AUSTRALIA
BLOODWOOD CREEK, QUEENSLAND

Project milestones:

August 2011
First electricity generated at Bloodwood Creek

February 2011
First gas produced from UCG Panel 2

August 2010
Construction of UCG Panel 2 and 3 commences

July 2009
5MW Power Station construction commences

February 2009
Successful commercial trials completed

Phase 1 power generation: 5MW power station

In August 2011 our pilot-scale 5MW Power Station located at Bloodwood Creek in Queensland achieved an Australian first in power generation from UCG syngas.

The latter half of 2010 and early 2011 was a challenging period as the Queensland Department of Environment and Resource Management (DERM) temporarily restricted operations to investigate a release of process water from surface containment on site from 2009. Following a thorough investigation of the matter, DERM accepted our report and agreed with our findings that there was no ongoing environmental harm. We are committed to upholding the strong environmental credentials which Carbon Energy was founded upon. While we experienced delays during this period, we have been able to successfully demonstrate the value of our keyseam technology.

UCG Panel 2 has been producing syngas continuously since March 2011 and in the month that followed we achieved our optimal operating configuration with syngas produced from the Product Well in accordance with our unique UCG panel design.

Product gas heating values rapidly reached the target range of 5-6 MJ/m^3 with sustained gas production periods achieving heating values in excess of 6MJ/m^3. During the second quarter of 2011 controlled changes to operating parameters were made to optimise gasifier performance. The effectiveness of improvements implemented from the learnings of Panel 1 was confirmed.

Syngas was introduced to the 5MW Power Station in May 2011 allowing the testing of each engine to commence. Initial testing of the engines was completed successfully by the end of June 2011. The July milestone of testing power station load circuits was achieved. Additionally, the first engine successfully delivered electricity to the load bank and testing to 1MW was completed during August as scheduled.

Completion of the construction of electricity lines from the site to the local network and connection work by the network operator is progressing and targeted for completion in October 2011. In addition, the required amendment to our existing Environmental Authorities which would allow for an increase in the volume of gas consumed to enable operation of the 5MW Power Station at full load is being progressed with the Queensland Department of Environment and Resource Management (DERM). Subject to gaining these approvals we are on-track to export 5MW of electricity to the local electricity grid in October 2011 and look forward to generating our first revenue from an off-take agreement signed with Queensland Government-owned Ergon Energy. This is an important step in demonstrating the ability of Carbon Energy's advanced coal technology, keyseam, to deliver low-cost energy to Queenslanders.

In addition, this project has the dual benefit of stimulating economic growth in regional Queensland whilst significantly reducing the environmental impact of producing energy from coal when compared to traditional mining, surface gasification and coal seam gas production.

Drilling of UCG Panel 3 was also completed during 2010. When it is commissioned in 2012, Panel 3 will prove our ability to demonstrate a multi-panel operation that will enable consistent higher volume power generation to support larger developments. Learnings from the decommissioning of Panel 1 and re-design involved in the construction of Panel 2, including sophisticated directional drilling, have been applied to Panel 3 as well as the design of subsequent panels to optimise production in our expansion from pilot phase to commercial-scale operations.

The controlled decommissioning of UCG Panel 1 is continuing as planned. Results from the decommissioning process will be used to demonstrate the environmentally safe operations of a full life cycle of a UCG Panel in support of applications for long term gas production licences.

Phase 2 power generation: 25MW power station development

Our Queensland based Phase 2 and Phase 3 power station developments took a major step forward with the signing of a Power Station Development Agreement with Arcadia Energy Trading (Arcadia) in September 2010. Arcadia Energy Trading is affiliated with UK-based Arcadia Petroleum and is part of the Farahead Holdings group of companies that have a market capitalisation in excess of US$11 billion.

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The Power Station Development Agreement provides a framework for Carbon Energy and Arcadia to progressively develop the Power Generation Phase 2: 25MW Power Station and Power Generation Phase 3: 300MW Power Station based on UCG syngas from Bloodwood Creek's coal resource in Queensland.

The key terms of the announced agreement include:

- Arcadia will, upon Carbon Energy obtaining a Mining Lease for Bloodwood Creek, purchase the 25MW Power Station from Carbon Energy and enter into a long term Gas Supply Agreement, subject to certain conditions being met; and
- Carbon Energy and Arcadia will partner in the development of Carbon Energy's 300MW Power Station at the Company's proposed Blue Gum Energy Park, located close to the Bloodwood Creek coal resource.

Additionally this agreement presents the opportunity to work with an experienced and successful energy trading company providing complementary market knowledge and financial capability, which will assist in the successful progression of our development plans.

Connection arrangements for the 5MW Power Station are being designed to allow, as much as possible for the export of a further 25MW. Final commitments to the 25MW Power Station will be made once there is greater certainty on the Queensland Government's UCG policy such that the necessary financial investment is not subject to tenure risk.

Power generation phase 3: 300 MW power station and Blue Gum Energy Park

Plans for a 300MW Power Station fuelled by syngas and developed with our power station development partner, Arcadia Energy Trading, will be further developed in the future. It is anticipated that Federal Government's plan to implement policy for the reduction of carbon emissions will positively change the economics of our planned project. This is expected as the carbon intensity of the syngas-fuelled power station (CO_2/MWh of electricity generated) will be lower than the average intensity of coal fired electricity generation. In addition co-firing of coal and syngas could enable an existing power station using both fuels to be a net beneficiary of the pass through of lower carbon costs into electricity prices.

In December 2010 Carbon Energy finalised a concept study undertaken in conjunction with significant shareholder Incitec Pivot Limited which concluded that Carbon Energy's UCG syngas is suitable for commercial production of both ammonia and synthetic natural gas (SNG). The joint study was undertaken by international ammonia experts Ammonia Casale and confirms that Carbon Energy will be able to produce high value added products from syngas. The study assessed the feasibility of a standalone an ammonia plant, a combination of an ammonia plant and a 300MW power station and an independent synthetic natural gas plant. Each option assessed produced positive results confirming there are a range of alternatives for Carbon Energy to successfully bring UCG syngas to market at a commercial scale.

Power station at Bloodwood Creek

Tim Kurtz, Process Operator

Directional sign at Bloodwood Creek

Ray Thomas, Site Supervisor & Bob Foster, Project Engineer, at a daily staff briefing.

Resource highlights

JORC Resource Assessment

Location	Coal Thickness Cut-Off (m)	Indicated (Mt)	Inferred (Mt)	TOTAL (Mt)
Bloodwood Creek, Australia	2 5[1]	218 158	280 57	498 215
Kogan, Australia	2 5[1]		170 149	170 149

Notes: 1. Optimal target for Underground Coal Gasification

Competent Person Statement – Coal

The information in this table that relates to resources is based on information compiled by Dr C.W. Mallett, Technical 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 mineralisation 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.

Tenement Status at end June 2011

Tenement	Status	Sub-Blocks as at March 2011	Sub-Blocks as at June 2011	Area Sq km
MLA 50253	Application	1342 ha	1342 ha	15
MDL 374	Granted	2687 ha	2687 ha	32
867	Granted	191	191	670
869	Granted	64	64	213
868	Granted	177	177	605
1132	Granted	23	23	78
1109	Granted	65	65	224
			Total	1,837