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Carbon Energy (Operations) Pty Ltd
ABN 61 105 176 967

ASX Announcement

5 August 2016

Carbon Energy 2016 Annual Report

Carbon Energy Limited (ASX:CNX) hereby provides the Carbon Energy 2016 Annual Report, together with its 2016 Corporate Governance Statement and Appendix 4G.

Copies of the attached documents are also available on the Carbon Energy website at www.carbonenergy.com.au.

Security holders who have elected to receive a hard copy of the 2016 Annual Report will do so with the Notice of Meeting for the 2016 Annual General Meeting that will be distributed in due course.

For and on behalf of the Board.

Catherine Costello
Chief Financial Officer & Company Secretary

carbonenergy

ANNUAL REPORT **2016**

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Carbon Energy is an energy innovator and developer of world leading underground coal gasification (UCG) technology *keyseam*®.

We are committed to establishing *keyseam* as the gasification technology of choice for monetising deep coal resources worldwide.

Initially developed in conjunction with the CSIRO, Australia's leading research and development organisation, keyseam's highly controlled and proven technology unlocks gas resources previously considered too deep or uneconomic to reach.

Carbon Energy is the only UCG company to successfully complete a full-lifecycle trial under intense independent environmental scrutiny and the only UCG Company to successfully complete the key recommendations of the Queensland Government process, signed off by the Queensland Chief Scientist. We provide comprehensive end-to-end UCG services from site selection through to rehabilitation.

Carbon Energy is headquartered in Brisbane, Australia and is listed on the Australian Stock Exchange (ASX:CNX).

CHAIRMAN and MANAGING DIRECTOR REPORT

"CHINA'S HIGH LEVEL OF COAL CONSUMPTION, IT'S MARKET SIZE AND STRONG DEMAND FOR LOWER EMISSION COAL TECHNOLOGIES, MAKES THE WORLD'S SECOND LARGEST ECONOMY A COMPELLING OPPORTUNITY FOR *keyseam*."

Dr Chris Rawlings
Chairman

Dr Chris Rawlings, Chairman and Morné Engelbrecht, Managing Director

On behalf of the Board, it is our pleasure to present Carbon Energy's Annual Report for the financial year ended 30 June 2016.

This financial year has been both rewarding and challenging. Your Company has successfully commenced execution of its strategy for international expansion and also received official confirmation from the Queensland government that the Company has met the recommendations set by the Independent Scientific Panel (ISP). This achievement has been our most important priority since we began trials at Bloodwood Creek, eight years ago. It is extremely satisfying to receive official recognition of the results we have achieved. A copy of the letter from Dr Geoff Garrett, Queensland Chief Scientist, has been included on page 8 following our report.

This year has not been without its disappointments. The State government's decision to ban UCG in Queensland has compelled Carbon Energy to adjust its domestic strategy. While these changes will impact the geographical location and timing of our activities the strategy remains the same – to develop a profitable large scale commercial project.

More than a year ago your Company deliberately chose, to diversify the business to ensure we are well placed to extract maximum value from our assets and to deliver multiple opportunities to leverage our unique *keyseam* technology.

“CARBON ENERGY IS THE ONLY COMPANY TO SUCCESSFULLY COMPLETE THE RECOMMENDATIONS OF THE GOVERNMENT APPOINTED INDEPENDENT SCIENTIFIC PANEL.”

Morné Engelbrecht
Managing Director

In line with this strategy, outcomes from the reporting period include:

- Establishment and incorporation of the JinHong New Energy JV, which positions *keyseam* as commercial technology to be licenced in China,
- Becoming a Foundation Partner of the International UCG Research Centre, a part of the world's largest mining university, China University of Mining Technology,
- Continuing to perfect our bespoke UCG technology through the continued rehabilitation and environmental monitoring of operations at our Bloodwood Creek pilot site, and
- Formation of a Memorandum of Understanding (MOU) with Photon Energy to explore the development of up to 20MW of solar energy and to assess the feasibility of an innovative power storage solution at the Bloodwood Creek site in Queensland, Australia.

We also progressed and continue to pursue a number of other licencing options for *keyseam*, with active opportunities currently being advanced in South America, Asia and other Australian states, where supportive frameworks for UCG development exist.

JinHong New Energy Joint Venture (JV)

The demonstrated and scientifically assessed trial results at the Bloodwood Creek UCG Pilot Project in Queensland have provided strong confidence in the Company's *keyseam* technology throughout its complete lifecycle and generated strong interest offshore, with most interest coming from Asia.

China's, high level of coal consumption, it's market size and the nation's a strong demand for lower emission coal technologies, makes the world's second largest economy a compelling opportunity for *keyseam.* Additionally China's central planning agency, the National Development and Reform Commission (NDRC) identified UCG as a clean energy pillar in its current 13th five-year-plan which was announced in March this year.

Strides have been made with the Company's China strategy during the year, culminating with the incorporation of the JinHong New Energy JV in June 2016. The JV is the foundation of Carbon Energy's strategy for growth and to commercialise its UCG technology, in China.

Under the JV agreement, JinHong will contribute US$30m towards developing a commercial demonstration project upon the JV meeting certain milestones.

The JV will have a non-exclusive licence to use Carbon Energy's *keyseam* technology, up until the successful commissioning of a Chinese Demonstration Project, but can sub-license *keyseam* technology in China during the non-exclusive period. The licence will become exclusive (within the People's Republic of China) after the successful commissioning of the Demonstration Project.

The achievement of registration triggers the formal signing of the Technology Licensing and Technical Services Agreements. The technology license was signed in July 2016. Carbon Energy will provide technical and design services support, supervision and training for all JV projects under the Technical Services Agreement.

The registration is a significant step forward for Carbon Energy and represents a key milestone in our ambitions to commercialise the Company's *keyseam* technology in China. It is the first part of our strategy to develop a vertically integrated gas business within China and one that we expect to see will develop into a portfolio of projects.

JinHong is committed to advancing progress on the first demonstration project, however have indicated that they want to see progress being made on the renegotiation and/or replacement of the convertible note facility before they commit to capitalising the joint venture entity.

Demand for UCG in China, a favourable and supportive government framework and a solid JV partner, JinHong (an associate of our major shareholder, Kam Lung Investment Development Company Limited) each reinforce the good commercial sense of doing business in the region.

We are excited and encouraged by the opportunity to make a solid contribution to the Chinese energy mix and look forward to keeping shareholders updated on progress.

International UCG Research Centre

Another significant achievement of this Financial Year has been the invitation to be a foundation partner in the International UCG Research Centre, established as part of the world's largest mining university, China University of Mining and Technology.

While the Centre is being established by the University following the inclusion of UCG in China's current five-year-plan, it is envisioned to be an influential, state of the art, research centre of international significance.

The Centre will bring together potential industry collaborators to evaluate technologies for specific coal deposits and industry applications. It is an important platform through which Carbon Energy can showcase its technology to an influential and highly receptive industry audience in China.

Our Technical Director, Dr Cliff Mallett has been appointed a Director of the Centre, and is currently assisting the Centre in defining its strategic direction and priorities.

Both the JV registration and Carbon Energy's participation in the International UCG Research Centre introduces a transformational shift for the Company and acknowledges a long term future beyond Australia.

Carbon Energy's *keyseam* Technology

During the past year your Company has continued to perfect its bespoke technology. Despite the disappointing decision by the Queensland government to ban on UCG in our home state, the results proven under a rigorous and scientific methodology can not be taken away.

Carbon Energy is the only company to successfully complete the recommendations of the government appointed Independent Scientific Panel (ISP) and in doing so your Company has proven its *keyseam* technology as a safe effective resources innovation. Having successfully demonstrated our technology not only during operations but also during decommissioning and, throughout this year, during its rehabilitation activities, your Company has set a new benchmark in innovation testing in the resources industry.

Subsequent to year end the Queensland government Chief Scientist provided Carbon Energy with a letter acknowledging the company has successfully proven its technology following assessment parameters set out by the Queensland government. While this acknowledgement does not reverse the decision to ban UCG in this State, it does officially recognise the success of Carbon Energy's *keyseam* technology which we have worked so hard to achieve.

Our technology is now more advanced than other UCG technologies, having proven its entire life-cycle process.

In comparison to other UCG technologies, Carbon Energy's innovative technology is clearly differentiated:

- Firstly our process identified early on that site selection and depth of operations is critical to success. Our site selection methodology remains unrivalled and an essential part of our technology offering;
- Process controls and design of our technology has meant we are in full control of our operations, allowing for operations that are environmentally safe and managed in a responsible risk based manner; and
- Our trial included the submission of a decommissioning report and rehabilitation plan to the Queensland government, which no other proponent has done and which we can demonstrate.

This all adds up to a world first scientific demonstration, which your Company will continue to perfect and improve upon.

A potential future for Bloodwood Creek and the Solar 120 initiative

During the year, the Queensland government reaffirmed its commitment to investigating the path to achieving a 50% renewable energy target for the state by 2030.

Alongside this commitment, a range of initiatives have been implemented to promote further investment into renewable energy developments, including the Solar 120 initiative. In collaboration with the Australian Renewable Energy Agency (ARENA), the Solar 120 initiative will support the development of up to 120 megawatts of solar generation through local, large-scale solar projects, like the planned solar project proposed for Carbon Energy's Bloodwood Creek site.

While we are at an early stage in the MOU with Photon Energy, the Bloodwood Creek site is well suited to develop a solar plant. Bloodwood Creek is ideally located for large-scale solar energy generation, as evidenced by similar sites being planned in the area. The site's location with close proximity to the local grid connection means capital expenditure costs are limited, and would enable the transfer of electricity quickly to the local grid.

In order to progress the project, Carbon Energy will need to secure land for the solar farm, confirm generation capacity in the local grid and seek council approvals. It is possible that if this process goes smoothly, the Company could be generating revenue from the solar project within 24 months – which would be an excellent commercial outcome for shareholders.

Under the MOU, Carbon Energy and Photon Energy have agreed a six month target timeframe to assess the potential to develop the solar project. At the same time we will conduct a feasibility study to determine whether the Bloodwood Creek UCG infrastructure can be used for an innovative energy storage solution.

A strong position and an abundance of opportunity

Moving forward the Company remains in an outstanding position strategically and will continue to play to its strengths:

- We have a unique, Australian-developed technology: *keyseam*, which has been scientifically proven and acknowledged by experts that it is an innovation and more effective than other UCG technologies;
- *keyseam* has been tested through the Bloodwood Creek Pilot project with stringent technical and environmental conditions;
- Our achievements at Bloodwood Creek have enabled us to negotiate a joint venture in China with JinHong;
- Having completed a successful pilot project and obtaining sign-off from Queensland's Chief Scientist, we will be able to negotiate licencing agreements in other jurisdictions;
- We have unique IP and an excellent team of people who can now deploy *keyseam* in other environments. This positions us well to provide full spectrum consulting services to support licencing agreements; and
- Through our MOU with Photon Energy, we are able to explore both development of a commercial scale solar generation plant and the feasibility of using the site for an innovative power storage system. These present potential commercial outcomes for the site and our assets.

The Year Ahead

As we look to the years ahead our strategy remains focused on three core areas to maximise long term shareholder value:

1. Establish *keyseam* as a commercial technology to be licensed in China;
2. Focus on further licensing opportunities in newly industrialised nations with strong cleaner energy demand; and
3. Extract the maximum value from existing assets.

Social Responsibility

During the period, we continued to focus on safety. The safety of our employees, contractors and all those involved in our business is of the highest importance. We continuously monitor our sites 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 adhere strictly to our Environmental Policy, as well as to relevant laws and regulations. We recorded no environmental incidents for the year and no non-compliances or improvement notices resulting from audits performed by regulatory bodies.

Corporate update

In June 2016 it was reported that CEO and Managing Director, Morné Engelbrecht would be moving on from his role with Carbon Energy. Morné leaves the Company following almost five years, a period of significant strategic transition and some challenging times. The Board wishes to record its appreciation for the significant contribution Morné has made during his time at Carbon Energy and we wish him well for the future.

While the Company continues to expand into other regions of the world, we will be seeking a new leader with appropriate skills - particularly in Asia - to take the Company forward during its next phase of growth. From15 August 2016, I will be stepping into the role of Interim Executive Chairman until a suitable candidate is identified and on board.

On behalf of the Board and Management team, we also 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. We are especially thankful to Kam Lung Development Company Ltd and the shareholders who supported the Rights Issue in April 2016, where we raised $3.48 million. We have commenced the 2017 financial year from a strong position, with solid prospects both offshore and domestically. Looking forward, we will forge ahead with our China strategy, continue to seek all avenues to realise return from our current assets and progress international licencing opportunities.

We look forward to keeping shareholders apprised during the course of the year.

Dr Chris Rawlings
Chairman

Morné Engelbrecht
Managing Director and CEO

QUEENSLAND
CHIEF SCIENTIST LETTER

19th July 2016

Queensland Government

Office of the **Queensland Chief Scientist**

Mr Chris Rawlings
Chairman
Carbon Energy Limited
PO Box 2118,
Toowong DC,
Qld 4066

Dear Chris

UCG/CARBON ENERGY

1. In June 2013, in my capacity as Queensland Chief Scientist, and on behalf of the Queensland Department of Natural Resources and Mining (DNRM), I led a formal peer review process of the Independent Science Panel (ISP) Report commissioned by DNRM around Underground Coal Gasification in Queensland. This report had been authored by a consulting team led by Professor Chris Moran, at that time head of the Sustainable Minerals Institute at the University of Queensland.

2. In this peer review process I was supported, inter alia, by Professor Paul Greenfield AO, a chemical engineer and international water expert, formerly Vice Chancellor of the University of Queensland, and a Fellow of the Australian Academy of Technological Sciences and Engineering (FTSE), the Institution of Chemical Engineers, UK (FIChE) and an Honorary Fellow of the Institution of Engineers, Australia (FIEAust, CPEng).

As part of the process we also interacted extensively with Professor Robin Batterham, who had been engaged as a technical adviser by Carbon Energy. A former Australian Chief Scientist and Chief Technology Officer for mining giant Rio Tinto, and an International Fellow of the Royal Academy of Engineering, Robin has served as President of the Institution of Chemical Engineers (UK) and of the Australian Academy of Technological Sciences and Engineering.

Personally, and as a former Professor of Metallurgy, I was familiar with the technology. After a decade of research and field trials, the company Carbon Energy was spun out of Australia's - and one of the world's largest - national science agency, the CSIRO, during my tenure there as Chief Executive.

3. Following extended discussions with the Peer Review Panel, agreement was reached on amendments to the ISP Report, and a copy of the final report's Executive Summary is attached.

4. Following this, the final Report and its recommendations were accepted by DNRM as an action requirement for companies engaged in UCG trials.

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Website http://www.chiefscientist.qld.gov.au/

5. Subsequently Carbon Energy satisfactorily completed the two key recommendations required by the final ISP report - specifically, demonstrating safe and effective decommissioning of the pilot panel and completing a plan for rehabilitation. These actions were independently reviewed by consultants to the Queensland Department of Environment and Heritage Protection (DEHP).

Carbon Energy was the only pilot participant to meet the recommended requirements.

6. It is fair to say that Carbon Energy has taken a robust, science based approach to the process evaluation and its keyseam technology is different from other technologies. (Noting also that Professor Batterham has formally written in support of Carbon Energy's technology.)

It is clear that Carbon Energy has contributed to the collective understanding of Underground Coal Gasification and the conditions under which the operation is likely to be both safe and successful.

7. Thus, from my perspective as the Queensland Chief Scientist, the successful completion of the science and technology aspects required through the ISP process by Carbon Energy using its proprietary keyseam technology is acknowledged, in that particular location under the pilot conditions. It was the exception in this regard.

8. It is therefore apparent that a combination of the right technology, the right conditions and robust science based controls means that successfully tested technologies like keyseam might well have a role in exploiting energy elsewhere. Indeed, the ISP refers to the "undoubted future importance of UCG as a viable energy source of global significance".

9. Notwithstanding the Queensland Government's recent decision not to allow UCG projects to proceed in the State - understandable in the context of complications and adverse publicity associated with other perceived similar technologies/operations - investment in Carbon Energy's technology will no doubt be considered in other jurisdictions, on the basis of the company's willing and successful participation - and substantial financial investment - in the Queensland Government's UCG assessment processes.

Sincerely yours,

Dr Geoff Garrett AO, FTSE, PrEng
Queensland Chief Scientist

Cc:
Hon Anthony Lynham, Minister for State Development and Minister for Natural Resources and Mines MP
Hon Steven Miles, Minister for Environment and Heritage Protection and Minister for National Parks and the Great Barrier Reef MP
Mr Jim Reeves - Director-General, Department of Environment and Heritage Protection
Mr James Purtill - Director-General, Department of Natural Resources and Mines

Office of the Queensland Chief Scientist

EXECUTIVE **MANAGEMENT**

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

MornéEngelbrecht 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.

Offering over 15 years' oil and gas and resources industry experience across various jurisdictions, including Australia, South Africa, the United Kingdom, Papua New Guinea and China, Morné provides leadership across all facets of the business as well as driving and executing the strategy of the Company.

Prior to joining Carbon Energy Morné held various financial, commercial and advisory senior management positions and is a Chartered Accountant and a member of the Australian Institute of Company Directors.

Ms Catherine Costello
Chief Financial Officer &
Company Secretary
BCom, MSc, CA, GradDipACG

Catherine Costello joined Carbon Energy in April 2014 as the Company's Chief Financial Officer and assumed the role of Company Secretary in September 2015. Catherine has 20 years of international experience in the mining, engineering and technology sectors. Her experience extends to global listed entities undergoing significant growth and she brings extensive financial, commercial 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 is a member of the Chartered Accountants Australia and New Zealand and a member of the Governance Institute of Australia.

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 20 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. Cliff was Chairman of the international Underground Coal Gasification Association (UCGA) 2013-2015 and in April 2016 was appointed Director of the China University of Mining Technology UCG Research Centre in Xuzhou.

Mr Stuart MacKenzie
General Counsel
Bsc LLB

Mr Terry Moore
General Manager
Operations

Stuar MacKenzie brings to the Company strong resources and legal experience having worked initially as a geologist in Canada before becoming a corporate lawyer at Blake Dawson Waldron (now Ashurst) and Stikeman Elliott. From 2001 Stuart served as an internal legal counsel and company secretary for Placer Dome Asia Pacific, Lihir Gold and Pacific Aluminium as well as advising Barrick Gold on two projects in PNG and is currently also general counsel for Chinova Resources.

Terry l Manager Operations
Terry Moore is responsible for the development and ongoing operations of Carbon Energy's global projects. Terry has over 35 years engineering experience in both the resources and energy sectors and 20 years' experience in senior management roles, including roles with Ausenco Operations and Downer EDI Mining. His experience covers extensive electrical, mechanical, civil and maintenance engineering disciplines, as well as design and constructions projects from concept through 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 team of project, environment and safety professionals.

DIRECTORS' REPORT

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 almost 15 years. His strong industry knowledge backed by a pragmatic, results-driven approach is a great advantage to the Company. In 2014, Dr Rawlings was awarded the prestigious Queensland Resources Council Medal for his contributions to the Resources sector over the past 35 years.

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 a Director 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.

Offering over 16 years' oil and gas and resources industry experience across various jurisdictions, including Australia, South Africa, the United Kingdom, Papua New Guinea and China, Mr Engelbrecht provides leadership across all facets of the business as well as driving and executing the strategy of the Company.

Prior to joining Carbon Energy Mr Engelbrecht held various financial, commercial and advisory senior management positions and is a Chartered Accountant and a member of the Australian Institute of Company Directors.

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

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 over 30 years' experience in transforming technical innovation into practical commercial outcomes. She has 15 years' experience as a Chief Executive and over 20 years' experience 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:

- ABM Resources Limited (from October 2014 to March 2016) Non-Executive Director; and
- Energy Resources of Australia Limited (from January 2005 to June 2015) 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, CA

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

Mr Huihai Zhuang
Non-Executive Director
BS degree (Shantou University)

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

Mr Hogan is a Chartered Accountant providing business advisory services to a diverse range of clients. Mr Hogan was previously a Strategy and Development Executive with Incitec Pivot Ltd. Mr Hogan continues to provide some financial and commercial advisory services to Incitec Pivot on an arms length, fee for service basis. Prior to joining Incitec Pivot in early 2008, 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:

- OneAll International Ltd (from December 2015) Non-Executive Director
- SGX listed Fabchem China Ltd (from July 2008 to November 2013) Non-Executive Director

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

Rozman was appointed to the Board on 7 April 2010.

Mr Rozman holds degrees in mining engineering and mineral economics and has 35 years' international experience in mining operations, joint ventures and corporate management. He was previously Chief Operating Officer of major gold producer, AurionGold and Chief Executive Officer of coal seam gas explorer and producer, CH4 Gas Limited.

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 2010) Non-Executive Director
- ABM Resources Limited (from May 2014 to October 2014) Non-Executive Director, and
- TSX listed Mawson West Limited (from February 2011 to April 2014) Non-Executive Director

Mr Rozman is also a Director of some Pacific Road Capital entities and holds and has held a number of other non-listed directorships.

Mr Rozman is Chair of the Remuneration Committee and a member of the Nomination Committee.

Mr Zhuang was appointed to the Board on 29 October 2015.

Mr Zhuang is 100% owner of our cornerstone investor Kam Lung Investment Development Company (Kam Lung). Mr Zhuang was appointed to the Board as the nominee for Kam Lung following their increase in shareholding to 19.99%. Mr Zhuang brings to the board strong networks across Chinese business and government sectors which is anticipated to create a more effective cultural and relationship building leverage for the Company in doing business in China.

BOARD OF **DIRECTORS**
& Company Secretary

Mr George Su
Mr Zhuang's Alternate Director and Translator
BA (Bus Admin)

Mr Su was appointed to the Board on 4 December 2015.

Mr Su has over 30 years business experience in the Asia Pacific region and is currently based in Sydney. Mr Su was formerly head of the Australian operations of CITIC Securities, China's largest investment bank, between 2009 and 2013. He continues to work with CITIC Securities as their business partner for Australia through Silk Road Corporate Finance Pty Ltd, providing corporate advisory services.

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

- Oriental Technologies Investment Limited (from September 2007) Non-Executive Director after serving as Managing Director since 1998 ; and
- YPB Group Limited (from July 2014) Non-Executive Director.

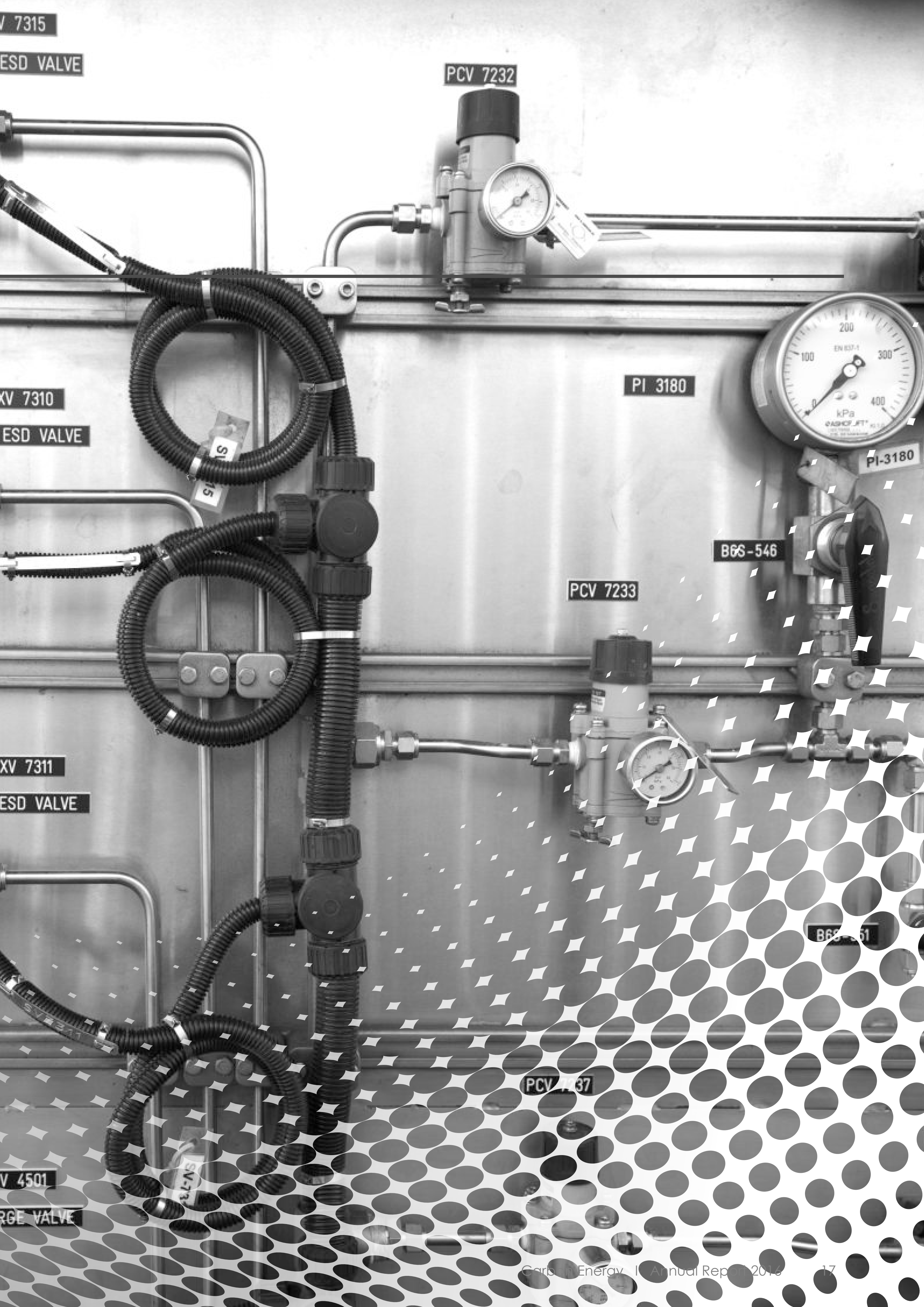
Mr Su served as an independent director on the board of Macquarie Bank's China property fund between 2006 and 2014.

Mr Su serves as Alternate Director where Mr Zhuang has notified that he is unable to attend Company board meetings or attend to specific business. Mr Su is also engaged by Mr Zhuang in the capacity of translator.

Ms Catherine Costello
Chief Financial Officer & Company Secretary
BCom, MSc, CA, GradDipACG

Ms Costello joined Carbon Energy in April 2014 as the Company's Chief Financial Officer and assumed the role of Company Secretary in September 2015. Ms Costello has 20 years of international experience in the mining, engineering and technology sectors. Her experience extends to global listed entities undergoing significant growth and she brings extensive financial, commercial and corporate governance skills. Prior to accepting the position with Carbon Energy, Ms Costello held several senior management roles including senior financial positions in Ausenco, Lihir Gold (now Newcrest Mining) and Placer Dome (now Barrick Gold).

Ms Costello has a Bachelor of Commerce Degree from the University of Queensland, a Master of Science (Mineral Economics) from Curtin University, is a member of the Chartered Accountants Australia and New Zealand and a member of the Governance Institute of Australia.


PCV 7232
PI 3180
PI-3180
PCV 7233
ESD VALVE
XV 7310
ESD VALVE
XV 7311
ESD VALVE

Directors' Report

Board Information

Your Directors present their Report on the Company and its controlled entities for the financial year ended 30 June 2016.

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
Dr Helen Garnett - Non-Executive Director
Mr Peter Hogan - Non-Executive Director
Mr Louis Rozman - Non-Executive Director
Mr Huihai Zhuang - Non-Executive Director
Mr George Su - Mr Zhuang's Alternative Director and translator

Mr Morné Engelbrecht

Mr Engelbrecht was appointed to the Board in July 2013 and will retire post the reporting period on 12 August 2016. The Board would like to take this opportunity to acknowledge the valuable contribution Mr Engelbrecht made to the Company during his tenure.

Company Secretary

Ms Costello has been Chief Financial Officer since the start of the financial year to the date of this Annual Report and assumed the additional role of Company Secretary from 30 September 2015. Ms Costello'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 & Company Secretary
Ms Tracy Bragg – General Counsel and Company Secretary (resigned 30/09/2015)
Mr Justin Haines – General Manager, Technical Services (resigned 14/08/2015)
Dr Clifford Mallett – Technical Director
Mr Stuart MacKenzie – General Counsel
Mr Terry Moore – General Manager, Operations

Corporate Governance Statement

The Company's 2016 Corporate Governance Statement and Appendix 4G can be located on the Company's website:
www.carbonenergy.com.au/irm/content/corporate governance.aspx

Principal Activities

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

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

Operating Results

The loss of the Consolidated Group after providing for income tax amounted to $100,545,304 (2015: loss $6,170,765). The loss for the year includes a $95,666,870 impairment charge against the Company's Blue Gum Gas project assets following the announcement by the Queensland government to ban UCG in Queensland. Excluding the impairment charge above, the Company's operating loss for the year was $4,878,434 which was an improvement on the prior loss reflecting the Company's continued focus on reducing costs, notwithstanding the lower revenue from both technology service fees and the research and development tax incentive rebate.

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 2016 (2015: nil).

Directors' Report

Review of Operations

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

China

The Company's priorities were re-focused over the first half of FY16 with the commencement of the JinHong Joint Venture becoming the key priority.

China has supportive policies in place for UCG technologies and has included cleaner coal to energy production as an area of focus in its current five-year-plan, which commenced in March 2016.

During the period, Carbon Energy laid the foundation for strong growth in China by entering into a Joint Venture agreement with Beijing JinHong Investment Development Co. (JinHong) with the exclusive focus of building a vertically integrated gas business. The formation of the Beijing JinHong New Energy Development Co. (JV) was approved by shareholders on 30 November 2015 at the Company's Annual General Meeting and, as announced on 17 June 2016, has been formally registered with the Chinese corporate registry.

JinHong is committed to advancing progress on the first demonstration project, however have indicated that they want to see progress being made on the renegotiation and/or replacement of the convertible note facility before they commit to capitalising the joint venture entity. This has caused some delays in advancing the activities of the joint venture. The company is in negotiations with third parties in relation to the renegotiation of the existing convertible note and/or replacement of the convertible note.

During the last quarter of the financial year Carbon Energy was invited to be a foundation partner of the International UCG research centre in China. On 29 April 2016, the Company announced it had formally joined the Centre which is part of one of the world's largest mining universities, the China University of Mining and Technology.

In April 2016, Carbon Energy announced it secured a strategic leadership position, joining China University of Mining and Technology's globally significant International Underground Coal Gasification Research Centre as a founding member.

The Centre was established to encourage the development of UCG technology by industry and Government groups alike, as the environmentally acceptable utilisation method for coal.

It has been formed inline with the Chinese Government's 13th five-year-plan, a vital macro driver underpinning the expansion of China's UCG industry.

MOU with Photon Energy – Potential Solar Power Generation at Bloodwood Creek

On 23 June 2016, the Company announced a Memorandum of Understanding (MOU) with Photon Energy NV (Photon Energy) to evaluate the development of a large scale solar power generation plant with up to 20 MW capacity at the Company's Bloodwood Creek facility in Queensland.

The assessment will explore the use of the site's existing infrastructure and assets already in place.

This is a positive step for the Bloodwood Creek site. In the absence of further UCG development, the MOU will enable Carbon Energy to realise some of the site's potential and contribute to Australia's growing renewable energy needs.

Corporate Affairs

On 27 November 2015 the Company advised it had been served with proceedings filed by Summa Resource Holdings LLC (Summa) against it in the United States District Court for the Northern District of California (Complaint).

As announced to the ASX on 6 May 2016, the Court dismissed the Complaint without the need for a hearing.

Significant Changes in the State of Affairs

- Carbon Energy secured funding from cornerstone investor Kam Lung Investment Development Company on 28 September 2015, increasing it's shareholding to 19.99% at the time,
- Shareholders approved the formation of the Chinese based JinHong JV on 30 November 2015, at the Company's AGM,
- On 11 April 2016 Carbon Energy raised $3.48 million under the rights issue with Kam Lung

Directors' Report

sub-underwriting the rights issue to $1.8 million in addition to taking up its full entitlement, increasing its shareholding at the time to 29.19%.

After Balance Date Events

Rights Issue Shortfall

Further to the close of the renounceable rights issue on 4 April 2016, under its Rights Issue Shortfall allocation the Company issued 30,769,232 shares on 4 July 2016 raising $400,000 before costs.

Confirmation of Successful Completion of the ISP Process in QLD

On 25 July 2016 the Company received a letter and announced that it had received confirmation from the Queensland government Chief Scientist, Dr Geoff Garrett that Carbon Energy has satisfactorily completed the recommendations of the government appointed Independent Scientific Panel (ISP).

The letter (refer page 8) follows the safe and successful operation of Carbon Energy's Bloodwood Creek pilot plant project.

Dr Garrett acknowledges Carbon Energy as the only pilot participant to meet the recommendations of the ISP and that the Company's *keyseam* technology is different from any other.

The letter also highlights references the ISP's conclusions reached in 2013 re-noting the "undoubted future importance of UCG as a viable energy source of global significance."

Since the Queensland government announced its ban on UCG on the 18 April 2016 the Company has held several meetings with the Government including the Minister of Natural Mines and Resources as well as other senior government officials. Despite acknowledgement of the work Carbon Energy has done to date there have been no changes proposed in regards to the proposed legislation to ban UCG in Queensland.

Carbon Energy has done everything in its power to seek amendments to the government's proposed legislation changes. This has included seeking advice at the highest level on the legal options available to the Company.

Following the delivery of the Decommissioning Report and Rehabilitation Plan to the Queensland government in FY15, environmental sampling of groundwater and measurement of other environmental metrics continues at Bloodwood Creek.

The Queensland government's letter is significant for the Company which can now officially confirm that it effectively operated a successful and safe demonstration of its technology under the strictest regulatory controls. This confirmation may help to reduce the need for in-depth pilot operations in other jurisdictions, and may help to reduce the steps to commercialisation with its projects in China.

Interim Executive Chairman

Dr Chris Rawlings will be appointed Interim Executive Chairman from 15 August 2016 whilst the Company continues its search for a permanent Chief Executive Officer and Managing Director.Apart from the matters noted above, since the end of the financial year, the Directors are not aware of any other matters or circumstances not otherwise dealt with in the report or financial statements that have significantly, or may significantly affect the operations of the Company or the Consolidated Group, the results of the operations of the Company or the Consolidated Group, or the state of affairs of the Company or the Consolidated Group in subsequent financial years.

Non-audit Services

No fees were paid for non-audit services to Grant Thornton during the year ended 30 June 2016.

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 section 300(9) of the Corporations Act.

Proceedings on Behalf of the Company

No person has applied to the Court under section 237 of the Corporations Act for leave to bring proceedings on behalf of the Company, or to

Directors' Report

intervene in any proceedings to which the Company is a party, for the purpose of taking responsibility on behalf of the Company for all or part of those proceedings.

No proceedings have been brought or intervened in on behalf of the Company with leave of the Court under section 237 of the Corporations Act.

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	13	13	5	5	6	6	1	1
Morné Engelbrecht	13	13	NM	NM	NM	NM	1	1
Helen Garnett	13	11	5	4	NM	NM	1	1
Peter Hogan	13	13	5	5	6	6	1	1
Louis Rozman	13	12	NM	NM	6	5	1	1
Huihai Zhuang	9[1]	2[1]	NM	NM	NM	NM	1	0
George Su(Alternate)[2]	5[1]	5[1]	NM	NM	NM	NM	1	1

NM – Not a member of the Committee.

1. Of the nine meetings that Mr Zhuang was eligible to attend:
   (a) two were unscheduled meetings that Mr Zhuang was not available to attend;
   (b) five were attended by Mr Su as Mr Zhuang's alternate; and
   (c) two were attended by Mr Zhuang and Mr Su, with Mr Su being invited as Mr Zhuang's translator.
2. Mr Su attended seven meetings in total, five as Mr Zhuang's alternate and two as Mr Zhuang's translator.

Directors' Interests

As at 18 July 2016, the interests of the Directors in shares and unlisted options of the Company are:

	No. Shares Held		Listed Options		Unlisted Options	
	Direct	Indirect	Direct	Indirect	Direct	Indirect
Chris Rawlings	-	9,100,000	-	3,950,000	-	-
Morné Engelbrecht	4,546,109	-	355,093	-	9,115,441	-
Helen Garnett	339,205	377,101	188,151	-	-	-
Peter Hogan	-	750,000	-	220,000	-	-
Louis Rozman [1]	477,272	161,607,249	75,000	-	-	35,000,000
Huihai Zhuang	-	514,760,847	-	171,818,615	-	-
George Su (Alternate)	-	-	-	-	-	-
Total	**5,362,586**	**686,595,197**	**618,644**	**175,988,615**	**9,115,441**	**35,000,000**

1. Indirect share and option holdings represent some Pacific Road Capital entities of which Louis Rozman is an employee and Director.

Directors' Report

Remuneration Report (Audited)

The Directors are pleased to present Carbon Energy Limited's 2016 Remuneration report which sets out information about the remuneration of the Company's Non-Executive Directors, Executive Director and other Key Management Personnel. The information provided in this report has been audited as required by section 308(3C) of the Corporations Act and forms part of the Directors' report.

Key Management Personnel

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

Non-Executive Directors

(refer to pages 14 to 16 for details about each Director):

Chris Rawlings	Chairman and Non-Executive Director
Helen Garnett	Non-Executive Director
Peter Hogan	Non-Executive Director
Louis Rozman	Non-Executive Director
Huihai Zhuang	Non-Executive Director (from 29/10/2015)
George Su	Alternate Non-Executive Director for Huihai Zhuang (from 04/12/2015)

Executive Director

Morné Engelbrecht	Chief Executive Officer and Managing Director

Other Key Management Personnel

Tracy Bragg	General Counsel and Company Secretary (to 30/09/2015)
Catherine Costello	Chief Financial Officer and Company Secretary (Company Secretary from 30/09/2015)
Justin Haines	General Manager, Technical Services (to 14/08/2015)
Stuart MacKenzie	General Counsel (Casual) (from 27/11/2015)
Cliff Mallett	Technical Director
Terry Moore	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.
- Non-Executive Director fees.

The 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.au

Voting and Comments made at the Company's 2015 Annual General Meeting

The Company received more than 92% of "yes" votes on its remuneration report for the 2015 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 annum plus statutory superannuation to each

Directors' Report

Remuneration Report (Audited)

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. In the prior year the Board resolved to reduce Non-Executive Directors fees by between 20% and 100% for the March 2015 quarter. Fees were reinstated for the June 2015 quarter with the exception of Mr Rozman, as Pacific Road Capital Management Holdings Pty Ltd elected to waive his June 2015 and September 2015 quarter fees.

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 Executive Director and other Executives, was developed by the Remuneration Committee after seeking professional advice from independent consultants and was approved by the Board. All permanent Executives and the Executive Director receive a base salary, superannuation, car park and performance incentives.

The Remuneration Committee reviews Executive packages annually by reference to group performance, Executive performance, comparable information from industry sectors and other listed companies and independent advice. The performance of Executives is reviewed annually by the Executive 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, shares, options, performance rights, and other incentive payments are reviewed by the Remuneration Committee annually as part of the review of Executive remuneration and a recommendation is put to the Board for approval. All bonuses, shares, options, performance rights, and other incentives must be linked to predetermined performance criteria. The Board can exercise its discretion in relation to approving performance incentives and can recommend changes to the Remuneration Committee recommendations. Any changes must be justified by reference to measurable performance criteria.

In June 2016, the Remuneration Committee reviewed the structure of the performance incentives. Further details can be found in the Executive Remuneration Framework below.

Remuneration Consultant

From time to time the Remuneration Committee will engage advisors to assist in the continual evolution and development of the Group's remuneration policies and framework. No remuneration consultants have been engaged during the current year.

Executive Remuneration Framework

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

1. Total Fixed Remuneration.
2. Short Term Incentive (STI).
3. Long Term Incentive (LTI).

The STI and LTI components paid to permanent Executives each range between 15% and 30% of their fixed remuneration package and are payable in shares, performance rights or options in Carbon Energy Limited. The Remuneration Committee has the discretion to approve payment of the STI component as cash in lieu of shares. For the STI assessed on the FY16 performance period the remuneration committee applied their discretion to approve the payment of all STI's as cash. This decision took into account the prior taxation issues that had arisen for participants balanced with industry trends towards cash for STI's.

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

Total Fixed Remuneration

Total Fixed Remuneration comprises base salary and statutory superannuation. 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 data gathered from multiple sources which may include market surveys, external remuneration consultants, and internal feedback as to market conditions, as considered 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 Executives 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 an STI to the permanent Executives including the Executive Director to achieve the following objectives:

- Focus Executives on the achievement of key targets as well as individual contribution that the Board believes will lead to sustained and improved business performance.
- 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 (KPIs). At the end of each financial year, the Executives (excluding the Executive Director) would be allocated a number of shares equivalent to the cash value of the STI, based on the 90 day VWAP prior to the Remuneration Committee endorsement of the recommended share allocation (subject to the Remuneration Committee's discretion to pay the STI as cash in lieu of shares). The Executive Director's STI is paid in cash, unless the Executive Director elects to receive shares or options and this is approved by the Remuneration Committee and the shareholders. No STI's were awarded to the Executive Director or permanent Executives for the FY15 year due to failure to meet the FY15 KPI's. These STI's would normally be paid in the subsequent year. For the current year, the Remuneration Committee has determined that the Executive Director and permanent Executives will be awarded a discretionary incentive of 50% of their maximum entitlement. Due to a number of factors outside of the Executives control that resulted in moving performance targets, the Remuneration Committee determined that a discretionary award of 50% fairly acknowledged the efforts of Executives while balancing the interests of shareholders.

The Executive Director's 3 year term ceased on 17 June 2016. The Board and the Executive Director have agreed to extend the original employment contract to 12 August 2016.

Long Term Incentive (LTI)

On 13 February 2015, the Remuneration Committee approved changes to the LTI arrangements applicable to Executives for the FY15 and subsequent financial years.

The Remuneration Committee approved a 3 year Executive performance rights LTI plan be put in place for the 2017 financial year (applying to all Executives including the Executive Director, noting the LTI for the Executive Director will require shareholder approval). The new LTI plan will incorporate 1, 2 and 3 year performance periods, with 1/3 of the allocated performance rights being tested annually. The performance hurdles will be market based and service based tests, in equal proportions. The inclusion of a service based test is in recognition that significant developments can be progressed during a performance period, however given the Company's stage in its lifecycle, may not be fully reflective in the share price at that point in time. The quantum of the LTI grants has been determined as 71,243,236 performance rights to be allocated between the Executives. As noted above the performance rights will be equally

Directors' Report

Remuneration Report (Audited)

divided into 3 separate tranches (23,747,745) with each tranche tested at the end of each financial year against the set performance hurdles. Each testing period 50% of the performance rights (11,873,873) will vest if the Executive remains employed, while the remaining 50% will be measured against the following performance hurdles:

- For tranche 1 (30/06/17): Successful ignition of the JinHong JV demonstration project resulting in an exclusive *keyseam* licence being granted to the JinHong JV;
- For tranche 2 (30/06/18): Advancing the demonstration project to commitment to commercial scale production; and
- For tranche 3 (30/06/19): Securing at least one third party licencing and technical service agreements either through the JV or worldwide.

Each performance right is a conditional entitlement to one fully paid ordinary share in Carbon Energy Limited.

To align with the Executive Director's current LTI plan, a two year transitional LTI plan was introduced for the other Executives to cover the 2015 and 2016 financial years. The plan comprised the following:

- 2.5 million share rights with a vesting date of 30 June 2015, with vesting subject to the market price of the shares as at 30 June 2015 being no less than 7.5 cents ($0.075) per share (these share rights forfeited on 30 June 2015 as the share price performance hurdle was not achieved).
- 2.5 million share rights with a vesting date of 30 June 2016, with vesting subject to the market price of the shares as at 30 June 2016 being no less than 10.5 cents ($0.105) per share. (these share rights forfeited on 30 June 2016 as the share price performance hurdle was not achieved).

In each case the share rights would only vest provided the Executive remains employed with the Company on the vesting date.

The Executive Director LTI arrangements as approved at the annual general meeting on 21 November 2013 comprised 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 the share price performance hurdle was not achieved).
- 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 (these options were forfeited on 30 June 2015 as the share price performance hurdle was not achieved).
- 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 (these options were forfeited on 30 June 2016 as the share price performance hurdle was not achieved).

Relationship between Remuneration and the Company's Performance

Prior to 1 July 2013 the Company did not link key performance indicators to the Company's financial performance. The Company linked key performance indicators for the LTI to the Company's share price performance from 1 July 2013 to 17 June 2016 for the Executive Director and 1 July 2014 to 30 June 2016 for other permanent Executives. The performance of the Company's share price was considered the best indicator of value creation for shareholders at the Company's stage of development. This has been reassessed going forward with Remuneration linked to key milestones in the Company's development phase.

In FY2015 the share price increased 13% from $0.015 to $0.017. In FY2016 the share price decreased 12% from $0.017 to $0.015.

Directors' Report

Remuneration Report (Audited)

Details of Remuneration

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

2016	Cash						Non-cash			
	Short term employee benefits				Post employment benefits		Share-based Payments Expense		Forfeited Options	Performance Related
	Cash Salary	Bonus	Directors Fee (vi)	Other (v)	Super Contributions	Total Cash Payments	Options (vii)	Shares		
	$	$	$	$	$	$	$	$	$	%
NON-EXECUTIVE DIRECTOR										
Chris Rawlings	-	-	120,000	-	11,400	**131,400**	-	-	-	-
Helen Garnett	-	-	50,000	-	4,750	**54,750**	-	-	-	-
Peter Hogan(i)	-	-	40,000	-	-	**40,000**	-	-	-	-
Louis Rozman(ii)(vi)	-	-	30,000	-	-	**30,000**	-	-	-	-
Huihai Zhuang(iii)	-	-	26,957	-	-	**26,957**	-	-	-	-
George Su(iv)	-	-	-	-	-	-	-	-	-	-
SUB-TOTAL $	**-**	**-**	**266,957**	**-**	**16,150**	**283,107**	**-**	**-**	**-**	
EXECUTIVE DIRECTOR										
Morné Engelbrecht (v)(vii)	397,582	-	-	43,859	30,000	**471,441**	43,188	-	(129,567)	8%
SUB-TOTAL $	**397,582**	**-**	**-**	**43,859**	**30,000**	**471,441**	**43,188**	**-**	**(129,567)**	
GRAND TOTALS	**397,582**	**-**	**266,957**	**43,859**	**46,150**	**754,548**	**43,188**	**-**	**(129,567)**	

(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) Huihai Zhuang's fees are paid directly to Silk Road Capital Finance, an associated entity of George Su.
(iv) George Su does not receive Director fees from the Company as he is Huihai Zhuang's Alternate when appointed and translator for Board meetings and correspondence. George Su's fees for these services have been negotiated between Huihai Zhuang and George Su.
(v) Other payments include car parking, associated fringe benefits tax and a partial cash out of annual leave.
(vi) Pacific Road Capital Management Holdings Pty Limited elected to waive 100% of Mr Rozman's fee for the first quarter of 2016.
(vii) Morné Engelbrecht was granted 99,999,999 options with share price performance hurdles. As at 30 June 2016 the remaining 33,333,333 were forfeited as a result of failure to meet the share price performance hurdles for this year.

Directors' Report

Remuneration Report (Audited)

Details of Remuneration (continued)

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

2015	Cash						Non-cash			
	Short term employee benefits				Post employment benefits		Share-based Payments Expense		Forfeited Options	Performance Related
	Cash Salary	Bonus	Directors Fee (v)	Other	Super Contributions	Total Cash Payments	Options (vi)	Shares		
	$	$	$	$	$	$	$	$	$	%
NON-EXECUTIVE DIRECTOR										
Chris Rawlings	-		114,000	-	10,830	**124,830**	-	-	-	-
Max Cozijn(i)	-		32,308	-	3,069	**35,377**	-	-	-	-
Helen Garnett	-		47,500	-	4,513	**52,013**	-	-	-	-
Peter Hogan(ii)	-		30,000	-	-	**30,000**	-	-	-	-
Louis Rozman(iii)	-		20,000	-	-	**20,000**	-	-	-	-
SUB-TOTAL $	**-**		**243,808**	**-**	**18,412**	**262,219**	**-**	**-**	**-**	
EXECUTIVE DIRECTOR										
Morné Engelbrecht (iv)	383,291	23,254	-	1,775	29,998	**438,318**	60,975	-	(92,535)	17%
SUB-TOTAL $	**383,291**	**23,254**	**-**	**1,775**	**29,998**	**438,318**	**60,975**	**-**	**(92,535)**	
GRAND TOTALS	**383,291**	**23,254**	**243,808**	**1,775**	**48,409**	**700,537**	**60,975**	**-**	**(92,535)**	

(i) Max Cozjin retired as Non-Executive Director on 21 April 2015
(ii) Peter Hogan's fees were paid directly to Incitec Pivot Limited.
(iii) Louis Rozman's fees were paid directly to Pacific Road Capital Management Holdings Pty Limited.
(iv) Morné Engelbrecht agreed to reduce his salary by 20% during the period 1 February 2015 to 30 April 2015 in recognition of the prevailing business cash flows during that period.
(v) Non-Executive Director fees were reduced by between 20% and 100% for one quarter in recognition of the prevailing business cash flows during that period. Pacific Road Capital Management Holdings Pty Limited elected to waive 100% of Mr Rozman's fees for an additional quarter.
(vi) Morné Engelbrecht was granted 99,999,999 options with share price performance hurdles. As at 30 June 2015 33,333,333 have not yet vested, 33,333,333 were forfeited as a result of failure to meet the share price performance hurdles for 2014 and 33,333,333 were forfeited as a result of failure to meet the share price performance hurdles for this year.

Details of Remuneration (continued)

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

2016	Cash					Non-cash				
	Short term employee benefits		Post-employment benefits			Long-term benefits	Share-based Payments			
	Cash Salary	Other (v)	Super Contributions	Termination Costs	Total	Long Service Leave	Rights (vi)	Shares	Forfeited Right s(vii)	Performance Related
	$	$	$	$	$	$	$	$	$	%
Tracy Bragg (i)	51,016	3,558	5,097	10,341	**70,012**	-	3,240	-	(6,480)	4%
Catherine Costello(ii)	265,506	12,023	25,674	-	**303,203**	-	12,960	-	(16,200)	4%
Justin Haines(iii)	37,435	893	3,556	30,019	**71,903**	-	1,080	-	(4,320)	1%
Stuart MacKenzie (iv)	84,524	-	8,030	-	**92,554**	-	-	-	-	0%
Cliff Mallett	170,441	4,121	34,995	-	**209,557**	5,044	12,960	-	(16,200)	6%
Terry Moore(ii)	237,534	26,023	34,998	-	**298,555**	-	12,960	-	(16,200)	4%
TOTALS	**846,456**	**46,618**	**112,350**	**40,360**	**1,045,784**	**5,044**	**43,200**	**-**	**(59,400)**	

(i) Tracy Bragg ceased to be a KMP upon termination on 30 September 2015.
(ii) Other payments include a partial cash out of annual leave.
(iii) Justin Haines ceased to be a KMP upon termination on 14 August 2015.
(iv) Stuart MacKenzie commenced as General Counsel on 27 November 2015 on a casual basis.
(v) Other payments include car parking, car benefits and a partial cash out of annual leave.
(vi) The value of performance rights is calculated as at the grant date. Performance rights are valued using a Monte Carlo pricing model. The amounts disclosed as part of remuneration have been determined by allocating the grant date value on a straight-line basis over the period of grant date to vesting date.
(vii) Each Executive was granted 5,000,000 performance rights in FY15 with share price performance hurdles. As at 30 June 2016 the remaining 2,500,000 per Executive were forfeited as a result of either termination of employment or failure to meet the share price performance hurdles for this year.

Directors' Report

Remuneration Report (Audited)

Details of Remuneration (continued)

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

2015	Cash				Non-cash				Performance Related
	Short term employee benefits		Post-employment benefits		Long-term benefits	Share-based Payments			
	Cash Salary (v)	Other (i)	Super Contributions	Total	Long Service Leave	Options & Rights (ii) (iii)	Shares (iv)	Forfeited Options & Rights	
	$	$	$	$	$	$	$	$	%
Tracy Bragg	190,161	14,047	19,369	**223,576**	-	3,190	5,584	(1,965)	4%
Catherine Costello	212,199	1,940	20,159	**234,298**	-	4,503	222	(1,965)	2%
Justin Haines	263,209	2,218	18,783	**284,210**	-	1,795	1,563	(1,965)	1%
Cliff Mallett	178,232	2,475	16,932	**197,640**	5,587	314	(6,002)	(1,965)	(3%)
Terry Moore	222,513	2,375	21,139	**246,026**	-	3,549	7,150	(1,965)	4%
TOTALS	**1,066,314**	**23,054**	**96,382**	**1,185,750**	**5,587**	**13,351**	**8,787**	**(9,825)**	

(i) Car parking and car benefits.
(ii) The value of options and rights is calculated as at the grant date. Options are valued using a Black Scholes option pricing model and rights are valued using a Monte Carlo pricing. The amounts disclosed as part of remuneration have been determined by allocating the grant date value on a straight-line basis over the period of grant date to vesting date.
(iii) The value of options and shares include the reversal of the prior year accrual for the 2014 option and share grants, not determined until 2015. The final approval grant of 2014 options and shares was lower than the estimated grant resulting in a credit against the value of the 2015 grant and accrual.
(iv) The expense booked relates to the grant of the shares for 2014 performance and represents the variance between the estimated expense accrued in 2014 and the actual expense upon final determination of achievement of Executive STI KPIs. No STI shares in relation to 2015 performance were accrued as compensation and expensed during the 2015 year due to failure to meet KPIs.
(v) Each Executive agreed to a salary reduction during the period 1 February 2015 to 30 April 2015 (ranging from 20-40%) in recognition of the prevailing business cash flows during that period

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 such that they do not require shareholder approval.

.Name	Term of Agreement	Total Fixed Remuneration (per annum)	Notice Period(iii)	Termination Payments(iii)(iv)(v),(vii)
Morné Engelbrecht(i)	Fixed term contract to 12 August 2016	$425,000	-	-
Chris Rawlings(ii)	From 15 August 2016 until two weeks after the start date of the Chief Executive Officer and Managing Director	$295,651	-	-
Catherine Costello	No fixed term	$295,650(v)	3 months	-
Stuart MacKenzie	Casual basis	nil	7 days	-
Cliff Mallett	3 year fixed term contract to 30 June 2019	$205,432	3 months	12 months
Terry Moore	No fixed term	$270,720(vi)	3 months	-

(i) Morné Engelbrecht's term of appointment was extended from 17 June 2016 to 12 August 2016.
(ii) Chris Rawlings will be appointed Interim Executive Chairman from 15 August 2016 and will remain in this position until two weeks after the start date of the newly appointed Chief Executive Officer and Managing Director. The employment agreement will be terminated two weeks after the start date of the newly appointed Chief Executive Officer & Managing Director. Upon termination Dr Rawlings will revert back to Non-executive Chairman on the same terms and conditions prior to his appointment as Interim Executive Chairman.
(iii) Base salary payable if the Company terminates employment without cause.
(iv) Payable if the Company terminates employment during the term of the agreement.
(v) In addition to the above, the Executive is entitled to receive 20% base salary (cash or equivalent value in shares, at Board discretion) in the event of a change in control of the group.
(vi) In addition, the group is committed to pay 15% Total Fixed Remuneration in the event of a change in control of the group.
(vii) Where no termination payment is specified, statutory entitlements on termination apply, based on length of service.

Directors' Report

Remuneration Report (Audited)

Details of Options and Performance Rights

The following options and performance rights were provided to Executives:

	Options Granted as Remuneration 2016	Options & Rights Granted as Remuneration 2015 (v)
Morné Engelbrecht	-	5,541,564
Tracy Bragg (i)	-	6,172,186
Catherine Costello	-	5,229,190
Justin Haines (ii)	-	6,161,745
Stuart MacKenzie (iii)	-	-
Cliff Mallett	-	5,854,363 (iv)
Terry Moore	-	6,193,919
TOTALS	**-**	**35,152,967**

(i) Tracy Bragg ceased to be a KMP upon termination on 30 September 2015.
(ii) Justin Haines ceased to be a KMP upon termination on 14 August 2015.
(iii) Stuart MacKenzie commenced as General Counsel on 27 November 2015 on a casual basis.
(iv) 657,887 of 2015 grants and all the 2014 grant were exercised during the 2015 year on approval from the Chairman on the basis that the underlying shares received upon the exercise of the options were not being sold but transferred to a related party holding.
(v) These options and performance rights were granted as part of the LTI for the 2015 & 2016 financial year. Terms and conditions for the grant are included in the Financial Statements, Note 15, Share Based Payments.

Options accrued and expensed during the 2016 year that were granted as compensation are as follows:

2016	Options Expensed $	Options Forfeited (iv) Number	Year Options Forfeited were Granted
Morné Engelbrecht	43,188	33,333,333	2014
Tracy Bragg (i)	3,240	2,500,000	2015
Catherine Costello	12,960	2,500,000	2015
Justin Haines (ii)	1,080	2,500,000	2015
Stuart MacKenzie (iii)	-	-	-
Cliff Mallett	12,960	2,500,000	2015
Terry Moore	12,960	2,500,000	2015
TOTALS	**86,388**	**45,833,333**	

(i) Tracy Bragg ceased to be a KMP upon termination on 30 September 2015
(ii) Justin Haines ceased to be a KMP upon termination on 14 August 2015
(iii) Stuart MacKenzie commenced as General Counsel on 27 November 2015 on a casual basis.
(iv) 33,333,333 options and 12,500,000 performance rights were forfeited as a result of failure to meet share price performance hurdle.

Details of Options and Performance Rights (continued)

Options expensed during the 2015 year that were accrued or granted as compensation are as follows:

2015	Options Expensed (i) $	Options & Rights Forfeited (ii)	Year Options & Rights Forfeited were Granted
Morné Engelbrecht	60,975	33,333,333	2014
Tracy Bragg	3,190	2,500,000	2015
Catherine Costello	4,503	2,500,000	2015
Justin Haines	1,795	2,500,000	2015
Cliff Mallett	314	2,500,000	2015
Terry Moore	3,549	2,500,000	2015
TOTALS	**74,356**	**45,833,333**	

(i) Options have vested and with the exception of 657,887 options vested to Cliff Mallett, (which received Chairman approval on the basis that the underlying shares were not sold but transferred to a related party holding) have not been exercised (out of the money).
(ii) Forfeited as a result of failure to meet share price performance hurdles.

No options were exercised during the 2016 year. During the 2015 year, 1,092,843 options were exercised at an exercise price of $0.026 that were granted as compensation in prior periods to current Key Management Personnel. A further 657,887 options relating to the 2015 grant were exercised at an exercise price of $0.0301. Each option converted into one ordinary share of Carbon Energy Limited.

	Number of Options Exercised	Number of Ordinary Shares issued	Amount Paid $	Amount Unpaid $
2016				
Nil	-	-	-	-
2015				
Cliff Mallett	1,750,730	1,750,730	48,216	Nil

Directors' Report

Remuneration Report (Audited)

Equity Instruments held by Key Management Personnel

The tables on the following pages show the number of:

- options or performance rights 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

2016	Balance at 1 Jul 2015	Granted as Remuneration	Options Forfeited	Net Change Other	Balance at 30 Jun 16	Total Vested 30 Jun 16	Total Exercisable 30 Jun 16	Total Unvested 30 Jun 16
Chris Rawlings	3,950,000	-	-	-	3,950,000	3,950,000	3,950,000	-
Morné Engelbrecht	44,417,867	-	(34,947,333)	-	9,470,534	9,470,534	9,470,534	-
Helen Garnett	188,551	-	-	-	188,551	188,551	188,551	-
Peter Hogan	220,000	-	-	-	220,000	220,000	220,000	-
Louis Rozman (i)	44,720,845	-	(9,645,845)	-	35,075,000	35,075,000	35,075,000	-
Huihai Zhuang (ii)	-	-	-	171,818,615	171,818,615	171,818,615	171,818,615	-
George Su (iii)	-	-	-	-	-	-	-	-
TOTAL	**93,497,263**	**-**	**(44,593,178)**	**171,818,615**	**220,722,700**	**220,722,700**	**220,722,700**	**-**

(i) Indirect Holding (35,000,000) represents Pacific Road Resources Funds; Louis Rozman is an employee and Director of some Pacific Road Capital entities. While Mr Rozman has no power to exercise or control the exercise of these options, they are disclosed as a result of the Pacific Road Capital entities being party to the $10 million Convertible Note with Carbon Energy Limited which gave rise to the issue of options.
(ii) Huihai Zhuang commenced as a Director on 29 October 2015.
(iii) George Su was appointed as an alternative Director to Huihai Zhuang on 4 December 2015.

(b) Option Holdings held Directly and Indirectly by Other Key Management Personnel

2016	Balance at 1 Jul 2015	Granted as Remuneration	Options Forfeited	Net Change Other(i)(ii)	Balance at 30 Jun 16	Total Vested 30 Jun 16	Total Exercisable 30 Jun 16	Total Unexercisable 30 Jun 16
Tracy Bragg (i)	3,672,186	-	(2,500,000)	(1,172,186)	-	-	-	-
Catherine Costello	2,729,190	-	(2,500,000)	-	229,190	229,190	229,190	-
Justin Haines(ii)	6,373,153	-	(3,360,000)	(3,013,153)	-	-	-	-
Stuart MacKenzie (iii)	-	-	-	-	-	-	-	-
Cliff Mallett	5,871,963	-	(2,500,000)	-	3,371,963	3,371,963	3,371,963	-
Terry Moore	6,119,168	-	(3,110,000)	-	3,009,168	3,009,168	3,009,168	-
TOTAL	**24,765,660**	**-**	**(13,970,000)**	**(4,185,339)**	**6,610,321**	**6,610,321**	**6,610,321**	**-**

(i) Tracy Bragg ceased to be a KMP upon termination on 30 September 2015.
(ii) Justin Haines ceased to be a KMP upon termination on 14 August 2015.
(iii) Stuart MacKenzie commenced as General Counsel on 27 November 2015 on a casual basis.

Directors' Report

Remuneration Report (Audited)

Equity Instruments held by Key Management Personnel (continued)

(c) Share Holdings held Directly and Indirectly by Directors

2016	Balance at 1 Jul 2015	Granted as remuneration	Renounceable Rights Issue	Net Change Other	Balance at 30 Jun 16
Chris Rawlings	7,150,000	-	1,950,000	-	9,100,000
Morné Engelbrecht	4,546,109	-	-	-	4,546,109
Helen Garnett	665,652	-	50,654	-	716,306
Peter Hogan	600,000	-	150,000	-	750,000
Louis Rozman(i)	123,744,483	-	102,272	38,237,766	162,084,521
Huihai Zhuang (ii)	-	-	219,097,104	295,663,743	514,760,847
George Su (iii)	-	-	-	-	-
TOTAL	**136,706,244**	**-**	**221,350,030**	**333,901,509**	**691,957,783**

(i) Includes direct holding of 477,272 shares and indirect holding of 161,607,249 shares. The Indirect holding represents Pacific Road Resources Funds; Louis Rozman is an employee and Director of some of Pacific Road Capital entities. While Mr Rozman has no power to exercise or control the disposal of these shares, they are disclosed as a result of the Pacific Road entities being party to the $10 million Convertible Note with Carbon Energy Limited.
(ii) Huihai Zhuang commenced as a Director on 29 October 2015.
(iii) George Su was appointed as an alternate Director to Huihai Zhuang on 4 December 2015.

2015	Balance at 1 Jul 2014	Options Exercised	Granted as remuneration	Net Change Other	Balance at 30 Jun 15
Chris Rawlings	6,850,000	-	-	300,000(i)	7,150,000
Morné Engelbrecht	4,506,109	-	-	40,000(i)	4,546,109
Max Cozijn(ii)	1,917,511	-	-	1,917,511	-
Helen Garnett	565,652	-	-	100,000(i)	665,652
Peter Hogan	500,000	-	-	100,000(i)	600,000
Louis Rozman (iii)	105,821,535	-	-	17,922,948(iv)	123,744,483
TOTAL	**120,160,807**	**-**	**-**	**16,545,437**	**136,706,244**

(i) Acquired through 2014 share purchase plan.
(ii) Max Cozijn retired as a Director on 21 April 2015, share holdings no longer reportable from this date.
(iii) Includes direct holding of 375,000 shares and indirect holding of 123,369,483 shares. The indirect holding represents Pacific Road Resources Funds; Louis Rozman is an employee and Director of some of Pacific Road Capital entities. While Mr Rozman has no power to exercise or control the disposal of these shares, they are disclosed as a result of the Pacific Road entities being party to the $10 million Convertible Note with Carbon Energy Limited.
(iv) Includes 300,000 shares acquired through the 2014 share purchase plan and 17,622,948 issued under the terms of the $10 million Convertible Note.

Directors' Report

Remuneration Report (Audited)

Equity Instruments held by Key Management Personnel (continued)

(d) Share Holdings held Directly and Indirectly by Other Key Management Personnel

2016	Balance at 1 Jul 2015	Options Exercised	Granted as remuneration	Net Change Other(i)(ii)	Disposal	Balance at 30 Jun 16
Tracy Bragg (i)	2,250,378	-	-	(1,050,378)	(1,200,000)	-
Catherine Costello	698,659	-	-	-	(200,000)	498,659
Justin Haines (ii)	500,000	-	-	(500,000)	-	-
Stuart MacKenzie (iii)	-	-	-	-	-	-
Cliff Mallett (iv)	19,609,607	-	-	-	-	19,609,607
Terry Moore	4,967,912	-	-	-	-	4,967,912
TOTAL	**28,026,556**	**-**	**-**	**(1,550,378)**	**(1,400,000)**	**25,076,178**

(i) Tracy Bragg ceased to be a KMP upon termination on 30 September 2015.
(ii) Justin Haines ceased to be a KMP upon termination on 14 August 2015.
(iii) Stuart MacKenzie commenced as General Counsel on 27 November 2015 on a casual basis.
(iv) These shares are held indirectly through a self managed superannuation fund.

2015	Balance at 1 Jul 2014	Options Exercised	Granted as remuneration(i)	Net Change Other(ii)	Disposal	Balance at 30 Jun 15
Tracy Bragg	-	-	2,550,378	-	300,000	2,250,378
Catherine Costello	-	-	498,659	200,000	-	698,659
Justin Haines	2,159,042	-	2,527,661	-	4,186,703	500,000
Cliff Mallett (iii)	16,000,000	1,750,730	1,858,877	-	-	19,609,607
Terry Moore	2,070,248	-	2,597,664	300,000	-	4,967,912
TOTAL	**20,229,290**	**1,750,730**	**10,033,239**	**500,000**	**4,486,703**	**28,026,556**

(i) These shares were granted as part of the 2014 STI/LTI.
(ii) Acquired through the 2014 share purchase plan.
(iii) These shares are held indirectly through a self managed superannuation fund.

Directors' Report

Remuneration Report (Audited)

Loans to Key Management Personnel

In 2016 and 2015 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 2016.

Huihai Zhuang (Non-Executive Director) is a Director of a Kam Lung Investment Development Co. Ltd (Kam Lung) which is a major shareholder of Carbon Energy Limited. During the year the Company paid Kam Lung $18,000 as a sub-underwriting fee for underwriting the Renounceable Rights Issue to $1,800,000.

George Su (Non-Executive Director) is a Director of a Silk Road Capital Finance. Amounts paid to Silk Road Capital Finance for Mr Zhuang's services as a Director amount to $26,957 for the year ended 30 June 2016.

Other related party transactions:

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

  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. Pacific Road 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 35,000,000 options have vested in connection with the Facility with varying expiry dates as follows:

Options	Grant Date	Price	Expiry Date
7,000,000	25/01/2012	$0.1678	18/01/2017
28,000,000	29/02/2015	$0.1678	25/02/2017

Directors' Report

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
25/01/2012 (i)	7,000,000	$0.1678	25/01/2012	18/01/2017
25/01/2012 (i)	28,000,000	$0.1678	25/01/2012	25/02/2017
15/10/2013 (ii)	3,507,861	$0.0260	15/10/2013	15/10/2016
06/12/2013 (ii)	3,573,877	$0.0260	06/12/2013	15/10/2016
26/08/2014 (iii)	3,953,516	$0.0301	26/08/2015	25/08/2017
26/08/2014 (iii)	5,541,564	$0.0301	26/08/2015	25/08/2017

(i) Options issued to Pacific Road Capital Management as part of the $10,000,000 Convertible Note Facility (refer Note 5(g)).
(ii) Options granted as remuneration to the Key Management Personnel during 2013 financial year.
(iii) Options granted as remuneration to the Key Management Personnel during 2014 financial year.

Directors' Report

Auditor's Independence Declaration

The lead auditor's independence declaration for the year ended 30 June 2016 has been received and can be found on page 39 of the Annual Report.

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

On behalf of the Directors

Dr Chris Rawlings
Chairman

Brisbane, Queensland
5 August 2016

Morné Engelbrecht
Managing Director

Brisbane, Queensland
5 August 2016

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Auditor's Independence Declaration
To the Directors of Carbon Energy Ltd

In accordance with the requirements of section 307C of the Corporations Act 2001, as lead auditor for the audit of Carbon Energy Ltd for the year ended 30 June 2016, 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 audit; and

b no contraventions of any applicable code of professional conduct in relation to the audit.

Grant Thornton

GRANT THORNTON AUDIT PTY LTD
Chartered Accountants

Cameron Smith

Cameron Smith
Partner - Audit & Assurance

Brisbane, 5 August 2016

Grant Thornton Audit Pty Ltd ACN 130 913 594
a subsidiary or related entity of Grant Thornton Australia Ltd ABN 41 127 556 389

FINANCIAL REPORT 2016

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2016 Financial Report

Consolidated Statement of Profit or Loss and Other Comprehensive Income

FOR THE YEAR ENDED 30 JUNE 2016

		CONSOLIDATED GROUP	
	Notes	2016 $	2015 $
Revenue and other income			
Technology service fee revenue	2	189,069	285,268
Other income	2	2,560,429	3,906,430
Total revenue and other income		**2,749,498**	**4,191,698**
Employee benefits expense	3	(3,066,278)	(4,195,896)
Administration, legal and corporate costs		(1,680,457)	(1,759,193)
Consultancy costs		(546,111)	(1,327,150)
Operating expenditure		(314,013)	(309,537)
Share-based payments	3,15	(75,588)	(83,113)
Depreciation expense	3	(183,052)	(228,713)
Finance costs	3	(1,752,442)	(1,878,719)
Movement in fair value of derivatives	5(f)	9,020	1,884
Impairment expense	3	(95,677,350)	(634,148)
Loss before income tax expense		**(100,536,774)**	**(6,222,887)**
Income Tax Benefit/(Expense)	4	(8,530)	52,122
Loss for the Year		**(100,545,304)**	**(6,170,765)**
Other comprehensive income for the year (net of tax)		-	-
Total Loss including comprehensive income for the year		**(100,545,304)**	**(6,170,765)**
Loss attributable to Owners of the Parent		(100,545,304)	(6,170,765)
Total Loss and comprehensive income attributable to Owners of the Parent		(100,545,304)	(6,170,765)
Overall Operations			
Basic loss per share (cents per share)	7	(6.64)	(0.47)
Diluted loss per share (cents per share)	7	(6.64)	(0.47)

The above consolidated statement of profit or 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 2016

		CONSOLIDATED GROUP	
	Notes	**2016 $**	**2015 $**
Assets			
Current Assets			
Cash and cash equivalents	5(a)	2,208,071	1,688,736
Trade and other receivables	5(b)	177,821	51,878
Other current assets	5(c)	78,027	65,424
Total Current Assets		**2,463,919**	**1,806,038**
Non-Current Assets			
Trade and other receivables	5(b)	267,553	267,553
Intangible assets	6(b)	47,968,814	47,902,732
Construction work in progress	6(c)	-	2,555,334
UCG panel assets	6(d)	-	1,786,888
Property, plant & equipment	6(e)	692,707	834,191
Deferred exploration and evaluation costs	6(f)	-	90,376,990
Other non-current asset	6(g)	-	860,326
Total Non-Current Assets		**48,929,074**	**144,584,014**
Total Assets		**51,392,993**	**146,390,052**
Liabilities			
Current Liabilities			
Trade and other payables	5(d)	643,270	435,158
Loans and borrowings	5(e)	-	1,165,937
Derivative financial liability	5(f)	-	9,020
Financial Liability	5(g)	9,210,047	-
Provisions	6(h)	864,031	386,699
Total Current Liabilities		**10,717,348**	**1,996,814**
Non Current Liabilities			
Provisions	6(h)	2,898,203	3,727,577
Financial Liabilities	5(g)	-	8,029,675
Total Non Current Liabilities		**2,898,203**	**11,757,252**
Total Liabilities		**13,615,551**	**13,754,066**
Net Assets		**37,777,442**	**132,635,986**
Equity			
Issued Capital	8	244,226,148	238,614,976
Reserves	9	20,003,609	19,928,021
Accumulated losses		(226,452,315)	(125,907,011)
Total Equity		**37,777,442**	**132,635,986**

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 2016

	Notes	Issued Capital	Options Reserve	Share-Based Payments Reserve	Other Reserve	Accumulated Losses	Total
		$	$	$	$	$	$
Balance at 1 July 2014		235,606,127	1,650,453	15,983,667	2,101,590	(119,736,246)	135,605,591
Shares issued during the year	8	3,252,563	-	-	--	-	3,252,563
Transaction Costs	8	(243,714)	-	-	-	-	(243,714)
Exercise of options	9	-	(47)	(14,734)	-	-	(14,781)
Movement in share option reserve on	9	-	-	207,092	-	-	207,092
Losses attributable to member of parent		-	-	-	-	(6,170,765)	(6,170,765)
Balance at 30 June 2015		**238,614,976**	**1,650,406**	**16,176,025**	**2,101,590**	**(125,907,011)**	**132,635,986**
Balance at 1 July 2015		238,614,976	1,650,406	16,176,025	2,101,590	(125,907,011)	132,635,986
Shares issued during the year	8	5,908,206	-	-	-	-	5,908,206
Transaction Costs	8	(297,034)	-	-	-	-	(297,034)
Movement in share option reserve on	9	-	-	75,588	-	-	75,588
Losses attributable to member of parent		-	-	-	-	(100,545,304)	(100,545,304)
Balance at 30 June 2016		**244,226,148**	**1,650,406**	**16,251,613**	**2,101,590**	**(226,452,315)**	**37,777,442**

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

Financial Report

Consolidated Cash Flow Statement

FOR THE YEAR ENDED 30 JUNE 2016

	Notes	CONSOLIDATED GROUP 2016 $	2015 $
Cash flows from Operating activities			
Receipts from customers		69,463	172,331
Payments to suppliers and employees		(6,129,129)	(8,140,077)
Receipt of Government Grants		2,490,344	3,787,536
Interest received		60,370	91,442
Taxes paid		(8,530)	-
GST receipts from Australian Taxation Office		267,871	412,879
Other receipts		6,132	12,745
Net cash flows used in operating activities	5(a)	**(3,243,479)**	**(3,663,144)**
Cash flows from Investing Activities			
Payments for property, plant and equipment		(41,568)	(19,684)
Proceeds from disposal of property, plant and equipment		3,819	-
Proceeds on sale of AFS asset		-	-
Proceeds from sale of tenements		-	-
Payments for Exploration & Evaluation costs		(88,423)	(196,881)
Payments for Intangible Assets		(38,385)	(85,709)
Net cash flows used in investing activities		**(164,557)**	**(302,274)**
Cash flows from Financing Activities			
Proceeds from issues of shares		5,406,836	2,566,152
Proceeds from short term loan facility		-	2,665,937
Repayment of short term loan facility		(1,165,937)	(1,500,000)
Term facility costs		(16,493)	(219,413)
Capital raising and financing costs		(297,034)	(245,636)
Net cash flows provided by financing activities		**3,927,372**	**3,267,040**
Net increase/ (decrease) in cash and cash equivalents held		519,335	(698,378)
Cash and cash equivalents at the beginning of the financial year		1,688,736	2,387,114
Cash and cash equivalents at the end of the financial year	5(a)	**2,208,071**	**1,688,736**

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

Notes to the Financial Statements
Group Performance

1. BASIS OF PREPARATION

The consolidated financial statements are presented in Australian dollars, unless otherwise stated.

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 described in the notes. Historical cost is generally based on the fair values of the consideration given in exchange for assets.

(a) 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 Group to continue as going concerns, fund the development and commercialisation of its *keyseam* UCG technology and repay or refinance the $10 million convertible note in January 2017 is dependent upon securing additional funds in the coming months from amongst a range of sources/opportunities including:

- the receipt of the R&D cash incentive to be lodged with the ATO in or around July 2016;
- entering into or refinancing debt facilities;
- the receipt of fees for services provided to the JinHong Joint Venture in China;
- the further licensing and services relating to the Company's *keyseam* UCG technology;
- the evaluation of a renewable energy project at Bloodwood Creek site being determined as feasible and securing funding for the project; and/or
- issuing new equity.

Factors which can influence these opportunities include, but are not limited to, progress of current development and licensing activities, acknowledgement of the proven scientific credentials of the Company's *keyseam* technology by the Queensland government, progress on the evaluation of the renewable energy project 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 Group not receive the forecast cash inflows and additional funding referred to above there are material uncertainties as to whether the Company and the 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.

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 Consolidated Group not continue as going concern.

(b) Principles of Consolidation

A controlled entity is any entity over which Carbon Energy Limited if it is exposed, or has rights, to variable returns from its involvement with the subsidiary and has the ability to affect those returns through its power over the subsidiary.

A list of controlled entities is contained in Note 11 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 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 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.

(c) 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 that they believe to be reasonable under the circumstances. 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 Group. Actual results may differ from these estimates.

(c) Critical Accounting Estimates and Judgements (continued)

The estimates and judgements which involve a higher degree of complexity or that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next period are addressed in the following notes:

Note 2	Revenue (recognition of revenue)
Note 6(a)	Non-financial assets and liabilities (estimated impairment of assets)
Note 6(e)	Non financial assets and liabilities (estimate of the useful life of property, plant and equipment)
Note 6(h)	Non financial assets and liabilities (provision for rehabilitation)
Note 15	Share based payments

2. REVENUE AND OTHER INCOME

	2016 $	2015 $
Revenue		
Technology service fee revenue	189,069	285,268
	189,069	**285,268**
Other income		
Government grants	2,490,344	3,787,536
Interest received	60,135	106,836
Other income	9,950	12,058
	2,560,429	**3,906,430**

Recognition and Measurement

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 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 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 Group's activities, as described below.

Technology Service Fees
The Group provides technology services to customers. Where the delivery of services are provided on a fixed price basis, 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. Otherwise technology services fees are provided on a cost plus an agreed margin basis.

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 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 statement of financial position as a deduction against the assets carrying value.

The Group receives a research and development (R&D) tax incentive 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 Group recognises rebates upon receipt, this income relates to expenditure incurred in the prior financial year.

Interest Received
Interest revenue is recognised using the effective interest rate method.

Critical Accounting Estimates

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. The technology service fees earned during the current year were provided on a cost plus agreed margin. In the prior year the delivery of services was provided on a fixed price basis, with all services provided and recognised during that period.

Notes to the Financial Statements
Group Performance

3. EXPENSES

	Note	2016 $	2015 $
Depreciation			
Motor vehicles	6(e)	6,326	3,406
Plant & equipment	6(e)	176,726	225,307
	6(e)	183,052	228,713
Impairment			
Trade receivables	5(b)	10,480	634,148
Construction work in progress	6(c)	2,555,334	-
UCG Panel assets	6(d)	1,785,796	-
Property, plant and equipment	6(e)	-	-
Deferred exploration and evaluation costs	6(f)	90,465,414	
Chile Project asset	6(g)	860,326	-
		95,677,350	634,148
Employment expenses			
Remuneration and on-costs		2,872,578	3,950,269
Superannuation expense		193,700	245,627
		3,066,278	4,195,896
Share based payments expense			
Share based payments	15	75,588	83,113
		75,588	83,113
Finance costs			
Interest expense		519,774	614,998
Finance facility fees		4,893	157,926
Pacific Road convertible note accretion expense		1,180,372	1,057,233
Rehabilitation provision accretion expense		44,149	48,585
Other finance costs		3,254	(23)
		1,752,442	1,878,719
Operating lease rental expense		404,284	390,151

Recognition and Measurement

Depreciation
Refer to Note 6(e) for details on depreciation

Impairment
Refer to Note 6(a) for details on impairment

Employee Benefits
Refer to Note 6(h) for details on employee provisions and Note 15 for details on share based payments and employee superannuation.

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.

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.

4. INCOME TAX

Income Tax recognised in the Consolidated Statement of Profit or Loss

	2016 $	2015 $
Current year tax (benefit)/expense	(8,530)	52,122
Deferred tax expense	-	-
Prior year tax expense	-	-
Income tax (benefit)/expense	**(8,530)**	**52,122**

Reconciliation between tax (benefit)/expense and profit/(loss) before income tax

	2016 $	2015 $
Operating loss before taxation	(100,536,773)	(6,222,887)
Tax at the Australian tax rate of 30% (2015:30%)	30,161,032	1,866,866
Tax effect of amounts which are not taxable in calculating taxable income		
Non-deductible items	(3,554,669)	(2,204,738)
Other deductible items	43,915	67,657
Net exempt income	736,763	1,109,578
Revaluation and gain on disposal on Investment not subject to income tax	(261,047)	-
Other tax credit not recognised (i)	(8,530)	52,122
Difference in overseas tax rates	-	(221)
Deferred tax assets not brought to account	(27,125,994)	(839,142)
Income tax (benefit)/expense	**(8,530)**	**52,122**

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

Deferred Tax Assets

Future Income tax benefits not brought to account, the benefits of which will only be realised if the conditions for deductibility set out below occur. An income tax Consolidated Group was formed from 1 July 2008

	2016 $	2015 $
Balance at the beginning of the year	70,456,678	69,695,351
Adjustment to prior year carry forward losses	48,306	(57,435)
Temporary differences	(22,273)	(20,380)
Tax losses (after income tax at 30%)	27,125,994	839,142
Deferred tax assets not brought to account	**97,608,705**	**70,456,678**

Recognition and Measurement

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 reporting date.

Deferred tax is accounted for using the statement of financial position 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 profit or loss and other 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.

Deferred tax assets and liabilities are offset where a legally enforceable right of set-off exists, when they relate to income taxes levied by the same taxation authority and the Group intends to settle its current tax assets and liabilities on a net basis.

The amount of benefits brought to account or which may be realised in the future is based on the assumption that no adverse change will occur in income taxation legislation and the anticipation that the 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.

5. FINANCIAL ASSETS AND LIABILITIES

Financial assets	Note	Current	Non-current	2016 $ Total	Current	Non-current	2015 $ Total
Cash and cash equivalents							
Cash at bank		258,071	-	258,071	238,736	-	238,736
Short term deposits		1,950,000	-	1,950,000	1,450,000	-	1,450,000
Total cash and cash equivalents	5(a)	2,208,071	-	2,208,071	1,688,736	-	1,688,736
Trade and other receivables							
Trade receivables		138,277	-	138,277	663,619	-	663,619
Provision for impairment of trade receivable		(10,480)	-	(10,480)	(634,148)	-	(634,148)
Other receivables		50,024	-	50,024	22,407	-	22,407
Deposits		-	267,553	267,553	-	267,553	267,553
Total trade and other receivables	5(b)	177,821	267,553	445,374	51,878	267,553	319,431
Other current assets							
Unbilled Revenue		25,121	-	25,121	-	-	-
Prepayments		52,906	-	52,906	65,424	-	65,424
Total other current assets	5(c)	78,027	-	78,027	65,424	-	65,424
Total financial assets		2,463,919	267,553	2,731,452	1,806,038	267,553	2,073,591

Financial liabilities	Note	Current	Non-current	2016 $ Total	Current	Non-current	2015 $ Total
Trade and other payables							
Trade payables		370,652	-	370,652	293,944	-	293,944
Other payables		272,618	-	272,618	141,214	-	141,214
Total trade and other payables	5(d)	643,270	-	643,270	435,158	-	435,158
Loans and borrowings							
Loan facility (secured)	5(e)	-	-	-	1,165,937	-	1,165,937
Derivative financial liability							
Derivative out of Credit Suisse loan facility	5(f)	-	-	-	9,020	-	9,020
Financial liabilities							
Convertible note facility (secured)	5(g)	9,210,047	-	9,210,047	-	8,029,675	8,029,675
Total financial liabilities		9,210,047	-	9,210,047	-	8,029,675	8,029,675

5(a) Cash and Cash Equivalents

	2016 $	2015 $
Cash and cash equivalents	2,208,071	1,688,736
Reconciliation of cash flow from operations with loss after income tax		
Loss after income tax	(100,545,303)	(6,170,765)
Adjustments for:		
Depreciation	183,052	228,713
Interest expense	517,860	719,413
Accretion expense (FV discount)	1,153,766	828,573
Share options expensed	75,588	378,723
Movement in fair value of derivative	(9,020)	(1,884)
Impairment of non financial assets	95,666,870	-
Asset disposal	(3,818)	-
Other	2	468
Changes in assets and liabilities:		
(Increase)/Decrease in trade receivables and other current assets	(138,546)	1,382,591
Increase /(Decrease) in trade creditors and accruals	208,113	(517,214)
(Decrease) / Increase in deferred revenue	-	(873,106)
(Decrease)/Increase in provisions	(352,042)	361,344
Net cash flows used in operating activities	(3,243,479)	(3,663,144)

5(a) Cash and Cash Equivalents (continued)

Recognition and Measurement

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.

5(b) Trade and Other Receivables

Provision for impairment of trade receivables

A provision for impairment has been made against a debtor for rechargeable expenses. In 2015, advance payments for deferred billings were applied against the $1,394,317 due from Haoqin Mining in relation to the Inner Mongolia Project. A provision has been made against the Haoqin project due to the continued delay experienced in payment.

Non-current other receivables are for deposits in relation to the lease of office premises, environmental bonds and a bank credit card facility.

5(c) Other Current Assets

Unbilled revenue includes amounts to be charged to the Beijing JinHong New Energy Development Co.

5(d) Trade and Other Payables

Other payables relates to expenses incurred and not yet invoiced.

5(e) Loans and borrowings

On 29 January 2015 the Company secured a loan facility with Macquarie bank for $1.2 million to assist in funding its short term working capital requirements prior to receipt of the 2015 Research and Development tax incentive rebate. The facility was drawn down on 30 January 2015 and subsequently repaid in full during August 2015, upon receipt of the Research and Development rebate from the Australian Tax Office. Financing costs incurred for this facility during 2016 were $16,493.

	2016 $	2015 $
Opening balance	**1,165,937**	**-**
Loan proceeds	-	2,665,937
Less: Repayment	(1,165,937)	(1,500,000)
Secured loan debt outstanding at balance date	-	1,165,937
Unused credit facility	-	34,063

5(f) Derivative Financial Liability

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 had 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 was treated as an embedded derivative and accordingly the value was classified as a derivative financial liability and measured at fair value.

The options expired on 15 November 2015 without being exercised by Credit Suisse. The derivative financial liability value was reduced to Nil resulting in a credit to the profit and loss of $9,020 for period from extinguishment of the liability.

The reconciliation of the derivative financial liability is as follows:

	2016 $	2015 $
Opening balance	9,020	10,904
Additions	-	-
Fair value adjustment recognised in the profit and loss	(9,020)	(1,884)
Closing balance	**-**	**9,020**

5(g) Financial Liabilities

	2016 $	2015 $
Opening balance	8,029,675	6,972,442
Accretion	1,180,372	1,057,233
Closing balance	**9,210,047**	**8,029,675**

The total secured Pacific Road Capital "Pacific Road" convertible note outstanding at 30 June 2016 is $10,000,000. A reconciliation of the financial liability to the convertible note is as follows:

	2016 $
Financial liability as at 30 June 2016	9,210,047
Fair value discount to unwind in future periods	789,953
Convertible note outstanding as at 30 June 2016	**10,000,000**
Future interest payments at 5% (refer to Note 10(b))	278,082

The Equity component of $2,101,590 has been credited to equity (Other Reserve). 35,000,000 unlisted 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. The 2013 rights issue resulted in a recalculation of the exercise price of these options which has reduced to $0.061. These options expired on 15 November 2015 without being exercised by Pacific Road

Pacific Road 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 a 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 Road Convertible Note Facility is secured by a mortgage over the UCG technology and software transferred from CSIRO to Carbon Energy and 100% of the shares in Carbon Energy (Operations) Pty Limited, the subsidiary that owns the UCG technology and software transferred from CSIRO.

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 8.

As noted, the Facility is to be repaid by 18 January 2017, less than 12 months from the date of signing the financial report. This note should be read in conjunction with Note 1(a) Going Concern.

The Company is currently working with third parties in relation to the renegotiation and/or replacement of the convertible note facility. The Company's Chinese joint venture partner has indicated that they want to see progress being made on the renegotiation and/or replacement of the convertible note facility to de-risk the capitalisation of the Chinese Joint Venture and the progress being made on advancing the activities of the joint venture.

5(h) Accounting Policies - 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.

Financial Assets

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 profit or loss and other comprehensive income in the period in which they arise.

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.

5(h) Accounting Policies - Financial Instruments (continued)

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 profit or loss and other comprehensive income.

De-recognition of Financial Assets
Financial assets are derecognised where the contractual rights to receipt of cash flows expires 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.

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.

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 facilities to assist with 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.

Compound Instruments
The component parts of compound instruments (convertible bonds) issued by the 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 Group’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 re-measured. 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.

De-recognition of Financial Liability
The Group derecognises financial liabilities when, and only when the 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.

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.

Notes to the Financial Statements
Assets and Liabilities

6. NON FINANCIAL ASSETS AND LIABILITIES

30 June 2016	Note	Opening balance	Additions	Impairment loss	Change in rehabilitation provision	Other movements	Closing balance
Technology asset							
Intangible assets	6(b)	**47,902,732**	**66,082**	**-**	**-**	**-**	**47,968,814**
Queensland assets							
Construction work in progress	6(c)	2,555,334	-	(2,555,334)	-	-	-
UCG panel assets	6(d)	1,786,888	-	(1,785,796)	(1,092)	-	-
Property, plant and equipment	6(e)	834,191	41,568	-	-	(183,052)	692,707
Deferred exploration and evaluation costs	6(f)	90,376,990	77,944	(90,454,934)	-	-	-
		95,553,403	**119,512**	**(94,796,064)**	**(1,092)**	**(183,052)**	**692,707**
Other non-financial assets and liabilities							
Other non current asset	6(g)	860,326	-	(860,326)	-	-	-
Current provisions	6(h)	386,699	202,209	-	579,413	(304,290)	864,031
Non-current provisions	6(h)	3,727,577	26,967		(856,341)	-	2,898,203
		4,974,602	**229,176**	**(860,326)**	**(276,928)**	**(304,290)**	**3,762,234**
Total non financial assets		**148,430,737**	**414,770**	**(95,656,390)**	**(278,020)**	**(487,342)**	**52,423,755**

30 June 2015	Note	Opening balance	Additions	Impairment loss	Change in rehabilitation provision	Other movements	Closing balance
Technology asset							
Intangible assets	6(b)	47,598,834	87,225		216,673		47,902,732
Queensland assets							
Construction work in progress	6(c)	2,555,334	-	-	-	-	2,555,334
UCG panel assets	6(d)	1,774,901	-	-	11,987	-	1,786,888
Property, plant and equipment	6(e)	1,043,282	19,684	-	-	(228,775)	834,191
Deferred exploration and evaluation costs	6(f)	90,180,110	196,880	-	-	-	90,376,990
		95,553,627	216,564	-	11,987	(228,775)	95,553,403
Other non-financial assets and liabilities							
Other non current asset	6(g)	860,326	-	-	-	-	860,326
Current provisions	6(h)	829,337	312,020	-	(509,103)	(245,555)	386,699
Non-current provisions	6(h)	2,923,595	17,634	-	786,348	-	3,727,577
		4,613,258	329,654	-	277,245	(245,555)	4,974,602
Total non financial assets		147,765,719	633,443	-	505,905	(474,330)	148,430,737

6(a) Impairment of Tangible and Intangible Assets other than Goodwill

Recognition and Measurement

At the end of each reporting period, the 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
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.

Tangible Assets
At the end of each reporting period, tangible assets are assessed for events or changes in circumstances that indicate that the carrying amount may not be recoverable. Deferred exploration and evaluation costs are assessed under AASB 6- Exploration for and Evaluation of Mineral Resources. All other assets are assessed under AASB 136 – Impairment of Assets.

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).

6(a) Impairment of Tangible and Intangible Assets other than Goodwill (continued)

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.

Critical Accounting Estimates

The Group assesses impairment at each reporting date by evaluating conditions specific to the Group that may lead to impairment of assets. Where an impairment trigger exists, the recoverable amount of the asset is determined. The value-in-use and/or fair value, less cost of disposal calculations performed in assessing recoverable amounts incorporate a number of key estimates.

UCG Intangible Assets
The value in use cash flows have been estimated for each potential project based on the technology, licence and service fees and ongoing royalty contractual arrangements entered into or contracts under negotiation to date. The growth factor is based on known and potential projects expected to progress to a commercial scale.

Deferred Exploration and Evaluation Assets
The deferred exploration and evaluation assets are assessed for impairment indicators using guidance in AASB 6 which are deemed appropriate for the Group's stage of development. If an impairment trigger arose the recoverable value would be calculated by modelling the fair value less cost of disposal of the Blue Gum Gas Project. During the year the Queensland government announced it intended to not allow UCG in Queensland. This was effective from 18 April 2016 with legislation expected to be passed by the end of 2016. The success of a future gas project in Queensland would require the government or a subsequent government to reverse this decision, so the directors have determined that it is appropriate to book an impairment charge writing down the assets allocated top the Blue Gum Gas Project. The Company's Gross 100% Syngas Energy Reserves have been reclassified to 2C Contingent Resource.

Detailed information about each of these estimates and judgements is included in Note 6(b) and 6(f) respectively.

6(b) Intangible Assets

Recognition and Measurement

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.
- 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.

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 $88,424 (2015: $87,225) was added to the 'know-how' intangible asset during the 2016 financial year for ongoing patent costs following achievement of 'Proof of Concept' of the Company's *keyseam* UCG Technology.

Internally generated UCG intangible assets recognised by the Group have an indefinite life and are not amortised. 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. The Company has assessed that the asset is regenerative and knowledge continues to build. Such assets are tested for impairment in accordance with the policy stated in Note 6(a).

6(b) Intangible Assets (continued)

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 pre-tax discount rate of 20.0% (2015: 20.6%). The value in use cash flows have been estimated by management based on the technology, licence and service contractual arrangements entered into to date or contemplated and the estimated cash inflows expected to be generated over the life of such agreements. The underlying projects currently reflect an estimated project life of 25 years which is consistent with the expected scale of commercial projects of this nature. Growth in the cash flows assumes a number of international licensing projects progress to commercial scale. In addition, for China opportunities, it has been assumed that the JinHong joint venture (JinHong JV) will complete a demonstration project and obtain the exclusive right to license *keyseam* in China. The cash flow models assume the JinHong JV licenses one project before exclusivity is obtained and five projects once exclusivity is achieved. Under the terms of the JinHong JV agreement, the Company receives 90% of licence fees during the non-exclusive period and has a 30% interest once the JinHong JV has the exclusive rights. The Company receives 100% of the technical service fees from all China projects. Projects have been allocated probability weightings ranging from 5% to 100%. The recoverable value is sensitive to significant changes in these probability weightings. Management also believes that any other 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.

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.

6(c) Construction Work in Progress

Construction work in progress related to Panel 3 at Bloodwood Creek, Dalby in Queensland. This asset was impaired at 30 June 2016. Refer to Note 6(a) for detailed information.

6(d) UCG Panel Assets

Recognition and Measurement

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 depletion of the economically recoverable gas assets.

This asset was impaired at 30 June 2016. Refer to Note 6(a) for detailed information.

6(e) Property, Plant and Equipment

	Freehold Land	Motor Vehicles	Property, Plant & Equipment	Total
	$	$	$	$
At 30 June 2016				
Cost	408,016	82,246	1,262,634	1,752,896
Accumulated depreciation	-	(82,246)	(977,943)	(1,060,189)
Net book amount	**408,016**	**-**	**284,691**	**692,707**
Movement:				
Opening net book amount	408,016	6,326	419,849	834,191
Transfer between asset classes	-	-	-	-
Additions	-	-	41,568	41,568
Disposals	-	-	-	-
Depreciation expense	-	(6,326)	(176,726)	(183,052)
Closing net book amount	**408,016**	**-**	**284,691**	**692,707**
At 30 June 2015				
Cost	408,016	82,246	1,221,067	1,711,329
Accumulated Depreciation	-	(75,920)	(801,218)	(877,138)
Net book amount	**408,016**	**6,326**	**419,849**	**834,191**
Movements:				
Opening net book amount	408,016	19,814	615,452	1,043,282
Transfer between asset classes	-	(10,082)	10,082	-
Additions	-	-	19,684	19,684
Disposals	-	-	(62)	(62)
Depreciation expense	-	(3,406)	(225,307)	(228,713)
Closing net book amount	**408,016**	**6,326**	**419,849**	**834,191**

6(e) Property, Plant and Equipment (continued)

Recognition and Measurement

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

The cost of plant and equipment constructed within the 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 Group and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the statement of profit or loss and other comprehensive Income during the financial period in which they are incurred.

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

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

Motor vehicles	22.50%
Plant and equipment (includes furniture and fittings)	7.5-50%
Water monitoring assets	4%
Site infrastructure	4%
Bloodwood Creek Trial plant and equipment assets	4%

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each reporting 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 profit or loss and other comprehensive income.

Critical Accounting Estimates

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.

6(f) Deferred Exploration and Evaluation Costs

Recognition and Measurement

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 will be transferred to the relevant class of asset and depreciated 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.

This asset was impaired at 30 June 2016. Refer to Note 6(a) for detailed information.

6(g) Other Non-Current Asset

This asset relates to capitalised costs for a proposed UCG project in Chile.

During the year the Group recognised an impairment expense for this project of $860,326 to reflect the increased uncertainty around the timing of the project commencing.

Notes to the Financial Statements
Assets and Liabilities

6(h) Provisions

	2016 $	2015 $
Current		
Employee benefits	284,618	386,699
Rehabilitation	579,413	-
	864,031	**386,699**
Non-current		
Employee benefits	75,464	48,496
Rehabilitation	2,822,739	3,679,080
	2,898,203	**3,727,577**
Total provisions	**3,762,234**	**4,114,276**

Movement in provision - Rehabilitation:	2016 $	2015 $
Opening balance	3,679,080	3,401,835
Reduction for revised cost estimates	(356,865)	-
Cash spend	-	-
Movements in discount rates	249,844	94,019
Unwinding of discount	-	48,585
Movements in timing of expenditure	(169,907)	134,641
Closing balance	**3,402,152**	**3,679,080**
Current	**579,413**	**-**
Non-current	**2,822,739**	**3,679,080**

Recognition and Measurement

Employee Provisions

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

Liabilities expected to be settled within 12 months are measured at the amounts expected to be paid when the liabilities are settled. 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.

Liabilities not expected to be settled wholly within 12 months are measured as the present value of the estimated future cash outflows to be made by the 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 high quality corporate bonds with terms and currencies that match, as closely as possible, the estimated future cash outflows.

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, decommissioning of wells 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 while the asset remains capitalised, as all the assets to which restoration and rehabilitation had been capitalised have been impaired as at 30 June 2016, the current and any future changes in these costs are credited or expensed through the profit and loss. 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, when the cost of the asset was recognised.

Notes to the Financial Statements
Assets and Liabilities

6(h) Provisions (continued)

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.

As the Panel assets to which restoration and rehabilitation had been capitalised have been impaired as at 30 June 2016, the current and any future changes in these costs are credited or expensed through the profit and loss.

Critical Accounting Estimates

Provision for Restoration and Rehabilitation

The Group recognises that it has an obligation to restore and rehabilitate the area disturbed as a result of its exploration and development activities. The provision for rehabilitation is based on the best estimate of the current obligations to rehabilitate the Bloodwood Creek site.

The Group lodged a rehabilitation plan for the site with the Queensland government in the prior year and awaits the Queensland government's response. Notwithstanding that a response has not yet been received by the Queensland government the Group has reviewed the current estimate on the basis of the proposed plan and factoring in monitoring results subsequent to lodgement of the plan and has updated the provision. The current estimate uses valuations provided by external consultants. Three possible cases have been considered and weighted according to their likelihood.

To calculate the present value of the provision for rehabilitation, the Group has taken the weighted 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.

Notes to the Financial Statements
Capital Structure and Risk Management

7. EARNINGS PER SHARE (EPS)

	2016 $	2015 $
Net loss for the year attributable to members of the parent entity	(100,545,304)	(6,170,765)
Basic loss per share (cents per share)	(6.64)	(0.47)
Weighted average number of ordinary shares outstanding during the year used in calculation of basic EPS	**1,513,807,932**	1,315,727,953
Diluted loss per share (cents per share)	(6.64)	(0.47)
Weighted average number of ordinary shares outstanding during the year used in calculation of diluted EPS	**1,513,807,932**	1,315,727,953

Options and performance rights outstanding at 30 June 2016, totalling 495,273,222 are not considered to be dilutive potential ordinary shares as the effect is anti-dilutive due to the nature of vesting conditions.

8. ISSUED CAPITAL

	2016		2015	
	No. shares	$	No. shares	$
Share capital				
1,775,730,120 fully paid ordinary shares (2015: 1,345,742,829)				
Movement:				
Balance at start of period	1,345,742,829	238,614,976	1,265,979,607	235,606,127
Interest costs in relation to drawdown of Tranche A and Tranche B (Pacific Road convertible note facility)	38,237,766	501,370	17,622,948	499,999
Issue of shares as a result of share rights and options exercised under employee short and long term executive incentive plan	-	-	11,783,969	234,582
Exercise of listed options	-	-	12,000	767
Share purchase plan Issue	-	-	50,344,305	2,517,215
Private Placement Issue	123,845,128	1,924,081	-	-
Renounceable Rights Issue	267,904,397	3,482,755	-	-
Share issue costs	-	(297,034)	-	(243,714)
Balance at end of period	**1,775,730,120**	**244,226,148**	**1,345,742,829**	**238,614,976**

Ordinary Fully Paid Shares

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

Ordinary shares participate in dividends and the proceeds on winding up of the parent entity in proportion to the number of shares held. 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.

38,237,766 ordinary fully paid shares were issued at a price range from $0.010 to $0.0163 each under the $10 million Pacific Road Convertible Note Facility Agreement to cover the interest costs in relation to the Facility.

123,845,128 ordinary fully paid shares were issued at a price of $0.016 each for investment of shareholder funds from Kam Lung Development Company Ltd, raising $1,924,081.

267,904,367 ordinary fully paid shares were issued at a price of $0.013 each for the Renounceable Rights Issue raising $3,482,755 before costs.

Recognition and Measurement

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

Listed Options

As at year end the Company has on issue 443,696,404 $0.06 listed options expiring on 31 July 2016.

Unlisted Options and Performance Rights

As at year end the Company has on issue 51,576,818 unlisted options. All the unlisted options have vested and are exercisable. Exercise prices for unlisted options range from $0.026 to $0.1678.

The Company had no unlisted performance rights on issue at the end of the year.

Refer to Note 15 for further details of outstanding options and performance rights. Options and performance rights carry no rights to dividends and no voting rights.

8. 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 2016 (2015: Nil).

Stock Exchange Listing

Quotation has been granted for 1,775,730,120 (2015: 1,345,742,829) 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.

9. RESERVES

	2016 $	2015 $
Share based payments reserve	16,251,613	16,176,025
Options reserve	1,650,406	1,650,406
Other reserve	2,101,590	2,101,590
Total reserves	**20,003,609**	**19,928,021**

Movements in reserves and reserve balances are detailed in the consolidated statement of changes in equity. The nature and purpose of each reserve account is as follows:

Share Based Payments Reserve
The share based payments reserve is used to recognise the fair value of options and performance rights issued to employees, including Key Management Personnel in relation to equity-settled share based payments.

Options Reserve
The options reserve records the value of listed options on issue.

Other Reserve
The other reserve records the conversion option attached to the Pacific Road Convertible Note Facility. The conversion option remains deferred in the reserve until the conversion option is exercised. Refer to Note 5(g) for additional information.

10. FINANCIAL RISK MANAGEMENT

Financial Risk Management Objectives

The 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 Group's growth activities.

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

The 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 8 in the case of capital risk management.

10. FINANCIAL RISK MANAGEMENT (continued)

(a) Liquidity Risk

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

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

The following tables detail the 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 Group can be required to pay.

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

		Payables Maturity Analysis			
2016	**TOTAL**	**<1 year**	**1-2 years**	**2-3 years**	**>3 years**
Trade and other payables	643,270	643,270	-	-	-
Pacific Road Convertible Note	10,000,000	10,000,000	-	-	-
Macquarie Loan Facility	-	-	-	-	-
Interest payable	278,082	278,802	-	-	-
	10,921,352	**10,921,352**	**-**	**-**	**-**
2015					
Trade and other payables	435,158	435,158	-	-	-
Pacific Road Convertible Note	10,000,000	-	10,000,000	-	-
Macquarie Loan Facility	1,165,937	1,165,937	-	-	-
Interest payable	844,490	566,408	278,082	-	-
	12,445,585	**2,167,503**	**10,278,082**	**-**	**-**

(b) Market Risk

(i) Interest Rate Risk

The Group's exposure to the risks of changes in market interest rates relates largely to the 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 Group to cash flow interest rate risk.

The Pacific Road convertible note facility is a 5% fixed rate debt which exposes the 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 and 100% of the shares in Carbon Energy (Operations) Pty Limited, the subsidiary that owns the UCG technology and software transferred from CSIRO.

The Group entered into a $1.5m loan facility with Macquarie Bank on 29 January 2015 to assist in funding the Company's short term working capital requirements until receipt of the 2015 research and development tax incentive rebate. The loan repaid in full during August 2015, upon receipt of the Research and Development rebate from the Australian Tax Office. The loan had a fixed 13.5% interest rate for the drawn component and a 3% interest rate for the undrawn balance. The loan was secured by a mortgage over all other remaining assets of the Company not subject to the security held under the Pacific Road convertible note facility at the time the loan facility was entered into.

10. FINANCIAL RISK MANAGEMENT (continued)

(b) Market Risk (continued)

In regard to its interest rate risk, the 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 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 Group's exposure to interest rate risk and the effective weighted average interest rate for each class of these financial instruments.

	Weighted Ave		Floating Interest		Fixed Interest Rate		Non-Interest		Total	
	2016	2015	2016	2015	2016	2015	2016	2015	2016	2015
	%	%	$	$	$	$	$	$	$	$
Cash	2.85	2.84	255,069	237,926	1,950,000	1,450,000	3,002	810	**2,208,071**	1,688,736
Receivables	2.92	2.98	-	-	235,053	235,053	210,321	84,378	**445,374**	319,431
Total financial assets			**255,069**	237,926	**2,185,053**	1,685,053	**213,323**	85,188	**2,653,445**	2,008,167
Trade and other payables	-		-	-	-	-	(643,270)	(435,158)	**(643,270)**	(435,158)
Financial liability – Macquarie Bank	-	13.5	-	-	-	(1,165,937)	-	-	-	(1,165,937)
Financial liability – Pacific Road	5.00	5.00	-	-	(9,210,047)	(8,029,675)	-	-	**(9,210,047)**	(8,029,675)
Total financial liabilities			**-**	-	**(9,210,047)**	(9,195,612)	**(643,270)**	(435,158)	**(9,853,317)**	(9,630,770)
Net financial assets (liabilities)			**255,069**	237,926	**(7,024,995)**	(7,510,560)	**(429,947)**	(349,970)	**(7,199,872)**	(7,622,603)

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 2016		Interest Rate Risk Sensitivity 2015	
	+10% Profit $	-10% Profit $	+10% Profit $	-10% Profit $
Cash	718	(718)	676	(676)
Receivables	-	-	-	-
Total financial assets	**718**	**(718)**	**676**	**(676)**
Trade and other payables	-	-	-	-
Financial liability – Macquarie Bank	-	-	-	-
Financial liability – Pacific Road	-	-	-	-
Total financial liabilities	**-**	**-**	**-**	**-**
Net financial assets (liabilities)	**718**	**(718)**	**676**	**(676)**

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 2016 by approximately 25 basis points. This would represent approximately one RBA interest rate increase/(decrease) which is reasonably possible in the current environment.

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 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 Group only invests in equity securities approved by the Board of Directors and where the investment provides a strategic advantage to the Group. The Group 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 Group's foreign transactions have not been material however this will be monitored going forward to ensure foreign currency risk is managed effectively.

10. FINANCIAL RISK MANAGEMENT (continued)

(c) Credit Risk

Credit risk arises mainly from cash and cash equivalents and deposits with banks and financial institutions. Receivables include amounts owing from the Beijing JinHong New Energy Development Co. and, amounts on deposit and interest.

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 5(b) to the financial statements.

The credit risk for counterparties in trade and other receivables at 30 June 2016 are not credit rated by the Company. Their maturities are detailed below:

	2016 $	2015 $
Contracted maturities of receivables for year ended 30 June 2016		
Receivable:		
Less than 6 months	127,797	17,972
6 to12 months	-	-
1 to 5 years	-	-
Later than 5 years	-	-
	127,797	**17,972**

(d) Net Fair Values of Financial Instruments Carried at Fair Value through Profit and Loss

Fair Value Technique Utilised

The fair value of the financial liability was 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 was treated as an embedded derivative and the value classified as a derivative financial liability. These options were not exercised and expired on 15 November 2015.

Notes to the Financial Statements
Unrecognised Items

11. CONTROLLED ENTITIES

	Country of Incorporation	Principal Activity	Percentage Owned 2016 %	Percentage Owned 2015 %
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	Dormant company	100	100
Carbon Energy (Galilee) Pty Ltd	Australia	Dormant company	100	100
Carbon Energy (Latin America) Pty Ltd	Australia	Holding company for the investment in Mulpun, Chile	100	100
Carbon Energy Chile Limitada	Chile	To jointly assess and develop an Underground Coal Gasification project at Mulpun, Chile	100	100

The subsidiaries noted above are all controlled entities and are dependent on the parent entity for financial support. At year end, total loans to these subsidiaries amount to $40,730,292 (2015: $46,853,170).

12. PARENT ENTITY DISCLOSURES

Financial information for the parent entity is as follows:

	2016 $	2015 $
Assets		
Current assets	2,212,235	1,702,476
Non-current assets	45,269,166	140,466,805
Total assets	**47,481,401**	**142,169,281**
Liabilities		
Current liabilities	9,703,959	1,503,620
Non-current liabilities	-	8,029,675
Total liabilities	**9,703,959**	**9,533,295**
Equity		
Issued capital	244,226,148	238,614,976
Accumulated losses	(226,452,315)	(125,907,011)
Reserves		
Share based payments reserve	16,251,613	16,176,025
Options reserve	1,650,406	1,650,406
Other reserve	2,101,590	2,101,590
Total equity	**37,777,442**	**132,635,986**

	2016 $	2015 $
Loss for the year	100,545,304	6,170,766
Other comprehensive income	-	-
Total comprehensive loss	**100,545,304**	**6,170,766**

Refer Note 13(d) for Contingent Liabilities.

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 and 100% of the shares in Carbon Energy (Operations) Pty Limited, the subsidiary that owns the UCG technology and software transferred from CSIRO.

The inter company receivable has been written down to its recoverable amount. An impairment of $97,666,116 was recognised on other intercompany receivables for the year ended 30 June 2016 (2015: $6,242,104).

13. COMMITMENTS, CLAIMS, GUARANTEES, CONTINGENT ASSETS AND LIABILITIES, AND CREDIT FACILITIES

(a) Exploration Commitments

The Group is required to perform ongoing exploration expenditure and has certain statutory obligations to perform minimum exploration work on its tenements. 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 Group.

Applications have been lodged with the Department of Natural Resources & Mines (DNRM) for extensions to a number of tenements and consequently the statutory exploration commitments for these tenements are deferred and awaiting decision. The statutory expenditure requirements 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.

During the period the DNRM granted renewal of Mineral Development Licence 374 (MDL 374) through until 31 January 2018 following the lodgement of an updated work plan in October 2015. The original renewal application was lodged with DNRM in July 2012. The workplan stated that no further panels will be initiated until the Government finalises its policy in relation to Underground Coal Gasification and the necessary approvals are gained to support a commercial project, which is reflected in the renewal documents. On 18 April 2016 the Queensland government announced it would not allow UCG in Queensland with legislation expected to be passed by the end of 2016. In June 2016, the Government formally confirmed to the Company their decision to prohibit UCG activities in Queensland noting that activities relating to environmental rehabilitation and the decommissioning and removal of plant and equipment will be the only activities permitted on MDL 374.

	2016 $	2015 $
These obligations which are not provided for in the financial statements and are payable:		
• not later than one year	79,926	84,839
• later than one year but not later than five years	575,200	908,611
	655,126	**933,450**

(b) Operating Lease Commitment

The Group leases assets for operations including equipment and office premises. The leases have a life of between 11 months and 3 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.

	2016 $	2015 $
Non-cancellable operating leases contracted for but not capitalised in the financial statements		
• not later than one year	418,616	404,284
• later than one year but not later than five years	686,003	1,109,652
	1,104,619	**1,513,936**

(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.

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.

13. COMMITMENTS, CLAIMS, GUARANTEES, CONTINGENT ASSETS AND LIABILITIES, AND CREDIT FACILITIES (continued)

(d) Contingent Liabilities

The following contractual matters are in progress:

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 has dismissed the Complaint without the need for a hearing. The Court found that Carbon Energy had sufficiently demonstrated that permitting the action to proceed in the Northern District of California would be unnecessarily burdensome and that the factors considered by the Court weighed in favour of the matter being dismissed on the basis of forum non conveniens. Accordingly, the Court did not need to consider the merits of Carbon Energy's motions to dismiss and strike Summa's claim.

(e) Bank Guarantees

	2016 $	2015 $
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	32,500	32,500
Amount Utilised	(32,500)	(32,500)
Unused Bank Credit Facility	**-**	**-**
Interest rates on these credit facilities are variable and subject to adjustment.		
Bank Guarantee in relation to Environmental bonds	53,140	53,140
Bank Guarantee in relation to the entity's share of guarantee for lease of office premises	181,913	181,913

(f) Other Credit Facilities

	2016 $	2015 $
Pacific Road convertible note facility	10,000,000	10,000,000
Macquarie Bank finance facility	-	1,165,937
	10,000,000	**11,165,937**
Unused credit facility	**-**	34,063

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 and 100% of the shares in Carbon Energy (Operations) Pty Limited. The facility is due to be repaid on/before 18 January 2017. Refer to Note 1(a) Going Concern and Note 5 Financial Assets and Liabilities for additional information.

14. EVENTS SUBSEQUENT TO BALANCE DATE

As announced on the 25 July 2016 the Company received confirmation from the Queensland government Chief Scientist, Dr Geoff Garrett (refer page 8) that Carbon Energy has satisfactorily completed the recommendations of the government appointed Independent Scientific Panel (ISP) and was the only Company to have done so. The ISP process has therefore now been successfully concluded.

Further to the close of the renounceable rights issue on 4 April 2016, under its Rights Issue Shortfall allocation the Company issued 30,769,232 shares on 4 July 2016 raising $400,000 before costs.

The Company has entered into a sub-lease for a portion of its corporate office accommodation, effective from 1 August 2016. Minor capital costs will be incurred to sub-divide the office accommodation.

Apart from the matters noted above, the Directors are not aware of any other matters or circumstances not otherwise dealt with in the report or financial statements that have significantly, or may significantly affect the operations of the Company or the Group, the results of the operations of the Company or the Group, or the state of affairs of the Company or the Group in subsequent financial years.

Notes to the Financial Statements
Other Information

15. SHARE BASED PAYMENTS

(a) Short Term Executive Incentive (STI)

Refer to the Remuneration Report, contained in the Director's Report for information on the Group's Short Term Incentive program.

(b) Long Term Executive Incentive (LTI)

Refer to the Remuneration Report, contained in the Director's Report for information on the Group's Long Term Incentive program.

(c) Convertible Note

The Pacific Road 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) Employee Options and Performance Rights

The following table summarises movements in options/performance rights for the year ended 30 June 2016:

Grant date 2016	Expiry date	Exercise price	Balance at start of year Number	Granted during the year Number	Exercised during the year Number	Expired/ Forfeited during the year Number	Balance at the end of the year Number	Exercisable at the end of the year Number
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	15/11/2015	$0.061	61,728,395	-	-	(61,728,395)	-	-
16/11/2012	15/11/2015	$0.061	9,645,845	-	-	(9,645,845)	-	-
02/01/2013	31/12/2015	$0.12	3,084,000	-	-	(3,084,000)	-	-
15/10/2013	15/10/2016	$0.026	3,507,861	-	-	-	3,507,861	3,507,861
06/12/2013	15/10/2016	$0.026	3,573,877	-	-	-	3,573,877	3,573,877
06/12/2013	30/06/2019	$0.06	33,333,333	-	-	(33,333,333)	-	-
26/08/2014	25/08/2017	$0.0301	3,953,516	-	-	-	3,953,516	3,953,516
20/11/2014	25/08/2017	$0.0301	5,541,564	-	-	-	5,541,564	5,541,564
31/03/2015	30/06/2016	-	12,500,000	-	-	(12,500,000)	-	-
			171,868,391	**-**	**-**	**(120,291,573)**	**51,576,818**	**51,576,818**
Weighted average exercise price			**$0.0744**	**$0.0000**	**$0.0000**	**$0.0559**	**$0.1230**	**$0.1230**

The following table summarises movements in options / performance rights for the year ended 30 June 2015:

Grant date 2015	Expiry date	Exercise price	Balance at start of year Number	Granted during the year Number	Exercised during the year Number	Expired/ Forfeited during the year Number	Balance at the end of the year Number	Exercisable at the end of the year Number
13/11/2008	10/12/2014	$1.00	10,000,000	-	-	10,000,000	-	-
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	15/11/2015	$0.061	61,728,395	-	-	-	61,728,395	61,728,395
16/11/2012	15/11/2015	$0.061	9,645,845	-	-	-	9,645,845	9,645,845
02/01/2013	31/12/2015	$0.12	3,084,000	-	-	-	3,084,000	3,084,000
15/10/2013	15/10/2016	$0.026	4,600,407	-	1,092,843	-	3,507,861	3,507,861
06/12/2013	15/10/2016	$0.026	3,573,877	-	-	-	3,573,877	3,573,877
06/12/2013	30/06/2018	$0.06	33,333,333	-	-	33,333,333	-	-
06/12/2013	30/06/2019	$0.06	33,333,333	-	-	-	33,333,333	-
26/08/2014	25/08/2017	$0.0301	-	4,611,403	657,887	-	3,953,516	3,953,516
20/11/2014	25/08/2017	$0.0301	-	5,541,564	-	-	5,541,564	5,641,564
31/03/2015	30/06/2015	-	-	12,500,000	-	12,500,000	-	-
31/03/2015	30/06/2016	-	-	12,500,000	-	-	12,500,000	-
			194,299,487	**35,152,967**	**1,750,730**	**55,833,333**	**171,868,391**	**126,035,058**
Weighted average exercise price			**$0.1277**	**$0.0087**	**$0.0275**	**$0.2149**	**$0.0744**	**$0.0855**

15. SHARE BASED PAYMENTS (continued)

No options were exercised during the 2016 year. In the 2015 year 1,750,730 options were exercised at a weighted average exercise price of $0.0275 (2014: nil). 1,092,843 of these options granted as compensation to current Executives in prior periods were exercised at an exercise price of $0.026. A further 657,887 of these options relating to the 2015 Executive grant were exercised at an exercise price of $0.0301.

The Options outstanding at 30 June 2016 had a weighted average exercise price of $0.1233 (2015: $0.0744) and a weighted average remaining contractual life of 8.2 months (2015: 1.74 years). Exercise prices range from $0.026 to $0.1678 in respect of options outstanding at 30 June 2016 (2015: $0.00 to $0.1678).

Fair Value of Options and Performance Rights Granted

No options were granted during the 2016 year. The assessed fair value of the options granted during the 2015 year was $0.51 per option. 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.

No grants were made during the year. The model inputs for options granted during the prior year ended 30 June 2015 included:

2015 Grant Date	26 August 2014	26 August 2014	31 March 2015	31 March 2015
Number of Options/Performance Rights	4,611,403	5,541,564	12,500,000	12,500,000
Valuation methodology	Black Scholes	Black Scholes	Monte Carlo	Monte Carlo
Weighted average exercise price	$0.0301	$0.0301	Nil	Nil
Weighted average life of option	3.00 years	3.00 years	0.25 years	1.25 years
Underlying share price	$0.0231	$0.0231	$0.0230	$0.0230
Expected share price volatility	67.40%	67.40%	110.0%	110.0%
Risk free interest rate	2.71%	2.71%	2.18%	1.92%

(e) Shares

The Company issues shares to employees as part of the STI plan. No shares were issued to employees during the 2016 year.

The Convertible Note Facility Agreement also requires the Company to pay interest of 5% per annum on the $10,000,000 facility. The Pacific Road 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 2016.

Issue Date	No. of Shares	Description	Deemed Value
28/08/2015	9,475,744	Interest costs in relation to Pacific Road Convertible Note Facility	$0.0133
30/11/2015	8,875,169	Interest costs in relation to Pacific Road Convertible Note Facility	$0.0142
11/03/2016	7,815,783	Interest costs in relation to Pacific Road Convertible Note Facility	$0.0163
01/06/2016	12,071,070	Interest costs in relation to Pacific Road Convertible Note Facility	$0.0101

The following table summarises the share based payment shares issued during the year ended 30 June 2015.

Issue Date	No. of Shares	Description	Deemed Value
01/09/2014	5,576,434	Interest costs in relation to Pacific Road Convertible Note Facility	$0.0226
15/10/2014	10,033,239	Issue of Ordinary Share under the Company's Short and Long Term Executive Incentive Plan for the 2013-2014 financial year	$0.0171
16/10/2014	1,750,730	Exercise of options under Executive Short and Long Term Executive Incentive Plan	$0.0360
01/12/2014	2,838,455	Interest costs in relation to Pacific Road Convertible Note Facility	$0.0444
02/03/2015	4,272,115	Interest costs in relation to Pacific Road Convertible Note Facility	$0.0295
02/06/2015	4,935,944	Interest costs in relation to Pacific Road Convertible Note Facility	$0.0247

15. SHARE BASED PAYMENTS (continued)

(f) Expenses arising from share-based payment transactions

A total expense arising from share based payment transactions of $501,370 was recognised during the year and included in finance costs (2015: $500,000).

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

	2016 $	2015 $
Shares issued under the short term incentive scheme	-	21,641
Shares issued under the long term incentive scheme	-	(12,674)
Options issued under the long term incentive scheme	75,588	74,326
Closing balance	**75,588**	**83,113**

Recognition and Measurement

The 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.

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 instruments at the grant date.

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 Group's estimate of equity instruments that will eventually vest, with a corresponding increase in equity. At the end of each reporting period, the 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.

Critical Accounting Estimates

The 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 and performance rights. Fair valuation inputs are detailed above.

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.

16. RELATED PARTY TRANSACTIONS

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

	2016 $	2015 $
Short-term employee benefits	1,641,831	1,741,495
Post-employment benefits	158,500	144,791
Long-term benefits	5,044	6,413
Share-based payments (i)	86,388	83,113
TOTAL	**1,891,763**	**1,975,812**

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

	2016 Shares	2015 Shares
(b) Key Management Personnel share transactions		
Subscription for new ordinary shares and options by key management personnel as a result of:		
Short term incentive grants	-	10,033,239
Share Purchase Plan	-	1,340,000
Private Placement (Held in escrow until 07/10/16)	123,845,128	-
Rights issue	221,350,030	-
Pacific Road Convertible Note Facility - Interest costs in relation to drawdown of Tranche A and Tranche B	38,237,766	17,622,948

Options and performance rights granted as remuneration during the period:

	2016 Options	2015 Options
$0.0301 vested unlisted options expiring 25/08/17	-	10,152,967
Performance Rights expiring 30/06/18[1]	-	12,500,000
Performance Rights expiring 30/06/19[2]	-	12,500,000

[1] Forfeited as a result of failure to meet share price performance hurdles

[2] 5,000,000 forfeited on resignation of key management personnel and 7,500,000 forfeited as a result of failure to meet share price performance hurdles

	2016 $	2015$
(c) Director – Related Entities		
Other service fees charged to Carbon Energy Limited of which Peter Hogan was both a Director of Carbon Energy Limited and consultant to Incitec Pivot Limited subsidiary at that time.	40,000	30,000
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	20,000
Other service fees charged to Carbon Energy Limited of which George Su was both an Alternate Director of Carbon Energy Limited and Director of Silk Road Corporate Finance Pty Limited at that time	26,957	-
Underwriting fees charged to Carbon Energy Limited of which Huihai Zhuang was both a Director of Carbon Energy Limited and Kam Lung Investment Development Company Ltd at that time	18,000	-

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

Huihai Zhuang (Non-Executive Director) holds a Directorship and shares in a Kam Lung Investment Development Co. Ltd, company which is a shareholder of Carbon Energy Limited.

Notes to the Financial Statements
Other Information

16. RELATED PARTY TRANSACTIONS (continued)

(d) Other Related Party Transactions

$10 million Convertible Note

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

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. Pacific Road 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. 9,645,845 options expired during the year. A total of 35,000,000 options remain vested with varying expiry dates as follows:

Options	Grant Date	Price	Expiry Date
7,000,000	25/01/2012	$0.1678	18/01/2017
28,000,000	29/02/2012	$0.1678	25/02/2017

Further information on this transaction is included under Note 5(g).

China Joint Venture

On 28 September 2015, the Company announced that it would seek to form a Beijing incorporated contractual Joint Venture (JV or Joint Venture) (which operates in a manner consistent with an unincorporated joint venture) with Beijing JinHong Investment Co., Ltd (JinHong) with the purpose of developing and promoting UCG technology in China including developing and operating a commercial Demonstration Project in China. The formation of the JV pursuant to the Joint Venture Agreement was subject to obtaining applicable approvals from Carbon Energy Shareholders and the Chinese Government which has now been received.

JinHong is ultimately controlled by Mr Zhuang (Non-executive Director) who also controls Kam Lung Investment Development Company (Kam Lung) (Shareholder). At the time of entering into the Joint Venture the Company also secured further funding from its cornerstone investor Kam Lung who has increased its shareholding in Carbon Energy at that time to 19.99%.

Kam Lung is a Hong Kong based private investment company and is 100% owned by Mr Zhuang. Mr Zhuang's business interests are primarily real estate, new technologies and resources, and extend into China, Hong Kong and Australia. JinHongis also ultimately controlled by Mr Zhuang.

The Company provided services to JinHong during the year for agreed pre incorporation activities in relation to the JV totalling $142,079.

The Company's Chinese joint venture partner is committed to advancing progress on the demonstration project however have indicated that they want to see progress being made on the renegotiation and/or replacement of the convertible note facility before they commit to capitalising the joint venture entity. This has caused some delays in advancing the activities of the joint venture. As noted in Note 5(g) the company is in negotiations with third parties in relation to the renegotiation of the existing convertible note and/or replacement of the convertible note.

17. REMUNERATION OF AUDITORS

	2016 $	2015 $
(a) Auditor of the parent entity:		
• reviewing the half year financial report	35,000	30,000
• auditing the annual financial report	45,000	70,000
• other non audit services – advisory services	-	-
	80,000	**100,000**
(b) Network firm of the parent entity auditor:		
• other non audit services – advisory services	-	15,789
	-	**15,789**

The auditor of Carbon Energy Limited was Deloitte Touche Tohmatsu up until their resignation on 28 June 2016. The Board has appointed Grant Thornton as auditor, which is subject to ratification by shareholders at the next Annual General Meeting of the Company. Grant Thornton has completed the 30 June 2016 audit.

18. STATEMENT OF OPERATIONS BY SEGMENT

The 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 Group accounted for revenue of $189,069 (2015:$285,268) with all amounts relating to technology services performed in Australia and delivered to Chinese projects.

19. SUMMARY OF ACCOUNTING POLICIES

This note provides a list of the significant accounting policies adopted in the preparation of these consolidated financial statements to the extent they have not already been disclosed in the other notes above. These policies have been consistently applied to all the years presented, unless otherwise stated. The financial statements are for the Group consisting of Carbon Energy Limited and its controlled entities. Carbon Energy Limited is a listed, for profit, public company, incorporated and domiciled in Australia

(a) Statement of compliance

The consolidated financial statements of the Group are a general purpose financial report which has been prepared in accordance with the Corporations Act, Australian Accounting Standards and Interpretations, International Financial Reporting Standards (IFRS) and complies with other requirements of the law.

The financial statements were authorised for issue by the Directors on 5 August 2016.

(b) 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 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 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.

(c) 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 Group’s foreign operations are translated into Australian dollars using exchange rates prevailing at the end of the reporting period, 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.

(d) Good 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.

Notes to the Financial Statements
Other Information

19. SUMMARY OF ACCOUNTING POLICIES (continued)

(e) New and amended standards adopted by the Group

The Group has adopted all of the new and revised Standards and Interpretations issued by the AASB that are relevant to its operations and effective for the current annual reporting period. 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 Group.

(f) Accounting standards issued but not effective

Certain new accounting standards and interpretations have been published that are not mandatory for 30 June 2016 reporting periods and have not been early adopted by the Group. The Group's assessment of the impact of these new standards and interpretations is set out below.

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' (December 2014), AASB 2014-7 'Amendments to Australian Accounting Standards arising from AASB 9' (December 2014)	1 January 2018	30 June 2019	No impact based on current financial instruments
AASB 15 Revenue from contracts with customers, AASB 2014-5 Amendments to Australian Accounting Standards arising from AASB 15	1 January 2018	30 June 2019	No impact to current contracts
AASB 2014-10 'Amendments to Australian Accounting Standards – Sale or Contribution of Assets between an Investor and its Associate or Joint Venture'	1 January 2016	30 June 2018	No impact from current transactions
AASB 2015-1 'Amendments to Australian Accounting Standards – Annual Improvements to Australian Accounting Standards 2012-2014 Cycle'	1 January 2016	30 June 2018	Not material
AASB 2015-2 'Amendments to Australian Accounting Standards – Disclosure Initiative: Amendments to AASB 101'	1 January 2016	30 June 2017	Enhanced disclosure
AASB 16 Leases	1 January 2019	30 June 2020	No impact to current contracts

Financial Report

Directors' Declaration

The Directors of the Company declare that:

1. The financial statements and notes, as set out on pages 40 to 73, are in accordance with the Corporations Act 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, including compliance with accounting standards and giving a true and fair view of the financial position and performance of the Group.
   (d) the Directors have been given the declarations required by section 295A of the Corporations Act.
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.
   (b) the financial statements and notes referred to in section 295(3)(b) of the Corporations Act for the financial year comply with the Accounting Standards.
   (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.

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	**Morné Engelbrecht**
Chairman	**Managing Director**

Brisbane, Queensland

5 August 2016

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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 (the "Company"), which comprises the consolidated statement of financial position as at 30 June 2016, 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 year then ended, 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.

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. The Directors' responsibility also includes 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. The Directors also state, in the notes to the financial report, in accordance with Accounting Standard AASB 101 Presentation of Financial Statements, the 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 us to 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.

Independence

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

Auditor's 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 2016 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 financial report also complies with International Financial Reporting Standards as disclosed in the notes to the financial statements.

Material uncertainty regarding continuation as a going concern

Without modifying our opinion, we draw attention to Note 1(a) 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 and / or re-negotiating or re-financing existing debt facilities in the coming months. The matters set out in Note 1(a) indicate the existence of a material uncertainty that may cast significant doubt about the Company's and the Consolidated Group's ability to continue as a going concern 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, and at the amounts stated in the financial report.

Report on the remuneration report

We have audited the remuneration report included in pages 22 to 36 of the directors' report for the year ended 30 June 2016. 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.

Auditor's opinion on the remuneration report

In our opinion, the remuneration report of Carbon Energy Limited for the year ended 30 June 2016, complies with section 300A of the Corporations Act 2001.

Grant Thornton

GRANT THORNTON AUDIT PTY LTD
Chartered Accountants

Cameron Smith

Cameron Smith
Partner - Audit & Assurance
Brisbane, 5 August 2016

Tenement Schedule

As at 30 June 2016

Tenement Number	Grant date	Expiry Date	Holder	% of interest held	Sub-blocks as at 30 June 2016
EPC 867 [1, 2]	18/02/2005	17/02/2015	Carbon Energy (Operations) Pty Ltd	100%	167
EPC 868 [1]	18/02/2005	17/02/2015	Carbon Energy (Operations) Pty Ltd	100%	44
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[3]	Application	-	Carbon Energy (Operations) Pty Ltd	100%	(1,342 ha)
MDL374 [2, 3]	01/02/2008	31/01/2018	Carbon Energy (Operations) Pty Ltd	100%	(2,868 ha)
PFL6 [1]	13/04/2010	12/04/2015	Carbon Energy (Operations) Pty Ltd	100%	(3 ha)

1 PFL 6, EPC 867 and EPC 868 renewals were submitted to the Department of Natural Resources and Mines on time and are currently with the Department for review.
2 MDL 374 is wholly contained within EPC 867.
3 MLa 50253 is wholly contained within MDL 374.

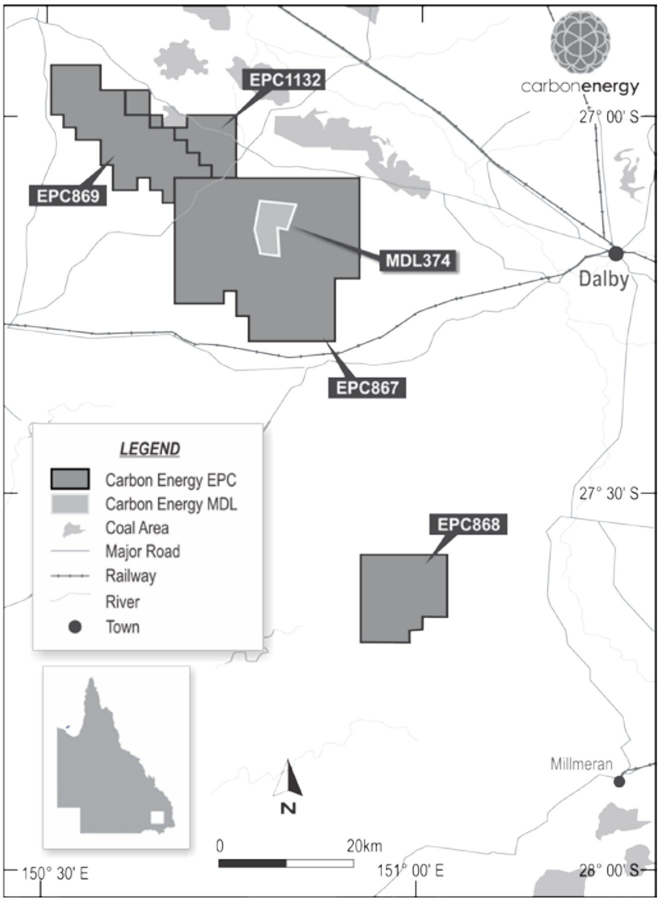

Figure 1 Tenement Location

Tenement Schedule

As at 30 June 2016

Carbon Energy Resources Statement

The Company's Inferred Thermal Coal Resources and equivalent Syngas Resources as at 30 June 2016, reported in accordance with 2012 Edition of the Australasian Code for Reporting of Exploration Results, Mineral Resources and Ore Reserves (JORC Code) guidelines and the 2007 Society of Petroleum Engineers (SPE) Petroleum Resources Management System (PRMS) guidelines (respectively), are:

Tenure	Location	Commodity Classification[1]				
		Coal Resource		Syngas ResourceEquivalent[2]		
		Mineral Resource Category	Thermal Coal Resource (Mt)**	Reserve and Resource Classification	Gross (100%) Syngas Energy (PJ)**	Reserve Notes
MDL374	Kogan, QLD	Inferred	243	2C Contingent Resource	2,512.4	Undeveloped, unconventional
EPC867*	Kogan, QLD	Inferred	1,448	2C Contingent Resource	13,384.4	
EPC868	Millmeran, QLD	Not assessed due to insufficient data				
EPC869	Kogan, QLD	Inferred	449	2C Contingent Resources	4,150.3	
EPC1132	Kogan, QLD	Inferred	132	2C Contingent Resources	1,220.1	
	Totals:	**Thermal Coal Inferred Resources**	**2,272 Mt**	**2C Syngas Resource**	**21,267.2 PJ**	

* EPC 867 excludes resources contained within MDL 374.

** Refer to Mineral Resource and Syngas Resource Governance and Disclosures for accompanying notes.

Thermal coal can be gasified to produce syngas, so either coal or syngas can be extracted from the Company's tenements. Syngas is a mixture of methane, hydrogen and carbon monoxide. Accordingly, this table sets out the Company's conventional thermal coal resources as well as the alternative unconventional Syngas Resources equivalent. However, it should be noted that the coal asset can only be utilised as either coal or syngas and not both.

Tenement Schedule

As at 30 June 2016

Mineral Resource and Syngas Resource Governance & Disclosures

Mineral Resources are estimated by suitably qualified competent persons who are consultants to Carbon Energy in accordance with the requirements of the JORC Code, using industry standard techniques and consultants' internal guidelines for the estimation and reporting of Mineral Resources.

Syngas Resources are estimated by suitably qualified petroleum reserves and resources evaluators who are consultants to Carbon Energy in accordance with the requirements of the 2007 SPE PRMS, using industry standard techniques and consultants' internal guidelines for the estimation and reporting of Syngas Reserves and Resources. The Company will review the reported Syngas Resources in the future as the Policies of the Queensland government pertaining to commercial UCG activities continue to evolve and change. The company will also continue to review and report on any material changes in the underlying information (including but not limited to syngas production, coal resource amendment or update, syngas production technology amendment or update, or changes to tenure) and in any event once per annum through the Annual Reports', Reserve and Resource reporting process.

The Mineral Resource and Syngas Resource Statements included in the 2016 Annual Report are reviewed by the suitably qualified competent person (in the case of the Mineral Resources) and the qualified petroleum reserves and resources evaluator (in the case of the Syngas Resources), as described.

Syngas Resource Governance and Disclosures

Following on from the State Governments 18 April 2016 announcement to not allow UCG in Queensland, MHA Petroleum Consultants LLC (MHA), were re-engaged by the company to review their previous Reserve Resource Report of 19 September 2014, which contained estimates of UCG Reserves and Contingent Resources.

Based on the State Governments decisions and subsequent communications, it is the opinion of MHA that there are currently no Reserves associated with MDL 374, EPC 867, EPC 869 and EPC1132 located in the Surat Basin, Queensland, Australia. As such, all 1P, 2P and 3P Reserves which were previously assigned to MDL 374 and EPC 867 have now been reclassified as 2C Contingent Resources.

The decision made by MHA to; (a) re-classify Reserves to 2C Contingent Resources, and (b) to recognize that it is appropriate and justified for Carbon Energy to continue to assign 2C Contingent Resources to the referenced assets in light of the recent decision by the Queensland government is based upon the definitions and guidelines published in the 2007 SPE PRMS, as well as the 2011 Guidelines for Application of the PRMS, as approved by the SPE.

It is the opinion of MHA that the appropriate sub-class of Contingent Resources is **Development Unclarified or on Hold**. This sub-class is defined within the PRMS as:

A discovered accumulation where project activities are on hold and/or where a commercial development may be subject to a significant delay.

Further, the PRMS offers the following guidelines in respect of using this sub-class of Contingent Resources in an estimate such as this:

The project is seen to have potential for eventual commercial development, but further appraisal/evaluation activities are on hold pending the removal of significant contingencies external to the project, or substantial further appraisal/evaluation activities are required to clarify the potential for eventual commercial development.

Tenement Schedule

As at 30 June 2016

Carbon Energy Syngas Reserve & Resource Comparison 2015 to 2016

Area	Category	2016 Gross Gas Volumes (PJ)	2015 Gross Gas Volumes (PJ)*	Gross Gas Volume Change (PJ)
MDL374	1P Reserves	-	11.0	(11.0)
	2P Reserves	-	1,737.9	(1,739.4)
	3P Reserves	-	2,512.4	(2,512.4)
	2C Contingent Resource	2,512.4	-	2,512.4
EPC 867	3P Reserves	-	5,650.0	(5,650.0)
	2C Resources	13,384.4	7,734.3	5,650.1
EPC 869	2C Resources	4,150.3	4,150.3	-
EPC 1132	2C Resources	1,220.1	1,220.1	-
Totals	**1P Reserves**	**-**	**11.0**	**(11.0)**
	2P Reserves	**-**	**1,737.9**	**(1,737.9)**
	3P Reserves	**-**	**8,162.4**	**(8,162.4)**
	2C Resources	**21,267.2**	**13,104.7**	**8,162.5**

Notes on Syngas Reserves and Resources:

- 1P Reserves = Proved
- 2P Reserves = Proved + Probable
- 3P Reserves = Proved + Probable + Possible
- 2C Resources = 2C Contingent Resources

All Gas Resource Estimates (**Gas Estimates**) in this statement are reported in accordance with the requirements of ASX Listing Rules 5.25 to 5.28. It is noted in particular that:

(a) This statement refers to Gas Estimates reported on 19 September 2014 and released to the market on 22 September 2014 and subsequently reviewed 15 July 2016.

(b) All Gas Estimates are based on the deterministic method for estimation of petroleum resources at the field and project levels and are attributable to the gross (100 percent) ownership interest of Carbon Energy in certain coal properties located in MDL 374, EPC 867, EPC 869 and EPC 1132 located in the Surat Basin of Queensland, Australia.

(c) All Gas Estimates are reported using the following conversion factors as relevant:

(i) UCG Energy conversion factor is 16.73 GJ of Syngas per tonne of coal gasified;

(ii) UCG Syngas to Synthetic Natural Gas (SNG) conversion factor is 38.5 to 25.

All Syngas Resources stated in this Report are underdeveloped and unconventional Resources.

The Gas Estimates in this statement 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, is a qualified Petroleum Reserves and Resources Evaluator and is an employee of MHA Petroleum Consultants of Denver, USA. Timothy Hower has approved this statement as a whole to the extent it relates to contingent resources and has consented to the use of the statement in relation to contingent resource estimates and supporting information contained in the statement, in the form and context in which they are included.

Tenement Schedule

As at 30 June 2016

Coal Resource

Syngas Resource Governance and Disclosures

Carbon Energy Coal Resource Comparison 2015 to 2016

Tenure	Mineral Resource Category	2016 Coal Resource (Mt)	2015 Coal Resource (Mt)*	Resource Change (Mt)
MDL 374[1]	Inferred	243	243	-
EPC867[2]	Inferred	1,448	1,448	-
EPC868	Not assessed due to insufficient data	-	-	-
EPC869	Inferred	449	449	-
EPC1132	Inferred	132	132	-
	Totals:	**2,272**	**2,272**	**-**

*Refer to Mineral Resource and Syngas Resource Governance and Disclosures for accompanying notes.
1 EPC 867 excludes resources contained within MDL 374.

Notes on Coal Resources:

Inferred Resources are conceptual in nature. Constraints on the Inferred Resources are as follows:

(a) Points of observation less than 4km apart and not exceeding 1km past the last data point.
(b) Minimum seam thickness of 2m (in aggregate of plys).
(c) Maximum stone parting thickness of 0.5m.
(d) Maximum raw ash of 50%.
(e) Drill holes classed as valid points of observations were defined as holes where:
  (i) The entire coal seam was cored or, the drillhole contained slimline geophysics.
  (ii) Drillhole seam intersection has reasonable stratigraphic correlation.

The annual review of the Company's Inferred Resources concluded that in the absence of any new Carbon Energy drill data, no adjustment to the Inferred Resources was necessary.

For the purposes of ASX Listing Rule 5.23, Carbon Energy confirms that it is not aware of any new information or data that materially affects the information included in the 2 April 2013 Updated Resources Statement and that all material assumptions and technical parameters underpinning the estimates in the Updated Resources Statement continue to apply and have not materially changed.

The information in this statement that relates to in-situ coal resources potential is based on and fairly represents information and supporting documents prepared by GeoConsult Pty Ltd's Adrian Buck and reviewed by GeoConsult Pty Ltd's Warwick Smyth.

Adrian Buck is a member of the Australasian Institute of Mining and Metallurgy and has 10 years experience relevant to the style of the 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 (JORC Code).

Tenement Schedule

As at 30 June 2016

Notes on Coal Resources: (continued)

Warwick Smyth is a member of the Australasian Institute of Mining and Metallurgy (CP) Geology and a member of 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 25 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 (JORC Code).

Adrian Buck and Warwick Smyth of GeoConsult Pty Ltd have 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 statement are on a time and materials basis. Adrian Buck and Warwick Smyth as representatives for GeoConsult Pty Ltd have approved the Resources and Reserve Statement as a whole to the extent it relates to mineral resources and ore reserves and consents 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 Adrian Buck, Warwick Smyth or GeoConsult Pty Ltd.

Shareholder Information

As at 1 August 2016

The shareholder information set out below was applicable as at 1 August 2016.

(a) Distribution of Share Holdings as at 1 August 2016.

Size of Share Holdings	Number of Shareholders	Shares	% of Issued Capital
1 - 1,000	387	149,740	0.01%
1,001 - 5,000	922	2,732,449	0.15%
5,001 - 10,000	711	5,820,117	0.32%
10,001 – 50,000	1,510	39,111,210	2.17%
50,001 - 100,000	559	42,911,397	2.38%
100,001 and over	1,206	1,715,779,384	94.98%
Total Shareholders	**5,290**	**1,806,504,297**	**100.00%**

(b) Of the above total 3,122 Ordinary Shareholders hold less than a marketable parcel.

(c) Shareholders in excess of 5% holding are:

- Kam Lung Investment Development Company Limited holds 514,760,847 ordinary shares, of which 123,845,128 are held in escrow until 7 October 2016.
- Pacific Road Group holds 161,607,249 ordinary shares.

(d) 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.

(e) Other Information

1. The name of the Company Secretary is Ms Catherine Costello.
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. Detailed schedules of exploration and mining tenements held are included in the tenement schedule.
7. Directors' interest in share capital is disclosed in the Directors Report.
8. Unquoted Securities – Details of the 51,576,818 unlisted options on issue are detailed in Note 15(d).
   - 8.2 Pacific Road Group holds options of 35,000,000 representing 68% of the unlisted options on issue.
   - 8.3 Mr Morné Engelbrecht, Managing Director holds options of 9,115,441 representing 18% of unlisted options on issue.

Shareholder Information

As at 1 August 2016

Twenty Largest Shareholders

Shareholders (Fully Paid Ordinary)	Number of Shares	%
Kam Lung Investment Development Company Limited	514,760,847	28.49%
Pacific Road	161,607,249	8.95%
Incitec Pivot Limited	75,556,040	4.18%
Citicorp Nominees Pty Limited	55,509,784	3.07%
BNP Paribas Nominees Pty Ltd	33,309,752	1.84%
CSIRO	28,346,389	1.57%
Lujeta	23,327,539	1.29%
Mr Ross Francis Stanley	22,875,000	1.27%
HSBC Custody Nominees (Australia) Limited	22,453,340	1.24%
Mr Clifford William Mallett & Mrs Wendy Justin Mallett	19,609,607	1.09%
Twynam Agricultural Group Pty Ltd	18,000,000	1.00%
JP Morgan Nominees Australia Limited	16,831,989	0.93%
Mr Kaushik Biyani	15,740,878	0.87%
Silver Fox Nominees Pty Ltd	14,415,002	0.80%
Claymore Investments Pty Ltd	12,000,000	0.66%
Mr Alexander Gontmakher	10,000,000	0.55%
Pebet Pty Limited	9,500,000	0.53%
Invia Custodian Pty Limited	9,100,000	0.50%
Mr Darren Furzer & Mrs Lynne Margaret Furzer	8,300,000	0.46%
ABN AMRO Clearing Sydney Nominees Pty Ltd	7,922,402	0.44%
Top 20 Shareholders	**1,079,165,818**	**59.73%**
TOTAL ISSUED SHARES as at 1 August 2016	**1,806,504,297**	**100.00%**

CORPORATE DIRECTORY

Directors

Dr Chris Rawlings
Non-Executive Chairman
Mr Morné Engelbrecht
Managing Director & Chief Executive Officer
Dr Helen Garnett
Non-Executive Director
Mr Peter Hogan
Non-Executive Director
Mr Louis Rozman
Non-Executive Director
Mr Huihai Zhuang
Non-Executive Director
Mr George Su
Alternative Director for Mr Huihai Zhuang

Company Secretary

Ms Catherine Costello

Management Team

Mr Morné Engelbrecht
Chief Executive Officer and Managing Director
Ms Catherine Costello
Chief Financial Officer
Dr Cliff Mallett
Technical Director
Mr Stuart MacKenzie
General Counsel
Mr Terry Moore
General Manager Operations

Carbon Energy Limited

ABN 56 057 552 137

ASX Code: **CNX**

Registered & Principal Office

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Postal Address:
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TOOWONG DC QLD 4066

Share Registry

Link Market Services Limited
Level 12
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Sydney NSW 2000
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carbonenergy

www.carbonenergy.com.au

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Carbon Energy Limited | ABN 56 057 552 137

Corporate Governance

Carbon Energy Limited

Corporate Governance Statement – 2016

This corporate governance statement has been approved by the Board. It is current as at 5 August 2016.

The Board and senior executives of Carbon Energy Limited (**Company**) are committed to acting responsibly, ethically and with high standards of integrity as the Company strives to create shareholder value. The Company is committed to implementing the highest standards of corporate governance appropriate for a company of its size and operations. This corporate governance statement outlines the corporate governance practices in place or adopted by the Board in the financial year ended 30 June 2016 by reference to the ASX Corporate Governance Council's Corporate Governance Principles and Recommendations (3rd Edition) (**Recommendations**).

The Board considers and applies the Recommendations taking into account the circumstances of the Company. Where the Company's practices depart from a Recommendation, this corporate governance statement identifies the area of divergence and reasons for it, or the alternative practices adopted by the Company.

The documents that govern the Company's corporate governance framework, including its Constitution, charters and policies are set out at the end of this corporate governance statement, together with links to where those documents can be accessed on the Company's website.

Principle 1: Lay solid foundations for management and oversight

1.1 Disclose the respective roles and responsibilities of board and management and those matters expressly reserved to the board and those delegated to management

The Board and executives are committed to acting responsibly, ethically and with high standards of integrity as the Company strives to create shareholder value. The Board is responsible for the strategic direction of the Company with oversight and review of the management and administration of the Company.

It is the role of senior executives to manage the Company in accordance with the direction and delegation of the Board and the responsibility of the Board to provide leadership to, and oversee the activities of management in carrying out these delegated duties.

The respective roles and responsibilities of the Board, its Committees and senior executives are set out in the Board and Committee Charters. These Charters are available on the Company's website. Details on the number of meetings held throughout the year and attendance at those meetings can be found on page 21 of the 2016 Annual Report.

1.2 Companies should carry out appropriate checks of board candidates and provide information to shareholders that is material to their candidacy

The Board has established policies and procedures that apply to the appointment of new Directors, which include checks as to the person's character, experience, education and appropriate background checks. At each annual general meeting (**AGM**), the Company provides shareholders with all material information in its possession relevant to a decision on whether or not to elect or re-elect a director.

1.3 Companies should have a written agreement with each director and executive setting out the terms of their appointment

Non-Executive Directors are provided a formal letter of appointment which sets out their duties and responsibilities, rights and remuneration entitlements. Senior executives are employed under individual service contracts which set out their terms of employment including details of their duties, responsibilities, rights and remuneration entitlements.

1.4 The company secretary of a listed entity should be accountable directly to the Chair of the Board for matters relevant to the Board

The role of Company Secretary is carried out by Catherine Costello who is the Company's Chief Financial Officer and Company Secretary. Ms Costello reports directly to the Chief Executive Officer and Managing Director in respect of her role as Chief Financial Officer. For any matter specific to company secretarial duties or relevant to the Board, the Company Secretary is accountable directly to the Chair of the Board.

1.5 Companies should have a policy concerning diversity and disclose that policy, together with measurable objectives for achieving gender diversity and its progress towards achieving those objectives

The Board has adopted a diversity policy, which sets out the Company's commitment to diversity and inclusion in the workplace (**Diversity Policy**). The Diversity Policy does not include a requirement for the Board to establish measurable objectives for achieving gender diversity. The Company aims to achieve an appropriate mix of diversity on its Board, in senior executives and throughout the Company. Given the small size of the Company workforce, the Board has determined that it is not currently necessary or practicable to establish measurable objectives in this area.

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	5 out of 16 (31%)
Senior Executives Positions	1 out of 5 (20%)
Non-Executive Directors	1 out of 5 (20%)

The Diversity Policy is available on the Company's website.

1.6 Companies should disclose the process for evaluating the performance of the Board, its committees and individual Directors

The performance of the Board, each Board Committee and each individual Directors is evaluated under the direction of the Chair. An appropriate questionnaire is completed by all

Directors on a bi-annual basis. The results are collated and then discussed by the Board to ensure all points of view are considered and learnings addressed.

An evaluation of the Board, its committees and individual Directors was completed in August 2014 in accordance with the process disclosed above.

1.7 Companies should disclose the process for evaluating the performance of senior executives

Senior executives are subject to annual performance evaluations following the end of each financial year. This involves the assessment of performance against specific measurable criteria, taking into account the Company's strategy and objectives. For the year under review, performance evaluations were carried out in June 2016. Senior executives are required to prepare their strategic objectives for review and approval by the Board, which assess performance against these objectives, taking into account the person's ongoing suitability for the relevant role.

Details on management performance incentives and remuneration are contained in the remuneration report section of the Directors' Report, on pages 22 to 36 of the 2016 Annual Report.

Principle 2: Structure the Board to add value

For the majority of the year, the Board had six Directors comprising one Executive Director and five Non-Executive Directors, three of whom were independent. Mr Su was appointed as Mr Zhuang's alternate and translator on 4 December 2016. The Directors of the Company during the financial year are listed with a brief description of their qualifications, appointment date, experience and special responsibilities on pages 14 to 16 of the 2016 Annual Report.

2.1 The Board should establish an appropriately structured nomination committee

The Nomination Committee Charter sets out the Nomination Committee's role and responsibilities, which includes Board renewal, succession planning, induction and evaluation. Reflecting the current size and composition of the Board and Company, the Board has elected to carry out the functions of the Nomination Committee. Details on the number of meetings held throughout the year and attendance at those meetings can be found on page 21 of the 2016 Annual Report.

The Nomination Committee's Charter is available on the Company's website.

2.2 The Board should establish and disclose a board skills matrix on the skills and diversity for Board membership

The Board considers that there is currently an appropriate mix of skills, diversity and experience on the Board, taking into account the size of the Company, the stage of its development and the nature of its operations. The Company seeks to maintain a Board of Directors with a broad range of financial, industry and other relevant skills, experience and knowledge. The Board has developed a matrix to consider the appropriate mix of skills, experience, expertise and diversity across its current membership and to assist in identifying what may be required of candidates in the event a new director is required.

Skills and Experience of Directors	
Resource and/or Oil & Gas Industry Experience	✓✓✓
CEO Experience	✓✓✓
Legal and/or Commercial	✓✓
Financial	✓✓✓
Stakeholder	✓✓
Board Governance & Diversity	✓✓✓

2.3 The Company should disclose whether its Directors are independent

The independence of Directors was measured during the reporting period having regard to the Company's Assessing the Independence of Directors Policy (**Independence Policy**), which provides that an independent director will be determined by reference to the defining characteristics as set out in Box 2.3 of the Recommendations. The Independence Policy also provides that an independent director is a director who is not a member of management and is 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 Independence Policy is available on the Company's website.

The following table sets out the Directors of the Company during the reporting period, including their length of service and non-executive and independent status.

Name	Appointment date	Current length of Service	Non-executive?	Independent?
Chris Rawlings	1 July 2011	5 years	Yes	Yes
Morné Engelbrecht	23 July 2013	2 year 11 months	No	No
Helen Garnett	6 September 2010	5 years 9 months	Yes	Yes
Peter Hogan	29 August 2008	7 years 10 months	Yes	Yes
Louis Rozman	7 April 2010	6 years 2 months	Yes	No
Huihai Zhuang	29 October 2015	9 months	Yes	No
George Su Su (Mr Zhuang's alternate)	4 December 2015	8 months	Yes	No

2.4 The majority of the Board should be comprised of independent Directors

Following an assessment of Director independence, in accordance with the Independence Policy, the Company announced on 26 November 2014 that Peter Hogan has been determined to be independent[1]. Therefore, from that date, the Board has had a majority of independent Directors.

[1] The Board noted that Mr Hogan's association with a shareholder of the Company is limited to the provision of financial and commercial advisory services to that company in Mr Hogan's professional capacity on an arm's length, fee for service basis.

2.5 The Chair should be an independent Director and should not be the same person as the CEO

Dr Chris Rawlings is the independent non-executive Chairman. The roles of the Chairman and Chief Executive Officer and Managing Director are not exercised by the same individual. The Board Charter sets out the distinct responsibilities of each role.

2.6 The Board should establish a program for inducting new directors and provide appropriate professional development opportunities for Directors

New Directors are provided with a formal letter of appointment and induction pack, which includes a range of information to allow them to gain an understanding of their rights and responsibilities, the role of the Board, its Committees and senior executives and the Company's financial, strategic, operational and risk management policies and position. The Board Charter provides that the Company Secretary is responsible for arranging an induction program for any new director to enable the Director to gain an understanding of matters including the Company's operations and the industry in which it operates, the Company's culture and values, and its financial, strategic, operational and risk management position. The program may include presentations and meetings with Directors and senior executives and site visits. Directors are encouraged to undertake professional development opportunities as and when required in order to further develop and maintain their skills and knowledge.

Principle 3: Promote ethical and responsible decision making

3.1 Companies should establish a Code of Conduct

The Company has established a Code of Conduct (**Code**), which applies to all Directors, senior executives and staff (**Employees**). The Code promotes practices that aim to foster the Company's key values, which include providing a safe and healthy work environment, encouraging Employees to act with fairness, honesty and integrity, being aware of and abiding by relevant laws and regulations and maintaining high standards of professional behaviour. Employees are expected to be honest and ethical in their dealings with each other and all stakeholders. Employees are responsible for actively reporting any inappropriate behaviour, corrupt practices or any breaches of the law or the Code. In order to do so employees are encouraged to follow the steps outlined in the Whistleblower Policy.

The A summary of the Code and the Whistleblower Policy are available on the Company's website.

Principle 4: Safeguard integrity in corporate reporting

4.1 The Board should establish an appropriately structured audit committee

The Board has established an Audit and Risk Committee. The Audit and Risk Committee is comprised of three independent non-executive Directors. The Chair of the Committee, Helen Garnett, is an independent non-executive Director and has significant experience in risk and financial matters. The membership of the Audit and Risk Committee, including members' qualifications and experience, are set out on pages 14 to 16 of the 2016 Annual Report. Details on the number of meetings held throughout the year and attendance at those meetings can be found on page 21 of the 2016 Annual Report.

The Audit and Risk Committee and the Board as a whole discusses directly with the auditors in respect of each half year and full year, all relevant financial aspects of the Company. Information about the selection and appointment of the external auditor and regarding the rotation of external audit engagement partners is set out in the Company's Selection and Appointment of External Auditor Policy.

The Audit and Risk Committee Charter which sets out the Committee's role and responsibilities, composition, structure and membership requirements is available on the Company's website.

4.2 CEO and CFO certification of financial statements

Prior to Board approval of the Company's quarterly, half year and annual financial reports, the Chief Executive Officer and Managing Director and the Chief Financial Officer provide the Board with declarations required under section 295A of the *Corporations Act 2001* (Cth) (**Corporations Act**) and Recommendation 4.2.

For the periodic financial reports provided during the year, the Chief Executive Officer and Managing Director and the Chief Financial Officer provided the Board with declarations that, in their opinion, the financial records of Company had been properly maintained and that the financial statements complied with the appropriate accounting standards and gave a true and fair view of the financial position and performance of the Company and that those opinions had been formed on the basis of a sound system of risk management and internal control which was operating effectively.

4.3 External auditor availability at AGM

The external auditor attends the Company's Annual General Meeting and is available to answer shareholder questions about the conduct of the audit and preparation and conduct of the Independent Auditor's Report. Shareholders are also given the opportunity to submit written questions prior to the meeting. The Company considers that this is important in promoting and encouraging shareholder participation and reflects and supports the roles of the auditor and the auditor's accountability to shareholders.

Principle 5: Make timely and balanced disclosure

5.1 Companies should establish continuous disclosure policies and ensure compliance with those policies

The Company has adopted a Continuous Disclosure Policy that sets out the policies and procedures relating to:

- the reporting of price sensitive information to the Company Secretary for review;
- the preparation, approval and release of announcements containing price sensitive information or potentially price sensitive information to the market; and

- compliance by the Company with its continuous disclosure obligations under the Corporations Act and ASX Listing Rules, and to ensure accountability at a senior executive level for that compliance.

The Continuous Disclosure Policy is available on the Company's website.

Principle 6: Respect the rights of shareholders

6.1 The Company should provide information about itself and its governance to shareholders on its website

The Company's website www.carbonenergy.com.au provides detailed information about its business and operations.

The Investor Centre section of the website provides helpful information to shareholders and a link to the Company's share registrar, Link Market Services. The Investor Centre also provides an investor fact sheet, investor FAQs, analyst reports and webcasts.

The Announcements & Reports section contains ASX and media announcements, industry news, roadshow and investor presentations and annual and periodic reports.

Shareholders can find information about the Company's corporate governance practices on the website within the Corporate Governance section under About Us. This includes the Company's Constitution, Board and Committee Charters and the Company's other corporate governance policies.

6.2 The Company should design and implement an investor relations program to facilitate effective two-way communication with shareholders

The Company is committed to engaging with shareholders and using a variety of tools to facilitate effective two-way communication. In doing so it has adopted a Shareholder Communications Policy which outlines the range of media used to communicate with shareholders and the types of information provided. The Company encourages participation by shareholders at the Company's general meetings, investor presentations and via the contact details provided on the Company's website.

The Shareholder Communications Policy is available on the Company's website.

6.3 The Company should disclose the policies and processes it has in place to facilitate and encourage participation at meetings of shareholders

The Company sees general meetings as an important forum for reciprocal communication between itself and shareholders. Such meetings allow opportunities for shareholders to hear from and put questions to the Board, senior executives and the external auditor. In order to maximise shareholder participation at general meetings, and to enable those shareholders who are unable to attend, the Company welcomes questions or comments to be submitted prior to the meeting. Such questions or comments will, where appropriate, be answered or responded to at the general meeting, either verbally or in writing.

6.4 The Company should provide the option to send and receive communications from the Company and its Share Registry in electronic form

The Company provides shareholders with the option of receiving communications from, and sending communications to, the Company and Share Registry electronically, for reasons of cost, convenience and environmental considerations. The Company provides a printed copy of the Annual Report only to those shareholders who have specifically elected to receive a printed copy. Other shareholders are advised that the Annual Report is available on the Company's website.

Shareholders are encouraged to register on the Company website to receive email alerts of ASX announcements and media releases and other news.

The Company's share register is managed and maintained by Link Market Services Limited. Shareholders can access their shareholding details or make enquiries about their shareholding electronically through the Link Market Services Investor Centre or by emailing registrars@linkmarketservices.com.au.

Principle 7: Recognise and manage risk

7.1 The Company should establish an appropriately structured risk management committee for the oversight of material business risks

During the reporting period, the Audit and Risk Committee was responsible for assisting the Board in fulfilling its corporate governance responsibilities in regard to financial risk management, the oversight and management of material business risks and the effectiveness of the Company's management of its material business risks.

7.2 The Board or a Committee of the Board should review the Company's risk framework at least annually to satisfy itself that it continues to be sound

An annual workshop involving Board representative and senior management was held during the reporting period. The Audit and Risk Committee subsequently reviewed the outcomes from the workshop and this process resulted in minor changes to the structure of the risk register in the areas of inherent and residual risk assessment. An assessment and management of opportunities to enhance the achievement of business opportunities was introduced and a scenario analysis tool also incorporated into the risk register to be used as and when appropriate.

7.3 The Company should disclose the structure and role of its internal audit function

The Company does not retain a dedicated internal audit function. The Board considers this is appropriate, taking into account the Company's stage of development, the scale of its operations and the relative simplicity of its finance function. The internal audit function performed by senior management comprises:

- regular review and testing of the adequacy of controls for risks identified as in the higher range;
- management confirmation on a periodic basis that the assessment of identified risks and their controls remain appropriate; and

- identification of any new risks or enhanced controls that may be required.

Where considered appropriate, external guidance may be sought on specific risks or controls. The Audit and Risk Committee regularly discusses the appropriateness of controls with the external auditor and if considered necessary would initiate an audit of a particular function.

7.4 The Company should disclose their economic, environmental and social sustainability risks and how those risks are managed

Managing economic sustainability is central to the Company's operation and ongoing viability. The most significant risk currently being managed is cash resources and the Company's ability to secure further licensing and technology services revenue streams as well as additional capital investment. The Company ensures its organisational structure includes appropriate resources to manage these risks. A key focus of senior executives is on securing sustaining financial resources and optimising existing cash resources and, where required, external advisors will be engaged to assist senior executives.

The Company has invested significantly in proving its environmental credentials through its Bloodwood Creek pilot study site. During the prior year the Company submitted its Decommissioning Report and a Rehabilitation Plan to the Department of Environment and Heritage Protection (**DEHP**). These reports demonstrated that the Company's gas production technology is safe, effective, highly controlled and minimises impact on groundwater volumes and quality. In relation to the management of ongoing environmental sustainability and the potential associated risks, the Company meets all of its compliance obligations and reports appropriately to designated statutory bodies. Sampling procedures that follow industry best practice have been adopted including samples being sent to two independent laboratories for analysis every month. All data captured through the monitoring process is analysed thoroughly to ensure the Company can respond quickly in the event there is any variance in the data collected.

Community support is considered the most significant social sustainability risk. At its Surat Basin, Queensland site the Company employs local community members and contractors and purchases the majority of its supplies through local suppliers. The Company engages with the broader community through active involvement in local community business groups and forums and is available to answer any concerns raised by the community.

Principle 8: Remunerate fairly and responsibly

8.1 The Board should establish an appropriately structured remuneration committee

The Board has established a Remuneration Committee. Louis Rozman is Chair of the Remuneration Committee. Mr Rozman is not an independent director but is independent of Management and the Board has taken into account his extensive experience in matters pertaining to remuneration and believe he is the most appropriate appointment at this time. The membership of the Remuneration Committee throughout the year under review, including their qualifications and experience are set out on pages 14 to 16 of the 2016 Annual Report. Details on the number of meetings held throughout the year and attendance at those meetings can be found on page 21 of the 2016 Annual Report.

The Remuneration Committee Charter, which sets out the Remuneration Committee's role and responsibilities, composition, structure and membership requirements is available on the Company's website.

8.2 The Company should distinguish between non-executive directors' remuneration and that of executive directors and senior executives

Non-Executive Directors are paid fees from an aggregate sum approved by shareholders of the Company. Non-Executive Directors are remunerated at a fixed fee for their time and responsibilities and their remuneration is not linked to the operating performance of the Company. There are no termination or retirement benefits for Non-Executive Directors other than superannuation.

Remuneration of the Chief Executive Officer and Managing Director and senior executives consists of a base salary, superannuation, fringe benefits and performance incentives. Performance incentives may include options granted at the discretion of the Board and subject to obtaining relevant approvals.

Details of remuneration, including the Company's policy on remuneration are contained in the Remuneration Report, which forms part of the Directors' Report on pages 22 to 36 of the 2016 Annual Report.

8.3 The Company should establish a policy on whether participants in equity based remuneration schemes are able to enter into transactions which limit the economic risk of participating in those schemes

The Company's Securities Trading Policy specifically prohibits Directors and senior executives from entering into transactions that would limit the economic risk of any unvested entitlements under any equity-based remuneration schemes. Further, Directors and senior executives are prohibited from entering into margin loan arrangements or arrangements whereby their securities in the Company may be used as collateral, without prior approval. Breaches of this policy are regarded as serious misconduct.

Governance Documents

Constitution
http://www.carbonenergy.com.au/Constitution

Charters

- **Board**
  http://www.carbonenergy.com.au/BoardCharter
- **Audit and Risk Committee**
  http://www.carbonenergy.com.au/AuditRiskCommittee
- **Nomination Committee**
  http://www.carbonenergy.com.au/NominationCommittee
- **Remuneration Committee**
  http://www.carbonenergy.com.au/RemunerationCommittee

Policies

- **Assessing the Independence of Directors Policy**
  http://www.carbonenergy.com.au/IndependenceDirectors
- **Securities Trading Policy**

http://www.carbonenergy.com.au/SecuritiesTrading

- **Code of Conduct (Summary)**
  http://www.carbonenergy.com.au/CodeConduct
- **Continuous Disclosure Policy (Summary)**
  http://www.carbonenergy.com.au/ContinuousDisclosure
- **Shareholder Communications Policy**
  http://www.carbonenergy.com.au/ShareholderCommunication
- **Diversity Policy**
  http://www.carbonenergy.com.au/Diversity
- **Whistleblower Policy**
  http://www.carbonenergy.com.au/Whistleblower
- **Remuneration Policy**
  http://www.carbonenergy.com.au/Remuneration
- **Risk Management Policy (Summary)**
  http://www.carbonenergy.com.au/RiskManagement
- **Anti-bribery and Anti-corruption policy**
  http://www.carbonenergy.com.au/AntiBriberyandCorruptionPolicy

Rules 4.7.3 and 4.10.3[1]

Appendix 4G

Key to Disclosures
Corporate Governance Council Principles and Recommendations

Name of entity

Carbon Energy Limited

ABN/ARBN	Financial year ended
56 057 552 137	30 June 2016

Our corporate governance statement[2] for the above period above can be found at:[3]

☐ these pages of our annual report: ________________________________

☑ this URL on our website: http://www.carbonenergy.com.au/corporate-governance

The Corporate Governance Statement is accurate and up to date as at 5 August 2016 and has been approved by the board.

The annexure includes a key to where our corporate governance disclosures can be located.

Date here: 5 August 2016

Print name: Catherine Costello
Chief Financial Officer and Company Secretary

[1] Under Listing Rule 4.7.3, an entity must lodge with ASX a completed Appendix 4G at the same time as it lodges its annual report with ASX.

Listing Rule 4.10.3 requires an entity that is included in the official list as an ASX Listing to include in its annual report either a corporate governance statement that meets the requirements of that rule or the URL of the page on its website where such a statement is located. The corporate governance statement must disclose the extent to which the entity has followed the recommendations set by the ASX Corporate Governance Council during the reporting period. If the entity has not followed a recommendation for any part of the reporting period, its corporate governance statement must separately identify that recommendation and the period during which it was not followed and state its reasons for not following the recommendation and what (if any) alternative governance practices it adopted in lieu of the recommendation during that period.

Under Listing Rule 4.7.4, if an entity chooses to include its corporate governance statement on its website rather than in its annual report, it must lodge a copy of the corporate governance statement with ASX at the same time as it lodges its annual report with ASX. The corporate governance statement must be current as at the effective date specified in that statement for the purposes of rule 4.10.3.

[2] "Corporate governance statement" is defined in Listing Rule 19.12 to mean the statement referred to in Listing Rule 4.10.3 which discloses the extent to which an entity has followed the recommendations set by the ASX Corporate Governance Council during a particular reporting period.

[3] Mark whichever option is correct and then complete the page number(s) of the annual report, or the URL of the web page, where the entity's corporate governance statement can be found.

ANNEXURE – KEY TO CORPORATE GOVERNANCE DISCLOSURES

	Corporate Governance Council recommendation	We have followed the recommendation in full for the whole of the period above. We have disclosed …	We have NOT followed the recommendation in full for the whole of the period above. We have disclosed …
PRINCIPLE 1 – LAY SOLID FOUNDATIONS FOR MANAGEMENT AND OVERSIGHT			
1.1	A listed entity should disclose: (a) the respective roles and responsibilities of its board and management; and (b) those matters expressly reserved to the board and those delegated to management.	… the fact that we follow this recommendation: ☑ in our Corporate Governance Statement **OR** ☐ at this location: ________________________________ *Insert location here* … and information about the respective roles and responsibilities of our board and management (including those matters expressly reserved to the board and those delegated to management): ☑ at this location: http://www.carbonenergy.com.au/corporate-governance	☐ an explanation why that is so in our Corporate Governance Statement **OR** ☐ we are an externally managed entity and this recommendation is therefore not applicable
1.2	A listed entity should: (a) undertake appropriate checks before appointing a person, or putting forward to security holders a candidate for election, as a director; and (b) provide security holders with all material information in its possession relevant to a decision on whether or not to elect or re-elect a director.	… the fact that we follow this recommendation: ☑ in our Corporate Governance Statement **OR** ☐ at this location: ________________________________ *Insert location here*	☐ an explanation why that is so in our Corporate Governance Statement **OR** ☐ we are an externally managed entity and this recommendation is therefore not applicable
1.3	A listed entity should have a written agreement with each director and senior executive setting out the terms of their appointment.	… the fact that we follow this recommendation: ☑ in our Corporate Governance Statement **OR** ☐ at this location: ________________________________ *Insert location here*	☐ an explanation why that is so in our Corporate Governance Statement **OR** ☐ we are an externally managed entity and this recommendation is therefore not applicable

Corporate Governance Council recommendation		We have followed the recommendation in full for the whole of the period above. We have disclosed …	We have NOT followed the recommendation in full for the whole of the period above. We have disclosed …
1.4	The company secretary of a listed entity should be accountable directly to the board, through the chair, on all matters to do with the proper functioning of the board.	… the fact that we follow this recommendation: ☑ in our Corporate Governance Statement **OR** ☐ at this location: ____________________ *Insert location here*	☐ an explanation why that is so in our Corporate Governance Statement **OR** ☐ we are an externally managed entity and this recommendation is therefore not applicable
1.5	A listed entity should: (a) have a diversity policy which includes requirements for the board or a relevant committee of the board to set measurable objectives for achieving gender diversity and to assess annually both the objectives and the entity's progress in achieving them; (b) disclose that policy or a summary of it; and (c) disclose as at the end of each reporting period the measurable objectives for achieving gender diversity set by the board or a relevant committee of the board in accordance with the entity's diversity policy and its progress towards achieving them and either: (1) the respective proportions of men and women on the board, in senior executive positions and across the whole organisation (including how the entity has defined "senior executive" for these purposes); or (2) if the entity is a "relevant employer" under the Workplace Gender Equality Act, the entity's most recent "Gender Equality Indicators", as defined in and published under that Act.	… the fact that we have a diversity policy that complies with paragraph (a): ☐ in our Corporate Governance Statement **OR** ☐ at this location: ____________________ *Insert location here* … and a copy of our diversity policy or a summary of it: ☑ at this location: http://www.carbonenergy.com.au/DiversityPolicy … the measurable objectives for achieving gender diversity set by the board or a relevant committee of the board in accordance with our diversity policy and our progress towards achieving them: ☐ in our Corporate Governance Statement **OR** ☐ at this location: ____________________ *Insert location here* … and the information referred to in paragraphs (c)(1) or (2): ☑ in our Corporate Governance Statement **OR** ☐ at this location: ____________________ *Insert location here*	☑ an explanation why that is so in our Corporate Governance Statement **OR** ☐ we are an externally managed entity and this recommendation is therefore not applicable

Corporate Governance Council recommendation		We have followed the recommendation in full for the whole of the period above. We have disclosed …	We have NOT followed the recommendation in full for the whole of the period above. We have disclosed …
1.6	A listed entity should: (a) have and disclose a process for periodically evaluating the performance of the board, its committees and individual directors; and (b) disclose, in relation to each reporting period, whether a performance evaluation was undertaken in the reporting period in accordance with that process.	… the evaluation process referred to in paragraph (a): ☑ in our Corporate Governance Statement **OR** ☐ at this location: ________________________________ *Insert location here* … and the information referred to in paragraph (b): ☑ in our Corporate Governance Statement **OR** ☐ at this location: ________________________________ *Insert location here*	☐ an explanation why that is so in our Corporate Governance Statement **OR** ☐ we are an externally managed entity and this recommendation is therefore not applicable
1.7	A listed entity should: (a) have and disclose a process for periodically evaluating the performance of its senior executives; and (b) disclose, in relation to each reporting period, whether a performance evaluation was undertaken in the reporting period in accordance with that process.	… the evaluation process referred to in paragraph (a): ☑ in our Corporate Governance Statement **OR** ☐ at this location: ________________________________ *Insert location here* … and the information referred to in paragraph (b): ☑ in our Corporate Governance Statement **OR** ☐ at this location: ________________________________ *Insert location here*	☐ an explanation why that is so in our Corporate Governance Statement **OR** ☐ we are an externally managed entity and this recommendation is therefore not applicable

Corporate Governance Council recommendation		We have followed the recommendation in full for the whole of the period above. We have disclosed …	We have NOT followed the recommendation in full for the whole of the period above. We have disclosed …
PRINCIPLE 2 - STRUCTURE THE BOARD TO ADD VALUE			
2.1	The board of a listed entity should: (a) have a nomination committee which: (1) has at least three members, a majority of whom are independent directors; and (2) is chaired by an independent director, and disclose: (3) the charter of the committee; (4) the members of the committee; and (5) as at the end of each reporting period, the number of times the committee met throughout the period and the individual attendances of the members at those meetings; **OR** (b) if it does not have a nomination committee, disclose that fact and the processes it employs to address board succession issues and to ensure that the board has the appropriate balance of skills, knowledge, experience, independence and diversity to enable it to discharge its duties and responsibilities effectively.	[If the entity complies with paragraph (a):] … the fact that we have a nomination committee that complies with paragraphs (1) and (2): ☑ in our Corporate Governance Statement **OR** ☐ at this location: ________________________ *Insert location here* … and a copy of the charter of the committee: ☑ at this location: http://www.carbonenergy.com.au/NominationCommittee … and the information referred to in paragraphs (4) and (5): ☐ in our Corporate Governance Statement **OR** ☑ at this location: Carbon Energy 2016 Annual Report [If the entity complies with paragraph (b):] … the fact that we do not have a nomination committee and the processes we employ to address board succession issues and to ensure that the board has the appropriate balance of skills, knowledge, experience, independence and diversity to enable it to discharge its duties and responsibilities effectively: ☐ in our Corporate Governance Statement **OR** ☐ at this location: ________________________ *Insert location here*	☐ an explanation why that is so in our Corporate Governance Statement **OR** ☐ we are an externally managed entity and this recommendation is therefore not applicable

Corporate Governance Council recommendation		We have followed the recommendation in full for the whole of the period above. We have disclosed …	We have NOT followed the recommendation in full for the whole of the period above. We have disclosed …
2.2	A listed entity should have and disclose a board skills matrix setting out the mix of skills and diversity that the board currently has or is looking to achieve in its membership.	… our board skills matrix: ☑ in our Corporate Governance Statement **OR** ☐ at this location: ______________________________________ *Insert location here*	☐ an explanation why that is so in our Corporate Governance Statement **OR** ☐ we are an externally managed entity and this recommendation is therefore not applicable
2.3	A listed entity should disclose: (a) the names of the directors considered by the board to be independent directors; (b) if a director has an interest, position, association or relationship of the type described in Box 2.3 but the board is of the opinion that it does not compromise the independence of the director, the nature of the interest, position, association or relationship in question and an explanation of why the board is of that opinion; and (c) the length of service of each director.	… the names of the directors considered by the board to be independent directors: ☑ in our Corporate Governance Statement **OR** ☐ at this location: ______________________________________ *Insert location here* … where applicable, the information referred to in paragraph (b): ☑ in our Corporate Governance Statement **OR** ☐ at this location: ______________________________________ *Insert location here* … the length of service of each director: ☑ in our Corporate Governance Statement **OR** ☐ at this location: ______________________________________ *Insert location here*	☐ an explanation why that is so in our Corporate Governance Statement
2.4	A majority of the board of a listed entity should be independent directors.	… the fact that we follow this recommendation: ☐ in our Corporate Governance Statement **OR** ☐ at this location: ______________________________________ *Insert location here*	☑ an explanation why that is so in our Corporate Governance Statement **OR** ☐ we are an externally managed entity and this recommendation is therefore not applicable

Corporate Governance Council recommendation		We have followed the recommendation in full for the whole of the period above. We have disclosed …	We have <u>NOT</u> followed the recommendation in full for the whole of the period above. We have disclosed …
2.5	The chair of the board of a listed entity should be an independent director and, in particular, should not be the same person as the CEO of the entity.	… the fact that we follow this recommendation: ☑ in our Corporate Governance Statement **<u>OR</u>** ☐ at this location: ______________________________ *Insert location here*	☐ an explanation why that is so in our Corporate Governance Statement **<u>OR</u>** ☐ we are an externally managed entity and this recommendation is therefore not applicable
2.6	A listed entity should have a program for inducting new directors and provide appropriate professional development opportunities for directors to develop and maintain the skills and knowledge needed to perform their role as directors effectively.	… the fact that we follow this recommendation: ☑ in our Corporate Governance Statement **<u>OR</u>** ☐ at this location: ______________________________ *Insert location here*	☐ an explanation why that is so in our Corporate Governance Statement **<u>OR</u>** ☐ we are an externally managed entity and this recommendation is therefore not applicable
<u>PRINCIPLE 3 – ACT ETHICALLY AND RESPONSIBLY</u>			
3.1	A listed entity should: (a) have a code of conduct for its directors, senior executives and employees; and (b) disclose that code or a summary of it.	… our code of conduct or a summary of it: ☑ in our Corporate Governance Statement **<u>OR</u>** ☐ at this location: ______________________________ *Insert location here*	☐ an explanation why that is so in our Corporate Governance Statement

Corporate Governance Council recommendation		We have followed the recommendation in full for the whole of the period above. We have disclosed …	We have NOT followed the recommendation in full for the whole of the period above. We have disclosed …
PRINCIPLE 4 – SAFEGUARD INTEGRITY IN CORPORATE REPORTING			
4.1	The board of a listed entity should: (a) have an audit committee which: (1) has at least three members, all of whom are non-executive directors and a majority of whom are independent directors; and (2) is chaired by an independent director, who is not the chair of the board, and disclose: (3) the charter of the committee; (4) the relevant qualifications and experience of the members of the committee; and (5) in relation to each reporting period, the number of times the committee met throughout the period and the individual attendances of the members at those meetings; **OR** (b) if it does not have an audit committee, disclose that fact and the processes it employs that independently verify and safeguard the integrity of its corporate reporting, including the processes for the appointment and removal of the external auditor and the rotation of the audit engagement partner.	[If the entity complies with paragraph (a):] … the fact that we have an audit committee that complies with paragraphs (1) and (2): ☑ in our Corporate Governance Statement **OR** ☐ at this location: ________________________________ *Insert location here* … and a copy of the charter of the committee: ☑ at this location: http://www.carbonenergy.com.au/AuditCommittee … and the information referred to in paragraphs (4) and (5): ☐ in our Corporate Governance Statement **OR** ☑ at this location: Carbon Energy 2016 Annual Report [If the entity complies with paragraph (b):] … the fact that we do not have an audit committee and the processes we employ that independently verify and safeguard the integrity of our corporate reporting, including the processes for the appointment and removal of the external auditor and the rotation of the audit engagement partner: ☐ in our Corporate Governance Statement **OR** ☐ at this location: ________________________________ *Insert location here*	☐ an explanation why that is so in our Corporate Governance Statement

Corporate Governance Council recommendation		We have followed the recommendation in full for the whole of the period above. We have disclosed …	We have NOT followed the recommendation in full for the whole of the period above. We have disclosed …
4.2	The board of a listed entity should, before it approves the entity's financial statements for a financial period, receive from its CEO and CFO a declaration that, in their opinion, the financial records of the entity have been properly maintained and that the financial statements comply with the appropriate accounting standards and give a true and fair view of the financial position and performance of the entity and that the opinion has been formed on the basis of a sound system of risk management and internal control which is operating effectively.	… the fact that we follow this recommendation: ☑ in our Corporate Governance Statement **OR** ☐ at this location: ____________________ *Insert location here*	☐ an explanation why that is so in our Corporate Governance Statement
4.3	A listed entity that has an AGM should ensure that its external auditor attends its AGM and is available to answer questions from security holders relevant to the audit.	… the fact that we follow this recommendation: ☑ in our Corporate Governance Statement **OR** ☐ at this location: ____________________ *Insert location here*	☐ an explanation why that is so in our Corporate Governance Statement **OR** ☐ we are an externally managed entity that does not hold an annual general meeting and this recommendation is therefore not applicable
PRINCIPLE 5 – MAKE TIMELY AND BALANCED DISCLOSURE			
5.1	A listed entity should: (a) have a written policy for complying with its continuous disclosure obligations under the Listing Rules; and (b) disclose that policy or a summary of it.	… our continuous disclosure compliance policy or a summary of it: ☑ in our Corporate Governance Statement **OR** ☐ at this location: ____________________ *Insert location here*	☐ an explanation why that is so in our Corporate Governance Statement
PRINCIPLE 6 – RESPECT THE RIGHTS OF SECURITY HOLDERS			
6.1	A listed entity should provide information about itself and its governance to investors via its website.	… information about us and our governance on our website: ☑ at this location: www.carbonenergy.com.au	☐ an explanation why that is so in our Corporate Governance Statement

Corporate Governance Council recommendation		We have followed the recommendation in full for the whole of the period above. We have disclosed …	We have <u>NOT</u> followed the recommendation in full for the whole of the period above. We have disclosed …
6.2	A listed entity should design and implement an investor relations program to facilitate effective two-way communication with investors.	… the fact that we follow this recommendation: ☑ in our Corporate Governance Statement **<u>OR</u>** ☐ at this location: ____________________________________ *Insert location here*	☐ an explanation why that is so in our Corporate Governance Statement
6.3	A listed entity should disclose the policies and processes it has in place to facilitate and encourage participation at meetings of security holders.	… our policies and processes for facilitating and encouraging participation at meetings of security holders: ☑ in our Corporate Governance Statement **<u>OR</u>** ☐ at this location: ____________________________________ *Insert location here*	☐ an explanation why that is so in our Corporate Governance Statement **<u>OR</u>** ☐ we are an externally managed entity that does not hold periodic meetings of security holders and this recommendation is therefore not applicable
6.4	A listed entity should give security holders the option to receive communications from, and send communications to, the entity and its security registry electronically.	… the fact that we follow this recommendation: ☑ in our Corporate Governance Statement **<u>OR</u>** ☐ at this location: ____________________________________ *Insert location here*	☐ an explanation why that is so in our Corporate Governance Statement

<table>
<tr><th colspan="2">Corporate Governance Council recommendation</th><th>We have followed the recommendation in full for the whole of the period above. We have disclosed …</th><th>We have <u>NOT</u> followed the recommendation in full for the whole of the period above. We have disclosed …</th></tr>
<tr><td colspan="4"><u>PRINCIPLE 7 – RECOGNISE AND MANAGE RISK</u></td></tr>
<tr><td>7.1</td><td>The board of a listed entity should:
(a) have a committee or committees to oversee risk, each of which:
(1) has at least three members, a majority of whom are independent directors; and
(2) is chaired by an independent director,
and disclose:
(3) the charter of the committee;
(4) the members of the committee; and
(5) as at the end of each reporting period, the number of times the committee met throughout the period and the individual attendances of the members at those meetings; <u>OR</u>
(b) if it does not have a risk committee or committees that satisfy (a) above, disclose that fact and the processes it employs for overseeing the entity's risk management framework.</td><td>[If the entity complies with paragraph (a):]
… the fact that we have a committee or committees to oversee risk that comply with paragraphs (1) and (2):
☑ in our Corporate Governance Statement <u>OR</u>
☐ at this location:
____
Insert location here

… and a copy of the charter of the committee:
☑ at this location:
http://www.carbonenergy.com.au/AuditCommittee

… and the information referred to in paragraphs (4) and (5):
☐ in our Corporate Governance Statement <u>OR</u>
☑ at this location:
<u>Carbon Energy 2016 Annual Report</u>

[If the entity complies with paragraph (b):]
… the fact that we do not have a risk committee or committees that satisfy (a) and the processes we employ for overseeing our risk management framework:
☐ in our Corporate Governance Statement <u>OR</u>
☐ at this location:
____
Insert location here</td><td>☐ an explanation why that is so in our Corporate Governance Statement</td></tr>
</table>

Corporate Governance Council recommendation		We have followed the recommendation in full for the whole of the period above. We have disclosed …	We have NOT followed the recommendation in full for the whole of the period above. We have disclosed …
7.2	The board or a committee of the board should: (a) review the entity's risk management framework at least annually to satisfy itself that it continues to be sound; and (b) disclose, in relation to each reporting period, whether such a review has taken place.	… the fact that we follow this recommendation: ☑ in our Corporate Governance Statement **OR** ☐ at this location: ______________________________ *Insert location here*	☐ an explanation why that is so in our Corporate Governance Statement
7.3	A listed entity should disclose: (a) if it has an internal audit function, how the function is structured and what role it performs; **OR** (b) if it does not have an internal audit function, that fact and the processes it employs for evaluating and continually improving the effectiveness of its risk management and internal control processes.	[If the entity complies with paragraph (a):] … how our internal audit function is structured and what role it performs: ☐ in our Corporate Governance Statement **OR** ☐ at this location: ______________________________ *Insert location here* [If the entity complies with paragraph (b):] … the fact that we do not have an internal audit function and the processes we employ for evaluating and continually improving the effectiveness of our risk management and internal control processes: ☑ in our Corporate Governance Statement **OR** ☐ at this location: ______________________________ *Insert location here*	☐ an explanation why that is so in our Corporate Governance Statement
7.4	A listed entity should disclose whether it has any material exposure to economic, environmental and social sustainability risks and, if it does, how it manages or intends to manage those risks.	… whether we have any material exposure to economic, environmental and social sustainability risks and, if we do, how we manage or intend to manage those risks: ☑ in our Corporate Governance Statement **OR** ☐ at this location: ______________________________ *Insert location here*	☐ an explanation why that is so in our Corporate Governance Statement

Corporate Governance Council recommendation		We have followed the recommendation in full for the whole of the period above. We have disclosed …	We have <u>NOT</u> followed the recommendation in full for the whole of the period above. We have disclosed …
<u>PRINCIPLE 8 – REMUNERATE FAIRLY AND RESPONSIBLY</u>			
8.1	The board of a listed entity should: (a) have a remuneration committee which: (1) has at least three members, a majority of whom are independent directors; and (2) is chaired by an independent director, and disclose: (3) the charter of the committee; (4) the members of the committee; and (5) as at the end of each reporting period, the number of times the committee met throughout the period and the individual attendances of the members at those meetings; **<u>OR</u>** (b) if it does not have a remuneration committee, disclose that fact and the processes it employs for setting the level and composition of remuneration for directors and senior executives and ensuring that such remuneration is appropriate and not excessive.	[If the entity complies with paragraph (a):] … the fact that we have a remuneration committee that complies with paragraphs (1) and (2): ☐ in our Corporate Governance Statement **<u>OR</u>** ☐ at this location: ____________________________________ *Insert location here* … and a copy of the charter of the committee: ☑ at this location: http://www.carbonenergy.com.au/RemunerationCommittee … and the information referred to in paragraphs (4) and (5): ☐ in our Corporate Governance Statement **<u>OR</u>** ☑ at this location: <u>Carbon Energy 2016 Annual Report</u> [If the entity complies with paragraph (b):] … the fact that we do not have a remuneration committee and the processes we employ for setting the level and composition of remuneration for directors and senior executives and ensuring that such remuneration is appropriate and not excessive: ☐ in our Corporate Governance Statement **<u>OR</u>** ☐ at this location: ____________________________________ *Insert location here*	☑ an explanation why that is so in our Corporate Governance Statement **<u>OR</u>** ☐ we are an externally managed entity and this recommendation is therefore not applicable

Corporate Governance Council recommendation		We have followed the recommendation in full for the whole of the period above. We have disclosed …	We have NOT followed the recommendation in full for the whole of the period above. We have disclosed …
8.2	A listed entity should separately disclose its policies and practices regarding the remuneration of non-executive directors and the remuneration of executive directors and other senior executives.	… separately our remuneration policies and practices regarding the remuneration of non-executive directors and the remuneration of executive directors and other senior executives: ☑ in our Corporate Governance Statement **OR** ☐ at this location: ______________________________ *Insert location here*	☐ an explanation why that is so in our Corporate Governance Statement **OR** ☐ we are an externally managed entity and this recommendation is therefore not applicable
8.3	A listed entity which has an equity-based remuneration scheme should: (a) have a policy on whether participants are permitted to enter into transactions (whether through the use of derivatives or otherwise) which limit the economic risk of participating in the scheme; and (b) disclose that policy or a summary of it.	… our policy on this issue or a summary of it: ☑ in our Corporate Governance Statement **OR** ☐ at this location: ______________________________ *Insert location here*	☐ an explanation why that is so in our Corporate Governance Statement **OR** ☐ we do not have an equity-based remuneration scheme and this recommendation is therefore not applicable **OR** ☐ we are an externally managed entity and this recommendation is therefore not applicable
ADDITIONAL DISCLOSURES APPLICABLE TO EXTERNALLY MANAGED LISTED ENTITIES			
-	*Alternative to Recommendation 1.1 for externally managed listed entities:* The responsible entity of an externally managed listed entity should disclose: (a) the arrangements between the responsible entity and the listed entity for managing the affairs of the listed entity; (b) the role and responsibility of the board of the responsible entity for overseeing those arrangements.	… the information referred to in paragraphs (a) and (b): ☐ in our Corporate Governance Statement **OR** ☐ at this location: ______________________________ *Insert location here*	☐ an explanation why that is so in our Corporate Governance Statement
-	*Alternative to Recommendations 8.1, 8.2 and 8.3 for externally managed listed entities:* An externally managed listed entity should clearly disclose the terms governing the remuneration of the manager.	… the terms governing our remuneration as manager of the entity: ☐ in our Corporate Governance Statement **OR** ☐ at this location: ______________________________ *Insert location here*	☐ an explanation why that is so in our Corporate Governance Statement