



CarbonEnergy

> Annual Report 2010

CARBON ENERGY



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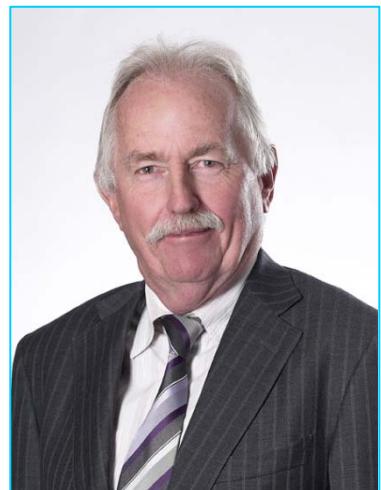
Chairman's Message

Dear Shareholder,

Carbon Energy remains committed to the development of Underground Coal Gasification (UCG) syngas as a key contributor to Australia's energy mix and one of the preferred sources of energy for producing lower emission, coal-generated power as well as advancing the development of further downstream processing of syngas into liquid fuels, chemicals and fertilisers.

As a measure of our progress over the past 2 years, Carbon Energy is now acknowledged as one of the few companies in Australia with the technology and track record capable of delivering this goal. Our growth strategy remains focused on three key elements:

- build a portfolio of local and international coal resource assets suitable for the production of UCG syngas.
- continue to develop and enhance the competitive advantage delivered by our superior UCG technology.
- actively identify key markets and commercial partners as close as possible to resource centres and infrastructure.



During the year we completed the divestment of all activities in the business which was not core to UCG. This included the sale of our gold interests in the Laverton area of Western Australia to Crescent Gold, the spin out of Carbon Energy's uranium assets into a separately listed vehicle called Energia Minerals and the sale of a 6.1% interest in Magma Metals.

The primary focus for Carbon Energy over the past twelve months has been on managing a successful transition from its current project development phase to the commercialisation of our UCG technology. This has involved building an operational capability that can deliver the integration of our UCG technology with the operation of power generating facilities at Bloodwood Creek.

In the latter months of 2009, construction commenced on our 5MW power station which is expected to be commissioned in the second half of 2010. Plans are well advanced for an additional 25MW power station to be built at Bloodwood Creek which will include trialling carbon capture and storage technology.

The independent certification of our UCG syngas reserves, in accordance with Society of Petroleum Engineers guidelines, confirmed the significant energy potential located in one of Carbon Energy's tenements in the Surat Basin. It was an important milestone in establishing UCG syngas as a major new energy source for Australia.

Several commercial agreements were signed during the year including a commercial off-take agreement with Ergon Energy that will be worth \$2 million per annum – the Company's first commercial contract for electricity.

The signing of our first international agreement with one of the world's biggest mining and exploration companies, Antofagasta Minerals, was a highlight of the year. It was all the more significant because Carbon Energy was chosen by Antofagasta as its preferred joint venture partner after a two-year study of UCG and the different technologies available from UCG companies worldwide.

Looking to the next 12-18 months we have a considerable pipeline of activity building from the agreements already in place. Our 5MW power station is anticipated to be producing its first revenues and we expect to be progressing with development of Australia's first lower emissions coal project – a 25MW power station fuelled by syngas and incorporating the trialling of carbon capture and treatment capability.

Since the last year's Annual Report there have been three changes to the composition of the Board. In February 2010, Mr Peter McIntyre, a long standing Non-Executive Director of Carbon Energy, resigned due to other business commitments and we thank Peter for his contribution to the development of the Company. On 7 April 2010 we welcomed the appointment of Mr Louis Rozman as a Non-Executive Director and the nominee of Pacific Road Capital. Pacific Road, a private equity manager which invests in the global mining industry, acquired a 10% interest in Carbon Energy from CSIRO. Mr Rozman brings extensive experience to the board in project development and operations, including gas and power generation, on a number of resource projects around the world.

On the 6th September 2010, we welcomed the appointment of Dr Helen Garnett as a Non-Executive Director. Dr Garnett is an accomplished Company Director with extensive experience of taking technical innovation and delivering practical commercial outcomes. She has 15 years experience as a Chief Executive and over 16 years as a non executive director and has been closely associated with the resource and energy sectors throughout this time.

As the demand for low-cost cleaner energy continues to grow in Australia and internationally, coal continues to be the world's fastest growing fuel producing approximately 80% of Australia's electricity. Our ability to deploy the Company's world-leading UCG technology to carefully select sites and produce base-load electricity from deep coal resources previously considered stranded assets while reducing emissions and preserving environmental quality are some of our many strengths.

We remain committed to our vision of making a step change reduction in the cost of producing cleaner energy and chemical feedstock using UCG syngas. This is how we intend to meet growing energy demand in Australian and key international markets, proving growth for the Company that's both sustainable and generates maximum value for our shareholders.

Having focused our efforts on commissioning Australia's first commercial power plant fuelled by UCG syngas and launching our next power generation project in Chile, 2010 has been a challenging year and one of many achievements. On behalf of the Board, I would like to express my sincere appreciation for the significant effort by our team of very dedicated employees, many of whom are new to the Company in the last year.

Finally I would like to thank shareholders for their continuing support as we build Carbon Energy into a world leader in the production of clean energy and chemicals from UCG syngas.

Yours Sincerely



Kim Robinson
Chairman

28 September 2010

Managing Director's Report

Activities for the past 12 months have been firmly focused on building both our production history and operational expertise, establishing a strong base from which to progress further commercialisation of our unique Underground Coal Gasification (UCG) technology.



BUILDING ALLIANCES AND STRENGTHENING PARTNERSHIPS

The year began strongly with several Queensland, national and international companies eager to partner with Carbon Energy in the development of UCG as an alternative energy source. Agreements executed during the first half of the financial year included:

- A commercial off-take agreement with Queensland Government-owned Ergon Energy.
- In December Carbon Energy signed its first international agreement with Antofagasta Minerals to develop a trial power project in Mulpuin, Chile utilising its UCG technology
- An agreement with Queensland's ZeroGen that will combine Carbon Energy's UCG syngas technology with ZeroGen's techniques for carbon dioxide injection involving carbon capture and storage.
- A Heads of Agreement with Liberty Resources Ltd to develop Liberty's coal resource in Queensland's Galilee Basin which allows for Carbon Energy to acquire an 80% interest.

The off-take agreement with Ergon Energy was particularly significant as it represented Carbon Energy's first commercial contract for electricity that will be produced at our Bloodwood Creek 5MW facility power plant, following its completion and commissioning in late 2010. When fully commissioned, there will be enough power generated from this plant to supply 4000 homes.

Our expectation this time last year was that the 5MW plant would be in production early 2010. Events conspired against us however with construction activity slowed in December/January 2010 by wet weather and flooding in south-east Queensland which limited access to site, preventing delivery of key plant items. A further delay was experienced by the late access to the specialist drill rig required for construction of the second UCG panel. Partly as a consequence of these delays, the Company took the opportunity to bring forward plans for drilling a third panel and to transfer the primary fuel source for the 5MW power station to panel two. It is now planned that panel one (our initial proof of concept panel) will be put through a controlled decommissioning process which will provide the opportunity to demonstrate and report on the operation of the complete life cycle of a UCG panel. The results from this exercise will provide valuable operational data for the planning of Carbon Energy's full scale commercial operations which are the subject of a current Mining Lease Application.

There is no doubt that the experience gained over the past ten months in developing the 5MW plant, essentially a proof of concept for power generation, will assist significantly in improving our planning and preparation for the next stage of commercial development; a 25MW power station which will be located adjacent to the 5MW power plant.

During the last few months of this financial year preplanning commenced for the construction of the 25MW power station which will incorporate the trialling of carbon capture technologies, an important part of providing a clean coal electricity generation solution. The scoping study for the project is expected to be progressed in the new year and we have been actively engaged in discussions with a number of parties interested in participating in the project.

Carbon Energy's vision is to develop a major energy and industrial park at its Blue Gum property near Kogan in regional Queensland consisting of a 300MW low emission power station, synthetic natural gas plant and world scale chemical production facility. Approvals have commenced and discussions are ongoing with prospective partners for this development.

The potential for UCG internationally is significant and establishing a portfolio of coal resources offshore together with a network of quality alliances and partnerships is key to building a strong pipeline of commercial projects.

As mentioned above, in December 2009 Carbon Energy signed its first international agreement with Antofagasta Minerals to develop a UCG power project in Mulpun, Chile utilising Carbon Energy's UCG technology. The significance of this cannot be overstated given the size and reputation of Antofagasta Minerals globally, one of the world's largest mining and exploration companies Antofagasta plc which had a market capitalisation of £11 billion at 10 September 2010 and a top 100 listing on the London Stock Exchange (LSE).

Antofagasta spent two years researching UCG and the capability of UCG companies from all over the world before selecting Carbon Energy as its preferred joint venture partner, a testament to our technical capability and commercial acumen. Over the past nine months we have been working on phase one of a four phase programme involving site selection and site evaluation, environmental approvals, in addition to developing and finalising a work plan, schedule and budget for an initial trial in order to progress to Carbon Energy's first major power generation project in Chile.

CARBON ENERGY'S MAIDEN UCG RESERVES CERTIFICATION

An additional major activity finalised in December 2009, was Carbon Energy's Maiden UCG Reserves Certification, a world first.

As you may be aware companies that are involved in the coal industry report their resource availability as a JORC Resource; for example, Carbon Energy announced in March 2009 the results of its drilling programme, which has been in progress at Bloodwood Creek and Kogan, of a JORC Resource of 668 million tonnes (Indicated and Inferred). Because Carbon Energy's UCG process converts coal into gas (energy), the Company commissioned an independent third party to undertake certification of its potential energy reserves. This type of certification is typically undertaken by natural gas and coal seam gas companies; however this is the first time this type of third party certification had been applied to a UCG energy source.

In December, Carbon Energy announced that it has received an independent reserve statement from MHA Petroleum Consultants (MHA) confirming the large energy potential from the Company's UCG syngas reserves located in two of its tenements, EPC867 and EPC869, in the Surat Basin in south-eastern Queensland.

We feel this is an important step in the development of a national UCG market as it is the first time that UCG syngas volumes have had independent third party certification under the SPE guidelines anywhere in the world.

Area	Category	Gross Gas Volumes (PJ)
	1P Reserve (Proven)	11.0
Bloodwood Creek EPC 867 (including MDL 374)	2P Reserve (Proven + Probable)	743.9
	3P Reserve (Proven + Probable + Possible)	1,042.8

The reserve estimates used in this document were compiled by Mr Timothy Hower of MHA Petroleum Consultants, Colorado, USA, a qualified person under ASX Listing Rule 5.11. Mr Hower has consented to the use of the reserve information contained within this document in the form and context in which it appears.

The 2P Reserve identified by MHA is centred on the southern half of Carbon Energy's MDL 374 and is contained within an area which is approximately 20% of the MDL. Consequently, there is significant potential to add to this reserve within the MDL through additional exploration drilling.

The Company's Stage 3 plans for the establishment of a major energy and industrial hub to be located adjacent to its Bloodwood Creek site, near Dalby in regional south-east Queensland. The 2P Reserve identified to date is expected to be sufficient to operate all three of the following projects for over 15 years:

- A 300 MW base load power station, and
- A world scale ammonia plant, and
- A 20 PJ p.a. synthetic natural gas plant.

There is significant scope to increase the resource based within MDL 374 and to support Carbon Energy's ambition to develop a major energy and industrial hub in regional Queensland.

LOOKING AHEAD

By the end of calendar 2010, it is expected that Carbon Energy will have completed and commissioned its 5MW power station with first revenue starting to flow from sales of electricity into the local grid. Two more UCG panels will also have been completed at Bloodwood Creek to support the power projects. On 6th September 2010, Carbon Energy entered into a Power Station Development Agreement with Arcadia Energy Trading for partnering on the proposed 25MW project and planned 300MW project. Funding and approvals for the project will continue to be advanced during the 2010/2011 financial year. The Company along with our partner Antofagasta Minerals S.A. will continue to progress the Chilean project which will see the formation of a new Joint Venture entity, while the commencement of drilling for the pilot project is due to commence in the first half of 2011.

In line with our stated international expansion, we are planning to open an office in the United States early in the New Year. As you may be aware the United States has huge coal resources (many of which are suitable for UCG), a growing focus on the production of energy from indigenous sources to reduce its dependence on imported fuels. This office will enable the Company to better evaluate potential coal opportunities, commercial projects and partnering opportunities.

A Scoping Study was commenced in May to better understand the commercial opportunity to process our UCG syngas into alternative high value products such as ammonia and synthetic natural gas. The initial findings from the study are expected to be available in late 2010.

Carbon Energy remains focused on the further development of our pipeline of commercial projects which are concentrated in two areas:

- The involvement of additional business partners for the development of our Queensland resource in the areas of low emission power generation, synthetic natural gas production and liquid fuels.
- The establishment of a portfolio of coal resources throughout Australia and internationally using our unique UCG technology as leverage.

There is significant interest in our technology internationally and discussions continue with a number of major global players in the mining and energy sectors.

EMPLOYEES

Over the past year we have been very focused on establishing a firm foundation for the next stage of our growth. This has involved further investment in people in order to develop our capability at the operational level - vital for successfully commercialising Carbon Energy's UCG technology.

The pace of development is reflected in the growth of our employee numbers. This time last year we had 26 employees, half of whom were operating our project at Bloodwood Creek. Total employee numbers have since increased to 36, with the majority of these working on site which is the result of the Company's transition to the next stage, involving the integration of Carbon Energy's UCG technology with the operation of a power generating facility. The Board recently approved a restructure of the senior executive team including the appointment of Mr Andrew (Andy) Mifflin to the position of Chief Operating Officer and Mr John Bidwell as General Manager Project Development.

Andy joined Carbon Energy in January 2010 as General Manager Technical Services responsible for evaluating and developing coal resources suitable for underground coal gasification both in Australia and overseas. With the deadline for commissioning our first power station now only weeks away, his role has been expanded to include the operational management of the UCG facility and its integration with the planned power stations. Andy has over 30 years experience in the coal industry in Australia and the UK, including the development and operation of underground coal mines, having held senior management roles with AMCI/Vale Australia, Centennial Coal and Xstrata/MIM.

John Bidwell joined Carbon Energy in April as General Manager Project Development. He has held business leadership, management, and operational positions in Australia, New Zealand and South America in the energy and related infrastructure sectors. John has held senior management roles with Leighton Contractors, AJ Lucas and AGL (including spending some time in Chile as Executive Director of AGL's gas utility, Gas Valpo). He has been working closely with the Commercial, Operations and Technical Services groups in the commissioning of the 5 MW power station and will then manage the design and development of the 25 MW power project. John's knowledge and experience, particularly in project delivery will complement our existing expertise in underground coal gasification as we move to commercial gas production in Australia and around the world.

I am confident that the next twelve months will be a period of accelerated growth for Carbon Energy as we move towards the full commercialisation of our UCG syngas projects both in Australia and overseas, building on the strong foundation that has been put in place over the past year.

Yours sincerely



Andrew Dash
Managing Director

28 September 2010

2010 Corporate Overview

Carbon Energy's balance sheet at the commencement of the 2010 financial year benefited from completion of the previous June capital raising resulting in July 2009 cash reserves of \$32.6 million with a total issued capital of 579,104,045 fully paid ordinary shares.

The equity raising via placement to institutional and sophisticated investors provided the Company with the necessary capital to progress the development of its UCG technology to the next stage - commercialisation. The first step, involving the installation of a 5MW power generation unit and associated facilities, is designed not only to demonstrate the conversion of syngas to power but also to deliver the Company's first revenue stream. In July 2009 Carbon Energy signed a commercial off-take agreement with Ergon Energy, a Queensland Government owned electricity provider, to generate enough power to supply approximately 4000 homes with electricity each year. The contract, once initiated, is worth approximately \$2 million per year.

Consistent with Carbon Energy's strategy to obtain equity interests in additional coal deposits, a Heads of Agreement was signed in July 2009 with Liberty Resources to establish a joint venture to develop Liberty's coal resources in the Galilee Basin.

During the first half of the year the Company executed its stated plan of divesting its non-core mineral assets in order to focus on its UCG activities. In August 2009, Carbon Energy announced the sale of its gold interests in the Laverton area of Western Australia to Crescent Gold for \$2.5 million cash and \$1.5 million deferred consideration. In October 2009, its 6.1% holding in Magma Metals was sold for \$6.5 million in cash and in December 2009 Carbon Energy demerged its uranium assets via a \$7.5 million initial public offering (IPO). Carbon Energy retained a 42% interest in the new company, named Energia Minerals Limited.

In December 2009 Carbon Energy signed its first international agreement with Antofagasta Minerals to develop a power project in Mulpun, Chile utilising its UCG technology. Once feasibility studies have been completed it is anticipated that both parties will enter into a joint venture to develop commercial projects based on UCG syngas. Antofagasta is one of the world's biggest mining and exploration companies.

In March 2010, Carbon Energy welcomed a new cornerstone investor, Pacific Road Capital, through an agreement to purchase a 10% stake from CSIRO. Pacific Road subsequently on-sold a 4.9% stake to one of the Pacific Road Resources Fund's significant international investment fund shareholders, leaving it with a direct holding of 5.1% and an option to acquire CSIRO's remaining 4.8% interest in Carbon Energy at a price of \$0.93 per share.

On 26 May 2010, 15 million shares were issued to Constellation Energy Pty Ltd in consideration for the supply of drilling services to the value of \$3,000,000 by Constellation for the Bloodwood Creek Trial in 2008.

At the close of the 2010 financial year, Carbon Energy had cash reserves of \$18.8 million and 609,497,650 fully paid shares on issue. This included 15,375,000 shares issued during the course of the year via the exercise of employee and director options from which a total of \$3.206 million was raised.



Gas Production
August 2009-July 2010



Power Station
Construction October 2009



Power Station
Near Finalisation – July 2010

Corporate Summary

ISSUED CAPITAL

Following the placement of shares with new institutional shareholders on 5 June 2009, the total issued capital at 30 June 2009 was 547,296,637 fully paid ordinary shares. The second tranche of the share placement together with residual shares for the acquisition of CEOPL was approved by shareholders at a General Meeting on 20 July 2009, increasing the Company's issued capital to 579,104,045 shares.

In addition, 15 million shares were issued to Constellation Energy in May 2010 in consideration for the supply of drilling services for the Bloodwood Creek Trial in 2008.

During the year 15,375,000 shares were issued through the exercise of options. At 30 June 2010 there were a total of 49,930,000 unlisted options on issue with exercise prices between 20c and \$1.60 (with expiry dates ranging between 31 October 2010 and 22 March 2015). The vast majority are subject to meeting annual performance measures.

BOARD AND MANAGEMENT

Two appointments were made to the executive management team during the year to strengthen the Company's operational capability.

Andrew Mifflin was appointed General Manager Operations and Technical Services. He joined Carbon Energy in January 2010 as General Manager Technical Services responsible for evaluating and developing coal resources suitable for underground coal gasification both in Australia and overseas. His role was expanded in July to Chief Operating Officer to include the operational management of the UCG facility and its integration with the planned power stations.

John Bidwell was appointed General Manager Project Development. He joined Carbon Energy in May 2010 and has been working closely with the Commercial, Operations and Technical Services groups in the commissioning of the 5MW power station. He is also responsible for managing the design and development of the 20-25MW power project.

In February 2010 Peter McIntyre, Non-Executive Director, resigned from the board due to other business commitments.

Following the announcement in March 2010 of Pacific Road Resources Fund's intention to acquire a 10% stake in Carbon Energy, Louis Rozman – a Director of Pacific Capital - was invited to join the board. Carbon Energy's other cornerstone investor and largest shareholder, Incitec Pivot, also has a seat on the board.

In early September 2010, Dr Helen Garnett was appointed as a Non-Executive Director and agreed to be a member and Chair of the Audit Committee.

INVESTMENTS

Carbon Energy holds 29 million shares in ASX listed uranium explorer Energia Minerals Limited (ASX: EMX). Energia was listed in December 2009 following Carbon Energy's decision to spin off its uranium interests into a separate listed entity. Its uranium assets are located in Western Australia, South Australia, Queensland and the NT as well as Northern Italy.

As at 30 June 2010 Energia's share price was \$0.09 valuing the shareholding at \$2.6 million.

Operations Review

2010 Overview

2010 was a year of transition as Carbon Energy progressed from the successful demonstration of its UCG technology through a 100-day pilot trial to commencing the development of small to large scale commercial projects at its strategically located Bloodwood Creek site in Queensland. The operational experience gained during this stage together with the ongoing refinement of the Company's unique modelling tools will provide a strong platform from which Carbon Energy can launch its technology into other domestic and offshore markets.

A key element of this transition period was the divestment of all activities that were not central to Carbon Energy's strategy of producing clean energy and chemical feedstock from Underground Coal Gasification (UCG) syngas. These included the:

- sale of Carbon Energy's 6.1% shareholding in Magma Metals Limited
- execution of an Asset Sale Agreement with Crescent Gold Limited in relation to all of its gold interests in the Laverton area of Western Australia.
- spin out of Carbon Energy's uranium assets into a separately listed vehicle, Energia Minerals, with Carbon Energy retaining a 42% interest.

By the end of calendar 2009, a total of \$9 million had been raised from the asset divestment programme. These funds were used to accelerate the commercialisation of a number of opportunities associated with the development of Carbon Energy's UCG projects in Australia and abroad.

Carbon Energy is recognised internationally for the superiority of its technology, both in terms of innovation and also the rigor of its scientific modelling. This was affirmed in December 2009 when Antofagasta Minerals S.A. selected Carbon Energy as their preferred joint venture partner following a two year process in which the capabilities of UCG companies from all over the world were subject to a rigorous due diligence process. Antofagasta is one of the world's major international copper producers with its activities concentrated mainly in Chile. It is listed on the London Stock Exchange and is a constituent of the FTSE 100 Index.

Expansion of Carbon Energy's coal resource inventory is one of three key activities targeted for achieving the Company's strategic goals. In order to accurately represent the scale and potential end use of Carbon Energy's existing coal assets, the decision was taken in December 2009 to depart from established practice and obtain independent certification of its UCG syngas reserves in accordance with Society of Petroleum Engineers (SPE) guidelines. This was the first time that UCG syngas volumes had received independent certification under SPE guidelines (as opposed to estimated reserves using the JORC code) anywhere in the world. MHA Petroleum Consultants confirmed the large energy potential (2P reserves of 744 PJ) from Carbon Energy's UCG Syngas Reserves located in two of its tenements in the Surat Basin.

Exploration drilling in Western Australia, under a Heads of Agreement with Eneabba Gas Limited, failed to identify a coal resource suitable for UCG. The Agreement expired in December 2009.

The major area of operational focus during the year centred on the construction of a 5MW power station to be powered by syngas produced from the Company's underground coal gasification facility at Bloodwood Creek. While the power station and associated infrastructure were largely complete by year end, delays associated with wet weather in December/January 2010 and long lead times experienced in hiring the specialty rig required for Carbon Energy's unique panel design and insufficient gas quality from Panel 1, pushed the commissioning date well into calendar 2010.

As a result the decision was taken in February to reconfigure the panel design and plans were accelerated to drill two more panels with gas from Panel 2 to become the primary fuel source for the 5MW power station. Construction of Panel 2 commenced in May and by the end of June directional drilling was well underway. Initiation of the UCG Panel 2 is scheduled for September 2010, subject to approval from the Department of Environment and Resource Management following their assessment of an Environmental Evaluation report lodged on 20 August this year.



Vertical Drilling Panel 2 – May



Panel 2 - injection well head



Panel 2 knock-out skid which forms part of the gas production facilities



UCG Panel 2 injection well

Bloodwood Creek

The success of any project starts with selecting the right site and the work undertaken initially by CSIRO was key to the selection of Bloodwood Creek.

The main criteria being coal quality and depth, future groundwater and geology behaviour, plus a location close to existing infrastructure, are key to assessing an attractive site both on an environmental and commercial basis.

Regional and local geological data reveal many coal deposits in Queensland's Surat Basin potentially attractive to deploy Carbon Energy's UCG technology. However in addition to meeting Carbon Energy's coal resource requirements; the site must also meet the Company's environmental, social responsibility and economic criteria. For example, the Bloodwood Creek site was specifically selected for its location away from prime agricultural land and well clear of good quality aquifers such as the Great Artesian Basin.

Carbon Energy's Bloodwood Creek site is located between Dalby and Chinchilla in the Surat Basin, is not suitable for prime agriculture and has an existing groundwater supply which is generally too saline for human consumption, stock water or irrigation. This site is adjacent to a large forestry area which borders two sides of Carbon Energy's property, minimising possible disturbance to local residents from the Company's development.

The geology of the trial area was characterised through data capture of 2D seismic and downhole geophysical information. Geotechnical and coal quality data was collected from a cored hole drilled directly into the UCG panel zone. This monitoring bore was then used to house electronic devices to remotely collect data during the gasification process including water pressure, temperature, and micro-seismic activity.

This site also meets the Company's commercial development criteria as it is situated in close proximity to existing infrastructure such as roads, electricity transmission lines and gas pipelines; making it easier for Carbon Energy to send its product to market in addition to minimising any associated environmental impacts.

BLOODWOOD CREEK - STAGE 1 DEVELOPMENT

The 5MW power plant, which is due for completion towards the end of 2010, will be Australia's first commercial power generation from UCG syngas. Two new UCG Panels (Panel 2&3) commenced in May and have been successfully completed with drilling and above ground pipe-work construction finalised for Panel 2 in August.

After signing an off-take agreement with Queensland Government-owned Ergon Energy in July 2009, electricity generated from this power station will supply the local grid and be sufficient to provide approximately 4000 homes with power. This first phase of power generation is worth \$2 million per annum to Carbon Energy and is an important first step in UCG contributing to Queensland's clean energy mix of the future.

BLOODWOOD CREEK - PHASE 2 DEVELOPMENT

Planning for Phase 2 is well advanced, and it is anticipated that this will see the construction of an additional 25MW plant co-located with the 5MW plant at Carbon Energy's Bloodwood Creek site. This facility is being designed to include carbon capture technology enabling the Company to demonstrate the production of cleaner energy from coal. Discussions are currently underway for the selection of suitable carbon capture technology for the 25MW power plant. Arcadia Energy Trading is Carbon Energy's power station development partner for the 25MW power plant.

The Company has recognised the enormous opportunity for future energy and or chemical manufacturing development from its 668 Mt (450Mt Inferred and 218Mt Indicated with 2m cut-off) of JORC Resource at Bloodwood Creek. This was confirmed in December 2009 when the Company commissioned U.S.-based MHA Petroleum Consultants to undertake a third party certification of its energy reserves (the potential energy produced from the coal). MHA Identified that the available 2P Reserves alone (centred around only 20% of the Company's MDL 374), are sufficient to undertake the following projects with a life of over 15 years:

- A 300 MW base load power station, and
- A world scale ammonia plant, and
- A 20 PJ per annum synthetic natural gas plant.

Following additional exploration there will be significant scope to increase the resource base within MDL 374 that will support Carbon Energy's ambition to develop a major energy and industrial hub (Blue Gum Energy Park) in regional Queensland.

STAGE 3 – BLUE GUM ENERGY PARK

To assure the Company's growth path is secured at our Queensland location, Carbon Energy finalised the purchase of 517 hectares of land located adjacent to our Bloodwood Creek Site near Kogan in early 2009.

Carbon Energy expects the first stage of the Blue Gum Energy Park to incorporate the construction of a 300MW power plant fuelled by syngas from the nearby Bloodwood Creek site. This power station will then be able to provide electricity to other prospective manufacturing facilities that co-locate at Blue Gum; with the balance of the electricity generated flowing into Powerlink's national interconnector located a short distance from site. In September 2010, the Company entered into a Power Station Development Agreement with Arcadia Energy Trading whereby Arcadia will be the foundation customer for the Blue Gum Energy Park, purchasing syngas to fuel a 300MW power station.

Subject to Government approvals, it is anticipated that the power station could be exporting enough electricity to supply the equivalent of more than 300,000 homes by 2015.



Carbon Energy's 5MW Power Station at Bloodwood Creek, Queensland

Blue Gum Energy Park

Carbon Energy MLA50253 and Blue Gum Technology Park Area



[1] - Central gas processing and Gas Power-Station
[2] - Ammonia Plant
[3] - Chemical Plant
[4] - Transport Fuel manufacture

[5] - Synthetic Natural Gas manufacture
[6] - Commercial and Administration Facilities
[7] - Carbon Energy's existing UCG facility (Bloodwood Creek)

The property known as Blue Gum is ideal for the type of commercial development Carbon Energy has planned as the property is close to key energy infrastructure corridors including the Roma to Brisbane gas pipeline and the Queensland to NSW High Voltage Power Grid. Importantly Blue Gum is west of the Rabbit Proof Fence, the significance being that the area does not contain any Strategic Cropping Land and as such it is not suitable for high value agricultural or residential development.

A confirmation of the importance of Carbon Energy's 300MW to Queensland is the August 2010 publication of The Australian Energy Market Operator's ("AEMO") annual Statement of Opportunities. The report notes that Queensland may expect a shortfall in power station reserve capacity of 726MW in 2013/14.

In the AEMO Report Queensland has the largest and earliest shortfall of all Australian states in the National Electricity Market ("NEM") making Carbon Energy's planned 300MW power station at Blue Gum a part of the solution to the State's future electricity security requirements. Carbon Energy's cost of producing syngas will be lower than that of other sources of gas in Queensland and will have a smaller carbon footprint than traditional coal fired generation, meaning the Company is well-placed to contribute to the State's clean energy mix of the future.

Additional opportunities for large scale development at Blue Gum are a reflection of the properties inherent in UCG syngas including its suitability to be processed into high value products such as ammonia for fertiliser, synthetic natural gas (pipeline quality) and transport fuel. During 2010/2011, the Company will be working to progress the required State and Local Government approvals plus advancing discussions with potential development partners and customers.

Mulpun Project, Chile

In December 2009, Carbon Energy signed its first international agreement with Antofagasta Minerals.

Antofagasta Minerals, one of the world's largest mining and exploration companies, completed a two year due diligence process whereby the capability of UCG companies from around the world were rigorously assessed to determine the most suitable partner to develop its deep coal deposit in Mulpun. Based on the strength of Carbon Energy's superior UCG technology, the Company was selected by Antofagasta to conduct a trial project in Mulpun. This UCG site is located in southern central Chile, south of Santiago and just 40km east of the city of Valdivia.

Chile provides an ideal market opportunity for Carbon Energy's technology as the country's energy demand is forecast to grow at 6-7 per cent per annum, over the next 5-10 years. This project is consistent with Carbon Energy's strategy to build a portfolio of coal resources in attractive markets throughout the world by leveraging off the Company's core capability in UCG technology. Importantly, Antofagasta shares Carbon Energy's ambition to provide low cost and reliable cleaner energy in an environmentally responsible and sustainable manner. Antofagasta Minerals S.A. has formed a new energy division called Mulpun Energy which has carriage of the joint project on behalf of the larger organisation.

Initial drilling and hydrological results indicate the Mulpun site is suitable for UCG based on preliminary exploration undertaken by Antofagasta's Mulpun Energy team. Their approach to the technical and environmental development of this site has been very comprehensive. Following the completion of feasibility studies and mutual agreement on development plans, a Joint Venture will be established to begin work on the design, construction and operation of the trial project paving the way for commercial projects based on UCG syngas.

Environmental approval obtained by Mulpun Energy in August this year gave the green light to the parties' first stage joint UCG project in Mulpun. This is a key milestone in the development of the project and allows the parties to construct and operate a pilot scheme that includes the first UCG panel and on-site facilities.

To date, both parties have completed a significant programme of work together including:

Site evaluation for the trial project including seismic assessment and syngas production modelling,

Completing a detailed work plan and budget for the initial trial project,

- Obtaining Environmental approval for the trial, and
- Completion of market and economic feasibility studies for a variety of commercial uses for syngas, including power generation.

The primary focus going forward is the successful construction and operation of the first UCG panel in conjunction with commissioning studies into the optimal size and equipment selection for Carbon Energy's first major power generation project in Chile.

FEATURING CARBON ENERGY'S PARTNERS AT MULPUN ENERGY



Cristián Barrientos an experienced mining engineer was appointed General Manager of Mulpun Energy Project in Southern Chile, in January 2010. He has worked in Antofagasta Minerals since 2007, and has been involved in the development of numerous mining and energy projects.

Mr. Barrientos holds a Master's in Mining (Business) from Universidad de Chile and also a Master's in Mineral Economics from Curtin University, Western Australia.



Arturo Albornoz was appointed Business Development Manager in January 2010. Mr. Albornoz is focused on developing business opportunities for Mulpun Energy Project in Southern Chile. Member of Antofagasta Minerals since 2008, Mr. Albornoz is a Metallurgical Engineer who holds a Master of Science degree in Mining and Economics from Technical University of Helsinki, Finland.

For Antofagasta Minerals the Mulpun Energy project represents an interesting challenge, deploying new mining technologies to develop a local coal resource that to date has been considered a stranded asset.

Prior to being appointed to their current roles, both gentlemen have been involved in the project since its commencement in 2008 when the first evaluation to develop the Mulpun coal field was undertaken.

At a local level, this region of Chile is very interested in technology developments and environmental friendly opportunities to generate energy.



Carbon Energy's MD – Andrew Dash (3rd from left) with Senior Management from Antofagasta Minerals visiting the Mulpun Site April 2010



Arturo Albornoz (on the right) – Mulpun Energy's Business Development Manager visiting Carbon Energy's Queensland site in January 2010

STRATEGIC PARTNERS

"Carbon Energy has been an important support for developing our project in Mulpun. We appreciate Carbon Energy's continuous support and assistance in these nine months", said Barrientos.

"Mulpun Energy and Carbon Energy signed a cooperation agreement for the development of this project in 2009. Since then, Carbon Energy has brought all its technical experience in the engineering field into the design and implementation of the UCG technology, as it has done in various initiatives in Australia and other countries."

"For the development of this project, teams from both companies have exchanged knowledge during work trips made to Chile and Australia. This process has been efficient and has been assisted with regular scheduled project meetings throughout the past nine months."

"The next step is the construction and beginning of operations of the pilot scheme, which will be carried out in 2011. During this period, Carbon Energy's development experience will be essential," Mr Barrientos said.

ABOUT MULPUN ENERGY

Mulpun Energy's site is located at Mulpun, Los Ríos region, southern Chile.

In August 2010, the pilot scheme for the project was approved by local authorities, fulfilling an important step for the development of the project.

Since its beginnings, Mulpun Energy has been committed to caring and respecting the environment, as well as living in harmony with the various production activities that take place in the area.

Regarding the relationship between the company and its neighbours, Mulpun Energy is working together with communities to strengthen their bonds, paying special attention to its surroundings and promoting local capabilities through dialogue, active participation and integration to the project.

"We have given information continuously to our neighbours about the project, in an effort to maintain relationships based on transparency and equal access to information, being always available to answer their concerns", said Barrientos.

Sponsoring Young Business Talent

Carbon Energy participated in the 2010 Trade and Investment Queensland International Business Cadetship Program. This program offers a selection of young Queenslanders an excellent opportunity to enter the world of international business and provides growing Queensland companies with valuable in-market knowledge. Sponsored by Carbon Energy, Deanna Ferraro has completed the 2010 Trade & Investment Queensland International Business Cadetship for The Americas.

Spending most of her cadetship abroad based in the Trade & Investment Queensland office in Los Angeles, Deanna spent over 5 months investigating potential opportunities for Carbon Energy's UCG technology in the United States and evaluated a range of carbon capture and utilisation technologies, many of which are currently unavailable in Australia.

The findings from Deanna's work will form part of Carbon Energy's market evaluation for future United States project opportunities.



Deanna Ferraro and The Honourable Stephen Robertson MP, Minister for Natural Resources, Mines and Energy and Minister for Trade at the International Business Cadetship Graduation ceremony 26th August 2010.

Executive Management Team



From left to right: Dr Cliff Mallett, Andy Mifflin, Prem Nair, John Bidwell, Andrew Dash, and Peter Swaddle.

Over the past year Management has been very focused on establishing a firm foundation for the next stage of the Company's growth. This has involved further investment in people who bring additional experience and capability to our expanding business.

Within the Executive Team there have been two important changes, the first being Andy Mifflin's change of role from General Manager Technical Services (appointed in January) to Chief Operations Officer (July), Andy now takes on total responsibility for technical operations at the Company's Bloodwood Creek site which is expanding to become a fully integrated syngas to electricity generation facility.

The second change has been the recruitment of an additional senior executive team member, John Bidwell, who joined in May as General Manager Project Development. John has the responsibility of bringing to fruition a range of projects currently under development, such as the 5MW and 25MW power stations in Queensland and the Company's first international project in Chile.

ANDREW DASH – CHIEF EXECUTIVE OFFICER AND MANAGING DIRECTOR

BE (Chem), MCom

Andrew is responsible for the overall performance, leadership and growth of Carbon Energy. In addition Andrew is a Company Director and together with The Board sets the strategic direction of our expanding organisation. A key strategic objective is to focus the Company on the delivery of current and future growth projects that in turn deliver attractive shareholder returns. This growth will be assisted through development of suitable UCG projects here in Australia and overseas, either in our own right or through joint venture partnerships.

Andrew has a degree in Chemical Engineering from the University of Sydney and a Masters Degree in Commerce from the University of New South Wales. Andrew has extensive experience in the energy sector, with particular experience in the commercial development of gas operations and associated infrastructure.

DR CLIFF MALLETT - TECHNICAL DIRECTOR - UCG

MSc, PhD, FAIE

Cliff is responsible for the ongoing development of Carbon Energy's UCG technology. Additionally, Cliff undertakes assessment of potential coal deposits that may be suitable for the Company's expanding portfolio of Australian and international projects. Cliff is also heavily involved with the evaluation of emerging carbon capture and storage opportunities.

Cliff has been associated with advancing the development ("UCG") process technology for more than 15 years. Cliff 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 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.

PREM NAIR - CHIEF FINANCIAL OFFICER AND COMPANY SECRETARY

BBus (Acctg), MBA, FCA, FCIS, FTIA, MAICD

Prem is responsible for all the financial management within Carbon Energy, all financial and corporate regulatory compliance and reporting. Additionally Prem and his team cover Human Resource management and Information Technology support for the organisation.

Prem has over 30 years experience in the accounting profession and commercial arena. His experience includes leading finance teams in public listed entities covering exploration, resources, technology and construction industries. He has over 20 years experience in corporate governance and company secretarial roles.

ANDY MIFFLIN - CHIEF OPERATING OFFICER

BSc (Hons), MBA

Andy has overall responsibility for site development and operations as well as the technical implementation of the UCG technology. This is a challenging task; the site is continually changing as the Company operations expand. Over the coming months the Bloodwood Creek site will expand from being a single panel (for UCG Gas production) to multi-panel gas production facility with integrated power generation capabilities. In his capacity, Andy also has technical responsibility for the upcoming pilot site planned for Chile as well as assessing other areas of interest.

Andy has Bachelors Degree in Science, Mining Engineering (Hons.) plus a Master of Business Administration.

Andy is a professional mining engineer with over 30 years experience in senior management roles in the coal industry in Australia and the UK. He has significant experience in the development and operation of underground coal mines having held senior roles with AMCI/Vale Australia, Centennial Coal and Xstrata/MIM.

PETER SWADDLE - GENERAL MANAGER COMMERCIAL

Peter is primarily responsible for all external relationships. This activity covers business development with current and potential partners, project opportunity assessment, government and investor relations, plus marketing and company promotional activities.

Peter is a Senior Commercial and Marketing Executive with over 16 years experience with two of Australia's major national brand leaders. Peter has a proven track record in commercial development and strategic brand positioning and brand management with extensive experience in both product development and project management.

JOHN BIDWELL - GENERAL MANAGER PROJECT DEVELOPMENT

John is responsible for Carbon Energy's growing list of projects including the finalisation of the Stage 1, a 5MW power plant currently under construction and due to be finished later this year. In parallel, John is working on the Company's planned Stage 2 project at Bloodwood Creek, which will see Carbon Energy construct an additional 25MW power plant adjacent to the 5MW. John also has leadership of the Project Delivery Team for the Chilean project with the Company's partners Antofagasta Minerals SA.

John has held business leadership, management, and operational positions in Australia, New Zealand and South America, in energy and related infrastructure sectors. John's senior management experience includes major project management, mergers & acquisitions, operations. John has previously managed energy projects in Chile which is a great advantage to Carbon Energy as this is the Company's first international project.

Directors' Report

Board Information

Your Directors present their report on the Company and its controlled entities for the financial year ended 30 June 2010.

DIRECTORS

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



K. Robinson



A.M. Dash



C.W. Mallett



M.D.J. Cozijn



H. M. Garnett
(appointed 6 September
2010)



P.N. Hogan



L.I. Rozman
(appointed 7 April 2010)



I.W. Walker

P.T. McIntyre
(retired 12 February 2010)

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

COMPANY SECRETARY

Mr P Nair was appointed the Company Secretary on 1 January 2009. Details of Mr Nair's experience and qualifications are set out in the information on Directors and Company Secretary in the Directors' Report.

PRINCIPAL ACTIVITIES

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

- to successfully construct and commission its Underground Coal Gasification (UCG) project in Queensland, applying its world leading UCG technology,
- to build a portfolio of coal resource assets and complete mineral divestment activities.

OPERATING RESULTS

The consolidated loss of the Consolidated group after providing for income tax amounted to \$10,820,487 (2009: loss \$15,385,427).

DIVIDENDS PAID OR RECOMMENDED

No dividend was paid or declared during the year and the Directors do not recommend the payment of a dividend.

REVIEW OF OPERATIONS

A review of the Consolidated group's operations during the year and the results of those operations are contained in pages 4 to 19 of this Annual Report.

FINANCIAL POSITION

The net assets of the Consolidated group have increased by \$7,435,675 to \$154,557,868 during the financial year. The net increase is largely a result of the net proceeds from Share issues raising \$9,975,000 (Tranche 2 Share Placement) in July 2009.

The Directors believe the group is in a strong and stable financial position to progress its objectives and strategy.

SIGNIFICANT CHANGES IN STATE OF AFFAIRS

The following significant changes in the state of affairs of the Parent entity occurred during the financial year:

- (i) On 23 July 2009, the Company completed Tranche 2 of the Placement, issuing 24,418,605 fully paid shares at 43 cents. The first and second tranches of the Placement raised gross proceeds of \$32 million.
- (ii) Pursuant to Shareholder approval, granted at the general meeting on 20 July 2009, the Company allotted 7,407,408 fully paid shares as the final consideration for the acquisition of Carbon Energy (Operations) to Dr Mallett's nominee 4,629,630 fully paid shares and Mr Mark's nominee 2,777,778 fully paid shares
- (iii) During the year 15,375,000 Options were exercised (at an average of 20.85 cents each totalling \$3,206,250).
- (iv) On 26 May 2010, 15,000,000 fully paid shares were issued to Constellation Energy Pty Ltd in consideration for the supply of drilling services of \$3,000,000 by for the Bloodwood Creek Trial. The shares issued were in satisfaction of an obligation in an HOA announcement on 5 May 2008. The issue of shares to Constellation was previously approved by Shareholders on 23 June 2008.

AFTER BALANCE DATE EVENTS

Subsequent to Balance Date, the Company commenced proceedings in the Supreme Court of Queensland against Alexware Consulting Pty Ltd trading as Pangea Partners International ("Pangea") and Mr John Wedgwood, a former Carbon Energy employee. Pangea was the contractor originally engaged to build and commission Carbon Energy's 5MW power station.

The legal action brought about by Carbon Energy is in relation to serious irregularities in the performance of activities specified in the contract, and accordingly, Carbon Energy will be seeking damages from the parties named above.

Carbon Energy has suspended the contract with Pangea and has exercised its right to step in and complete any work it deems appropriate by way of variation to the contract. The legal proceedings will not affect the revised timetable for completion of the project. The damages being sought are not material to the ongoing funding of the Company's activities.

Carbon Energy together with its partner in Chile, Antofagasta Minerals ("Antofagasta"), has obtained Environmental Approval for the first stage of the parties' joint Underground Coal Gasification ("UCG") project in Chile in August 2010.

Drilling program for UCG Panel 2 and the above ground pipe work have been successfully completed. However, commencement of operations for Panel 2 is subject to the Queensland Department of Environment and Resource Management (DERM) review of the Company's Environmental Evaluation and notice from DERM that the Company may proceed. It is anticipated that DERM's review of the Environmental Evaluation will be completed shortly.

The Company has in early September 2010 executed a Power Station Development Agreement with Arcadia Energy Trading ("Arcadia") that, when completed, will result in the development of both a 25MW and a 300MW power station fuelled by syngas in Queensland.

On 6th September 2010, Dr Helen Garnett joined the Board as a Non-Executive Director.

No other matters of circumstance have arisen since the end of the financial year, which significantly affected or may significantly affect the operations of the Consolidated group, the results of those operations and the state of affairs of the Consolidated group in subsequent financial years.

FUTURE DEVELOPMENTS

Likely future developments in the operations of the Consolidated group are referred to in the Managing Director's Report on page 6 of this Annual Report. Further information regarding likely developments in the operations of the Consolidated group and likely results of those operations would, in the opinion of the Directors, be speculative and not in the best interests of the Consolidated group.

ENVIRONMENTAL ISSUES

The Consolidated group's operations are subject to significant environmental regulation under the Laws of the Commonwealth and State. On 20th August 2010, Carbon Energy submitted an Environmental Evaluation of its Bloodwood Creek site as requested by Queensland Department of Environment and Resource Management (DERM). The evaluation relates to an incident that occurred during the year at the Bloodwood Creek site which involved the release of UCG process water from the flare stack onto the ground with an amount running into a pond at Bloodwood Creek. The release was as a result of an accumulation of water from a process procedure which has since been altered for the new panel to prevent any reoccurrence. An immediate spill response was initiated with the water being pumped out and affected soils removed. Water sampling results have concluded that no environmental harm occurred as a result. Carbon Energy is confident that the Environmental Evaluation confirms that the Company's environmental practices and performance are sound.

MINERAL EXPLORATION

In Queensland, the Company has lodged financial assurance bonds for Environmental Authority Permits and associated security bonds of \$50,640.

COAL EXPLORATION AND UCG

Carbon Energy prides itself on the Company's environmental track record, which apart from the one isolated and rectified incident mentioned above, has remained untarnished. The Carbon Energy UCG project at Bloodwood Creek has complied with the conditions of the Environmental Authority Number MIN200647007 which was issued by the EPA on 14 December 2007. The Environmental Authority regulates the environmental aspects of all UCG activities authorised to be conducted on Mineral Development Licence 374. In addition, on 13th April 2010 Petroleum Facility Licence No.6 was granted to Carbon Energy together with Environmental Authority PEN200236408. This is for the processing of syngas on the MDL area which requires a separate tenure and approval under the Petroleum and Gas Act 2004.

The environmental management of the exploration drilling program is governed by the requirements of the Code of Environmental Compliance for Exploration and Mineral Development Projects, published by the Department of Environment and Natural Resources. All exploration activities over the past year have complied with the Code.

Carbon Energy has obtained all regulatory approvals, including environmental approvals, to allow the UCG demonstration trial and associated activities to be conducted on MDL 374, based on the submission and approval of the Environmental Management Plan. The growth of activities on-site requires an update of the Environmental Management Plan. The government agencies involved in permitting the demonstration trial have included the Department of Employment, Economic Development and Innovation; the Department of Environment and Resource Management; and the Department of Infrastructure and Planning.

Directors' Report

Information on Directors and Company Secretary

MR KIM ROBINSON – CHAIRMAN (NON-EXECUTIVE)

BSc (Geol)

Mr Robinson graduated from the University of Western Australia in 1973 with a Degree in Geology. Mr Robinson has subsequently amassed over 36 years involvement in the mineral exploration and mining industries, including the last 10 years as the Executive Chairman of Kagara Limited. He has been closely involved in the discovery, financing and development of numerous gold, base metal and nickel mines including Cosmos, Lounge Lizard and Emily Ann nickel mines, the Bounty and Mt McClure gold mines and the Mt Garnet, Balcooma, Mungana and Dry River South polymetallic mines. Mr Robinson is a Director of the Company, and is the Chairman of both the Audit and Remuneration Committees.

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

- Kagara Limited* (from September 1981) - Executive Chairman
- Apex Minerals NL* (from April 2006) – Non executive Chairman

* Denotes current directorship

MR ANDREW M. DASH – CHIEF EXECUTIVE OFFICER & MANAGING DIRECTOR

BE (Chem), MCom

Mr Dash was appointed to the Board on 30 June 2008.

Mr Dash was initially appointed to the position of Chief Operating Officer, The Board appointed Andrew in January 2009 to his current role as Chief Executive Officer and Managing Director. Andrew has a Degree in Chemical Engineering from the University of Sydney and a Masters Degree in Commerce from the University of New South Wales. He has extensive experience in the energy sector, with particular experience in the commercial development of gas operations and associated infrastructure. He had previously held executive management roles with the leading energy transmission business APA Group.

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

DR CLIFFORD W. MALLETT – TECHNICAL DIRECTOR (EXECUTIVE)

MSc, PhD, FAIE

Dr Cliff Mallett was appointed to the Board on 14 February 2008. Dr Mallett has been associated for more than 10 years in advancing the development of the Underground Coal Gas ("UCG") process technology. He has received degrees in Geology from the Universities of Queensland and Melbourne and held academic appointments at the Universities of Newcastle and Melbourne from 1966 to 1978.

He has almost 30 years experience in mining research at CSIRO, culminating in 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.

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

MR MAX D.J. COZIJN – DIRECTOR (NON-EXECUTIVE)

BCom, ASA, MAICD

Mr Cozijn has a Bachelor of Commerce Degree from the University of Western Australia, having graduated in 1972, and is an Associate of the Australian Society of Certified Practising Accountants and is a member of the Australian Institute of Company Directors. Mr Cozijn has over 30 years experience in the administration of listed mining and industrial companies, as well as various private operating companies.

Mr Cozijn was the Company's Finance Director between 1993 and 2008, and is now a Non-Executive Director.

Mr Cozijn also holds the following listed company Directorships:

- Oilex Ltd* (from September 1997) Non – executive Chairman
- Magma Metals Ltd* (from June 2005) Executive Director
- Malagasy Minerals Limited* (from September 2006) Executive Chairman
- Energia Minerals Limited* (from May 1997) Non – executive Director
- Elkeda Diamonds NL
(from April 2000 to November 2007) –Retired

* Denotes current directorship

DR HELEN M. GARNETT – DIRECTOR (NON-EXECUTIVE)

Appointed 6 September 2010

PSM, BSc (Hons), PhD, FTSE, FAICD

Dr Helen Garnett has over 25 years experience in transforming technical innovation into practical commercial outcomes. She has 15 years experience as a Chief Executive and over 16 years as a Non-Executive Director having been closely associated with the resource and energy sectors throughout this time. She is a Fellow of the Australian Institute of Company Directors and the Academy of Technical Sciences and Engineering.

Dr Garnett is currently Director of Australian Centre for Plant Functional Genomics, Director of National Centre for Vocational Education Research and Director of Museum and Art Galleries NT Foundation.

During the past three years Dr Garnett has held the following other listed company Directorships:

- Energy Resources of Australia Limited* (from Jan 2005) – Non-Executive Director

* Denotes current directorship

MR PETER N. HOGAN – DIRECTOR (NON-EXECUTIVE)

BBus, ACA

Appointed to the Board on 29 August 2008, Mr Hogan is a Chartered Accountant, and is currently a Strategy and Development Executive with Incitec Pivot Ltd. 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:

- Fabchem China Ltd (Singapore Stock Exchange listed)*
(from July 2008)

* Denotes current Directorship

MR LOUIS I. ROZMAN – DIRECTOR (NON-EXECUTIVE)

Appointed 7 April 2010

BEng, MGeos, FAusIMM CP (Man), MAICD

Mr Rozman holds degrees in mining engineering and mineral economics and has 30 years' experience in mining operations, joint ventures and corporate management in Australasia and Africa. He was previously Chief Operating Officer of major gold producer, Aurion Gold and Chief Executive Officer of coal seam gas producer, CH4 Gas Limited. Mr Rozman is a Fellow and Chartered Professional of the Australasian Institute of Mining and Metallurgy and a Member of the Australian Institute of Company Directors. He is a director of Pacific Road Capital, private equity mining investment fund and holds a number of non listed directorships.

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

- TSXV listed Timmins Gold Corp; (from Nov 08) – Non executive Director
- ASX listed Pacific Energy Limited; (from May 09) – Non executive Director.

MR IAN W. WALKER – DIRECTOR (NON-EXECUTIVE)

BSc (Geol) (Hons)

Mr Walker is a geologist with over 35 years experience in multi-commodity exploration within Australia and overseas, having graduated from the University of Western Australia in 1974 with an Honours Degree in Geology.

Mr Walker is a Member of the Australian Institute of Geoscientists.

Mr Walker was Managing Director of the Company between 1993 and 2008 and remains as a Non-Executive Director. He is also a Director of subsidiary companies Metex Resources NL, and Nickelex Pty Ltd.

During the past three years Mr Walker has held listed company Directorships of Energia Minerals Limited from May 1997.

MR PETER T. MCINTYRE – DIRECTOR (NON-EXECUTIVE)

Retired 12 February 2010

BSc, MBA, FIEAust

Mr McIntyre has been in the mining industry for nearly 30 years, including 15 years with WMC Ltd where he was involved in the development of major projects including St Ives Gold and Mt Keith Nickel, as well as Central Norseman Gold Operations. Since that time, Mr McIntyre has been involved at a corporate level having established and steered various companies through their early stage developments.

Mr McIntyre was the Managing Director of listed company, Extract Resources Limited, a uranium company with a major project in Namibia, a founding director of Kalahari Minerals (AIM-listed) and is currently a non-executive director of Atticus Resources Ltd. Mr McIntyre is a chartered Civil Engineer and a Fellow of the Institution of Engineers, Australia. He also completed an MBA program at the Massachusetts Institute of Technology in Boston.

- During the past three years Mr McIntyre has held the following other listed Company Directorships:
- Atticus Resources Ltd* (from 2007) – Non Executive Director
- Extract Resources Ltd
(from December 2003 to 15 September 2009) - Retired
- Kalahari Minerals Plc (from May 2006 to May 2008) - Retired

* Denotes current Directorship

MR PREM K. NAIR – CFO & COMPANY SECRETARY

B Bus (Acctg), MBA, FCA, FCIS, FTIA, MAICD

Mr Nair has over ten years experience with Australian professional accounting firms in various areas including business assurance and tax services and has over 20 years experience in start up companies, resource and constructing industries, holding senior executive finance roles with both publicly listed and unlisted entities. Mr Nair is the Chief Financial Officer and Company Secretary of the Company.

DIRECTORS' INTERESTS

As at the date of this report, the interests of the Directors in shares and unlisted options of the Company are:

	NO. OF SHARES HELD		UNLISTED OPTIONS	
	Direct	Indirect	Direct	Indirect
K. Robinson	2,000,000	-	-	-
I.W. Walker	941,629	7,634,974	-	-
M.D.J. Cozijn	12,544	3,015,796	-	-
C.W. Mallett	-	11,766,952	5,250,000	-
P.N. Hogan	-	250,000	-	-
A.M. Dash	-	-	30,000,000	-
TOTAL	2,954,173	22,667,722	35,250,000	-

Directors' Report

Corporate Governance Statement

STATEMENT

Carbon Energy Limited ("Company") has made it a priority to adopt systems of control and accountability as the basis for the administration of corporate governance. Some of these policies and procedures are summarised in this statement. Commensurate with the spirit of the ASX Corporate Governance Council's Corporate Governance Principles and Recommendations ("Principles & Recommendations"), the Company has followed each recommendation where the Board has considered the recommendation to be an appropriate benchmark for its corporate governance practices. Where the Company's corporate governance practices follow a recommendation, the Board has made appropriate statements reporting on the adoption of the recommendation. Where, after due consideration, the Company's corporate governance practices depart from a recommendation, the Board has offered full disclosure and reason for the adoption of its own practice, in compliance with the "if not, why not" regime.

DISCLOSURE OF CORPORATE GOVERNANCE PRACTICES

SUMMARY STATEMENT

	ASX P & R ¹	If not, why not ²		ASX P & R ¹	If not, why not ²
Recommendation 1.1	✓		Recommendation 4.3	✓	
Recommendation 1.2	✓		Recommendation 4.4 ³	n/a	n/a
Recommendation 1.3 ³	n/a	n/a	Recommendation 5.1	✓	
Recommendation 2.1		✓	Recommendation 5.2 ³	n/a	n/a
Recommendation 2.2	✓		Recommendation 6.1	✓	
Recommendation 2.3	✓		Recommendation 6.2 ³	n/a	n/a
Recommendation 2.4		✓	Recommendation 7.1	✓	
Recommendation 2.5	✓		Recommendation 7.2	✓	
Recommendation 2.6 ³	n/a	n/a	Recommendation 7.3	✓	
Recommendation 3.1	✓		Recommendation 7.4 ³	n/a	n/a
Recommendation 3.2	✓		Recommendation 8.1	✓	
Recommendation 3.3 ³	n/a	n/a	Recommendation 8.2	✓	
Recommendation 4.1	✓		Recommendation 8.3 ³	n/a	n/a
Recommendation 4.2	✓				

¹ Indicates where the Company has followed the Principles & Recommendations. ² Indicates where the Company has provided "if not, why not" disclosure.

³ Indicates an information-based recommendation. Information-based recommendations are not adopted or reported against using "if not, why not" disclosure – information required is either provided or it is not.

WEBSITE DISCLOSURES

Further information about the Company's charters, policies and procedures may be found at the Company's website www.carbonenergy.com.au, under the section marked Corporate Governance. A list of the charters, policies and procedures which are referred to in this Corporate Governance Statement, together with the recommendations to which they relate, are set out below.

Charters	Recommendation(s)
Board	1.1, 1.3
Audit Committee	4.3, 4.4
Nomination Committee	2.4, 2.6
Remuneration Committee	8.3

Policies and Procedures	Recommendation(s)
Policy and Procedure for Selection and (Re)Appointment of Directors	2.6
Process for Performance Evaluation	1.2, 2.5
Policy on Assessing the Independence of Directors	2.6
Policy for Trading in Company Securities (summary)	3.2, 3.3
Code of Conduct (summary)	3.1, 3.3
Policy on ASX Listing Rule Compliance (summary) and Compliance Procedures (summary)	5.1, 5.2
Procedure for Selection, Appointment and Rotation of External Auditor	4.4
Shareholder Communication Policy	6.1, 6.2
Risk Management Policy (summary)	7.1, 7.4

DISCLOSURE – PRINCIPLES & RECOMMENDATIONS

The Company reports below on how it has followed (or otherwise departed from) each of the Principles & Recommendations during the 2009/2010 financial year ("Reporting Period").

PRINCIPLE 1 – LAY SOLID FOUNDATIONS FOR MANAGEMENT AND OVERSIGHT

Recommendation 1.1:

Companies should establish the functions reserved to the Board and those delegated to senior executives and disclose those functions.

Disclosure:

The Company has established the functions reserved to the Board and has set out these functions in its Board Charter. The Board is collectively responsible for promoting the success of the Company through its key functions of overseeing the management of the Company, providing overall corporate governance of the Company, monitoring the financial performance of the Company, engaging appropriate management commensurate with the Company's structure and objectives, involvement in the development of corporate strategy and performance objectives and reviewing, ratifying and monitoring systems of risk management and internal control, codes of conduct and legal compliance.

The Company has established the functions delegated to senior executives and has set out these functions in its Board Charter. Senior executives are responsible for supporting the Managing Director and assisting the Managing Director in implementing the running of the general operations and financial business of the Company, in accordance with the delegated authority of the Board.

Senior executives are responsible for reporting all matters which fall within the Company's materiality thresholds at first instance to the Managing Director or, if the matter concerns the Managing Director, then directly to the Chair or the lead independent director, as appropriate.

Recommendation 1.2:

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

Disclosure:

The Managing Director is responsible for evaluating the senior executives. The performance of senior executives are reviewed individually and compared to key performance indicators which have been endorsed by the Board.

Recommendation 1.3:

Companies should provide the information indicated in the

Guide to reporting on Principle 1.

Disclosure:

During the Reporting Period the evaluation of senior executives took place in accordance with the disclosed process disclosed at Recommendation 1.2.

PRINCIPLE 2 – STRUCTURE THE BOARD TO ADD VALUE

Recommendation 2.1:

A majority of the Board should be independent directors.

Notification of Departure:

The Board was not comprised of a majority of independent directors.

Explanation for Departure:

The independent directors of the Board are Kim Robinson, Helen Garnett (appointed 6 September 2010) and former director Peter McIntyre (who retired 12 February 2010) and the non independent directors of the Board are Andrew Dash, Clifford Mallet, Max Cozijn, Peter Hogan, Ian Walker, and Louis Rozman (who was appointed on 7 April 2010).

In February 2010, the Company began an evaluation of the Board to review the strength and skill base of the directors, and where if possible, it could be enhanced. The Board has also undertaken internal discussions in an open forum to discuss its composition. The Board continues to review the composition to ensure it is appropriate for the Company's operations.

Recommendation 2.2:

The Chair should be an independent director.

Disclosure:

The independent Chair of the Board is Kim Robinson.

Recommendation 2.3:

The roles of the Chair and Chief Executive Officer should not be exercised by the same individual.

Disclosure:

The Managing Director is Andrew Dash who is not Chair of the Board.

Recommendation 2.4:

The Board should establish a Nomination Committee.

Notification of Departure:

The Company has not established a separate Nomination Committee.

Explanation for Departure:

The full Board considers those matters and issues that would usually fall to a Nomination Committee. The Board considers that no efficiencies or other benefits would be gained by establishing a separate Nomination Committee at this present time. Accordingly, the Board performs the role of Nomination Committee. Nomination Committee meetings are held separate from Board meetings.

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

Recommendation 2.5:

Companies should disclose the process for evaluating the performance of the Board, its committees and individual directors.

Disclosure:

The Chair is responsible for evaluation of the Board and, when deemed appropriate, Board committees and individual directors. The Nomination Committee is responsible for evaluating the Managing Director.

The process for evaluating the performance of the Board, individual directors and any applicable committees is:

- questionnaires are prepared by the Company Secretary and circulated to each Director for completion;
- the Company Secretary then summarises and collates the responses to the questionnaires and reports back to the Board; and
- the Board then reviews and discusses the report and addresses any issues as required.

Recommendation 2.6:

Companies should provide the information indicated in the *Guide to reporting on Principle 2*.

Disclosure:

Skills, Experience, Expertise and term of office of each Director

A profile of each director containing their skills, experience and expertise is set out in the Directors' Report. There is no set term for the office of for each Director. Further comments on directors' skills, experience and expertise relevant to position are set out in the Directors' Report.

Identification of Independent Directors

The independent directors of the Company are Kim Robinson, Helen Garnett (appointed 6 September 2010) and former director Peter McIntyre (who retired on 12 February 2010). These directors are independent as they are non-executive directors who are not members of management and who are free of any business or other relationship that could materially interfere with, or could reasonably be perceived to materially interfere with, the independent exercise of their judgment.

Independence is measured having regard to the relationships listed in Box 2.1 of the Principles & Recommendations and the Company's materiality thresholds. The materiality thresholds are set out below.

Company's Materiality Thresholds

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

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

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

Statement concerning availability of Independent Professional Advice

To assist directors with independent judgement, it is the Board's policy that if a director considers it necessary to obtain independent professional advice to properly discharge the responsibility of their office as a director then, provided the director first obtains approval for incurring such expense from the Chair, the Company will pay the reasonable expenses associated with obtaining such advice.

Nomination Matters

The full Board, in its capacity as the Nomination Committee, held two meetings during the Reporting Period.

To assist the Board to fulfil its function as the Nomination Committee, it has adopted a Nomination Committee Charter.

The explanation for departure set out under Recommendation 2.4 above explains how the functions of the Nomination Committee are performed.

Performance Evaluation

During the Reporting Period an evaluation of the Board, its committees, and individual directors took place in accordance with the process disclosed at recommendation 2.5.

Selection and (Re) Appointment of Directors

In determining candidates for the Board, the Nomination Committee (or equivalent) follows a prescribed procedure whereby it considers the balance of independent directors on the Board as well as the skills and qualifications of potential candidates that will best enhance the Board's effectiveness.

The board recognises that renewal is critical to performance and the impact of board tenure on succession planning. Each director other than the Managing Director must not hold office (without re-election) past the third annual general meeting following the director's appointment or three years whichever is the longer. At each annual general meeting a minimum of one director or a third of the total number of directors shall retire from office. A director who retires at an annual general meeting is eligible for re-election at that meeting. Re-appointment of directors is not automatic.

PRINCIPLE 3 – PROMOTE ETHICAL AND RESPONSIBLE DECISION-MAKING

Recommendation 3.1:

Companies should establish a Code of Conduct and disclose the code or a summary of the code as to the practices necessary to maintain confidence in the company's integrity, the practices necessary to take into account their legal obligations and the reasonable expectations of their stakeholders and the responsibility and accountability of individuals for reporting and investigating reports of unethical practices.

Disclosure:

The Company has established a Code of Conduct as to the practices necessary to maintain confidence in the Company's integrity, practices necessary to take into account their legal obligations and the expectations of their stakeholders and responsibility and accountability of individuals for reporting and investigating reports of unethical practices.

Recommendation 3.2:

Companies should establish a policy concerning trading in company securities by directors, senior executives and employees, and disclose the policy or a summary of that policy.

Disclosure:

The Company has established a policy concerning trading in the Company's securities by directors, senior executives and employees.

Recommendation 3.3:

Companies should provide the information indicated in the *Guide to reporting on Principle 3*.

Disclosure:

Please refer to the section above marked Website Disclosures.

PRINCIPLE 4 – SAFEGUARD INTEGRITY IN FINANCIAL REPORTING

Recommendation 4.1:

The Board should establish an Audit Committee.

Disclosure:

The Company has established an Audit Committee.

Recommendation 4.2:

The Audit Committee should be structured so that it:

- consists only of non-executive directors
- consists of a majority of independent directors
- is chaired by an independent Chair, who is not Chair of the Board
- has at least three members.

Notification of Departure:

For the majority of the Reporting Period, the Company complied with the compositional requirements set out in Recommendation 4.2. However, Peter McIntyre retired on 12 February 2010 with the consequence that the Company no longer complies with Recommendation 4.2 until Helen Garnett appointment on 6 September 2010.

Explanation for Departure:

Before the retirement of Peter McIntyre, the Audit Committee comprised three directors, Peter McIntyre (Chair), Kim Robinson and Peter Hogan. The independent directors of the Audit Committee were Kim Robinson and Peter McIntyre. Since the retirement of Peter McIntyre, the Audit Committee only comprises Kim Robinson and Peter Hogan until 6 September 2010 when Helen Garnett was appointed a member and Chair of the Audit Committee.

The Company is aware of its obligation under ASX Listing Rule 12.7 to comply with Recommendation 4.2 and since February 2010 and has actively looked to appoint a new non-executive independent director. The Company achieved this requirement with the appointed of Dr Garnett on 6 September 2010.

Recommendation 4.3:

The Audit Committee should have a formal charter.

Disclosure:

The Company has adopted an Audit Committee Charter.

Recommendation 4.4:

Companies should provide the information indicated in the *Guide to reporting on Principle 4*.

Disclosure:

The Audit Committee held two meetings during the Reporting Period. The following table identifies those directors who are members of the Audit Committee and shows their attendance at Committee meetings:

Name	No. of meetings attended
Kim Robinson	2/2
Peter Hogan	2/2
Peter McIntyre	1/1

Note: Helen Garnett joined the Audit Committee on 6 September 2010.

Details of each of the director's qualifications are set out in the Directors' Report.

Mr McIntyre has a Masters of Business Administration; Mr Hogan is a Chartered Accountant who was a partner of PricewaterhouseCoopers for 17 years. Both Messrs McIntyre and Hogan, through their qualifications, have brought and bring financial expertise to the Audit Committee. Furthermore the Company's Chief Financial Officer, Prem Nair, is available to attend Committee meetings by invitation and the Audit Committee has the opportunity to meet with the external auditor, if necessary.

The Company has established procedures for the selection, appointment and rotation of its external auditor. The Board is responsible for the initial appointment of the external auditor and the appointment of a new external auditor when any vacancy arises, as recommended by the Audit Committee (or its equivalent). Candidates for the position of external auditor must demonstrate complete independence from the Company through the engagement period.

The Board may otherwise select an external auditor based on criteria relevant to the Company's business and circumstances. The performance of the external auditor is reviewed on an annual basis by the Audit Committee (or its equivalent) and any recommendations are made to the Board.

PRINCIPLE 5 – MAKE TIMELY AND BALANCED DISCLOSURE

Recommendation 5.1:

Companies should establish written policies designed to ensure compliance with ASX Listing Rule disclosure requirements and to ensure accountability at a senior executive level for that compliance and disclose those policies or a summary of those policies.

Disclosure:

The Company has established written policies designed to ensure compliance with ASX Listing Rule disclosure and accountability at a senior executive level for that compliance.

Recommendation 5.2:

Companies should provide the information indicated in the Guide to reporting on Principle 5.

Disclosure:

Please refer to the section above marked Website Disclosures.

PRINCIPLE 6 – RESPECT THE RIGHTS OF SHAREHOLDERS

Recommendation 6.1:

Companies should design a communications policy for promoting effective communication with shareholders and encouraging their participation at general meetings and disclose their policy or a summary of that policy.

Disclosure:

The Company has designed a communications policy for promoting effective communication with shareholders and encouraging shareholder participation at general meetings.

Recommendation 6.2:

Companies should provide the information indicated in the Guide to reporting on Principle 6.

Disclosure:

Please refer to the section above marked Website Disclosures.

PRINCIPLE 7 – RECOGNISE AND MANAGE RISK

Recommendation 7.1:

Companies should establish policies for the oversight and management of material business risks and disclose a summary of those policies.

Disclosure:

The Board has adopted a Risk Management Policy, which sets out the Company's risk profile. Under the Policy, the Board is responsible for approving the Company's policies on risk oversight and management and satisfying itself that management has developed and implemented a sound system of risk management and internal control.

Under the Policy, the Board delegates day-to-day management of risk to the Managing Director, who is responsible for identifying, assessing, monitoring and managing risks. The Managing Director is also responsible for updating the Company's material business risks to reflect any material changes, with the approval of the Board. As part of the Company's risk management system, the Managing Director reports regularly to the Board on the management of material business risks and provides assurance to the Board, on behalf of management, that the Company's management of its material business risks are effective.

In fulfilling the duties of risk management, the Managing Director may have unrestricted access to Company employees, contractors and records and may obtain independent expert advice on any matter they believe appropriate, with the prior approval of the Board.

The Board has established a separate Audit Committee to monitor and review the integrity of financial reporting and the Company's internal financial control systems and risk management systems. The Board is presented with monthly financial reports with analysis on variances and explanations are provided. In addition, the following risk management measures have been adopted by the Board to manage the Company's material business risks:

- The Board has established authority limits for management which, if exceeded, will require prior board approval.
- The Board has adopted a compliance procedure for the purpose of ensuring compliance with the Company's continuous disclosure obligations.
- The Board has adopted a corporate governance manual which contains other policies to assist the Company to establish and maintain its governance practices.

The Company has established systems for managing its material business risks, these systems among other things comprise a detailed risk matrix showing the Company's business risks and their materiality based on scales of likelihood and consequences to the Company should they eventuate. The matrix also details controls put in place by the Company to manage material business risks. The material business risks of the Company are reviewed at each fortnightly management meeting. Management prepares a monthly report on risk management which is then tabled at each Board meeting. Risk management is a standing Board meeting agenda item.

The categories of risk reported on include: operations, Environmental, Human Capital, technology, Commercial, political and Financial reporting, Legal and Compliance.

Deloitte have assisted Management in conducting the following:

- Created a risk map through organisational research (interviews and documentation reviews).
- Identified the areas of highest risk through a high level risk analysis
- Created a risk dashboard to manage these risks based on ISO 31000
- Assigned management actions plans to critical risks.

Recommendation 7.2:

The Board should require management to design and implement the risk management and internal control system to manage the Company's material business risks and report to it on whether those risks are being managed effectively. The Board should disclose that management has reported to it as to the effectiveness of the Company's management of its material business risks.

Disclosure:

The Board has required management to design, implement and maintain risk management and internal control systems to manage the Company's material business risks. The Board also requires management to report to it confirming that those risks are being managed effectively. Further, the Board has received a report from management as to the effectiveness of the Company's management of its material business risks.

Recommendation 7.3:

The Board should disclose whether it has received assurance from the Chief Executive Officer (or equivalent) and the Chief Financial Officer (or equivalent) that the declaration provided in accordance with section 295A of the Corporations Act is founded on a sound system of risk management and internal control and that the system is operating effectively in all material respects in relation to financial reporting risks.

Disclosure:

The Managing Director (or equivalent) and the Chief Financial Officer (or equivalent) have provided a declaration to the Board in accordance with section 295A of the Corporations Act and have assured the Board that such declaration is founded on a sound system of risk management and internal control and that the system is operating effectively in all material respects in relation to financial risk.

Recommendation 7.4:

Companies should provide the information indicated in the *Guide to reporting on Principle 7*.

Disclosure:

The Board has received the report from management under Recommendation 7.2.

The Board has received the assurance from the Managing Director (or equivalent) and the Chief Financial Officer (or equivalent) under Recommendation 7.3.

PRINCIPLE 8 – REMUNERATE FAIRLY AND RESPONSIBLY

Recommendation 8.1:

The Board should establish a Remuneration Committee.

Disclosure:

The Company has established a Remuneration Committee.

Recommendation 8.2:

Companies should clearly distinguish the structure of non-executive directors' remuneration from that of executive directors and senior executives.

Disclosure:

Non-executive directors are remunerated at a fixed fee for time, commitment and responsibilities. Remuneration for non-executive directors is not linked to individual performance.

Pay and rewards for executive directors and senior executives consists of a base salary and performance incentives. Long term performance incentives may include options granted at the discretion of the Board and subject to obtaining the relevant approvals. Executives are offered a competitive level of base pay at market rates and are reviewed annually to ensure market competitiveness.

Recommendation 8.3:

Companies should provide the information indicated in the Guide to reporting on Principle 8.

Disclosure:

Details of remuneration, including the Company's policy on remuneration, are contained in the "Remuneration Report" which forms of part of the Directors' Report.

The Remuneration Committee held 1 meeting during the Reporting Period. The following table identifies those directors who are members of the Remuneration Committee and shows their attendance at Committee meetings:

Name	No. of meetings attended
Kim Robinson	1/1
Peter Hogan	1/1
Peter McIntyre	1/1

There are no termination or retirement benefits for non-executive directors (other than for superannuation).

The Company's Remuneration Committee Charter includes a statement of the Company's policy on prohibiting transactions in associated products which limit the risk of participating in unvested entitlements under any equity based remuneration schemes.

Directors' Report

Remuneration Report

This report details the nature and amount of remuneration for each Director of Carbon Energy Limited and for the Executives receiving the highest remuneration.

REMUNERATION POLICY

The remuneration policy, which sets the terms and conditions for the Managing Director and other Senior Executives, was developed by the Remuneration Committee after seeking professional advice from independent consultants and was approved by the Board. All Executives receive a base salary, superannuation, fringe benefits and performance incentives. The remuneration committee reviews Executive packages annually by reference to company performance, Executive performance, comparable information from industry sectors and other listed companies and independent advice. The performance of Executives is reviewed bi-annually, in February and August, by the Managing Director and his performance is reviewed by the remuneration committee, with revised remuneration packages generally taking effect from the 1st of July of the new financial year.

Executives are also entitled to participate in the employee option arrangement from time to time, as determined by the Board. Key performance indicators are established for each executive and relate to specific outcomes agreed between the Executive and the Company for the period involved. Furthermore, the Executive needs to be in the employment of the Consolidated group for the period to successfully meet the performance criterion for the granted options to vest. The amount of remuneration for all specified Directors and the specified Executives including all monetary and non-monetary components are detailed below. All remuneration paid to Executives is valued at the cost to the company and expensed. Any options that are issued are valued using the Black-Scholes methodology.

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.

The payment of bonuses, stock options 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, options and incentives must be linked to predetermined performance criteria. The Board can exercise its discretion in relation to approving incentives, bonuses and options and can recommend changes to the committee's recommendations. Any changes must be justified by reference to measurable performance criteria.

The company's Remuneration Committee Charter is set out on the company's website www.carbonenergy.com.au.

DETAILS OF REMUNERATION FOR YEAR ENDED 30 JUNE 2010

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

PARENT ENTITY DIRECTORS

2010	Salary \$	Directors Fee \$	Super Contributions \$	Other \$	Sub-total \$	Options (iii) Equity Settled \$	Total \$	Performance related %
Mr K. Robinson	-	60,000	5,400	-	65,400	-	65,400	0
Mr A.M. Dash	299,926	-	25,000	1,320	326,246	1,670,335	1,996,581	83.7
Dr C.W. Mallett	140,750	-	50,000	2,640	193,390	176,411	369,801	47.7
Mr M.D.J Cozijn	-	20,000	23,600		43,600		43,600	0
Mr P.N. Hogan (i)	-	40,000			40,000		40,000	0
Mr L. Rozman (ii) (appointed 7 Apr '10)	-	9,341			9,341		9,341	0
Mr I.W. Walker	-	-	43,600		43,600		43,600	0
Mr P.T. McIntyre (resigned 12 Feb '10)	-	24,666	2,220		26,886		26,886	0
Dr H.M. Garnett (appointed 6 Sep '10)	-	-	-	-	-	-	-	-
TOTALS	440,676	154,007	149,820	3,960	748,463	1,846,746	2,595,209	

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

(ii) Amounts paid to Pacific Road Partnership for Mr Rozman's services.

(iii) Options are calculated using the Black Scholes Methodology and calculated at the date of grant. As at the date of this report, the Board has not formally ratified the vesting of these options.

PARENT ENTITY DIRECTORS

2009	Salary \$	Directors Fee \$	Redundancies/ Retirement Costs \$	Super Contributions \$	Sub-total \$	Options \$	Total \$	Performance related %
Mr K. Robinson		50,000		4,500	54,500		54,500	
Mr A.M. Dash	295,399	-	-	32,854	328,253	2,126,659	2,454,912	86.6%
Dr C.W. Mallett	90,750	-	-	100,000	190,750	349,156	539,906	64.7%
Mr I.W. Walker	94,762	20,000	669,064	21,612	805,438	-	805,438	-
Mr M.D.J Cozijn	11,752	20,000	305,262	37,800	374,814	-	374,814	-
Mr P.T. McIntyre	-	40,000	-	3,600	43,600	-	43,600	-
Mr J.G Linley (appointed 15 Jul '08) & retired 21 May '09)	-	33,938	-	3,054	36,992	-	36,992	-
Mr P.N. Hogan (i) (appointed 29 Aug '08)		33,333	-	-	33,333	-	33,333	-
Mr R.G. Bunning (retired 15 Jul '08)		-	43,600	-	43,600	-	43,600	-
TOTALS	492,663	197,271	1,017,926	203,420	1,911,280	2,475,815	4,387,095	

The remuneration for each Executive Office of the Consolidated group during the year is noted as follows:

PARENT ENTITY EXECUTIVES

2010	Salary \$	Termination Costs \$	Super Contributions \$	Other Costs \$	Sub-total \$	Options (i) \$	Total \$	Performance related %
Mr J Bidwell (appointed 27 Apr '10)	28,749	-	12,501	-	41,250	-	41,250	-
Mr A Mifflin (appointed 18 Jan '10)	99,722	-	24,300	605	124,627	104,332	228,959	45.6
Mr P Nair	148,933	-	50,000	20,387	219,320	122,551	341,871	35.8
Mr P Swaddle	180,000	-	38,000	1,320	219,320	122,551	341,871	35.8
Mr J Wedgwood (resigned 7 May '10) (ii)	160,513	31,559	25,346	2,750	220,168	0(ii)	220,168	N/A
TOTALS	617,917	31,559	150,147	25,062	824,685	349,434(iii)	1,174,119	

(i) Options are calculated using the Black Scholes Methodology.

(ii) Upon resignation, \$185,216 worth of options was written back due to failure to meet the performance conditions for the options to vest.

(iii) After taking into account (ii) above, the total option cost amounted to \$164,218.

Performance Bonuses were awarded to Executive Directors and Executive Officers on successful achievement of key performance indicators.

2009	Salary \$	Redundancies/ Retirement Costs \$	Super Contributions \$	Performance Bonus \$	Sub-total \$	Options \$	Total \$	Performance related %
Mr R Mark	230,000	-	20,700	-	250,700	801,419	1,052,119	76.2%
Mr P Nair (appointed 1 Nov '08)	129,333	-	16,000	-	145,333	145,129	290,462	50.0%
Mr P Swaddle (appointed 27 Oct '08)	127,165	-	22,345	-	149,510	145,129	294,639	49.3%
Mr J Wedgwood	191,333	-	30,000	92,500	313,833	505,787	819,620	62.0%
Mr G Scott (resigned 1 Jan '09)	58,333	152,691	9,792	-	220,816	268	221,084	0.1%
TOTALS	736,164	152,691	98,837	92,500	1,080,192	1,597,732	2,677,924	

Options Granted as part of Remuneration:

KEY MANAGEMENT PERSONNEL

2010	Vested No.	Granted No.	Grant Date	Value per option at Grant Date \$	Exercise Price \$	First Exercise Date	Last Exercise Date
Mr A Mifflin (appointed 18 Jan '10)	1,000,000	22/03/10	\$0.28	\$0.80	30/06/11	22/03/15	
	1,000,000	22/03/10	\$0.23	\$1.20	30/06/12	22/03/15	
	1,000,000	22/03/10	\$0.20	\$1.60	30/06/13	22/03/15	

In 2010, all options issued to Executive Officers were as part of their at-risk remuneration and all options are all performance based. Options were granted for nil consideration.

SHARES ISSUED ON EXERCISE OF COMPENSATION OPTIONS

Options exercised during the 2010 year that were granted as compensation in prior periods are as follows:

KEY MANAGEMENT PERSONNEL

2010	No. of ordinary shares issued	Amount paid per share	Amount unpaid per share
Mr I.W. Walker	6,000,000	\$0.20	Nil
Mr M.D.J. Cozijn	3,000,000	\$0.20	Nil
TOTALS	9,000,000		

Options expensed during the 2010 year that were granted as compensation in current and prior periods are as follows:

2010	Options Expensed \$	Total Remuneration Represented by Options %	Options Exercised \$	Options Lapsed (\$)	Total \$
Mr A.M. Dash	1,670,335	83.7%	-	-	1,670,335
Dr C.W. Mallett	176,411	47.7%	-	-	176,411
Mr A Mifflin	104,332	45.6%	-	-	104,332
Mr P Nair	122,551	35.8%	-	-	122,551
Mr P Swaddle	122,551	35.8%	-	-	122,551
Mr J Wedgwood	-185,216*	N/A	-	-	-185,216
TOTALS	2,010,964**		-	-	2,010,964

* Options previously granted were cancelled on resignation of employee.

** Options are calculated using the Black Scholes Methodology and calculated at the date of grant.

SERVICE AGREEMENTS OF DIRECTORS AND EXECUTIVES

No new options were issued to Executive Directors during the year.

Mr Dash, Managing Director is employed under a four-year Executive Service Agreement (ESA) which commenced on 30 June 2008 and expires on 30 June 2012.

Dr Mallett, Technical Director is currently employed under a three-year ESA with Carbon Energy Ltd which commenced on 1 July 2008 and expires on 30 June 2011.

Mr Nair, CFO and Company Secretary is currently employed under a three-year ESA with Carbon Energy Ltd which commenced on 1 November 2008 and expires on 31 October 2011.

Mr Swaddle, General Manager Commercial is currently employed under a three-year ESA with Carbon Energy Ltd which commenced on 27 October 2008 and expires on 31 October 2011.

Mr Mifflin, Chief Operating Officer is currently employed under a three-year ESA with Carbon Energy Ltd which commenced on 18 January 2010 and expires on 17 January 2013. The following options were issued to Mr Mifflin on 22 March 2010:

No. of options	Exercise Price	Terms
1,000,000	\$0.80	Vest after 12 Months service and achievement of KPI's, expire 22/03/2015
1,000,000	\$1.20	Vest after 24 Months service and achievement of KPI's, expire 22/03/2015
1,000,000	\$1.60	Vest after 36 months service and achievement of KPI's, expire 22/03/2015
3,000,000		

Mr Bidwell, General Manager Project Development is currently employed on a contract basis with Carbon Energy Ltd on a monthly term.

Required notice periods for executives employed under Executive Service Agreements is three months from either party. A payment for termination benefit on early termination by the employer is payable, other than for gross misconduct and is equal to base salary and superannuation for 12 months.

The remuneration and terms of employment for the Non-Executive Directors (Messrs Robinson, Walker, Cozijn, Hogan, McIntyre and Dr Garnett) are subject to annual review with no fixed term, with one third of the Director's 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 inclusive of superannuation is \$43,600 per annum to each Non Executive Director and \$65,400 per annum to the Chair of the Board. The Chair of the Audit Committee is paid an additional \$10,000 per annum plus superannuation. No termination payment provisions are currently in place.

MEETINGS OF DIRECTORS DURING THE YEAR ENDED 2010

Director	Board Meeting		Audit 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
K. Robinson	9	9	2	2	1	1	2	2
A. Dash	9	9	NM	NM	NM	NM	2	2
C.W. Mallett	9	8	NM	NM	NM	NM	2	1
M.D.J. Cozijn	9	9	NM	NM	NM	NM	2	2
P.N. Hogan	9	8	2	2	1	1	2	2
L.I. Rozman (appointed 7 Apr '10)	3	3	NM	NM	NM	NM	1	1
I.W. Walker	9	9	NM	NM	NM	NM	2	2
P.T. McIntyre (retired 12 Feb 10)	4	4	1	1	1	1	0	0

NM – Not a member of the Committee

SHARE OPTIONS

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

UNLISTED

Grant Date	Vesting Date	Date of Expiry	Exercise Price	Number Under Option
23/12/2005	17/10/2008	31/10/2010	\$0.20	250,000
22/12/2006	1/01/2009	1/01/2011	\$0.20	125,000
22/06/2007	30/06/2008	30/06/2011	\$0.30	500,000
15/05/2008	03/07/2008	30/06/2011	\$0.60	1,000,000
16/09/2008	30/06/2009	10/12/2013	\$0.80	3,500,000
17/10/2008	31/10/2009	10/12/2013	\$0.80	2,000,000
17/10/2008	31/10/2010	10/12/2013	\$1.20	2,000,000
17/10/2008	31/10/2011	10/12/2013	\$1.60	2,000,000
13/11/2008	30/06/2009	10/12/2013	\$0.25	5,000,000
13/11/2008	30/06/2010	10/12/2013	\$0.35	7,000,000
13/11/2008	30/06/2011	10/12/2013	\$0.70	8,000,000
13/11/2008	30/06/2012	10/12/2014	\$1.00	10,000,000
13/11/2008	30/06/2009	10/12/2013	\$0.80	1,750,000
13/11/2008	30/06/2010	10/12/2013	\$1.20	1,750,000
13/11/2008	30/06/2011	10/12/2013	\$1.60	1,750,000
31/03/2009	30/06/2010	01/04/2012	\$0.25	100,000
31/03/2009	30/06/2010	01/04/2012	\$0.40	205,000
22/03/2010	30/06/2011	22/03/2015	\$0.80	1,000,000
22/03/2010	30/06/2012	22/03/2015	\$1.20	1,000,000
22/03/2010	30/06/2013	22/03/2015	\$1.60	1,000,000
				49,930,000

Directors' Report

UNLISTED

49,930,000 of these Options are on issue to Directors and employees of Carbon Energy Limited.

NON-AUDIT SERVICES

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

- All non-audit services are reviewed and approved by the Executive Directors prior to commencement to ensure they do not adversely affect the integrity and objectivity of the auditor; and
- The nature of the services provided do not compromise the general principles relating to auditor independence in accordance with APES 110: Code of Ethics for Professional Accountants set by the Accounting Professional and Ethical Standards Board.

Fees for non-audit services were paid to the external auditors Deloitte Touche Tohmatsu during the year ended 30 June 2010.

INDEMNIFYING OFFICERS AND AUDITORS

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 S300 (9) of the Corporations Act 2001.

PROCEEDINGS ON BEHALF OF THE COMPANY

No person has applied for leave of Court to bring proceedings on behalf of the Company or 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 any part of those proceedings.

The Company was not a party to any such proceedings during the year.

AUDITOR'S INDEPENDENCE DECLARATION

The lead auditor's independence declaration for the year ended 30 June 2010 has been received and can be found on page 51 of the Annual Report.

Signed in accordance with a resolution of the Board of Directors made pursuant to s298 (2) of the Corporations Act 2001.

On behalf of the directors



K. Robinson
Chairman



A.M. Dash
Managing Director

Brisbane, Queensland
28 September 2010

The Board of Directors
Carbon Energy Limited
Level 12
301 Coronation Drive
Milton QLD 4064

28 September 2010

Dear Board Members,

Carbon Energy Limited

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

As lead audit partner for the audit of the financial statements of Carbon Energy Limited for the financial year ended 30 June 2010, I declare that to the best of my knowledge and belief, there have been no contraventions of:

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

Yours sincerely

Deloitte Touche Tohmatsu

DELOITTE TOUCHE TOHMATSU

M. Sheerin

Matthew Sheerin
Partner
Chartered Accountant

Financial Report

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 30 JUNE 2010

CONSOLIDATED GROUP

	Notes	2010 \$	2009 \$
Other income	3	6,897,961	793,077
Employee benefits expense		(3,867,203)	(2,052,973)
Depreciation expense	4 (a)	(130,392)	(66,593)
Administration costs		(1,952,275)	(3,744,251)
Consultancy costs		(2,266,629)	(401,386)
Exploration expenditure		-	(1,142,276)
Tenement holding costs		(271,412)	(261,959)
Share-based payments		(2,074,912)	(4,322,570)
Restructuring costs		-	(1,048,350)
Bloodwood Creek costs		(4,713,935)	-
Other expenses		(1,366,126)	(530,513)
Net loss from equity accounted investment in associate	10	(1,075,564)	-
Impairment of gold assets		-	(2,607,633)
Loss before income tax expense		(10,820,487)	(15,385,427)
Income Tax Expense	6	-	-
Loss for the Year		(10,820,487)	(15,385,427)
Other comprehensive income for the year (net of tax)		-	-
Total comprehensive income for the year		(10,820,487)	(15,385,427)
LOSS ATTRIBUTABLE TO OWNERS OF THE PARENT		(10,820,487)	(15,385,427)
Total comprehensive income attributable to owners of the parent		(10,820,487)	(15,385,427)
OVERALL OPERATIONS			
Basic loss per share	5	(1.83)	(3.11)
• cents per share			
Diluted loss per share		(1.83)	(3.11)
• cents per share			

The above consolidated statement of comprehensive income should be read in conjunction with the following notes.

Financial Report

CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 30 JUNE 2010

	Notes	2010 \$	2009 \$
CONSOLIDATED GROUP			
ASSETS			
CURRENT ASSETS			
Cash and cash equivalents	8	18,874,230	21,747,232
Trade and other receivables	9	128,149	129,501
Exploration interest held for sale	12 (a)	-	4,000,000
Financial assets	12 (b)	-	4,508,000
TOTAL CURRENT ASSETS		19,002,379	30,384,733
NON-CURRENT ASSETS			
Trade and other receivables	9	1,408,403	440,774
Investment in Associate	10	4,324,438	-
Construction Work In Progress	11	14,825,380	-
Property, plant & equipment	13	10,672,036	10,506,605
Mine development	16	16,468,042	3,621,463
Deferred exploration and evaluation costs	15	89,714,658	101,451,222
Intangible assets	14	2,499,999	2,499,999
TOTAL NON-CURRENT ASSETS		139,912,956	118,520,063
TOTAL ASSETS		158,915,335	148,904,796
LIABILITIES			
CURRENT LIABILITIES			
Trade and other payables	17	4,125,198	1,688,795
Provisions	18	232,269	93,808
TOTAL CURRENT LIABILITIES		4,357,467	1,782,603
TOTAL LIABILITIES		4,357,467	1,782,603
NET ASSETS		154,557,868	147,122,193
EQUITY			
Issued capital	19	188,759,462	172,265,745
Reserves	20	6,427,014	4,664,569
Accumulated losses	21	(40,628,608)	(29,808,121)
TOTAL EQUITY		154,557,868	147,122,193

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

Financial Report

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 30 JUNE 2010

CONSOLIDATED GROUP

	Notes	Ordinary Issued Capital \$	Accumulated Losses \$	Option Reserve \$	Total \$
BALANCE AT 30 JUNE 2008		151,126,952	(14,422,694)	171,792	136,876,050
Shares issued during the year		22,647,000	-	-	22,647,000
Transaction costs		(1,524,342)	-	-	(1,524,342)
Movement in share option reserve on recognition of share based payments		-	-	4,508,912	4,508,912
Exercise of options		16,135	-	(16,135)	-
Loss attributable to members of parent entity		-	(15,385,427)	-	(15,385,427)
BALANCE AT 30 JUNE 2009		172,265,745	(29,808,121)	4,664,569	147,122,193
BALANCE AT 30 JUNE 2009		172,265,745	(29,808,121)	4,664,569	147,122,193
Shares issued during the year	19	16,706,250	-	-	16,706,250
Transaction Costs		(525,000)	-	-	(525,000)
Movement in share option reserve on recognition of share based payments		-	-	2,074,912	2,074,912
Exercise of options		312,467	-	(312,467)	-
Loss attributable to members of parent entity		-	(10,820,487)	-	(10,820,487)
BALANCE AT 30 JUNE 2010		188,759,462	(40,628,608)	6,427,014	154,557,868

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

Financial Report

CASH FLOW STATEMENT FOR THE YEAR ENDED 30 JUNE 2010

	Notes	2010 \$	2009 \$	CONSOLIDATED GROUP
CASH FLOWS FROM OPERATING ACTIVITIES				
Payments to suppliers and employees		(13,600,303)	(6,602,703)	
Payments for exploration expenditure		-	(1,326,058)	
Interest received		925,263	730,416	
Administration services		-	24,215	
Other receipts		207,477	48,042	
NET CASH (USED IN) OPERATING ACTIVITIES	27	(12,467,563)	(7,126,088)	
CASH FLOWS FROM INVESTING ACTIVITIES				
Payments for property, plant and equipment		(380,523)	(594,037)	
Proceeds from sale of property, plant and equipment		42,138	7,892	
BWC Trial Plant		-	(16,518,339)	
Payment for Exploration & Evaluation Expenditure		(163,269)	(936,465)	
Uranium initiative capitalised		-	(1,053,254)	
Payments for Construction in progress		(12,622,827)	-	
Proceeds from sale of Laverton Gold tenements	12	2,500,000	-	
Proceeds from return of security bonds		251,000	-	
Payment to Energia Minerals Limited for seed capital	10	(400,000)	-	
Investment in term deposits – performance bonds		-	(68,297)	
Proceeds from Constellation Energy		800,000	-	
Proceeds from sale of investments - Magma Metals	4 (b)	6,464,250	-	
NET CASH (USED IN) INVESTING ACTIVITIES		(3,509,231)	(19,162,500)	
CASH FLOWS FROM FINANCING ACTIVITIES				
Proceeds from issues of shares		14,703,792	22,425,000	
Capital raising costs		(1,600,000)	(41,000)	
Net cash flows provided by financing activities		13,103,792	22,384,000	
Net decrease in cash held		(2,873,002)	(3,904,588)	
Cash at the beginning of the financial year		21,747,232	25,651,820	
CASH AT THE END OF THE FINANCIAL YEAR	8	18,874,230	21,747,232	

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

Financial Report

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2010

NOTE 1 - STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES

The financial report covers the Consolidated Group of Carbon Energy Limited and its controlled entities. Carbon Energy Limited is a listed public company, incorporated and domiciled in Australia.

BASIS OF PREPARATION

The financial report has been prepared on a historical cost basis modified, where applicable, by the measurement at fair value of selected non-current assets, financial assets and financial liabilities. Cost is based on the fair values of the consideration given in exchange for assets. All amounts are presented in Australian dollars unless otherwise stated.

The financial report is a general purpose financial report that has been prepared in accordance with Australian Accounting Standards, Australian Accounting Interpretations, other authoritative pronouncements of the Australian Accounting Standards Board ("AASB"), and the Corporations Act 2001 and other requirements of the law.

Australian Accounting Standards set out accounting policies that the AASB has concluded would result in a financial report containing relevant and reliable information about transactions, events and conditions to which they apply. Compliance with Australian Accounting Standards ensures that the financial statements and notes also comply with International Financial Reporting Standards. Material accounting policies adopted in the preparation of this financial report are presented below. They have been consistently applied unless otherwise stated.

The following is a summary of the material accounting policies adopted by the Consolidated group in the preparation of the financial report. The accounting policies have been consistently applied, unless otherwise stated.

(A) GOING CONCERN

The financial report has been prepared on the 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.

For the year ended 30 June 2010 the Consolidated group incurred a loss of \$10,820,487 (2009: \$15,385,427) and recorded a net cash outflow from operating and investing activities of \$15,976,794 (2009: \$26,288,588). Further, for the year ended 30 June 2010 the Company incurred a profit of \$3,716,639 (2009: loss of \$9,865,764).

In concluding that the going concern basis is appropriate, the Directors considered many factors, including a cash flow forecast for twelve months from the signing of the financial report which included management's estimates of cash inflows and outflows for that period. The Directors also considered other internal and external factors that may impact the operations of the business and the Company and Consolidated group's ability to raise capital to fund its development projects. Taking into account the successful demonstration of the technology through the trial plant, future planned activities, operating costs and the expected funding requirements, the Directors are of the view that the going concern basis for preparation of the financial report is appropriate.

NOTE 1 - STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Notwithstanding the above, the ability of the Company and the Consolidated group to continue as going concerns is dependent on:

- (i) Receipt of government approval from the Queensland Department of Environment and Resource Management (DERM) in relation to the Consolidated group's environmental evaluation review. Without the approvals from DERM the operations at Bloodwood Creek and the commencement of panel 2 cannot continue. The Directors note that the required approval is not linked to the technological capabilities or development of the project. The Directors further note the Company's recent announcement regarding receipt of environmental approvals for a proposed UCG operation at the Consolidated Entity's joint venture operations in Chile.

Without the DERM's acceptance of the environmental evaluation review, the development at Bloodwood Creek cannot continue and it is highly likely that the carrying value of the assets attached to the Bloodwood Creek project will be significantly impaired. Whilst the Directors are confident that acceptance of the required government approvals will be forthcoming, uncertainty around the continued development of the Bloodwood Creek project exists until the approvals are granted.

- (ii) The ability of the Company and Consolidated group to raise additional funds in the form of a capital raising to continue development of the Bloodwood Creek project and fund the operations of the Consolidated group. The ability of the Company and Consolidated group to raise funds which is planned to be undertaken in the 2011 financial year will be dependent upon a number of factors including market sentiment, the progress of current development activities and the granting of government approvals referred to in i) (above). The Directors are confident of the Consolidated group's ability to undertake such a capital raising based on past demand for previous capital raisings and anticipated positive outcomes from the continued development of its UCG projects.

As a result of the above matters, there is material uncertainty as to whether the Company and the Consolidated group will be able to continue as going concerns and, therefore, whether they will realise their assets and extinguish their liabilities in the normal course of business and at the amounts stated in the financial report.

The financial report does not include adjustments relating to the recoverability and classification of recorded asset amounts or the amounts and classification of liabilities that might be necessary should the Company and Consolidated group not continue as going concerns.

(B) PRINCIPLES OF CONSOLIDATION

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

A list of controlled entities is contained in Note 30 to the financial statements.

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

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

Minority interests, being that portion of the profit or loss and net assets of subsidiaries attributable to equity interests held by persons outside the group, are shown separately within the equity section of the consolidated Statement of Financial Position and in the Statement of Comprehensive Income.

NOTE 1 - STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Business Combinations

Business combinations occur where control over another business is obtained and results in the consolidation of its assets and liabilities. All business combinations, including those involving entities under common control, are accounted for by applying the acquisition method. The acquisition method requires an acquirer of the business to be identified and for the cost of the acquisition and fair values of identifiable assets, liabilities and contingent liabilities to be determined as at acquisition date, being the date that control is obtained. Cost is determined as the aggregate of fair values of assets given, equity issued and liabilities assumed in exchange for control. Acquisition related costs are recognised in profit or loss as incurred. Any deferred consideration payable is discounted to present value using the entity's incremental borrowing rate.

Goodwill is recognised initially at the excess of the sum of consideration transferred over the acquirer's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities recognised. Impairment testing is performed annually.

(C) INCOME TAX

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

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

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

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

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

The amount of benefits brought to account or which may be realised in the future is based on the assumption that no adverse change will occur in income taxation legislation and the anticipation that the Consolidated group will derive sufficient future assessable income to enable the benefit to be realised and comply with the conditions of deductibility imposed by the law.

NOTE 1 - STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(D) PROPERTY, PLANT AND EQUIPMENT

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

Plant and equipment

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

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

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

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

Depreciation

The cost of all plant and equipment is depreciated on a reducing balance basis commencing from the time the asset is held ready for use as intended by management. Computers are depreciated on a straight line basis over their useful lives to the Consolidated group commencing from the time the asset is held ready for use.

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

Class of Fixed Asset and Depreciation Rate

Motor Vehicles 22.5%

Plant and Equipment 7.5-50%

Laverton Project Property, Plant and Equipment 10-40%

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

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

Gains and losses on disposals are determined by comparing proceeds with the carrying amount. These gains and losses are included in the Statement of Comprehensive Income.

(E) EXPLORATION AND EVALUATION EXPENDITURE

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

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.

NOTE 1 - STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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

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.

Restoration, rehabilitation and environmental costs necessitated by exploration and evaluation activities are expensed as incurred and treated as exploration and evaluation expenditure.

(F) MINE DEVELOPMENT COSTS

Mine development costs represent development expenditure in respect of areas of interest in which mining for UCG has commenced or likely to commence shortly. It is only carried forward when future economic benefits can be established. After the consolidated group moves into the commercial phase of the project, assets classified as mine developments costs will be moved to a producing asset category & amortised over the life of the asset.

The net carrying value of the area of interest is reviewed annually for impairment. In the event that the carrying value of an area exceeds its recoverable amount the asset will be written down to its recoverable amount.

(G) 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.

(H) FINANCIAL INSTRUMENTS

Recognition and Initial measurement

Trade date 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 transaction 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.

De-recognition

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.

NOTE 1 - STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

CLASSIFICATION AND SUBSEQUENT MEASUREMENT

(i) 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 Statement of Comprehensive Income in the period in which they arise.

(ii) 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.

(iii) Available-for-sale financial assets

Available-for-sale financial assets are non-derivative financial assets that are either designated as such or that are not classified in any of the other categories. They comprise investments in the equity of other entities where there is neither a fixed maturity nor fixed or determinable payments. Available-for-sale financial assets are reflected at fair value. Unrealised gains and losses arising from changes in fair value are taken directly to Comprehensive Income.

(iv) Financial liabilities

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

(v) 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.

(vi) Impairment

At each reporting date, the group assess whether there is objective evidence that a financial instrument has been impaired. In the case of available-for-sale financial instruments, a prolonged decline in the value of the instrument is considered to determine whether impairment has arisen. Impairment losses are recognised in the Statement of Comprehensive Income.

(I) IMPAIRMENT OF ASSETS

At each reporting date, the group reviews the carrying values of its tangible and intangible assets to determine whether there is any indication that those assets have been impaired. If such an indication exists, the recoverable amount of the assets, being the higher of the asset's fair value less costs to sell and value in use, is compared to the asset's carrying value. Any excess of the asset's carrying value over its recoverable amount is expensed to the Statement of Comprehensive Income.

Impairment testing is performed annually for goodwill and tangible assets with indefinite lives. Intangible assets not yet available for use are tested for impairment at least annually, and whenever there is an indication that the asset may be impaired.

Where it is not possible to estimate the recoverable amount of an individual asset, the group estimates the recoverable amount of the cash-generating unit to which the asset belongs.

NOTE 1 - STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(J) INVESTMENTS IN ASSOCIATES

Investments in associate companies are recognised in the financial statements by applying the equity method of accounting. The equity method of accounting recognises the group's share of post acquisition reserves of its associates. Significant influence is defined as the power to participate in the financial and operating policy decisions of the investee but is not control or joint control over those policies.

(K) INTEREST IN JOINT VENTURES

The consolidated group's share of the assets, liabilities, revenue and expenses of joint venture operations are included in the appropriate items of the consolidated financial statements.

The consolidated group's interests in joint venture entities are brought to account using the equity method of accounting in the consolidated financial statements.

The parent entity's interests in joint venture entities are brought to account using the cost method.

(L) INTANGIBLES

Intellectual Property

Expenditure during the research phase of a project is recognised as an expense when incurred. Development costs are capitalised only when technical feasibility studies identify that the project will deliver future economic benefits and these benefits can be measured reliably.

Development costs have a finite life and are amortised on a systematic basis matched to the future economic benefits over the useful life of the project and to commence amortisation upon commercial production.

(M) EMPLOYEE BENEFITS

Provision is made for the entity's liability for employee benefits arising from services rendered by employees to the balance date. Short term employee benefits have been measured at the amounts expected to be paid when the liability is settled, plus related on costs. Other long term employee benefits have been measured at the present value of the estimated future cash outflows to be made for those benefits. The fair value of equity granted is measured at grant date based on the fair value of services received.

Contributions are made by the Consolidated group to employee superannuation funds and are charged as expenses when incurred.

Equity Settled Compensation

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 fair value of shares is ascertained as the market bid price. The fair value of options is ascertained using a Black-Scholes pricing model which incorporates all market vesting conditions. 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. The group also enters into equity-settled share-based payment arrangements with major suppliers whereby the company (supplier) receives shares in Carbon Energy Limited as payment for services provided by the supplier. The equity granted is recognised based on the fair value of services provided.

NOTE 1 - STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(N) PROVISIONS

Provisions are recognised when the group has a legal or constructive obligation, as a result of past events, for which it is probable that an outflow of economic benefits will result and that outflow can be reliably measured. The amount recognised as a provision represents the best estimate of the consideration required to settle the present obligation at the end of the reporting period, taking into account the risks and uncertainties surrounding the obligation.

(O) CASH AND CASH EQUIVALENTS

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

(P) REVENUE AND OTHER INCOME

Interest revenue is recognised on a monthly basis taking into account the interest rates applicable to the financial assets. Gain from sale of investments is recognised on the date of the contract for sale note. All revenue is stated net of the amount of goods and services tax (GST).

(Q) GOODS AND SERVICES TAX (GST)

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

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

(R) CONTRIBUTED EQUITY

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

(S) CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

The Directors evaluate estimates and judgments incorporated into the financial report based on historical knowledge and best available current information. Estimates assume a reasonable expectation of future events and are based on current trends and economic data, obtained both externally and within the group.

Key Estimates – Impairment

The group assess 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. Value-in-use calculations performed in assessing recoverable amounts incorporate a number of key estimates.

An impairment review is completed annually on carried forward exploration costs resulting from relinquishments, transfers and ongoing exploration prospectivity and commercial value.

Key Estimates – Construction work in progress

The construction work in progress comprises of various assets located at the Bloodwood Creek site, namely 5MW Power Station Plant, Panels 2, 3, site modifications and water monitoring assets. These assets when completed and ready for use will be allocated to the appropriate asset category. After the consolidated group moves into the commercial phase of the project, these assets will be depreciated /amortised over the life of the respective assets.

NOTE 2 – ADOPTION OF NEW AND REVISED ACCOUNTING STANDARDS

2.1 STANDARDS AND INTERPRETATIONS AFFECTING AMOUNTS REPORTED IN THE CURRENT PERIOD (AND/OR PRIOR PERIODS)

The following new and revised Standards and Interpretations have been adopted in the current period and have affected the amounts reported in these financial statements. Details of other Standards and Interpretations adopted in these financial statements but that have had no effect on the amounts reported are set out in section 2.2.

Standards affecting presentation and disclosure

AASB 101 PRESENTATION OF FINANCIAL STATEMENTS (AS REVISED IN SEPTEMBER 2007), AASB 2007-8 AMENDMENTS TO AUSTRALIAN ACCOUNTING STANDARDS ARISING FROM AASB 101 AND AASB 2007-10 FURTHER AMENDMENTS TO AUSTRALIAN ACCOUNTING STANDARDS ARISING FROM AASB 101

AASB 101 (September 2007) has introduced terminology changes (including revised titles for the financial statements) and changes in the format and content of the financial statements.

AASB 8 - OPERATING SEGMENTS

AASB 8 is a disclosure Standard that has not resulted in a redesignation of the Group's reportable segments (see note 23).

AASB 2009-2 - AMENDMENTS TO AUSTRALIAN ACCOUNTING STANDARDS – IMPROVING DISCLOSURES ABOUT FINANCIAL INSTRUMENTS

The amendments to AASB 7 expand the disclosures required in respect of fair value measurements and liquidity risk. The Group has elected not to provide comparative information for these expanded disclosures in the current year in accordance with the transitional reliefs offered in these amendments.

AMENDMENTS TO AASB 5 NON- CURRENT ASSETS HELD FOR SALE AND DISCONTINUED OPERATIONS (ADOPTED IN ADVANCE OF EFFECTIVE DATE OF 1 JANUARY 2010)

Disclosures in these financial statements have been modified to reflect the clarification in AASB 2009-5

Further Amendments to Australian Accounting Standards arising from the Annual Improvements Project that the disclosure requirements in Standards other than AASB 5 do not generally apply to non-current assets classified as held for sale and discontinued operations.

2.2 STANDARDS AND INTERPRETATIONS ADOPTED WITH NO EFFECT ON FINANCIAL STATEMENTS

The following new and revised Standards and Interpretations have also been adopted in these financial statements. Their adoption has not had any significant impact on the amounts reported in these financial statements but may affect the accounting for future transactions or arrangements.

AASB 2008-7 AMENDMENTS TO AUSTRALIAN ACCOUNTING STANDARDS – COST OF AN INVESTMENT IN A SUBSIDIARY, JOINTLY CONTROLLED ENTITY OR ASSOCIATE

The amendments deal with the measurement of the cost of investments in subsidiaries, jointly controlled entities and associates when adopting A-IFRS for the first time and with the recognition of dividend income from subsidiaries in a parent's separate financial statements.

AASB 2008-1 AMENDMENTS TO AUSTRALIAN ACCOUNTING STANDARD – SHARE-BASED PAYMENTS: VESTING CONDITIONS AND CANCELLATIONS

The amendments clarify the definition of vesting conditions for the purpose of AASB 2, introduce the concept of 'non-vesting' conditions, and clarify the accounting treatment for cancellations.

NOTE 2 – ADOPTION OF NEW AND REVISED ACCOUNTING STANDARDS (CONTINUED)

AASB 2008-5 AMENDMENTS TO AUSTRALIAN ACCOUNTING STANDARDS ARISING FROM THE ANNUAL IMPROVEMENTS PROJECT AND AASB 2008-6 FURTHER AMENDMENTS TO AUSTRALIAN ACCOUNTING STANDARDS ARISING FROM THE ANNUAL IMPROVEMENTS PROJECT AASB 2009-4 AMENDMENTS TO AUSTRALIAN ACCOUNTING STANDARDS ARISING FROM THE ANNUAL IMPROVEMENTS PROJECT AND AASB 2009-5 FURTHER AMENDMENTS TO AUSTRALIAN ACCOUNTING STANDARDS ARISING FROM THE ANNUAL IMPROVEMENTS PROJECT

In addition to the changes affecting amounts reported in the financial statements described at 2.1 above, the amendments have led to a number of changes in the details of the Group's accounting policies – some of which are changes in terminology only, and some of which are substantive but have had no material effect on amounts reported.

AASB 3 'BUSINESS COMBINATIONS', AASB 127 'CONSOLIDATED AND SEPARATE FINANCIAL STATEMENTS' AND AASB 2008-3 'AMENDMENTS TO AUSTRALIAN ACCOUNTING STANDARDS ARISING FROM AASB 3 AND AASB 127'

This Standard introduces greater emphasis on the use of fair value through increasing the judgement and subjectivity around business combination accounting and requiring greater involvement of valuation experts. Further volatility in the income statement will be introduced through the separate accounting for transaction costs, changes in the fair value of contingent consideration, settlement of pre-existing contracts and share-based payments. The Standard also focuses on changes in control as a significant economic event, with requirements to remeasure interests to fair value on gaining or losing control, and to recognise all transactions between controlling and non-controlling shareholders whilst control is retained in equity.

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

Standard/Interpretation	Effective for annual reporting periods beginning on or after	Expected to be initially applied in the financial year ending
AASB 2009-5 Further Amendments to Australian Accounting Standards arising from the Annual Improvements Project	1 January 2010	30 June 2011
AASB 2009-8 Amendments to Australian Accounting Standards – Group Cash-Settled Share-based Payment Transactions	1 January 2010	30 June 2011
AASB 2009-10 Amendments to Australian Accounting Standards – Classification of Rights Issues	1 February 2010	30 June 2011
AASB 124 Related Party Disclosures (revised December 2009), AASB 2009-12 Amendments to Australian Accounting Standards	1 January 2011	30 June 2012
AASB 9 Financial Instruments, AASB 2009-11 Amendments to Australian Accounting Standards arising from AASB 9	1 January 2013	30 June 2014
AASB 2009-14 Amendments to Australian Interpretation – Prepayments of a Minimum Funding Requirement	1 January 2011	30 June 2012
Interpretation 19 Extinguishing Financial Liabilities with Equity Instruments	1 July 2010	30 June 2011

NOTE 3 – OTHER INCOME

CONSOLIDATED GROUP

	Note	2010 \$	2009 \$
OPERATING ACTIVITIES			
• administration services		-	11,172
• interest received		965,519	730,416
		<hr/>	<hr/>
		965,519	741,588
NON-OPERATING ACTIVITIES			
• Fair value adjustment on Energia Minerals Investment	4 (b) / 10	3,946,749	-
• Other Income		354,443	48,041
• Gain/loss on disposal of assets	4 (b)	1,631,250	3,448
		<hr/>	<hr/>
		5,932,442	51,489
TOTAL OTHER INCOME		6,897,961	793,077

NOTE 4 - LOSS FROM ORDINARY ACTIVITIES

CONSOLIDATED GROUP

		2010 \$	2009 \$
Loss from ordinary activities before income tax has been determined after:			
(a) Expenses			
Depreciation of Non-current assets			
• Motor Vehicles		8,311	807
• Plant & Equipment		122,081	59,780
• Laverton project property, plant and equipment		-	6,006
		<hr/>	<hr/>
TOTAL DEPRECIATION		130,392	66,593
Rental expenses on operating leases			
• Minimum lease payments		278,223	169,448
Loss on disposal of assets		42,563	-

NOTE 4 - LOSS FROM ORDINARY ACTIVITIES (CONTINUED)

CONSOLIDATED GROUP

	2010 \$	2009 \$
(b) Significant Transactions		
Gain on divestment of Uranium Assets		
• During the year, Carbon Energy Limited disposed of its Uranium interests and acquired a 42% interest in Energia Minerals Limited, a company incorporated in Australia and engaged in uranium exploration and mining via an Initial Public Offering. In exchange of seed capital of \$400,000 and uranium interests carried at \$1.05 million, Carbon Energy Minerals Limited received 4 million shares at \$0.10 and 25 million shares at \$0.20. A gain of \$3,946,746 was recognised representing the difference between the group carrying value disposed of and fair value of consideration received by way of investment in Energia Minerals Limited.	3,946,746	
Gain/loss investments		
• Net proceeds from the sale of Magma Metals Limited shares were received on 21 October 2009 and amounted to \$6,464,250. The carrying value of the investment at the date of disposal was \$4,508,000 resulting in a realised gain of \$1,956,250. In 2009 the investment was impaired by \$1,177,535 to reflect the fair value at that date.	1,956,250 (1,177,535)	
• Loss on disposal of Laverton Gold Assets (refer note 12a)	(325,000)	-
Share based payments	(2,074,912)	(4,322,570)
TOTAL	3,503,084	(5,500,105)

NOTE 5 - EARNINGS PER SHARE

CONSOLIDATED GROUP

	2010 \$	2009 \$
Net Loss for the year attributable to members of the parent entity	(10,820,487)	(15,385,427)
Basic loss per share		
• cents per share	(1.83)	(3.11)
Diluted loss per share		
• cents per share	(1.83)	(3.11)
(a) Weighted average number of ordinary shares outstanding during the year used in calculation of basic and diluted EPS	592,675,611	494,757,596

Options outstanding at 30 June 2010, totalling 49,930,000 are not considered potential ordinary shares as the effect is anti-dilutive.

NOTE 6 - INCOME TAX EXPENSE

CONSOLIDATED GROUP

	2010 \$	2009 \$
(a) The components of tax expense comprise		
Current year tax	-	-
Deferred tax	-	-
Recoupment of prior year's tax losses	-	-
R&D tax concession	-	-
	-	-
(b) The prima facie tax/(benefit) on Profit/(Loss) from ordinary activities is reconciled to the income tax expense as follows:		
Prima facie tax/(benefit) on Profit/(Loss) from ordinary activities before income tax at 30%	(10,820,487)	(15,385,427)
2010:30% (2009: 30%)	(3,246,146)	(4,615,628)
ADD TAX EFFECT OF:		
Non-deductible items	1,195,065	2,080,851
Other deductible items	(780,792)	(169,119)
Revaluation and gain on disposals of investments not subject to income tax	763,855	352,800
Deferred tax assets not brought to account	3,595,728	2,351,096
	-	-
Income tax attributable to entity		
(c) Deferred tax assets		
An income tax Consolidated group was formed from 1 July 2008. Taking into account deductions from acquisition of exploration assets and loss to 30 June 2009 amount to:	30,240,000	-
Deferred tax assets not brought to account, the benefits of which will only be realised if the conditions for deductibility set out in Note 1(b) occur	(63,569)	(599,511)
Temporary differences	3,595,728	9,742,459
Tax losses (after income tax at 30%)	33,772,159	9,142,948
TOTAL DEFERRED TAX ASSETS NOT BROUGHT TO ACCOUNT		

NOTE 7 - KEY MANAGEMENT PERSONNEL COMPENSATION

(a) Names and positions held of the consolidated and parent entity key management personnel in office during the financial year are:

EXECUTIVE / NON-EXECUTIVE DIRECTORS

Mr K. Robinson
Chairman (Non-Executive)

Mr A.M. Dash
Chief Executive Officer and Managing Director (Executive)

Dr C.W. Mallett
Technical Director (Executive)

Mr M.D.J. Cozijn
Director (Non-Executive)

Mr P.N. Hogan
Director (Non-Executive)

Mr L.I. Rozman
Director (Non-Executive)
(appointed 7 April 2010)

Mr I.W. Walker
Director (Non-Executive)

Mr P.T. McIntyre
Director (Non-Executive)
(retired 12 February 2010)

OTHER KEY MANAGEMENT PERSONNEL

Mr A. Mifflin – Chief Operating Officer
(appointed 18 January 2010)

Mr P. Nair – Chief Financial Officer & Company Secretary

Mr P. Swaddle – General Manager Commercial

Mr J. Bidwell – General Manager Project Development
(appointed 27 April 2010)

Mr J. Wedgwood – General Manager Operations
(resigned 7 May 2010)

NOTE 7 - KEY MANAGEMENT PERSONNEL COMPENSATION (CONTINUED)

	2010 \$	2009 \$
Short-term employee benefits	1,241,622	1,518,598
Post-employment benefits	331,526	1,472,874
Share-based payments	2,010,964	4,073,547
TOTAL	3,584,112	7,065,019

Detailed remuneration disclosures are provided in the remuneration report.

(b) Option Holdings held directly and indirectly by key management personnel:

2010 Directors	Balance at 01 Jul 09	Granted as Remuneration	Options Exercised	Net Change Other	Balance at 30 Jun 10	Total Vested 30 Jun 10	Total Exercisable 30 Jun 10	Total Unexercisable 30 Jun 10
Mr K. Robinson	2,000,000	-	2,000,000	-	-	-	-	-
Mr I.W. Walker	6,000,000	-	6,000,000	-	-	-	-	-
Mr M.D.J. Cozijn	3,000,000	-	3,000,000	-	-	-	-	-
Mr P.T. McIntyre (Retired 12 February 2010)	1,000,000	-	1,000,000	-	-	-	-	-
Dr C.W. Mallett	5,250,000	-	-	-	5,250,000	3,500,000	3,500,000	1,750,000
Mr A.M. Dash	30,000,000	-	-	-	30,000,000	12,000,000	12,000,000	18,000,000
Mr P.N. Hogan	-	-	-	-	-	-	-	-
Mr L. I Rozman (appointed 7 April 2010)	-	-	-	-	-	-	-	-
TOTAL	47,250,000	-	12,000,000	-	35,250,000	15,500,000	15,500,000	19,750,000

2009 Directors	Balance at 01 Jul 08	Granted as Remuneration	Options Exercised	Net Change Other	Balance at 30 Jun 09	Total Vested 30 Jun 09	Total Exercisable 30 Jun 09	Total Unexercisable 30 Jun 09
Mr K. Robinson	2,000,000	-	-	-	2,000,000	2,000,000	2,000,000	-
Mr R.G. Bunning (Retired 15 Jul 08)	1,000,000	-	-	(1,000,000)	-	-	-	-
Mr I.W. Walker	10,000,000	-	(4,000,000)	-	6,000,000	6,000,000	6,000,000	-
Mr M.D.J. Cozijn	5,000,000	-	(2,000,000)	-	3,000,000	3,000,000	3,000,000	-
Mr P.T. McIntyre	1,000,000	-	-	-	1,000,000	1,000,000	1,000,000	-
Dr C.W. Mallett	-	5,250,000	-	-	5,250,000	1,750,000	1,750,000	3,500,000
Mr A.M. Dash	-	30,000,000	-	-	30,000,000	5,000,000	5,000,000	25,000,000
Mr P.N. Hogan	-	-	-	-	-	-	-	-
Dr J.G. Linley	-	-	-	-	-	-	-	-
TOTAL	19,000,000	35,250,000	(6,000,000)	(1,000,000)	47,250,000	18,750,000	18,750,000	28,500,000

NOTE 7 - KEY MANAGEMENT PERSONNEL COMPENSATION (CONTINUED)

2010 Executives	Balance at 01 Jul 09	Granted as Remuneration	Options Exercised	Net Change Other	Balance at 30 Jun 10	Total Vested 30 Jun 10	Total Exercisable 30 Jun 10	Total Unexercisable 30 Jun 10
Mr R Mark	7,500,000	-	-	(7,500,000)	-	-	-	-
Mr J Wedgwood	3,000,000	-	-	(3,000,000) (i)	-	-	-	-
Mr P Nair	3,000,000	-	-	-	3,000,000	1,000,000	1,000,000	2,000,000
Mr P Swaddle	3,000,000	-	-	-	3,000,000	1,000,000	1,000,000	2,000,000
Mr G. Scott	1,250,000	-	-	(1,250,000)	-	-	-	-
Mr A. Mifflin	-	3,000,000	-	-	3,000,000	-	-	3,000,000
TOTAL	17,750,00	3,000,000	-	(11,750,000)	9,000,000	2,000,000	2,000,000	7,000,000

(i) These options lapsed prior to vesting on cessation of employment.

2009 Executives	Balance at 01 Jul 08	Granted as Remuneration	Options Expensed	Net Change Other (i)	Balance at 30 Jun 09	Total Vested 30 Jun 09	Total Exercisable 30 Jun 09	Total Unexercisable 30 Jun 09
Mr R Mark	-	7,500,000	-	-	7,500,000	2,500,000	2,500,000	5,000,000
Mr J Wedgwood	-	3,000,000	-	-	3,000,000	1,000,000	1,000,000	2,000,000
Mr P Nair	-	3,000,000	-	-	3,000,000	-	-	3,000,000
Mr P Swaddle	-	3,000,000	-	-	3,000,000	-	-	3,000,000
Mr G. Scott	1,250,000	-	-	-	1,250,000	1,250,000	1,250,000	-
TOTAL	1,250,000	16,500,000	-	-	17,750,000	4,750,000	4,750,000	13,000,000

(i) These options lapsed prior to vesting on cessation of employment.

NOTE 7 - KEY MANAGEMENT PERSONNEL COMPENSATION (CONTINUED)

(c) Share Holdings held directly and indirectly by key management personnel:

2010 Key Management Personnel	Balance at 01 Jul 09	Options Exercised	Net change Other	Balance at 30 Jun 10
PARENT ENTITY DIRECTORS				
Mr K. Robinson	-	2,000,000	-	2,000,000
Mr A.M. Dash	-	-	-	-
Dr C.W. Mallett	9,437,322	-	2,329,630	11,766,952
Mr M.D.J. Cozijn	2,128,340	3,000,000	(1,500,000)	3,628,340
Mr P.N. Hogan	100,000	-	100,000	200,000
Mr L. I. Rozman (appointed 7 Apr 2010)	-	-	-	-
Mr I.W. Walker	6,326,603	6,000,000	(3,750,000)	8,576,603
Mr P.T. McIntyre (retired 12 Feb 2010)	50,000	1,000,000	(1,050,000)	-
TOTAL	18,042,265	12,000,000	(3,870,370)	26,171,895

2010 Key Management Personnel	Balance at 01 Jul 09	Options Exercised	Net change Other	Balance at 30 Jun 10
EXECUTIVES				
Mr A Mifflin	-	-	-	-
Mr P. Nair	-	-	-	-
Mr P. Swaddle	-	-	-	-
Mr J Bidwell	-	-	-	-
Mr R. Mark	2,252,778	-	(2,252,778)	-
Mr J. Wedgwood	-	-	-	-
TOTAL	2,252,778	-	(2,252,778)	-

NOTE 7 - KEY MANAGEMENT PERSONNEL COMPENSATION (CONTINUED)

2009 Key Management Personnel	Balance at 01 Jul 08	Options Exercised	Net change Other	Balance at 30 Jun 09
PARENT ENTITY DIRECTORS				
Mr K. Robinson	4,840,280	-	(4,840,280) (i)	-
Mr R.G. Bunning (retired 15 July 2008)	4,465,389	-	(4,465,389) (ii)	-
Mr I.W. Walker	5,326,603	4,000,000	(3,000,000) (i)	6,326,603
Mr P.N. Hogan (appointed 29 Aug 2008)	-	-	100,000	100,000
Mr M.D.J. Cozijn	1,328,340	2,000,000	(1,200,000) (i)	2,128,340
Mr P.T. McIntyre	-	-	50,000	50,000
Dr C.W. Mallett	9,437,322	-	-	9,437,322
Mr A.M. Dash	-	-	-	-
Mr J.G. Linley (appointed 15 July 2008) (retired 21 May 2009)	-	-	(ii)	-
TOTAL	25,397,934	6,000,000	(13,355,669)	18,042,265
EXECUTIVES				
Mr R. Mark	2,777,778	-	(525,000)	2,252,778
Mr J. Wedgwood	-	-	(iii)	-
Mr P. Nair	-	-	-	-
Mr P. Swaddle	-	-	-	-
Mr G. Scott	-	250,000	(250,000) (ii)	-
TOTAL	2,777,778	250,000	(775,000)	2,252,778

(i) Directors disposed of 9,040,280 ordinary shares during the course of the year.

(ii) No longer a Director or employee.

(iii) Was provided with 250,000 fully paid CNX shares valued at 37 cents in August 2008 as performance bonus and these shares were sold during the year.

NOTE 8 - CASH AND CASH EQUIVALENTS

CONSOLIDATED GROUP

	2010 \$	2009 \$
CASH ON HAND	750	1,001
Cash at bank	12,873,480	406,231
Short term deposits	6,000,000	21,340,000
TOTAL CASH AND CASH EQUIVALENTS	18,874,230	21,747,232

The effective interest rate on deposits at call was 5.39% (2009 -7.56%) these deposits have an average maturity of 30 days.

NOTE 9 - TRADE & OTHER RECEIVABLES

CONSOLIDATED GROUP

	2010 \$	2009 \$
CURRENT		
Trade Receivables	9,073	38,511
Other Receivables	119,076	90,990
TOTAL CURRENT TRADE & OTHER RECEIVABLES	128,149	129,501
NON CURRENT		
Performance bonds (*)	203,403	410,774
Environmental bonds	30,000	30,000
Receivable from Crescent Gold Limited (refer note 12 a)	1,175,000	-
TOTAL NON CURRENT TRADE & OTHER RECEIVABLES	1,408,403	440,774

(*) Performance bonds represent term cash deposits held as security for bank guarantees given in connection with the company's rehabilitation bonds and premises lease commitments (Refer Note 26d).

All receivables are current and not impaired at 30 June 2010 (2009: all current).

NOTE 10 – INVESTMENT IN ASSOCIATE

During the year Carbon Energy Limited disposed of its Uranium interests and acquired a 42% interest in Energia Minerals Limited, a company incorporated in Australia and engaged in uranium exploration and mining via an Initial Public Offering. This transaction completes the demerger of uranium assets from Carbon Energy.

In exchange for injection of seed capital of \$400,000 and uranium interests carried at \$1.05 million, Carbon Energy Minerals Limited received 4 million shares at \$0.10 and 25 million shares at \$0.20. A gain of \$3,946,746 was recognised representing the difference between the group carrying value disposed of and fair value of consideration received by way of investment in Energia Minerals Limited. The resulting 42% interest in Energia Minerals Limited at 30 June 2010 has been accounted for as an associate on the basis that Carbon Energy Limited exerts significant influence over the entity.

The equity accounted loss for the year ended 30 June 2010 amounted to \$1,075,564 resulting in a carrying value of the investment as at 30 June 2010 of \$4,324,438.

CONSOLIDATED GROUP

	2010 \$	2009 \$
(a) Carrying amount of investment in associate:		
Balance at the beginning of the financial year	-	-
Investments made during the period	5,400,002	-
Share of associate's loss after income tax	(1,075,564)	-
BALANCE AT 30 JUNE 2010	4,324,438	-

NOTE 11 – CONSTRUCTION WORK-IN-PROGRESS

CONSOLIDATED GROUP

	2010 \$	2009 \$
(a) Carrying amount of Construction Work-in-progress:		
Balance at the beginning of the financial year	-	-
Additions during the year	14,825,380	-
BALANCE AT 30 JUNE 2010	14,825,380	-

The above costs relate to the construction of the 5MW power plant, panels 2, 3, site modification and water monitoring assets at Bloodwood Creek in Queensland. Commissioning of these assets is expected towards the end of the 2010 calendar year subject to lifting the environment protection order.

NOTE 12 – FINANCIAL ASSETS

CONSOLIDATED GROUP

Notes	2010 \$	2009 \$
CURRENT		
(a) Exploration Interest Laverton gold tenements held for sale		
On 30 November 2009, Carbon Energy Limited executed an asset sale agreement with Crescent Gold Limited pertaining to the sale of its gold interests in the Laverton area of Western Australia. The total consideration was \$2.5 million in cash and a further payment of \$1.5 million is contingent on gold production exceeding 75,000 ounces. The remaining consideration due from Crescent Gold has been classified as a receivable at 30 June 2010. The non-current receivable has been recognised at 30 June 2010 representing the directors' best estimate of the fair value of the contingent consideration receivable. Refer note 9.	-	4,000,000

(b) Held for trading financial assets comprise:

Listed investments, at fair value

- Shares in Listed corporations (refer note 4 (b)) - 4,508,000

NOTE 13 - PROPERTY, PLANT AND EQUIPMENT

	2010 \$	2009 \$
Freehold Land	408,016	408,016
Motor Vehicles – cost	40,348	76,470
Less accumulated depreciation	(8,311)	(74,956)
	32,037	1,514
Plant and equipment – cost	574,938	486,033
Less accumulated depreciation	(174,337)	(261,499)
	400,601	224,534
Laverton Project Property, Plant and Equipment - cost	-	355,441
Less accumulated depreciation	-	(314,282)
	-	41,159
Bloodwood Creek UCG Trial Construction – cost	9,831,382	9,831,382
Less accumulated depreciation	-	-
	9,831,382	9,831,382
TOTAL PROPERTY, PLANT & EQUIPMENT	10,672,036	10,506,605

NOTE 13 - PROPERTY, PLANT AND EQUIPMENT (CONTINUED)

(A) MOVEMENTS IN CARRYING AMOUNTS

Movement in the carrying amounts for each class of property, plant and equipment between the beginning and the end of the current financial year.

	Motor Vehicles \$	Property, Plant & Equipment \$	Project Plant & Equipment \$	Laverton	Bloodwood Creek	Total \$
CARRYING AMOUNT AT 1 JULY 2008	5,212	98,976	48,036	7,781,085	7,933,309	
Additions	-	593,354	682	16,518,340	17,112,376	
Disposals	(2,891)		(1,553)	-	(4,444)	
Depreciation expense	(807)	(59,780)	(6,006)	-	(66,593)	
Transfer to Mine Development				(3,621,463)	(3,621,463)	
Transfer to Deferred Exploration & Evaluation				(10,846,580)	(10,846,580)	
CARRYING AMOUNT AT 30 JUNE 2009	1,514	632,550	41,159	9,831,382	10,506,605	
CARRYING AMOUNT AT 1 JULY 2009						
Additions	40,348	340,176	-	-	380,523	
Disposals	(1,514)	(42,028)	(41,159)	-	(84,701)	
Depreciation expense	(8,311)	(122,081)	-	-	(130,392)	
CARRYING AMOUNT AT 30 JUNE 2010	32,037	808,617	-	9,831,382	10,672,036	

NOTE 14 – INTANGIBLE ASSETS

CONSOLIDATED GROUP

	2010 \$	2009 \$
Acquired on acquisition Licences and Intellectual property	2,499,999	2,499,999

The licence relates to the use of COSFLOW, modelling system which predicts the geotechnical hydrological effects and impacts on subsidence gas, and water flows of large scale coal removal. Intellectual property relates to modelling tools developed for site selection characterisation and gasifier design and gas production prediction specific to the application of UCG. In addition the intangible assets include research support agreements from CSIRO which the consolidated group can draw upon and have rights to geological data base in the Surat Basin. Intangible assets have finite useful lives. Amortisation charges for intangible assets will be included under depreciation and amortisation expense in the Statement of Comprehensive Income.

To date no impairment or amortisation has been charged against intangible assets. Amortisation will commence following commencement of a commercial UCG operation over the life of the operation.

NOTE 15 - DEFERRED EXPLORATION AND EVALUATION COSTS

CONSOLIDATED GROUP

	Note	2010 \$	2009 \$
EXPLORATION EXPENDITURE			
Exploration expenditure – cost		89,714,658	101,451,122
TOTAL CAPITALISED EXPLORATION AND EVALUATION EXPENDITURE		89,714,658	101,451,222
(a) Reconciled as follows:			
Opening Balance		101,451,222	95,222,555
Transfer from BWC		-	10,846,580
Transfer to financial assets held for sale		-	(4,000,000)
Transfer to mine development costs		(10,846,579)	-
Expenditure capitalised during year		163,269	1,989,719
Disposals	4 (b)	(1,053,254)	-
Expenditure written off during year		-	(2,607,632)
Cost carried forward in respect of areas of interest in Exploration and Evaluation phases		89,714,658	101,451,122

NOTE 16 - MINE DEVELOPMENT COSTS

CONSOLIDATED GROUP

	2010 \$	2009 \$
Opening balance	3,621,463	-
Additions	2,000,000	-
Transfer from deferred exploration and evaluation costs	10,846,579	-
Transfer costs from Bloodwood Creek trial plant	-	3,621,463
TOTAL MINE DEVELOPMENT COSTS	16,468,042	3,621,463

NOTE 17 - TRADE AND OTHER PAYABLES

CONSOLIDATED GROUP

	2010 \$	2009 \$
Trade payables	1,674,576	388,724
Sundry creditors and accrued expenses	2,450,622	1,184,331
Deferred consideration – acquisition of Carbon Energy (Operations) Pty Ltd	-	115,740
TOTAL TRADE AND OTHER PAYABLES	4,125,198	1,688,795

NOTE 18 - PROVISIONS

CONSOLIDATED GROUP

	2010 \$	2009 \$
PROVISION FOR ANNUAL LEAVE		
Opening balance	93,808	139,165
Increase in provisions	249,391	-
Benefits paid	(151,280)	(45,357)
CLOSING BALANCE	191,919	93,808
PROVISION FOR LONG SERVICE LEAVE		
Opening balance	-	110,209
Increase in provisions	40,350	-
Benefits paid	-	(110,209)
CLOSING BALANCE	40,350	-
TOTAL EMPLOYEE BENEFITS	232,269	93,808

A provision has been recognised for employee entitlements relating to annual leave and long service leave entitlements accrued at the balance date. The measurement and recognition criterion relating to employee benefits has been included in Note 1 to this report.

NOTE 19 - ISSUED CAPITAL

CONSOLIDATED GROUP

	2010 \$	2009 \$
609,497,650 (2009: 547,296,637) Fully paid ordinary shares	188,759,462	166,450,930
7,407,408 Fully paid ordinary shares to be issued for deferred consideration on acquisition of Carbon Energy (Operations) Pty Ltd	-	5,814,815
609,497,650 (2009: 554,704,045) Fully paid ordinary shares	188,759,462	172,265,745

NOTE 19 - ISSUED CAPITAL (CONTINUED)

	2010 No.	2009 No.
Ordinary Shares at the beginning of the reporting period	547,296,637	490,446,637
Shares issued during the year:		
• 23 July 2009 placement @ 43c per share	24,418,605	-
• 23 July 2009 exercise of 2nd Tranche Options on CEPL Acquisition 79c per share	7,407,408	-
• 17 August 2009 exercise of Directors options @ 15c per share	1,000,000	
• 16 September 2009 exercise of employee options @ 60c per share	1,000,000	-
• 2 October 2009 exercise of employee options @ 15c per share	250,000	-
• 10 November 2009 exercise of employee options @ 20c per share	500,000	-
• 15 December 2009 exercise of Directors options @ 15c per share	1,000,000	-
• 17 December 2009 exercise of Directors options @ 15c per share	3,125,000	-
• 16 March 2010 exercise of Directors options @ 20c per share	4,000,000	-
• 22 March 2010 exercise of Directors options @ 20c per share	2,500,000	-
• 31 March 2010 exercise of Directors options @ 20c per share	2,000,000	-
• 28 May 2010 issue of shares to Constellation Energy Pty Ltd @ 20c per share	15,000,000	-
• 14 August 2008 issue of performance based shares	-	600,000
• 27 October 2008 exercise of unlisted employee options @ 10c per share	-	250,000
• 25 March 2009 exercise of unlisted employee options @ 15c per share	-	4,000,000
• 31 March 2009 exercise of unlisted employee options	-	2,000,000
• 15 June 2009 placement @ 43c per share	-	50,000,000
At reporting date	609,497,650	547,296,637
• 30 June 2009 Deferred consideration on acquisition of Carbon Energy (Operations) Pty Ltd – future issues	-	7,407,408
Ordinary shares on issue including deferred consideration on acquisition of Carbon Energy (Operations) Pty Ltd	609,497,650	554,704,045

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

NOTE 19 - ISSUED CAPITAL (CONTINUED)

	No. Shares	\$
Balance at 1 July 2008	490,446,637	145,312,137
- Share placements	50,000,000	21,500,000
- Issue of shares under employee share plan	6,850,000	1,147,000
- Release from Option Reserve	-	16,135
- Share Issue costs *	-	(1,524,342)
BALANCE AT 30 JUNE 2009	547,296,637	166,450,930
30 June 2009 Deferred consideration on acquisition of Carbon Energy (Operations) Pty Ltd – future issues	7,407,408	5,814,815
Ordinary shares on issue including deferred consideration on acquisition of Carbon Energy (Operations) Pty Ltd	554,704,045	172,265,745
Balance at 1 July 2009 (excluding deferred consideration on acquisition of Carbon Energy (Operations) Pty Ltd)	547,296,637	166,450,930
Share Placements	24,418,605	10,500,000
Issue of shares on exercise of 2 nd Tranche Options on CEPL Acquistion	7,407,408	5,814,820
Issue of shares under employee share option plan	1,750,000	737,500
Issue of shares under Directors share option plan	13,625,000	2,468,750
Issue of shares to Constellation Energy	15,000,000	3,000,000
Release from Option Reserve	-	312,462
Share Issue costs	-	(525,000)
BALANCE AT 30 JUNE 2010	609,497,650	188,759,462

* Balance includes share issue costs that were equity settled during the 2009 financial year.

NOTE 19 - ISSUED CAPITAL (CONTINUED)

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

(b) At shareholders' meetings each ordinary share is entitled to one vote when a poll is called, otherwise each shareholder has one vote on a show of hands.

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 2010 (2009: Nil) and no dividends are expected to be paid in 2011.

STOCK EXCHANGE LISTING

Quotation has been granted for 609,497,650 of the Company's ordinary shares on all Member exchanges of the Australian Stock Exchange Limited ("ASX").

Quotation of the Company's ordinary shares on the Berlin Stock Exchange commenced in July 1997.

OPTIONS

As at the year end the Company has on issue 49,930,000 unlisted options of which 14,430,000 have vested and are exercisable. Exercise prices for unlisted options range from \$0.20 to \$1.60.

For information relating to share options issued to key management personnel during the financial year refer to Note 32, Share based payments.

NOTE 20 - RESERVES

OPTION RESERVE

The Option reserve records items recognised as expenses on valuation of employee share options.

	CONSOLIDATED GROUP	
	2010 \$	2009 \$
Balance at beginning of the year	4,664,569	171,792
Movement in share option reserve on recognition of share based payments	2,074,907	4,508,912
Exercise of options	(312,462)	(16,135)
BALANCE AT END OF THE YEAR	6,427,014	4,664,569

NOTE 21 – ACCUMULATED LOSSES

	CONSOLIDATED GROUP	
	2010 \$	2009 \$
Balance at beginning of the year	(29,808,121)	(14,422,694)
Loss attributable to the group	(10,820,487)	(15,385,427)
BALANCE AT END OF THE YEAR	(40,628,608)	(29,808,121)

NOTE 22 - INTERESTS IN JOINT VENTURES

Since the disposal of Laverton gold assets during the year, the Consolidated group no longer participates in any joint venture arrangements. During the 2010 financial year the Consolidated group settled all previous Joint Venture arrangements disclosed in the 2009 annual report.

NOTE 23 - STATEMENT OF OPERATIONS BY SEGMENT

The Consolidated group operates in one segment, being to produce clean energy and chemicals feedstock from Underground Coal Gasification (UCG) Syngas and reports to the chief operating decision-maker on this basis. As such one reportable segment has been identified.

NOTE 24 – PARENT ENTITY DISCLOSURES

	2010 \$	2009 \$
Financial Position		
Assets		
Current assets	18,291,152	30,097,313
Non-current assets	157,351,380	124,825,374
Total assets	175,642,532	154,922,687
Liabilities		
Current liabilities	16,639	1,269,594
Non-current liabilities	-	-
Total liabilities	16,639	1,269,594
Equity		
Issued capital	188,759,462	172,265,745
Accumulated losses	(19,560,583)	(23,277,221)
Reserves		
Share based payments reserve	6,427,014	4,664,569
Total equity	175,625,893	153,653,093

	2010 \$	2009 \$
Financial performance		
Profit/(loss) for the year	3,716,639	(9,865,764)
Other comprehensive	-	-
Total comprehensive income	3,716,639	(9,865,764)

Carbon Energy Limited had nil contingent liabilities at 30 June 2010 (2009: nil).

(A) OPERATING LEASE COMMITMENT

	2010 \$	2009 \$
Non-cancellable operating leases contracted for but not capitalised in the financial statements		
<ul style="list-style-type: none"> • not later than one year • later than one year but not later than five years 		
256,847	197,460	
498,625	512,817	
TOTAL OPERATING LEASE COMMITMENTS	755,472	710,277

These relate to property leases as follows:

Brisbane office lease commenced 1 November 2008 and expires 25 April 2013 with 5 year option. Rent increases are set at a 4% increase per annum.

NOTE 25 - FINANCIAL RISK MANAGEMENT

The Consolidated group's principal financial instruments comprise cash, short-term deposits and held for trading investments. The main purpose of these financial instruments is to finance the Consolidated group's operations. The Consolidated group has various other financial assets and liabilities such as trade receivables and trade payables, which arise directly from its operations. The main risks arising from the Consolidated group's financial instruments are cash flow interest rate risk and equity price risk. Other minor risks are either summarised below or disclosed at Note 19 in the case of capital risk management. The Managing Director and Chief Financial Officer review and agree policies for managing each of these risks.

(A) CASH FLOW INTEREST RATE RISK

The Consolidated group's exposure to the risks of changes in market interest rates relates primarily to the Consolidated group's cash deposits with a floating interest rate and its short term deposits and bonds with Fixed interest rates (these are predominantly 30 day revolving term deposits). These financial assets expose the Consolidated group to cash flow interest rate risk. All other financial assets and liabilities in the form of receivables and payables are non-interest bearing. The Consolidated group does not engage in any hedging or derivative transactions to manage interest rate risk. The following tables set out the carrying amount by maturity of the parent entity and Consolidated group's exposure to interest rate risk and the effective weighted average interest rate for each class of these financial instruments. Also included is the effect on profit and equity after tax if interest rates at that date had been 10% higher or lower with all other variables held constant as a sensitivity analysis. The Consolidated group has not entered into any hedging activities to cover interest rate risk. In regard to its interest rate risk, the Consolidated group continuously analyses its exposure. Within this analysis consideration is given to potential renewals of existing positions, alternative investments and the mix of fixed and variable interest rates.

CONSOLIDATED GROUP												
	Weighted Ave		Floating Interest		Fixed Interest Rate		Non-interest		Total		2009 \$	
	2010 %	2009 %	2010 \$	2009 \$	2010 \$	2009 \$	2010 \$	2009 \$	2010 \$	2009 \$		
FINANCIAL ASSETS												
Cash	4.77	4.131	12,873,480	406,231	6,000,000	21,340,000	750	1,001	18,874,230	21,747,232		
Receivables	5.00	3.80	-	-	203,403	410,774	1,333,149	159,501	1,536,552	570,275		
TOTAL FINANCIAL ASSETS			12,873,480	406,231	6,203,403	21,750,774	1,333,899	160,502	20,410,782	22,317,507		
FINANCIAL LIABILITIES												
Payables	-	-	-	-	-	-	-	(4,125,198)	(1,688,795)	(4,125,198)	(1,688,795)	
TOTAL FINANCIAL LIABILITIES								-	(4,125,198)	(1,688,795)	(4,125,198)	(1,688,795)
NET FINANCIAL ASSETS (LIABILITIES)			12,873,480	406,231	6,203,403	21,750,774	(2,791,299)	(1,528,293)	16,285,584	20,628,712		

NOTE 25 - FINANCIAL RISK MANAGEMENT (CONTINUED)

CONSOLIDATED GROUP

	Interest Rate Risk Sensitivity 2010		Interest Rate Risk Sensitivity 2009	
	+10% Profit \$	-10% Profit \$	+10% Profit \$	-10% Profit \$
FINANCIAL ASSETS				
Cash	90,026	(90,026)	89,797	(89,797)
Receivables	1,017	(1,017)	1,359	(1,359)
TOTAL FINANCIAL ASSETS	91,043	(91,043)	91,156	(91,156)
FINANCIAL LIABILITIES				
Payables	-	-	-	-
TOTAL FINANCIAL LIABILITIES	-	-	-	-
NET FINANCIAL ASSETS (LIABILITIES)	91,043	(91,043)	91,156	(91,156)

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 2010 by 45 basis points. This would represent approximately two RBA interest rate increases/(decreases) which is reasonably possible in the current environment particularly due to the volatile markets activities.

Based on the sensitivity analysis only interest revenue from cash deposits, short term, term deposits and bank and cash balances are impacted resulting in a decrease or increase in overall income.

(B) PRICE RISK

The Consolidated group is exposed to equity securities price risk. This arises from investments held and classified on the Statement of Financial Position as held for trading. The investments are tradeable on the ASX.

The Company held 10 million Shares in Magma Metals Ltd at 30 June 2009. During the 2009 financial year the Shares traded between \$0.21 and \$0.57 per share. The following table sets out the carrying amount of the consolidated and parent entity's exposure to equity securities price risk on held for trading investments. Also included is the effect on profit and equity after tax if these prices at that date had been 25% higher or lower with all other variables held constant as a sensitivity analysis

	Carrying Amount		Price Risk Sensitivity 2010		Price Risk Sensitivity 2009	
	2010	2009	-25%	+25%	-25%	+25%
			Profit	Equity		
Financial Assets: Held for trading	-	4,508,000	-	-	(1,127,000)	1,127,000

A sensitivity of 25% has been selected as this is considered reasonable given the current and recent trending and volatilities of both Australian and international stock markets.

NOTE 25 - FINANCIAL RISK MANAGEMENT (CONTINUED)

(C) CREDIT RISK

The Consolidated group is exposed to credit risk primarily from financial institutions. Receivables primarily include interest and amounts on deposit.

The maximum exposure to credit risk at balance date to recognised financial assets, is the carrying amount, net of any provisions for impairment of those assets, as disclosed in the Statement of Financial Position and notes to the financial statements.

The credit risk for counterparties in trade and other receivables at 30 June 2010 are not credit rated by the company. Their maturities are detailed below:

	CONSOLIDATED GROUP	
	2010 \$	2009 \$
Contracted maturities of receivable year ended 30 June 2010		
RECEIVABLE		
• Less than 6 months	128,149	129,501
• 6 to 12 months	-	-
• 1 to 5 years	233,403	440,774
• Later than 5 years	-	-
TOTAL	361,552	570,275

(D) LIQUIDITY RISK

The Consolidated group manages liquidity risk by maintaining sufficient cash reserves and marketable securities, and through the continuous monitoring of budgeted and actual cash flows.

	CONSOLIDATED GROUP	
	2010 \$	2009 \$
Contracted maturities of payables year ended 30 June 2010		
PAYABLE		
• Less than 6 months	4,125,198	1,688,795
• 6 to 12 months	-	-
• 1 to 5 years	-	-
• Later than 5 years	-	-
TOTAL	4,125,198	1,688,795

NOTE 25 - FINANCIAL RISK MANAGEMENT (CONTINUED)

(E) COMMODITY PRICE RISK

The consolidated group is exposed to commodity price risk. This risk arises from its activities directed at exploration and development of mineral commodities. If commodity prices fall, the market for companies exploring for these commodities is affected. The Consolidated group does not hedge its exposures.

(F) FOREIGN EXCHANGE 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 Consolidated group's foreign transactions are immaterial and it is not exposed to foreign currency risk.

(G) NET FAIR VALUES

For financial assets and liabilities, the net fair value approximates their carrying value. No financial assets and financial liabilities are readily traded on organised markets in standardised form, other than listed investments. The Consolidated group has no financial assets where carrying amount exceeds net fair values at balance date. The company's investment in Energia Minerals Limited will rise and fall depending on market volatility. At 30 June 2010 there were no changes noted in the underlying operations of Energia Minerals Limited and no price sensitive announcements made during the year that would suggest an impairment in the carrying value of the investment.

The consolidated group's payables at balance date are detailed in note 17 and comprise trade payables, sundry creditors and accrued expenses.

The consolidated group's receivables at balance date are detailed in Note 9 and comprise Bonds and GST input tax credits refundable by the ATO. The balance of receivables comprises sundry other debtors amounts receivable from related parties for services provided.

NOTE 26 – CONTINGENT LIABILITIES & COMMITMENTS

(A) EXPLORATION COMMITMENTS

Ongoing annual exploration expenditure is required to maintain title to the consolidated group's mineral exploration tenements and to earn an interest in various joint venture mining prospects. No provision has been made in the financial statements for these amounts as the amounts are expected to be fulfilled in the normal course of the operations of the consolidated group. The consolidated group has certain statutory obligations to perform minimum exploration work on its tenements.

CONSOLIDATED GROUP		
	2010 \$	2009 \$
These obligations which are not provided for in the financial statements and are payable:		
• not later than one year	230,000	3,060,000
• 2 to 5 years	1,775,000	-
TOTAL EXPLORATION COMMITMENTS	2,005,000	3,060,000

The above summary of statutory exploration commitments has currently been deferred and waiting on the 2011 decision from the Department of Employment & Economic Development. The Statutory expenditure requirement may be renegotiated with the relevant state department of Minerals and Energy, and expenditure commitments may be varied between tenements, or reduced subject to reduction of exploration area and/or relinquishment of non-prospective tenements.

NOTE 26 - CONTINGENT LIABILITIES AND COMMITMENTS (CONTINUED)

(B) OPERATING LEASE COMMITMENT

	CONSOLIDATED GROUP	
	2010 \$	2009 \$
Non-cancellable operating leases contracted for but not capitalised in the financial statements		
• not later than one year	256,847	197,460
• later than one year but not later than five years	498,625	512,817
TOTAL OPERATING LEASE COMMITMENTS	755,472	710,277

These relate to property leases as follows:

Brisbane office lease commenced 1 November 2008 and expires 25 April 2013 with 5 year option. Rent increases are set at a 4% increase per annum.

(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:

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

Coal Exploration and UCG

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

NOTE 26 - CONTINGENT LIABILITIES AND COMMITMENTS (CONTINUED)

(D) BANK GUARANTEES

CONSOLIDATED GROUP

	2010 \$	2009 \$
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 of (2009: \$410,774)		
Credit Facility - Deposit (Note 9)	203,403	410,774
Amount Utilised	(203,403)	(410,774)
Unused Credit Facility		-
Interest rates on these credit facilities are variable and subject to adjustment.		
Bank Guarantee in relation to the entity's share of guarantee for Lease of office premises	43,629	105,491

(E) PANEL 1 REHABILITATION

A UCG Panel 1 de-commissioning plan has been developed. Panel 1 will be rehabilitated by the re establishment of the original flare with the inclusion of adding LPG for odour elimination. The panel will then cease to have air injected into it. We will monitor pressure and flow through the ignition well flare for a couple of days to get a steady state. Steam will then be injected down the production well to remove any combustion by products back into the panel for combustion. The panel will then be allowed to slowly self extinguish with the ground water returning to previous levels. No provision has been provided in the accounts for this rehabilitation work due to the panel rehabilitation constituting a development activity which will provide information regarding future rehabilitation.

NOTE 27 - CASHFLOW INFORMATION

CONSOLIDATED GROUP

	2010 \$	2009 \$
(a) Reconciliation of cash flow from operations with loss after income tax		
Loss after income tax	(10,820,487)	(15,385,428)
Non-cash flows in loss		
Depreciation	130,392	66,593
Fair value adjustment on acquisition Energia investment	(3,946,747)	-
Unrealised loss on investments	-	1,177,535
Share Options expensed	2,074,912	4,322,570
Equity accounted loss in associate	1,075,564	-
Loss (Gain) on disposal of Plant & Equipment	42,563	(3,448)
Realised gain on sale on investments	(1,956,250)	
Capitalised exploration expenditure written off	-	2,607,633
Changes in assets and liabilities		
(Increase)/Decrease in receivables	(1,257,533)	510,080
(Increase)/Decrease in property plant and equipment	(380,523)	-
(Increase)/Decrease in exploration costs	1,053,254	-
(Increase)/Decrease in financial assets	(1,053,254)	-
Increase/(Decrease) in trade creditors and accruals	2,432,085	(266,057)
Increase/(Decrease) in provisions	138,461	(155,566)
Cash flow (used in) operations	<u>(12,467,563)</u>	<u>(7,126,088)</u>

NOTE 28 - RELATED PARTY TRANSACTIONS

CONSOLIDATED GROUP

	2010 \$	2009 \$
Transactions between related parties are on usual commercial terms and conditions no more favourable than those available to other parties unless otherwise stated.		
(a) Directors' Share Transactions:		
Directors and Director related entities hold directly, indirectly or beneficially as at the reporting date the following equity interests in the Company.		
Ordinary Shares	26,171,895	17,892,265
15 cent vested unlisted options expiring 31/12/09	-	5,000,000
20 cent vested unlisted options expiring 31/3/10	-	9,000,000
25 cent vested unlisted options expiring 10/12/13	5,000,000	5,000,000
35 cent vested unlisted options expiring 10/12/13	7,000,000	-
80 cent vested unlisted options expiring 10/12/13	1,750,000	1,750,000
\$1.20 vested unlisted options expiring 10/12/13	1,750,000	-

Directors and their related entities increased their share holdings by a net 8,129,630 (2009: net decrease of 7,505,669) ordinary shares through the exercise of employee share options, market transfers during the course of the year.

	2010 \$	2009 \$
(b) Director – Related Entities:		
Exploration Accommodation, Finance and Administration fees charged to Magma Metals Ltd of which Mr M.D.J. Cozijn is a Director amounted to:	-	13,485
Accounting services charged by Magma Metals Ltd of which Mr M.D.J. Cozijn is a Director amounted to:	-	27,188
Administration fees charged to Malagasy Minerals Ltd of which Mr M.D.J. Cozijn is a Director amounted to:	-	4,298
Administration fees charged to Oilex Ltd of which Mr M.D.J. Cozijn is a Director amounted to:	-	5,000
Other service fees charged to Carbon Energy Limited of which Mr I.W. Walker is a Director amounted to:	51,120	-

NOTE 28 (B) - RELATED PARTY TRANSACTIONS (CONTINUED)

Parent entity with significant influence over associated entity where Mr M.D.J. Cozijn and Mr I. W. Walker are Directors:

Carbon Energy Ltd was the ultimate parent entity of the Energia Minerals Limited ("Energia Group") until 18 December 2009. Post this date Carbon Energy Ltd ("Carbon Energy") remains an entity with significant influence over the Energia Group. As at 30 June 2010 Carbon Energy Ltd owns 41.73% of Energia Group.

TRANSACTIONS WITH RELATED PARTIES

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

ENERGIA GROUP ENTITY

On 16 October 2009 the Company entered into an Asset Sale and Purchase Agreement with Energia Group ("Sale Agreement") to dispose:

1. exploration licences Eo8/1644, Eo8/1645, Eo8/1646 and exploration licence application E45/2886, in Western Australia;
2. exploration licences EL 3650, EL 3680, EL 3682, EL 3683, EL 3957, EL 3958, EL 4035 and EL 3651 in South Australia;
3. exploration permit applications EPM 15489 and EPM 15491 in Queensland;
4. exploration licence applications EL 25269, EL 25272, EL 25264, EL 25267 in the Northern Territory; and
5. the Italian prospecting permits known as "Gorno NE", "Gorno NW", "Monte Golla", "Zambia", "Vedra", "Monte Pora" and "Punta Covolo" and the Italian prospecting permit applications known as "Novazza", "Val Vedello",

together with related mining information and certain plant and equipment.

The consideration payable by Energia Group to the Company under the Sale Agreement was a cash payment of \$41,174 (allocated to plant and equipment) and the issue to Carbon Energy of 25 million ordinary shares (allocated to all other assets the subject of the Sale Agreement, including the relevant Tenements and mining information).

During the year the Company received the balance of an outstanding loan of \$53,052 from Energia Group. The loan was interest free.

During the year the Energia Group reimbursed Carbon Energy \$33,474 representing administration costs paid by Carbon Energy on behalf of Energia prior to the listing of Energia on the 24 December 2009.

Messrs Walker and Cozijn are Non Executive Directors of Energia Group and receive directors fees from that entity.

NOTE 29 - EVENTS SUBSEQUENT TO BALANCE DATE

No matters of circumstances have arisen since the end of the financial year, which significantly affected or may significantly affect the operations of the Consolidated group, the results of those operations and the state of affairs of the Consolidated group in subsequent financial years, other than:

Subsequent to Balance Date, the Company commenced proceedings in the Supreme Court of Queensland against Alexware Consulting Pty Ltd trading as Pangea Partners International ("Pangea") and Mr John Wedgwood, a former Carbon Energy employee. Pangea was the contractor originally engaged to build and commission Carbon Energy's 5MW power station.

The legal action brought about by Carbon Energy is in relation to serious irregularities in the performance of the contract and accordingly, Carbon Energy will be seeking damages from the parties named above.

NOTE 29 - EVENTS SUBSEQUENT TO BALANCE DATE (CONTINUED)

Carbon Energy has suspended the contract with Pangea and has exercised its right to step in and complete any work it deems appropriate by way of variation to the contract. The legal proceedings will not affect the revised timetable for completion of the project. The damages being sought are not material to the ongoing funding of the Company's activities.

Carbon Energy together with its partner in Chile, Antofagasta Minerals ("Antofagasta"), has obtained Environmental Approval for the first stage of the parties' joint Underground Coal Gasification ("UCG") project in Chile in August 2010.

Drilling program for UCG Panel 2 and the above ground pipe work have been successfully completed. However, commencement of operations for Panel 2 is subject to Queensland Department of Environment and Resource Management (DERM)'s review of the Company's Environmental Evaluation and notice from DERM that the Company may proceed. It is anticipated that DERM's review of the Environmental Evaluation will be completed shortly.

The Company has in early September 2010 executed a Power Station Development Agreement with Arcadia Energy Trading ("Arcadia") that, when completed, will result in the development of both a 25MW and a 300MW power station fuelled by syngas in Queensland.

On 6th September 2010, Dr Helen Garnett joined the Board as a Non-Executive Director.

NOTE 30 - CONTROLLED ENTITIES

(A) CONTROLLED ENTITIES

	COUNTRY OF INCORPORATION	PRINCIPAL ACTIVITY	PERCENTAGE OWNED	
			2010 %	2009 %
Parent Entity: Carbon Energy Ltd (formerly named Metex Resources Ltd)	Australia	Parent entity of Carbon Energy group	-	-
Subsidiaries of Carbon Energy Ltd: *Metex Resources NL (formerly names Windarra Minerals NL)	Australia		-	100
*Nicklelex Pty Ltd	Australia		-	100
Carbon Energy (Holdings) Pty Ltd (CEH)	Australia	Holding company for Carbon Energy Operations	100	100
Carbon Energy (Operations) Pty Ltd (formerly named Carbon Energy Pty Ltd (CEOPL))	Australia	Facilitate the construction and commissioning of the Underground Coal Gasification project in Queensland.	100	100

The change of names as noted were effected on 9 July 2008.

The subsidiaries noted above are all controlled entities and are in the early stage of establishment and are dependent on the parent entity for financial support. At year end, total loans to these subsidiaries amount to \$58,498,711 (2009: \$31,275,898).

*These entities have are no longer part of the CNX Group as they were disposed as part of the divestment of the uranium assets.

NOTE 31 - REMUNERATION OF AUDITORS

CONSOLIDATED GROUP

	2010 \$	2009 \$
Auditor of the parent entity:		
• auditing or reviewing the financial report	52,500	-
• other non audit services – advisory services	189,298	-
	241,798	-
Other auditors		
• auditing or reviewing the financial report	-	44,710
• corporate advisory services	-	1,500
	-	46,210

NOTE 32 - SHARE - BASED PAYMENTS

The following Share-based payment arrangements were issued during the year:

No. of Options	Grant Date	Exercise Price	Vesting Date	Expiry Date
1,000,000	22/03/2010	\$0.80	30/06/2011	22/03/2015
1,000,000	22/03/2010	\$1.20	30/06/2012	22/03/2015
1,000,000	22/03/2010	\$1.60	30/06/2013	22/03/2015

All Options granted to Key Management personnel and employees are ordinary shares in Carbon Energy Limited, which confer a right of one ordinary share for every Option held.

None of the Options hold voting or dividend rights. If the Option holder ceases to be in the employment of the Company prior to vesting, the Options will lapse.

No. of Shares	Issue Date	Deemed Value
15,000,000	26/05/2010	\$0.20

The Company issued 15,000,000 fully paid shares (Securities) to Constellation Energy Pty Ltd in consideration for the supply of drilling services of \$3,000,000 by Constellation for the Bloodwood Creek Trial. The shares issued were in satisfaction of an obligation in an HOA announcement on 5 May 2008.

NOTE 32 - SHARE-BASED PAYMENTS (CONTINUED)

The following Share-based payment arrangements were issued during the 2009 financial year:

No. of Options	Grant Date	Exercise Price	Vesting Date	Expiry Date
5,000,000	13/11/2008	\$0.25	30/06/2009	10/12/2013
7,000,000	13/11/2008	\$0.35	30/06/2010	10/12/2013
8,000,000	13/11/2008	\$0.70	30/06/2011	10/12/2013
10,000,000	13/11/2008	\$1.00	30/06/2012	10/12/2014
1,750,000	13/11/2008	\$0.80	30/06/2009	10/12/2013
1,750,000	13/11/2008	\$1.20	30/06/2010	10/12/2013
1,750,000	13/11/2008	\$1.60	30/06/2011	10/12/2013
2,500,000	16/09/2008	\$0.80	30/06/2009	10/12/2013
2,500,000	16/09/2008	\$1.20	30/06/2010	10/12/2013
2,500,000	16/09/2008	\$1.60	30/06/2011	10/12/2013
1,000,000	16/09/2008	\$0.80	30/06/2009	10/12/2013
1,000,000	16/09/2008	\$1.20	30/06/2010	10/12/2013
1,000,000	16/09/2008	\$1.60	30/06/2011	10/12/2013
1,000,000	17/10/2008	\$0.80	31/10/2009	10/12/2013
1,000,000	17/10/2008	\$1.20	31/10/2010	10/12/2013
1,000,000	17/10/2008	\$1.60	31/10/2011	10/12/2013
1,000,000	17/10/2008	\$0.80	31/10/2009	10/12/2013
1,000,000	17/10/2008	\$1.20	31/10/2010	10/12/2013
1,000,000	17/10/2008	\$1.60	31/10/2011	10/12/2013
2,000,000	15/05/2008	\$0.60	03/07/2008	30/06/2011
351,000	31/03/2009	\$0.40	30/06/2008	01/04/2012
100,000	31/03/2009	\$0.25	30/06/2008	01/04/2012

NOTE 32 - SHARE-BASED PAYMENTS (CONTINUED)

CONSOLIDATED GROUP

	2010 \$		2009 \$	
	No. of Options	Weighted Average Exercise Price	No. of Options	Weighted Average Exercise Price
Outstanding at the beginning of the year	69,451,000	\$0.71	21,500,000	\$0.17
Granted				
15 May 2008	-	-	2,000,000	\$0.60
16 September 2008	-	-	10,500,00	\$1.20
17 October 2008	-	-	6,000,000	\$1.20
13 November 2008	-	-	35,250,000	\$0.73
31 March 2009	-	-	451,000	\$0.37
22 June 2007	-	-	-	-
22 March 2010	3,000,000	\$1.20	-	-
Exercised	(15,375,000)	\$0.21	(6,250,000)	\$0.15
Cancelled	(7,146,000)	\$1.38	-	-
Outstanding at year end	49,930,000	\$0.80	69,451,000	\$0.71
Exercisable at year end	21,430,000	\$0.49	27,500,000	\$0.32

There were 15,375,000 (2009: 6,250,000) options exercised during the year. These Options had a weighted average share price of \$0.208 (2009: \$0.46) at exercise date.

The Options outstanding at 30 June 2010 had a weighted average exercise price of \$0.80 and a weighted average remaining contractual life of 3.62 years. Exercise prices range from \$0.20 to \$1.60 in respect of options outstanding at 30 June 2010.

The weighted average fair value of the options granted during the year was \$1.20 (2009: \$0.87).

This price was calculated using a Black-Scholes option pricing model applying the following inputs:

Weighted average exercise price \$1.20

Weighted average life of option 4.73 years

Underlying share price \$0.58

Expected share price volatility 70%

Risk free interest rate 5.25%

Historical volatility has been the basis for determining expected share price volatility as it is assumed that this is indicative of future trend, which may not eventuate. Included under employee benefits expense in the Statement of Comprehensive Income is \$2,074,912 (2009: \$4,322,570) and relates, in full, to equity-settle share-based payment transactions.

NOTE 33 - COMPANY DETAILS

The registered office of the company is:

Carbon Energy Limited
Level 12, 301 Coronation Drive
Milton, QLD 4064

Financial Report

DIRECTORS' DECLARATION

The Directors of the Company declare that:

1. The financial statements and notes, as set out on pages 52 to 98, are in accordance with the Corporations Act 2001 and:
 - (a) there are reasonable grounds to believe that the company will be able to pay its debts as and when they become due and payable
 - (b) the attached financial statements are in compliance with International Financial Reporting Standards, as stated in note 1 to the financial statements
 - (c) in the directors' opinion, the attached financial statements and notes thereto are in accordance with the Corporations Act 2001, including compliance with accounting standards and giving a true and fair view of the financial position and performance of the Consolidated group
 - (c) the directors have been given the declarations required by s.295A of the Corporations Act 2001.
2. The Managing Director and Finance Director have each declared that:
 - (a) the financial records of the company for the financial year have been properly maintained in accordance with section 286 of the Corporations Act 2001;
 - (b) the financial statements and notes for the financial year comply with the Accounting Standards; and
 - (c) the financial statements and notes for the financial year give a true and fair view.

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:



K. Robinson
Chairman



A.M. Dash
Managing Director

Brisbane, Queensland
28 September 2010

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

Report on the Financial Report

We have audited the accompanying financial report of Carbon Energy Limited, which comprises the statement of financial position as at 30 June 2010, the statement of comprehensive income, the statement of cash flows and the statement of changes in equity for the year ended on that date, notes comprising a summary of significant accounting policies and other explanatory information, and the directors' declaration of the consolidated entity comprising the company and the entities it controlled at the year's end or from time to time during the financial year as set out on pages 52 to 99.

Directors' Responsibility for the Financial Report

The directors of the company are responsible for the preparation and fair presentation of the financial report in accordance with Australian Accounting Standards (including the Australian Accounting Interpretations) and the *Corporations Act 2001*. This responsibility includes establishing and maintaining internal control relevant to the preparation and fair presentation of the financial report that is free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances. In Note 1, the directors also state, in accordance with Accounting Standard AASB 101 *Presentation of Financial Statements*, that compliance with the Australian equivalents to International Financial Reporting Standards ensures that the financial report, comprising the consolidated financial statements and notes, complies 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. These Auditing Standards require that we comply with relevant ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance whether the financial report is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial report. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial report, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial report 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 entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Auditor's Independence Declaration

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

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 2010 and of its performance for the year ended on that date; and
 - (ii) complying with Australian Accounting Standards (including the Australian Accounting Interpretations) and the *Corporations Regulations 2001*; and
- (b) the financial report also complies with International Financial Reporting Standards as disclosed in Note 1.

Material Uncertainty Regarding Continuation as a Going Concern

Without qualifying our opinion, we draw attention to Note 1(A) in the financial report which indicates that the Company and Consolidated Entity are reliant on obtaining government approval for the continuation of operations at the Consolidated Entity's Bloodwood Creek site and on future capital raisings in order to be able to fund and continue the development of the Company and Consolidated Entity's operations. These conditions and other matters, as set out in Note 1(A), indicate the existence of material uncertainties which may cast significant doubt about the Company and Consolidated Entity's ability to continue as going concerns and 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.

Report on the Remuneration Report

We have audited the Remuneration Report included in pages 43 to 48 of the directors' report for the year ended 30 June 2010. 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

In our opinion the Remuneration Report of Carbon Energy Limited for the year ended 30 June 2010, complies with section 300A of the *Corporations Act 2001*.



DELOITTE TOUCHE TOHMATSU



Matthew Sheerin
Partner
Chartered Accountants
Brisbane, 28 September 2010

Tenement Schedule

AS AT 30 JUNE 2010

Tenement Number	Grant date	Expiry Date	Holder	% of interest held	Sub-blocks as at June 2010
EPC 867	18/02/2005	17/02/2010	Carbon Energy (Operations Pty Ltd)	100%	191
EPC 868	18/02/2005	17/02/2010	Carbon Energy (Operations Pty Ltd)	100%	177
EPC 869	14/10/2004	13/10/2009	Carbon Energy (Operations Pty Ltd)	100%	64
EPC 1109	14/02/2007	13/02/2012	Carbon Energy (Operations Pty Ltd)	100%	65
EPC 1132	21/06/2007	20/06/2012	Carbon Energy (Operations Pty Ltd)	100%	23
EPC 1741 Kogan West	Application	-	Carbon Energy (Operations Pty Ltd)	100%	35
MLA50253	Application	-	Carbon Energy (Operations Pty Ltd)	100%	1342 ha
MDL374	01/02/08	31/01/2013	Carbon Energy (Operations Pty Ltd)	100%	2687 ha

In accordance with Society of Petroleum Engineers (SPE) guidelines, the reserves in there properties are:

Area	Category	Gross Gas Volumes (PJ)
	1P Reserve (Proven)	11
Bloodwood Creek EPC 867 (including MDL 374)	2P Reserve (Proven + Probable)	743
	3P Reserve (Proven + Probable + Possible)	1,042

The reserve estimates used in this document were compiled by Mr Timothy Hower of MHA Petroleum Consultants, Colorado, USA, a qualified person under ASX Listing Rule 5.11. Mr Hower has consented to the use of the reserve information contained within this document in the form and context in which it appears.

COAL RESOURCE SUMMARY

AS AT 30 JUNE 2010

Location	Seam Thickness Cut-off	Indicated (Mt)	Inferred (Mt)	TOTAL (Mt)
Bloodwood Creek	2 5¹	218 158	280 57	498 215
Kogan	2 5¹		170 149	170 149
TOTAL RESOURCE	2 5¹	218 158	450 206	668 364

Notes:

1. Optimal target for Underground Coal Gasification

COMPETENT PERSON'S STATEMENT

COAL TENEMENTS

The information in this release that relates to resources is based on information compiled by Dr C.W. Mallett, Executive Director Carbon Energy Limited who is a member of the Australian Institute of Mining and Metallurgy. Dr Mallett has sufficient experience which is relevant to the style of mineralization and type of deposit under consideration and to the activity which he is undertaking to qualify as a Competent Person as defined in the 2004 Edition of the "Australasian Code for Reporting of Exploration Results, Mineral Resources and Ore Reserves". Dr Mallett consents to the inclusion in the release of the matters based on his information in the form and context in which it appears.

Shareholder Information

The shareholder information set out below was applicable as at 10 September 2010.

(A) DISTRIBUTION OF SHARE AND OPTION HOLDINGS AS AT 10 SEPTEMBER 2010.

Size of Holding and Option Holdings	Number of Shareholders	Shares	% of issued Capital
1 - 1,000	452	287,787	0.05
1,001 - 5,000	1,753	5,450,900	0.89
5,001 - 10,000	1,255	10,619,450	1.74
10,001 - 100,000	2,339	80,813,124	13.26
100,001 and over	420	512,326,389	84.06
Total Shareholders	6,219	609,497,650	100.00

(B) OF THE ABOVE TOTAL 498 ORDINARY SHAREHOLDERS HOLD LESS THAN A MARKETABLE PARCEL.

(C) SUBSTANTIAL SHAREHOLDERS NOTICES RECEIVED

Pacific Road Resources Fund holds 36,065,730 ordinary shares

Incitec Pivot Limited holds 66,554,864 ordinary shares

Lujeta Pty Ltd holds 29,625,000 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.

1. The name of the Company Secretary is Mr Prem Nair.
2. The address of the principal registered office in Australia is Level 12, 301 Coronation Drive, Milton, Brisbane, Queensland 4064, Telephone +61 7 3337 9944.
3. The register of securities is held at; Security Transfer Registrars Pty Ltd, 770 Canning Highway, Applecross WA 6153, Telephone +61 8 9315 2333.
4. Stock Exchange Listing Quotation has been granted for all the ordinary share of the company on all Member Exchanges of the Australian Stock Exchange Limited, and trade under the symbol CNX.
5. Quotation has also been granted for all the ordinary shares of the company on the Berlin and Frankfurt Stock Exchange (Third Market).
6. Detailed schedules of exploration and mining tenements held are included in the tenement schedule.
7. Directors' interest in share capital are disclosed in the Directors Report.

8. Unquoted Securities – Details of the 49.3 million unlisted options on issue are detailed in the Directors' report.

Mr A.M. Dash (Managing Director) holds options over 30 million ordinary shares representing 60.9% of the unlisted options on issue.

Dr C. W. Mallett (Executive Director) holds options over 5.25 million ordinary shares representing 10.7% of the unlisted options on issue. There is currently no on-market buy-back in place.

TWENTY LARGEST SHAREHOLDERS

AS AT 10 SEPTEMBER 2010

Shareholders (Fully Paid Ordinary)	Number of Shares	%
Incitec Pivot Ltd	66,554,864	10.92%
HSBC Custody Nom Aust. Ltd	37,663,703	6.18%
Citicorp Nom PL	32,135,173	5.27%
Lujeta PL	30,200,000	4.95%
Commonwealth Scientific & Industrial Research	28,346,389	4.65%
NV Pacific Road Carbon E	24,114,030	3.96%
Constellation Energy PL	15,000,000	2.46%
JP Morgan Nom Aust. Ltd	14,680,216	2.41%
Bridgelane PL	12,438,000	2.04%
Mallet C W & WJ	11,766,952	1.93%
Darley PL	9,500,000	1.56%
Stanley Ross Francis	9,500,000	1.56%
Harman Nom PL	9,300,000	1.53%
Equity Ttees Ltd	7,082,671	1.16%
Cassa Trading PL	6,848,471	1.12%
Elizabethan Super PL	6,355,224	1.04%
ANZ Nom PL	6,243,099	1.02%
PRCM Nom PL	5,975,850	0.98%
Morcombe Darren	5,000,000	0.82%
Computer Visions PL	4,500,000	0.74%
Top 20 Shareholders	343,204,642	56.3%
TOTAL ISSUED SHARES as at 10 September 2010	609,497,650	100%

Corporate Information

CARBON ENERGY LIMITED ABN 56 057 552 137 AND CONTROLLED ENTITIES EIGHTEENTH ANNUAL REPORT AND 2010 FINANCIAL STATEMENTS

CURRENT DIRECTORS:

K. Robinson BSc (Geol) – Chairman (Non-Executive)
A.M Dash BEng (Chem), MCom – Chief Executive Office & Managing Director (Executive)
C.W. Mallett MSc, PhD, FAIE – Technical Director (Executive)
M.D.J. Cozijn B Com, ASA, MAICD – Director (Non-Executive)
H.G. Garnett PSM, BSc (Hons), PhD, FTSE, FAICD (appointed 6 Sept. 2010) – Director (Non-Executive)
P.N. Hogan B.Bus, ACA – Director (Non-Executive)
L.I. Rozman BEng, MGeos, FAusIMM CP(Man), MAICD (appointed 7 Apr. 2010) – Director (Non-Executive)
I.W. Walker BSc (Geol) (Hons) – Director (Non-Executive)

SECRETARY:

P.K. Nair B Bus, MBA, FCA, FCIS, FTIA, MAICD

MANAGEMENT TEAM:

A. Dash – Chief Executive Office & Managing Director
C. Mallett – Technical Director
J. Bidwell – General Manager Project Development
A. Mifflin – Chief Operating Officer
P. Nair – Chief Financial Officer & Company Secretary
P. Swaddle – General Manager Commercial

REGISTERED & PRINCIPAL OFFICE:

Level 12, 301 Coronation Drive
MILTON QLD 4064

Telephone: +61 7 3337 9944, Facsimile: +61 7 3337 9945
Email: askus@carbonenergy.com.au

POSTAL ADDRESS:

PO Box 2118
TOOWONG DC QLD 4066

SHARE REGISTRY:

Security Transfer Registrars Pty Ltd
770 Canning Highway
APPLECROSS WA 615

SOLICITORS:

Gadens Lawyers
240 Queen Street
BRISBANE QLD 4001

ANNUAL GENERAL MEETING

The Annual General Meeting of Carbon Energy Limited
will be held at Royal On The Park
Cnr Alice & Albert Streets
Brisbane QLD 4000
at 9:30am on Thursday, 25th November 2010