b>          | <b>443,708,404</b> | <b>100.00%</b> |

# Corporate Directory

## Directors

**Dr Chris Rawlings**  
Non-Executive Chairman  
**Mr Morné Engelbrecht**  
Managing Director & Chief Executive Officer  
**Mr Max Cozijn**  
Non-Executive Director  
**Dr Helen Garnett**  
Non-Executive Director  
**Mr Peter Hogan**  
Non-Executive Director  
**Mr Louis Rozman**  
Non-Executive Director

## Executive Management Team

**Morné Engelbrecht**  
Managing Director & Chief Executive Officer  
**Catherine Costello**  
Chief Financial Officer  
**Dr Cliff Mallett**  
Technical Director  
**Tracy Bragg**  
General Counsel & Company Secretary  
**Justin Haines**  
General Manager Technical Services  
**Terry Moore**  
General Manager Operations

## Carbon Energy Limited

ABN 56 057 552 137

ASX Code: **CNX**

## Registered & Principal Office

Level 9, 301 Coronation Drive  
MILTON QLD 4064  
Telephone: + 617 3156 7777  
Facsimile: +617 3156 7776  
Email: askus@carbonenergy.com.au

### Postal Address:

PO Box 2118  
TOOWONG DC QLD 4066

## Share Registry

### Link Market Services Limited

Level 12  
680 George Street  
Sydney NSW 2000

## Solicitors

### HopgoodGanim

Level 8  
Waterfront Place  
1 Eagle Street  
BRISBANE QLD 4000

## Annual General Meeting

The Annual General Meeting of Carbon Energy Limited will be held at Queensland Art Gallery, Gallery of Modern Art (GOMA) Cinema B Stanley Place, Southbank, QLD 4101 at 10:00am on Thursday, 20th November 2014

[www.carbonenergy.com.au](http://www.carbonenergy.com.au)



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