HALF YEARLY REPORT

FOR THE PERIOD ENDED 31 DECEMBER 2017

carbonenergy

CONTENTS

DIRECTORS' REPORT

BOARD INFORMATION

The Directors of Carbon Energy Limited (Company) present their report together with the consolidated financial statements of the Consolidated Group, being the Company and its controlled entities, for the half-year ended 31 December 2017.

DIRECTORS

The names of Directors of the Company who held office during and since the end of the half-year period are:

Mr Peter Hogan	Chairman and Non-Executive Director
Mr George Su	Non-Executive Director
	Interim Executive Director (from 19 July 2017)
Mr Huihai Zhuang	Non-Executive Director
Mr Bryan O'Donnell	Chief Executive Officer and Managing Director (from 2 January 2018 and 8 January 2018 respectively)

PRINCIPAL ACTIVITIES

The principal activities of the Consolidated Group during the half-year period are:

- To progress the Beijing JinHong New Energy Co. Ltd joint venture.
- To license *keyseam*® technology internationally.
- To establish *keyseam*® as the underground coal gasification (UCG) technology of choice for UCG projects worldwide.
- To continue to prove and improve its proprietary UCG technology, *keyseam*®.

CONSOLIDATED RESULT

The Consolidated Group recorded a net loss after tax of $2,273,888 for the half-year ended 31 December 2017 (2016: net loss after tax of $36,932,631). The net loss after tax includes a $3,668,770 unrealised loss on fair value of financial dertivatives and a $3,712,241 gain recognised upon settlement of the Pacific Road Convertible Note Facility.

Other key financial results for the period are:

- Total revenue and other income of $4,020,649 which includes $3,712,241 gain recognised upon settlement of the Pacific Road Convertible Note Facility (2016: $1,463,275);
- Net assets of $343,340 (30 June 2017: net liabilities of $1,042,279); and
- Cash and cash equivalents of $1,642,419 (30 June 2017: $79,435).

REVIEW OF OPERATIONS

The Consolidated Group's operations are based around its UCG projects and business development opportunities.

Significant events during the period are as follows:

- The Company held its 2016 Annual General Meeting (AGM) on 18 July 2017, whereby shareholders passed all resolutions, including the approval of the recapitalisation transactions contemplated under the Amended Deed of Company Arrangement (DOCA) and the consolidation of share capital. All conditions precedent provided for under the DOCA was subsequently satisfied and the DOCA completion was achieved. The Company completed its 1:100 share consolidation on 24 July 2017. Further details are provided in the section below.
- On commencement of trading on 26 July 2017, the suspension of trading in the Company's securities was lifted by the ASX.
- Correspondence was received by the Company from Ferrier Hodgson (with reference to the appointment of Will Colwell and Tim Michael as Voluntary Administrators on 22 November 2016, Deed Administrators on 9 March 2017 and Trustees of the Carbon Energy Creditors' Trust on 20 July 2017), advising that the priority dividend to creditors was declared and paid on 13 September 2017 and a first and final dividend to unsecured creditors was declared and paid on 18 September 2017. All matters in respect of the Voluntary Administration, DOCA and Creditors' Trust are now finalised and the termination of the Creditors' Trust occurred on 23 October 2017.
- The Company held its 2017 AGM on 29 November 2017, whereby shareholders passed all resolutions.
- The Company announced the achievement of a key milestone by the Beijing JinHong New Energy Co. Ltd joint venture between the Consolidated Group and its partner Beijing JinHong Investment Co. Ltd (JinHong Joint Venture). The Kulen coal deposit located at the Mori (Mulei) County, Changji, Xinjiang, China has been selected for the continued development of a commercial demonstration project using the Consolidated Group's *keyseam*® technology for underground coal gasification (Mori UCG Project). Geotechnical modelling for the Mori UCG Project and UCG process model were completed by the end of 2017 and provided the underlying design criteria for the development of the initial Process Characterisation Panel to verify the predicted syngas quality and develop the configuration of panels to support a commercial UCG project in the coal deposit.
- The Company welcomed a number of appointments during the period:
  - Mr George Su was appointed Interim Executive Director from 19 July 2017;
  - Mr Ian Morgan was appointed as Company Secretary from 31 July 2017; and
  - Ms Ye-Fei Guo was appointed as Chief Financial Officer and joint Company Secretary, effective from 22 August 2017 and 5 October 2017 respectively.
- The Exploration Permit for Coal tenements were granted when the Consolidated Group's exploration goal was to find and characterise a coal resource suitable for a commercial UCG project in Queensland. On 24 August 2017, the Queensland Parliament passed legislation which places a moratorium on all activities relating to UCG through the Mineral Resources Act 1989. The Consolidated Group has reached a decision that continued development of the EPC tenements no longer aligns with the Consolidated Group's strategic direction. The Consolidated Group has been in contact with relevant Departments of the Queensland Government to commence the 'surrender' process for all EPC tenements. MDL374 tenement will be retained to enable the rehabilitation activities at the Bloodwood Creek site to continue.

REVIEW OF OPERATIONS (CONTINUED)

Completion of DOCA and recapitalisation transactions

As noted, the Company held its 2016 AGM on 18 July 2017, whereby shareholders passed all resolutions, including the approval of the recapitalisation transactions contemplated under the DOCA.

As part of the recapitalisation, the Company:

- entered into a secured convertible note facility with Kam Lung Investment Development Co Ltd (Kam Lung) whereby convertible notes totalling $9.2 million were issued (Kam Lung Convertible Note Facility);
- entered into a secured uncommitted cash advance facility, up to an aggregate limit of $5.0 million, with Kam Lung (Kam Lung Cash Advance Facility), which remains undrawn at the half-year ended 31 December 2017;
- entered into a $1.0 million unsecured loan facility with Pacific Road Capital A Pty Limited, Pacific Road Capital B Pty Ltd and Pacific Road Capital Management G.P. Limited (Pacific Road Group) (Pacific Road Loan Facility); and
- received $3.85 million consideration from Kam Lung for the issue of 4,679,911,281 ordinary fully paid shares in the Company (prior to the Company undertaking a 1:100 share consolidation on 24 July 2017).

Proceeds from the above were used by the Company to fund a number of transactions, including:

- the release and discharge of the Pacific Road Convertible Note Facility which matured on 18 January 2017 for $7 million;
- the repayment of $1.94 million to Kam Lung for $1.74 million of short-term interim funding and the $200,000 Administrators Indemnity Amount (as defined in the DOCA) previously made available by Kam Lung to the Company;
- the payment of $300,000 into a creditors' trust for the benefit of eligible creditors of the Deed Companies (as defined in the DOCA) whose claims will be released by the DOCA; and
- the settlement of various associated outstanding fees and costs.

All conditions precedent provided for under the DOCA were subsequently satisfied and DOCA completion was achieved.

EVENTS SUBSEQUENT TO THE REPORTING DATE

Subequent to the half-year ended 31 December 2017:

- The Company welcomed the appointment of Bryan O'Donnell as Chief Executive Officer and Managing Director, effective from 2 January 2018 and 8 January 2018 respectively.

- In January 2018, the Company received $1.0 million as a research and development (R&D) tax incentive rebate (inclusive of interest) from the Australian Taxation Office (ATO) for eligible R&D expenditure incurred in the prior 2017 financial year.

AUDITOR'S INDEPENDENCE DECLARATION

The auditor's independence declaration under section 307C of the *Corporation Act 2001* is set out on page 7 and forms part of the Directors' Report for the half- year ended 31 December 2017.

This report is signed in accordance with a resolution of the Board of Directors made pursuant to s.306(3) of the *Corporations Act 2001*.

On behalf of the Directors:

Peter A. Hogan

Peter Hogan

Chairman

Brisbane, Queensland
28 February 2018

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Auditor's Independence Declaration to the Directors of Carbon Energy Limited

In accordance with the requirements of section 307C of the *Corporations Act 2001*, as lead auditor for the review of Carbon Energy Limited for the half-year ended 31 December 2017. I declare that, to the best of my knowledge and belief, there have been:

a No contraventions of the auditor independence requirements of the *Corporations Act 2001* in relation to the review; and

b No contraventions of any applicable code of professional conduct in relation to the review.

Grant Thornton

Grant Thornton Audit Pty Ltd
Chartered Accountants

Cameron Smith

CDJ Smith
Partner - Audit & Assurance

Brisbane, 28 February 2018

CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME

FOR THE HALF-YEAR ENDED 31 DECEMBER 2017

		CONSOLIDATED GROUP	
		Half-year ended	
	Notes	Dec'17 $	Dec'16 $
Revenue and other income			
Technology service fee revenue		163,935	-
Other income	3	3,856,714	1,463,275
Total revenue and other income		**4,020,649**	**1,463,275**
Employee benefits expense	4	(845,154)	(1,370,438)
Administration, legal and corporate costs		(677,181)	(620,456)
Consultancy costs		80,894	(95,477)
Operating expenditure		(143,378)	(158,525)
Depreciation expense		(47,805)	(72,728)
Finance costs	4	(993,143)	(1,567,091)
Movement in fair value of derivatives	6	(3,668,770)	-
Impairment expense	4	-	(34,511,191)
Loss before income tax expense		**(2,273,888)**	**(36,932,631)**
Income tax expense		-	-
Loss for the period		**(2,273,888)**	**(36,932,631)**
Other comprehensive income for the period (net of tax)		**-**	**-**
Tota loss and comprehensive income for the period		**(2,273,888)**	**(36,932,631)**
Loss attributable to owners of the parent		**(2,273,888)**	**(36,932,631)**
Total loss and comprehensive income attributable to owners of the parent		**(2,273,888)**	**(36,932,631)**
Basic loss per share (cents per share)		(0.20)	(204.5)[1]
Diluted loss per share (cents per share)		(0.20)	(204.5)[1]

[1] The Dec'16 loss per share has been restated to reflect the Share Consolidation (1:100) completed on 24 July 2017.

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

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

AS AT 31 DECEMBER 2017

		CONSOLIDATED GROUP	
	Notes	Dec'17 $	Jun'17 $
Assets			
Current Assets			
Cash and cash equivalents		1,642,419	79,435
Trade and other receivables		1,451,675	1,287,204
Other current assets		219,539	69,140
Total Current Assets		**3,313,633**	**1,435,779**
Non-Current Assets			
Trade and other receivables		272,784	244,553
Property, plant & equipment		563,004	610,809
Intangible assets		13,536,045	13,509,367
Other non-current assets		232,067	-
Total Non-Current Assets		**14,603,900**	**14,364,729**
Total Assets		**17,917,533**	**15,800,508**
Liabilities			
Current Liabilities			
Trade and other payables		676,005	1,566,301
Loans and borrowings		-	1,710,000
Financial liabilities	5	1,000,000	10,000,000
Provisions		993,091	1,228,679
Total Current Liabilities		**2,669,096**	**14,504,980**
Non Current Liabilities			
Trade and other payables		451,246	-
Provisions		2,512,299	2,337,807
Financial liabilites	5	5,772,782	-
Financial derivatives	6	6,168,770	-
Total Non Current Liabilities		**14,905,097**	**2,337,807**
Total Liabilities		**17,574,193**	**16,842,787**
Net Assets		**343,340**	**(1,042,279)**
Equity			
Issued capital	7	248,390,911	244,731,404
Reserves		20,003,591	20,003,591
Accumulated losses		(268,051,162)	(265,777,274)
Total Equity		**343,340**	**(1,042,279)**

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

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

FOR THE HALF-YEAR ENDED 31 DECEMBER 2017

	Issued Capital $	Options Reserve $	Share-Based Payments Reserve $	Other Reserve $	Accumulated Losses $	Total $
Balance at 1 Jul 2016	244,226,148	1,650,406	16,251,613	2,101,590	(226,452,315)	37,777,442
Shares issued during the period	526,339	-	-	-	-	526,339
Transaction Costs	(21,083)	-	-	-	-	(21,083)
Exercise of options	-	(18)	-	-	-	(18)
Losses attributable to member of parent entity	-	-	-	-	(36,932,631)	(36,932,631)
Balance at 31 Dec 2016	**244,731,404**	**1,650,388**	**16,251,613**	**2,101,590**	**(263,384,946)**	**1,350,049**
Balance at 1 Jul 2017	244,731,404	1,650,388	16,251,613	2,101,590	(265,777,274)	(1,042,279)
Shares issued during the period	3,850,000	-	-	-	-	3,850,000
Transaction Costs	(190,493)	-	-	-	-	(190,493)
Losses attributable to member of parent entity	-	-	-	-	(2,273,888)	(2,273,888)
Balance at 31 Dec 2017	**248,390,911**	**1,650,388**	**16,251,613**	**2,101,590**	**(268,051,162)**	**343,340**

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

CONSOLIDATED CASH FLOW STATEMENT

FOR THE HALF-YEAR ENDED 31 DECEMBER 2017

	CONSOLIDATED GROUP Half-year ended	
	Dec'17 $	Dec'16 $
Cash flows from operating activities		
Payments to suppliers and employees	(2,875,522)	(3,161,826)
Receipt of government grants	-	1,384,419
Interest received	19,757	35,228
Other receipts	121,485	42,153
Net cash flows used in operating activities	**(2,734,280)**	**(1,700,026)**
Cash flows from investing activities		
Payments for property, plant and equipment	-	(59,444)
Payments for intangible assets	(31,319)	(14,994)
Payments for environmental bonds	-	(500)
Net cash flows used in investing activities	**(31,319)**	**(74,938)**
Cash flows from financing activities		
Proceeds from issues of shares	3,850,000	400,000
Proceeds from issue of convertible notes	8,300,000	-
Proceeds from borrowings	1,230,000	-
Repayment of borrowings	(8,940,000)	-
Capital raising and financing costs	(111,417)	(21,084)
Net cash flows provided by financing activities	**4,328,583**	**378,916**
Net increase in cash and cash equivalents held	**1,562,984**	**(1,396,048)**
Cash and cash equivalents at the beginning of the period	79,435	2,208,071
Effects of exchange rates changes on cash and cash equivalents	-	92
Cash and cash equivalents at the end of the period	**1,642,419**	**812,115**

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES

The consolidated interim financial report for the half-year ended 31 December 2017 comprises that of the Consolidated Group, being Carbon Energy Limited (Company) and its controlled entities. Carbon Energy Limited is a listed public company, incorporated and domiciled in Australia.

1.1 Statement of Compliance

The consolidated interim financial report is a general purpose financial report prepared in accordance with the *Corporations Act 2001* and AASB 134 *Interim Financial Reporting* (AASB 134). Compliance with AASB 134 ensures compliance with International Financial Reporting Standard IAS 34 *Interim Financial Reporting*. The consolidated interim financial report does not include notes of the type normally included in an annual financial report and should be read in conjunction with the most recent annual financial report for the year ended 30 June 2017 and any public announcements made by the Company during the half-year period in accordance with the continuous disclosure requirements of the *Corporations Act 2001*. For the purpose of preparing the consolidated financial statements, the Company is a for profit entity.

1.2 Basis of Preparation

The consolidated interim financial report is presented in Australian dollars, which is the Company's presentation and functional currency.

The accounting policies and methods of computation adopted in the preparation of the consolidated interim financial report are consistent with those adopted and disclosed in the Company's 2017 annual financial report for the year ended 30 June 2017, except for the impact of the Standards and Interpretations described below. These accounting policies are consistent with Australian Accounting Standards and with International Financial Reporting Standards.

1.3 Amendments to AASBs and the new Interpretation that are mandatorily effective for the current reporting period

The Consolidated Group has adopted all new and revised Standards and Interpretations issued by the Australian Accounting Standards Board (the AASB) that are relevant to its operations and effective for the half-year ended 31 December 2017. The adoption of these new and revised Standards and Interpretations did not have any material financial impact on the amounts recognised in the financial statements of the Consolidated Group.

1.4 Going Concern

The consolidated interim financial report for the half-year ended 31 December 2017 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.

The Company held its 2016 Annual General Meeting (AGM) on 18 July 2017, whereby shareholders passed all resolutions, including the approval of the recapitalisation transactions contemplated under the Amended Deed of Company Arrangement (DOCA) and the consolidation of share capital.

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

1.4 Going Concern (continued)

The ability to continue as a going concern is also dependent on securing funds from a range of sources and opportunities including:

- receipt of the research and development (R&D) tax incentive rebates (refer to Note 10 Events Subsequent to the Reporting Date for details of amount received in January 2018);
- receipt of fees for services provided to the Beijing JinHong New Energy Co. Ltd joint venture in China (JinHong Joint Venture); and
- further licensing and services relating to the Company's keyseam® UCG technology.

Factors which can influence these opportunities include, but are not limited to, progress of current development and licensing activities 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 Consolidated Group not receive the forecast cash inflows, there are material uncertainties as to whether the Consolidated Group will be able to continue as a going concern and therefore whether it will realise its assets and extinguish its liabilities in the normal course of business and at the amounts stated in the interim financial report.

The interim 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 Consolidated Group not continue as a going concern.

NOTE 2 – SEGMENT INFORMATION

The Consolidated Group operates in one segment, being provision of technical services to the clean energy and chemical feedstock industries through the extraction of 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.

NOTE 3 – REVENUE AND OTHER INCOME

	CONSOLIDATED GROUP	
	Dec'17 $	**Dec'16 $**
Other Income		
Government grants	-	1,384,419
Interest received	19,795	22,269
Net gain on settlement of Pacific Road Convertible Note Facility[1]	3,712,241	-
Other income	124,678	56,587
	3,856,714	**1,463,275**

[1] Refer to Note 5(b) Financial Liabilities – Pacific Road Convertible Note Facility for further information.

NOTE 4 – EXPENSES

	CONSOLIDATED GROUP	
	Dec'17 $	**Dec'16 $**
Impairment expense		
UCG Intangible asset	-	34,511,191
	-	**34,511,191**
Employment expenses		
Remuneration and on-costs	793,184	1,268,417
Superannuation expenses	51,970	102,021
	845,154	**1,370,438**
Finance costs		
Interest expense	394,341	253,800
Finance facility fees	451,246	-
Pacific Road Convertible Note Facility accretion expense	-	719,561
Kam Lung Convertible Note Facility accretion expense	140,865	-
Rehabilitation provision accretion expense	-	27,286
Refinancing expenses	-	567,475
Other	6,691	(1,031)
	993,143	**1,567,091**
Operating lease rental expense	**215,168**	**206,375**

NOTE 5 – FINANCIAL LIABILITIES

		CONSOLIDATED GROUP	
	Notes	**Dec '17 $**	**Jun '17 $**
Current			
Pacific Road Loan Facility	5(a)	1,000,000	-
Pacific Road Convertible note facility	5(b)	-	10,000,000
		1,000,000	**10,000,000**
Non-Current			
Kam Lung Convertible Note Facility – debt component	5(c)	5,772,782	**-**
		5,772,782	**-**
TOTAL FINANCIAL LIABILITIES		**6,772,782**	**10,000,000**

(a) Pacific Road Loan Facility

The Company has entered into a $1 million unsecured loan facility with the Pacific Road Group, which is interest free and shall be repayable upon the satisfaction of various conditions. The repayment of this loan is guaranteed by Kam Lung. If Kam Lung is required to make any payment in its capacity as guarantor under the Pacific Road Loan Facility, that payment will be a deemed advance under the Kam Lung Cash Advance Facility.

NOTE 5 – FINANCIAL LIABILITIES (CONTINUED)

(b) Pacific Road Convertible Note Facility

The release and discharge of the Pacific Road Convertible Note Facility, which matured on 18 January 2017, was settled by the Company in July 2017 for $7 million. Net gain on settlement of $3,712,241 is recognised in Profit or Loss and Note 3 Revenue and Other Income.

(c) Kam Lung Convertible Note Facility

In July 2017, the Company entered into a secured convertible note facility with Kam Lung, whereby convertible notes totalling $9.2 million were issued. Interest accrues at 8% per annum and is settled in cash or, subject to election, be capitalised to the outstanding principal or converted into shares or a combination of both. The Company must redeem each note on the maturity date, being the date that is 5 years from the issue of the notes. Notes may be converted, upon election by the noteholder, at any time on or after the first anniversary of the issue date.

The Kam Lung Convertible Note Facility has been classified in the financial statements as having two components – a host debt component and an embedded derivative component.

The host debt component represents a financial liability to the Consolidated Group and includes the impact of associated transaction costs. The host debt component is subsequently recorded at amortised cost using the effective interest method and unwinds over its life upon which, at maturity, the financial liability will equate to the face value of the $9.2 million of convertible notes outstanding plus any accrued interest capitalised to the convertible notes balance.

The embedded derivative component represents the conversion option within the Kam Lung Convertible Note Facility. Note 6 Financial Derivatives provides further information.

(d) Kam Lung Cash Advance Facility

In July 2017, the Company entered into a secured uncommitted cash advance facility, up to an aggregate limit of $5,000,000, which remains undrawn at the half-year ended 31 December 2017. Interest accrues at 8% per annum or if the parties so agree, the aggregate of BBSY in relation to the interest period for that advance and the 5.5% per annum margin. Interest may be capitalised or cash settled. The facility terminates on the fifth anniversary of the completion date under the DOCA.

NOTE 6 – FINANCIAL DERIVATIVES

	CONSOLIDATED GROUP	
	Dec '17 $	**Jun '17 $**
Kam Lung Convertible Note Facility – embedded derivative component	6,168,770	-
TOTAL FINANCIAL DERIVATIVES	**6,168,770**	**-**

The Kam Lung Convertible Note Facility has been classified in the financial statements as having two components – a host debt component and an embedded derivative component. The embedded derivative component represents the conversion option within the Kam Lung Convertible Note Facility and is recognised as separate financial instrument in the financial statements.

The options are valued at fair value using the Black Scholes option pricing model and unrealised movements to the fair value have been taken to the profit or loss during the period.

NOTE 6 – FINANCIAL DERIVATIVES (CONTINUED)

A reconciliation of the fair value liability is provided below:

	CONSOLIDATED GROUP
	Dec '17 $
Financial derivatives – initial fair value liability	2,500,000
Movement in fair value of derivatives	3,668,770
Financial derivatives – closing fair value liability	**6,168,770**

The Consolidated Group is required to disclose fair value measurements by level of fair value hierarchy and has classified the financial derivatives as level 2. This represents financial instruments that are not traded in an active market and whose fair value are determined using valuation techniques that maximise the use of observable market data where it is available.

NOTE 7 – ISSUES OF EQUITY INSTRUMENTS

Ordinary shares

	Dec '17 No. of shares	Dec '17 $	Jun '17 No. of shares	Jun '17 $
Shares capital				
Opening balance	1,813,428,879	244,731,404	1,775,730,120	244,226,148
Interest costs in relation to drawdown of Tranche A and Tranche B (Pacific Road convertible note facility)	-	-	6,924,582	126,027
Shares Issued (Kam Lung Convertible Notes)	4,679,911,281	3,850,000	-	-
Share Consolidation (1:100)	(6,428,406,645)	-	-	-
Exercise of listed options	-	-	4,945	312
Renounceable Rights Issue	-	-	30,769,232	400,000
Share issue costs	-	(190,493)	-	(21,083)
Closing balance	**64,933,515**	**248,390,911**	**1,813,428,879**	**244,731,404**

Ordinary Shares

On 19 July 2017, the Company issued 4,679,911,281 of ordinary fully paid shares to Kam Lung as part of the DOCA process.

On 24 July 2017, the Company completed its 1:100 share consolidation.

On commencement of trading on 26 July 2017, the suspension of trading in the Company's securities was lifted by the ASX.

Listed Options

There are no listed options on issue as at the half-year ended 31 December 2017. In the prior year ended 30 June 2017, the remaining listed options on issue expired without being exercised.

NOTE 7 – ISSUES OF EQUITY INSTRUMENTS (CONTINUED)

Unlisted Options and Performance Rights

There are no unlisted options on issue or performance rights granted as at the half-year ended 31 December 2017. All residual unlisted options on issue at prior year ended 30 June 2017 were cancelled or expired during the current half-year period. Options with respect to the embedded derivative component of the Kam Lung Convertible Note Facility is detailed in Note 6 Financial Derivatives.

NOTE 8 – RELATED PARTY TRANSACTIONS

Key Management Personnel

During the half-year ended 31 December 2017 and subsequent to year end, the following appointments were made to the Company:

- Mr George Su was appointed Interim Executive Director from 19 July 2017;
- Mr Ian Morgan was appointed as Company Secretary from 31 July 2017;
- Ms Ye-Fei Guo was appointed as Chief Financial Officer and joint Company Secretary, effective from 22 August 2017 and 5 October 2017 respectively; and
- Mr Bryan O'Donnell was appointed Chief Executive Officer and Managing Director, effective from 2 January 2018 and 8 January 2018 respectively.

Ms Catherine Costello completed her role as Chief Financial Officer and Company Secretary in July 2017 and Mr Terry Moore resigned as General Manager, Operations effective September 2017.

Shares and Other Transactions

As part of the DOCA process, the Company:

- entered into the Kam Lung Convertible Note Facility with Kam Lung;
- entered into the Kam Lung Cash Advance Facility with Kam Lung;
- entered into the Pacific Road Loan Facility with the Pacific Road Group;
- issued 4,679,911,281 ordinary fully paid shares in the Company to Kam Lung;
- settled the release and discharge of the Pacific Road Convertible Note Facility which matured on 18 January 2017; and
- repaid to Kam Lung the short-term interim funding and Administrators Indemnity Amount (as defined in the DOCA) previously made available by Kam Lung to the Company.

As a result, Kam Lung ownership in the Company increased to 80%. Mr Huihai Zhuang (Non-Executive Director of the Company) holds a Directorship and shares in Kam Lung.

Refer to Note 6 Financial Liabilities and Note 7 Issue of Equity Instruments for further information.

NOTE 9 – COMMITMENTS, CLAIMS, GUARANTEES, CONTINGENT ASSET, CONTINGENT LIABILITIES & CREDIT FACILITIES

(a) Exploration Commitments

The Exploration Permit for Coal tenements were granted when the Consolidated Group's exploration goal was to find and characterise a coal resource suitable for a commercial UCG project in Queensland. On 24 August 2017, the Queensland Parliament passed legislation which places a moratorium on all activities relating to UCG through the Mineral Resources Act 1989. The Consolidated Group has reached a decision that continued development of the EPC tenements no longer aligns with the Consolidated Group's strategic direction. The Consolidated Group has been in contact with relevant Departments of the Queensland Government to commence the 'surrender' process for all EPC tenements.

NOTE 9 – COMMITMENTS, CLAIMS, GUARANTEES, CONTINGENT ASSET, CONTINGENT LIABILITIES & CREDIT FACILITIES (CONTINUED)

(a) Exploration Commitments (continued)

MDL374 tenement will be retained to enable the rehabilitation activities at the Bloodwood Creek site to continue. A provision for rehabilitation liability continues to be provided for in the financial statements.

(b) Operating Lease Commitment

	CONSOLIDATED GROUP	
	Dec '17 $	**Jun '17 $**
Non-cancellable operating leases contracted for but not capitalised in the financial statements		
• not later than one year	440,472	429,931
• later than one year but not later than five years	38,824	256,072
TOTAL OPERATING LEASE COMMITMENTS	**477,296**	**686,003**
FUTURE MINIMUM SUBLEASE PAYMENTS EXPECTED TO BE RECEIVED	**(159,418)**	**(231,198)**

The Consolidated Group leases assets for office premises. The lease has a life of 13 months.

The lease for the Company's 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.

The Company entered into a lease agreement to sublet part of its Brisbane office lease. The sublease commenced on 1 August 2016 and expires on 30 January 2019. Rent increases are set at a 4% increase per annum.

(c) Claims of Native Title and Cultural Heritage

Mineral exploration

Native title claims may be made in accordance with the Native Title Act 1993 (NTA) 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. Where a tenement covers land over which native title has been extinguished, no native title process is applicable.

Exploration and UCG

A Cultural Heritage Management Plan (CHMP) was developed in partnership with the Aboriginal traditional owners of the lands the subject of the UCG demonstration trial and lapsed during the period ended 31 December 2017. The CHMP was registered under the provisions of the Aboriginal Cultural Heritage Act and ensured that there was 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 the Consolidated Group. The Consolidated Group has been in contact with relevant Departments of the Queensland Government to commence the 'surrender' process for all EPC tenements. The MDL374 tenement will be retained to enable the rehabilitation activities at the Bloodwood Creek site to continue and is not expected to cause any additional ground disturbances.

NOTE 9 – COMMITMENTS, CLAIMS, GUARANTEES, CONTINGENT ASSET, CONTINGENT LIABILITIES & CREDIT FACILITIES (CONTINUED)

(d) Bank Guarantees

	CONSOLIDATED GROUP	
	Dec '17 $	**Jun '17 $**
Bank credit facility (secured by cash term deposits)	10,000	-
Amount utilised at period end	(5,755)	-
Unused Bank Credit Facility	**4,245**	**-**
Interest rates on these credit facilities are variable and subject to adjustment.		
Bank Guarantees in relation to Environmental bonds	20,640	20,640
Bank Guarantee in relation to the entity's share of guarantee for Lease of office premises	181,912	181,912

The Consolidated Group also has a number of security deposits held by suppliers. These continue to be recorded in the financial statements.

(e) Contingent Liabilities

Summa Resources Holdings LLC (Summa)

As announced to the market on 25 November 2015, the Company was served with proceedings filed by Summa Resource Holdings LLC (Summa) against it in the United States District Court for the Northern District of California (the Complaint). On 6 May 2016 the Court dismissed the Complaint on the basis of forum non conveniens without the need for a hearing.

When the Company entered Voluntary Administration on 22 November 2016, Summa submitted a proof of debt to the Administrators totalling US$9 million in relation to a claim pursuant to a share sale agreement dated February 2011 between Summa and the Company. After correspondence between Summa and the Administrators, the Administrators determined that, in their opinion, Summa's claim was a "subordinate claim" against the Company within the meaning of Section 563A of the Corporations Act.

In general terms, creditors who have subordinate claims are postponed until all other debts payable by, and claims against, the Company have been satisfied. That is, subordinate creditors are placed last on the priority ladder. The DOCA provided that there was insufficient consideration available to fully repay unsecured creditors and accordingly insufficient funds were available to make any payment to subordinate creditors.

On approval of the DOCA, all unsecured claims against the Company which existed as at the date of appointment of the administrators were released in return for a right to participate in the trust fund established under the DOCA. This included any claim that Summa asserts against the Company.

Additional details on Summa's claim are provided in the financial statements for the year ended 30 June 2017.

(f) Other Credit Facilities

Refer to Note 5 Financial Liabilities for further information.

NOTE 10 – EVENTS SUBSEQUENT TO THE REPORTING DATE

Subequent to the half-year ended 31 December 2017:

- The Company welcomed the appointment of Bryan O'Donnell as Chief Executive Officer and Managing Director, effective from 2 January 2018 and 8 January 2018 respectively.
- In January 2018, the Company received $1.0 million as a R&D tax incentive rebate (inclusive of interest) from the ATO for eligible R&D expenditure incurred in the prior 2017 financial year.

DIRECTORS' DECLARATION

The Directors of the Company declare that:

a) in the Directors' opinion, the financial statements and notes, as set out on pages 8 to 20, are in accordance with the *Corporations Act 2001*, including compliance with accounting standards and giving a true and fair view of the Consolidated Group's financial position as at 31 December 2017 and of its performance for the half-year ended on that date; and

b) in the Directors' opinion, there are reasonable grounds to believe that the Company will be able to pay its debts as and when they become due and payable.

Signed in accordance with a resolution of the directors made pursuant to s.303(5) of the *Corporations Act 2001*.

On behalf of the Directors

Peter Hogan
Chairman

Brisbane, Queensland
28 February 2018

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

Report on the Half-Year Financial Report

Conclusion

We have reviewed the accompanying half-year financial report of Carbon Energy Limited (the Company) and its subsidiaries (the Group), which comprises the consolidated statement of financial position as at 31 December 2017, and the consolidated statement of profit or loss and other comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the half-year ended on that date, a description of accounting policies, other selected explanatory notes, and the directors' declaration.

Based on our review, which is not an audit, nothing has come to our attention that causes us to believe that the half-year financial report of Carbon Energy Limited does not give a true and fair view of the financial position of the Group as at 31 December 2017, and of its financial performance and its cash flows for the half-year ended on that date, in accordance with the *Corporations Act 2001*, including complying with Accounting Standard AASB 134 *Interim Financial Reporting*.

Directors Responsibility for the Half-Year Financial Report

The Directors of the Company are responsible for the preparation of the half-year 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 half-year financial report that gives a true and fair view and is free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express a conclusion on the half-year financial report based on our review. We conducted our review in accordance with Auditing Standard on Review Engagements ASRE 2410 *Review of a Financial Report Performed by the Independent Auditor of the Entity*, in order to state whether, on the basis of the procedures described, we have become aware of any matter that makes us believe that the half-year financial report is not in accordance with the *Corporations Act 2001* including giving a true and fair view of the Group's financial position as at 31 December 2017 and its performance for the half-year ended on that date, and complying with

Accounting Standard AASB 134 *Interim Financial Reporting* and the *Corporations Regulations 2001*. As the auditor of Carbon Energy Limited, ASRE 2410 requires that we comply with the ethical requirements relevant to the audit of the annual financial report.

A review of a half-year financial report consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with Australian Auditing Standards and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Independence

In conducting our review, we have complied with the independence requirements of the *Corporations Act 2001.*

Grant Thornton

Grant Thornton Audit Pty Ltd
Chartered Accountants

Cameron Smith

CDJ Smith
Partner - Audit & Assurance

Brisbane, 28 February 2018

Corporate Directory

Directors

Peter Hogan
Chairman and Non-Executive Director

George Su
Non-Executive Director
(Interim Executive Director)

Huihai Zhuang
Non-Executive Director

Bryan O'Donnell
Chief Executive Officer and Managing Director

Executive Management Team

Bryan O'Donnell
Chief Executive Officer and Managing Director

Ye-Fei Guo
Chief Financial Officer and Company Secretary

Ian Morgan
Company Secretary

Stuart MacKenzie
General Counsel

Dr Cliff Mallett
Technical Director

Carbon Energy Limited

ABN 56 057 552 137

ASX Code: **CNX**

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