Half-Year Financial Report

CARBON ENERGY
December 2010

Corporate Details

CARBON ENERGY LIMITED | ABN 56 057 552 137 | AND CONTROLLED ENTITIES

Incorporated under the Corporations Act 2001 in the State of Western Australia on 29 September 1992.

Half-Year Financial Report
For the period ended 31 December 2010

Directors
K. Robinson *BSc (Geology)* – Chairman (Non-Executive)
A.M. Dash *BEng (Chem), MCom* – Chief Executive Officer and Managing Director (Executive)
C.W. Mallett *MSc, PhD, FAIE* – Technical Director (Executive)
M.D.J. Cozijn *BCom, ASA, MAICD* – Director (Non-Executive)
H.G. Garnett *PSM, BSc (Hons), PhD, FTSE, FAICD* (appointed 6 September 2010) – Director (Non-Executive)
P.N. Hogan *BBus, ACA* – Director (Non-Executive)
L.I. Rozman *BEng, MGeos, FAusIMM CP (Man), MAICD* – Director (Non-Executive)
I.W. Walker *BSc (Geology) (Hons)* (resigned 31 December 2010) – Director (Non Executive)

Secretary
P.K. Nair *BBus (Acctg), MBA, FCA, FCIS, FTIA, MAICD*

Executive Management
A.M. Dash – Chief Executive Officer & Managing Director
C.W. Mallett – Technical Director
J. Bidwell – General Manager Projects
A. Mifflin – Chief Operating Officer (resigned 4 February 2011, Julian Hoskin appointed 24 January 2011)
P.K. Nair – Chief Financial Officer & Company Secretary
P. Swaddle – General Manager Commercial

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240 Queen Street
BRISBANE QLD 4001

Auditors
Deloitte Touche Tohmatsu
Level 25
Riverside Centre
123 Eagle Street
BRISBANE QLD 4001

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Directors' Report

Your Directors submit the financial report of the Consolidated group for the half-year ended 31 December 2010, made in accordance with a resolution of the Board.

Directors

The names of directors who held office during or since the end of the half-year:

- Mr Kim Robinson
- Mr Andrew Dash
- Dr Cliff Mallett
- Mr Max Cozijn
- Dr Helen Garnett (appointed 6 September 2010)
- Mr Peter Hogan
- Mr Louis Rozman
- Mr Ian Walker (resigned 31 December 2010)

Review of Operations

The Consolidated group incurred a loss from ordinary activities after income tax for the half-year of $6,696,327 (2009: loss $1,263,159). The loss reported in the December 2009 half-year period is lower in comparison with the current period due to several extraordinary income items amounting to $5.57million. Excluding the effect of these one-off transactions from 2009, the period to date loss is comparable between the two reporting periods.

Highlights for the Six Month Period

Operations

- The Company's 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, announced 6 September 2010. The Power Station Development Agreement provides a clear framework for Carbon Energy and Arcadia to progressively develop both Phase 2: 25MW Power Station and Phase 3: 300MW Power Station based on UCG syngas from Carbon Energy's Bloodwood Creek coal resource near Kogan in Queensland.
- Underground Coal Gasification (UCG) Panel 2 and associated capital works at Bloodwood Creek were completed and Panel 2 is ready for initiation.
- Drilling of Panel 3 was completed for commissioning.
- In August 2010 Carbon Energy advised that its partner in Chile, Antofagasta Minerals S.A. obtained Environmental Approval for the first stage of the parties' joint UCG project in Chile.
- During the half year further discussions were held with the Queensland Department of Environment and Resource Management (DERM) regarding amendments they require to the existing Environmental Authority for the Bloodwood Creek site to enable commissioning of UCG Panel 2 to proceed. Subsequent to December 2010 the Company received DERM's approval upon

implementing amended environmental conditions; this now enables Carbon Energy to move forward with the commissioning of Panel 2.

- A concept study was completed that confirmed the potential to utilise the gas produced by Carbon Energy's UCG technology for the manufacture of ammonia and synthetic natural gas (pipeline quality gas). The study was jointly commissioned by Carbon Energy and Incitec Pivot Limited.
- On 18 February 2011, Carbon Energy announced the signing of a Memorandum of Understanding (MoU) with Adani Enterprises Ltd (Adani), a member of the Adani Group of India, for the purpose of establishing a joint venture in India to pursue UCG.
- On 23 February 2011, Carbon Energy executed a Share Sale Agreement to acquire USA-based Clean Coal Inc. and UK-based Clean Coal Amasra Ltd. This transaction delivers projects in the United States of America and Turkey as developed by Clean Coal Ltd. The acquisition has the potential to increase Carbon Energy's coal resources by almost three fold to in excess of 2 billion tonnes and underpins the Company's plans to build an international portfolio of UCG projects.

Corporate

- On 9 December 2010 Carbon Energy completed a share placement of approximately 61 million shares at $0.33 to raise $20 million, before costs. Approximately $10 million (gross) received from the first tranche of capital raising in December 2010 with the remainder of funds from the second tranche ($10 million gross) received January 2011. Funds raised are to be used for the advancement of Australian and Chilean projects. Major shareholder Pacific Road Resources Fund 1 corner-stoned the issue and strong domestic and international interest resulted in the issue being oversubscribed. Major shareholder Incitec Pivot Limited participated in the placement to maintain its shareholding at 10%.
- The Company held its Annual General Meeting of Shareholders on 25th November 2010 in Brisbane. All resolutions put to Shareholders were unanimously passed on a show of hands.
- Dr Helen Garnett was appointed as a Non-Executive Director to the Board on 6 September 2010. Dr Garnett is an accomplished Company Director with over 25 years experience. Additionally, Dr Garnett took the role of Chair for the Company's Audit Committee.
- Mr Ian Walker resigned as a Non-Executive Director to assist the company in restructuring the Board as Carbon Energy evolves as an emerging energy company. The Board and Management wish to record our sincere appreciation for the significant contribution Ian has made in the advancement of Carbon Energy, and we wish Ian every success in his future endeavours.

Markets

Queensland

The Australian Energy Market Operator (AEMO) in its annual Statement of Opportunities, published 31 August 2010, highlights that Queensland may have a shortfall in power station reserve capacity of over 700 MW in 2013/14.

Queensland is forecast to have the largest and earliest shortfall in electricity supply of all states in Australia, making Carbon Energy's planned 300MW Power Station an integral part of the solution to the State's future electricity security requirements. Carbon Energy's cost of producing syngas is expected to be lower than that of other sources of gas in Queensland and will have a smaller carbon footprint than traditional coal-fired power generation.

Carbon Energy's plans to deliver low-cost base load generation capacity in Queensland can be expected to ease the pressure of increasing electricity prices on households and businesses across Queensland.

Carbon Energy continues to progress plans for power station development at Bloodwood Creek to provide the first commercial-scale UCG syngas-fired power generation into the Queensland electricity grid.

Bloodwood Creek, Queensland

Phase 1: 5MW Power Station Development

In November 2010, the Queensland Department of Environment and Resource Management (DERM) advised Carbon Energy that it had accepted the Company's environmental report as addressing the requirements of the Environmental Evaluation notice issued on 21 July 2010 and additional information notice issued on 21 September 2010. The evaluation related specifically to the containment of surface water on site, a common situation faced by many industries and not specifically Underground Coal Gasification (UCG), and at no time was groundwater impacted by the incident. As part of the evaluation, a comprehensive soil testing program was undertaken and has been independently assessed by a tier 1 Environmental Consultancy which confirmed that there was no ongoing effects or environmental harm.

The Company worked cooperatively with DERM to finalise amendments to the environmental conditions and on 11 February 2011 Carbon Energy received a notice to proceed enabling the Company to initiate gasification of UCG Panel 2. Complying with the amended conditions allows Carbon Energy to commence the operation of Panel 2 and to utilise the syngas produced for testing the Company's 5 MW power generator that has been installed at site to trial the commercialisation of Carbon Energy's world leading UCG technology.

The new conditions reflect recommendations from Carbon Energy's environmental reports to DERM in relation to handling process water. All recommended modifications were installed by the Company during December and January. The process water management system was adjusted to meet amendments to the Environmental Authorities which involved dedicated pumps and tanks for the process water disposal system.

DERM also requested that additional ground water monitoring wells be installed, which reflects recommendations from the Government's Independent Scientific Panel (ISP) report. In response to this request Carbon Energy is currently installing additional groundwater monitoring wells prior to the initiation of Panel 2, in addition to the 30 water monitoring wells already established at the Company's Queensland site.

Capital works at site have continued to progress and all construction and pre-commissioning activities for Panel 2 were completed in the six month period with Panel 2 standing ready for initiation. The 5MW Power Station is awaiting initiation of Panel 2 to allow the production of UCG syngas to feed the engines at site. Initial testing of the engines on LPG to trial the operation of the power station has been completed.

The controlled decommissioning of UCG Panel 1 is continuing. Results from this process will be used in submission for further developments to demonstrate the full lifecycle of a UCG panel.

Drilling and construction of Carbon Energy's UCG Panel 3 was also completed during the half-year period. When commissioned in 2011, this panel will provide Carbon Energy with the ability to demonstrate a multi-panel operation that will enable consistent higher volume power generation to support larger developments.

This project is currently in the final stages of construction with the power generated to be connected into the local electricity grid. Generation capacity from this project has been contracted to Ergon Energy under an agreement signed in July 2009.

During the half year period the following activities were undertaken:

- The entire surface infrastructure for UCG Panel 2 was installed and commissioned. Significant changes were incorporated into the equipment design to allow improved process measurement and control.
- The ignition well assembly was installed using a new improved design that minimised installation time and increased overall installation quality.
- Superior gas and water handling facilities were incorporated as part of the new design.

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 Carbon Energy's expansion from pilot phase to commercial-scale operations.

Process water facility constructed

Panel 2 Knock out pots and access platforms

UCG Panel 2 Ignition well head

UCG Panel 2 production well

Phase 2: 25MW Power Station Development

The Company's Queensland based Phase 2 and Phase 3 power station developments took a major step forward during the half year period with the signing of a Power Station Development Agreement with Arcadia Energy Trading (Arcadia) which was announced to the ASX on 6 September 2010.

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

The key terms of the announced agreement include:

- Arcadia will enter into a long term Power Purchase Agreement (PPA) to purchase the electricity produced by Carbon Energy's 25MW Power Station at Bloodwood Creek;
- 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 for Carbon Energy 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 Carbon Energy's development plans.

Arcadia Energy Trading is affiliated with UK-based Arcadia Petroleum and is part of the Farahead Holdings group of companies with a market capitalisation in excess of US$11 billion. Arcadia Petroleum itself has access to over US$4 billion in lines of credit.

Phase 3: 300 MW Power Station – Blue Gum Energy Park

Initial planning is underway for the proposed siting of a 300MW Power Station fuelled by Carbon Energy's Bloodwood Creek site at the adjoining Blue Gum Energy Park on land owned by Carbon Energy. Arcadia will partner with Carbon Energy in the development of the 300MW Power Station as a result of the parties' Power Station Development Agreement. It is intended that Arcadia will own the power station, estimated to cost approximately $350 million to develop, and be the first Blue Gum Energy Park customer to enter into a long term gas supply agreement. Long-term planning of key infrastructure is necessary to ensure that a transmission connection into Powerlink's local grid is secured such that power can be provided to the National Electricity Market.

Ammonia and Synthetic Natural Gas (SNG)

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. The study assessed the feasibility of a standalone ammonia plant, a combination of 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.

Chile

In December 2009 Carbon Energy executed an Agreement with Antofagasta Minerals S.A ("Antofagasta") to jointly assess and develop a coal deposit in Mulpun, Chile using Carbon Energy's Underground Coal Gasification (UCG) technology. Chile provides an ideal market opportunity for Carbon Energy as the country's energy demand is forecast to grow 6% to 7% p.a. over the next 5 to 10 years.

In August 2010 Carbon Energy's commercial partner in Chile, Antofagasta, obtained Environmental Approval for the first stage of the parties' joint Underground Coal Gasification (UCG) project in Chile. The Environmental Approval obtained is a key milestone in the development of the project and allows the parties to construct and operate a pilot project which includes their first UCG panel and associated above-ground facilities at Mulpun. The intention of the pilot is to confirm the quality of the gas produced from the Mulpun coal deposit to enable detailed design work and equipment selection to be undertaken for a major power generation project at that site.

A Carbon Energy team visited Chile during the half year period to commence site assessment for the drilling of the trial panel with Mulpun Energy, the subsidiary formed by Antofagasta to proceed with the UCG project in partnership with Carbon Energy. Seismic studies have been assessed to confirm the location and configuration of the initial UCG Panel. The drilling of boreholes for site characterisation was completed in the first quarter of 2011 and water monitoring is scheduled to commence during the second quarter of 2011 calendar year. Once the Front-End Engineering Design (FEED) is complete, the joint venture company will be formed which will earn Carbon Energy a 30% interest in the Mulpun coal deposit. Carbon Energy's UCG project in the town of Mulpun continues to progress well.

India

India is currently among the top three fastest growing economies of the world. Consequently, India's energy needs are rapidly expanding with its increased industrialisation and capacity addition in power generation. Coal is the most dominant source of energy in India's energy mix.

On 18 February 2011, Carbon Energy signed a Memorandum of Understanding (MoU) with Adani Enterprises Ltd (Adani), a member of the Adani Group of India, for the purpose of establishing a joint venture in India to pursue Underground Coal Gasification (UCG). The Adani Group of companies is a US$25 billion market capitalisation group with significant interests in power generation, port ownership and operation and coal mining and coal trading.

The first opportunity that Adani and Carbon Energy will explore has arisen as a result of Coal India Limited (a Government of India Undertaking) operating a tender process in which Indian coal firms have sought UCG technology partners to participate in joint venture development of UCG interests. The MoU facilitates the partnership between Carbon Energy and Adani to jointly participate in this tender submission.

The Memorandum of Understanding is for a period of 18 months during which it is anticipated that Adani and Carbon Energy will jointly prepare and submit a bid to establish a UCG project on Coal India tenements in India. If the bid is successful, Adani will bear all costs throughout the exploration phase, including Carbon Energy's reasonable costs, until exploration has been successfully conducted and a suitable UCG resource established. Adani and Carbon Energy then anticipate forming a joint venture company in India in which Adani will have a 75% share and commitment and Carbon Energy will have a 25% share and commitment.

United States of America and Turkey

During the six month period Carbon Energy undertook due diligence to evaluate a range of potential UCG projects and prospective locations. The purpose of this investigation was to identify the most attractive resources for UCG accompanied by a commercial transaction favourable to Carbon Energy and its shareholders. Carbon Energy's specifications for UCG involved determining suitable resource characteristics and locations, identifying multiple market opportunities for syngas and carbon dioxide (CO_2), in addition to ensuring a regulatory pathway exists for UCG project permitting in jurisdictions meeting technical and commercial criteria.

As a result of the work undertaken during the six month period, Carbon Energy executed a Share Sale Agreement to acquire USA-based Clean Coal Inc. and UK-based Clean Coal Amasra Ltd on 23 February 2011. The transaction delivers projects in the United States of America and Turkey as developed by Clean Coal Ltd.

- **Wyoming Project**: includes rights to explore and lease coal tenements with Anadarko Land Corporation over 113km^2. Carbon Energy is responsible for rents, minimum expenditures and production royalty to Anadarko.
- **Montana / North Dakota Project**: includes rights to explore and lease coal tenements with Great Northern Properties (subsidiary of the Quintana Capital Group) in an area over 276km^2. Carbon Energy is responsible for rents, minimum expenditures and production royalty to GNP.
- **Amasra Project**: 50/50 Joint Venture Agreement with Hema Endustri (subsidiary of the diversified Hattat Group) to develop UCG projects in Hema's coal tenements in Amasra, northern Turkey. Carbon Energy is responsible for initial pilot costs, while the JV is responsible for production royalty to state-owned mining company, Turkish Hard Coal Enterprises ("TTK").

This acquisition has the potential to increase Carbon Energy's coal resources by almost three fold to in excess of 2 billion tonnes and underpins the Company's plans to build an international portfolio of UCG projects.

The transaction is also consistent with Carbon Energy's strategy to diversify market and regulatory uncertainty. Each of the three project locations included in this transaction strongly meet the Company's resource, commercial and regulatory requirements. This is exemplified in the State of Wyoming, USA which has an established regulatory framework to facilitate permitting for a commercial-scale UCG project. The State of Montana, USA is expected to follow suit in the coming months. Additional benefits from this acquisition include access to higher priced energy markets compared with Queensland, key relationships with strategic partners associated with resource development and access to an additional revenue stream from the sale of CO_2 for Enhanced Oil Recovery (EOR).

Significant market opportunity currently exists in Turkey for power generation and the production of synthetic natural gas (SNG) as it is one of the fastest growing economies in Europe and imports approximately 70% of its energy needs. The acquisition referred to above includes a Joint Venture Agreement with Hema Endustri to develop a UCG project in Amasra, northern Turkey enabling Carbon Energy to take advantage of this lucrative market.

Resource

Coal Resource Summary at end December 2010

December 2010 Quarter Resource Statement

Location	Seam Thickness Cut-Off (metres)	Indicated (Mt)	Inferred (Mt)	TOTAL (Mt)
Bloodwood Creek	2	218	280	498
	5[1]	158	57	215
Kogan	2		170	170
	5[1]		149	149
Total Resource	**2**	**218**	**450**	**668**
	5[1]	**158**	**206**	**364**

Notes:
1. *Optimal target for Underground Coal Gasification*

Competent Person Statement – Coal

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 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.

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

AREA	CATEGORY	GROSS GAS VOLUMES(PJ)
Bloodwood Creek	**1P Reserve (Proven)**	**11**
	2P Reserve (Proven + Probable)	**743**
EPC 867 (including MDL 374)	**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.

Legal Action

- During the half year period, Carbon Energy commenced proceedings in the Supreme Court of Queensland against Alexware Consulting Pty 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 suspended the contract with Pangea and has exercised its right to takeover 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 Carbon Energy's activities.

Issued Capital

- The total issued capital at the end of December 2010 was 640,569,620 fully paid ordinary shares quoted on the Australian Stock Exchange. During the six month period 375,000 shares were issued on exercise of employee options and 30,696,970 shares were issued on the first tranche of capital raising completed during December 2010.
- A total of 39,955,000 unlisted options with exercise prices between 25c and $1.60 (with expiry dates ranging between 30 June 2011 and 22 March 2015, with the majority subject to meeting annual performance measures) are on issue.

Listed Investments

- Carbon Energy holds 29 million shares in ASX listed uranium explorer, Energia Minerals Limited (EMX). EMX is actively exploring in Western Australia and Italy.

Funds on Hand

- As at 31 December 2010 funds on hand were $11.83 million. In January 2011, the second tranche from the December 2010 Share Placement of $10.0 million (gross) was received.

Auditors Independence Declaration

- The lead auditor's independence declaration under section 307C of the Corporation Act 2001 is set out on page 13 for the half-year ended 31 December 2010.

This report is signed in accordance with a resolution of the Board of Directors.

K. Robinson
Chairman

A.M. Dash
Managing Director

Brisbane, 11th March 2011

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

11 March 2011

Dear Committee 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 review of the financial statements of Carbon Energy Limited for the half-year ended 31 December 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 review; and

(ii) any applicable code of professional conduct in relation to the review.

Yours sincerely

Deloitte Touche Tohmatsu

DELOITTE TOUCHE TOHMATSU

M. Sheerin

Matthew Sheerin
Partner
Chartered Accountants

Condensed Consolidated Statement of Comprehensive Income

FOR THE HALF-YEAR ENDED 31 DECEMBER 2010

		Consolidated Group	
	Notes	Dec 2010 $	Dec 2009 $
Revenue			
Finance income		280,755	588,081
Realised gain on sale of investment	3	-	1,956,250
Net gain on disposal	3	-	3,621,746
TOTAL Revenue		**280,755**	**6,166,077**
Expenditure			
Bloodwood Creek operating costs		(1,958,159)	(2,058,847)
Employee and consultancy costs		(2,977,966)	(2,783,419)
Administration, legal & corporate costs		(1,887,025)	(1,086,824)
Depreciation expense		(68,562)	(38,895)
Share-based payments	3	734,884	(1,263,297)
Net loss from equity accounted investment in associate		(820,254)	(197,954)
TOTAL Expenditure		**(6,977,082)**	**(7,429,236)**
Loss before income tax expense		**(6,696,327)**	**(1,263,159)**
Income Tax Expense		**-**	**-**
Loss for the Period		**(6,696,327)**	**(1,263,159)**
Other comprehensive income for the period (net of tax)		**-**	**-**
Total comprehensive income for the period		**(6,696,327)**	**(1,263,159)**
Loss attributable to owners of the parent		**(6,696,327)**	**(1,263,159)**
Total comprehensive income attributable to owners of the parent		**(6,696,327)**	**(1,263,159)**
Overall Operations:			
Basic loss per share (cents per share)		(1.09)	(0.22)
Diluted loss per share (cents per share)		(1.09)	(0.22)

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

Consolidated Statement of Financial Position

AS AT 31 DECEMBER 2010

		Consolidated Group	
	Notes	31 Dec 10 $	30 June 10 $
Assets			
Current Assets			
Cash and cash equivalents		11,833,197	18,874,230
Trade and other receivables	5	360,722	278,412
Total Current Assets		**12,193,919**	**19,152,642**
Non Current Assets			
Trade and other receivables	5	1,395,426	1,258,140
Investment in Associate	6	3,504,184	4,324,438
Property, plant and equipment	7	10,662,693	10,672,036
Construction Work in Progress	8	21,883,931	14,825,380
Deferred exploration and evaluation costs	9	89,714,658	89,714,658
Mine development	10	16,468,042	16,468,042
Intangible assets		2,499,999	2,499,999
Total Non Current Assets		**146,128,933**	**139,762,693**
Total Assets		**158,322,852**	**158,915,335**
Liabilities			
Current Liabilities			
Trade and other payables		1,316,053	4,125,198
Provisions		271,941	232,269
Total Current Liabilities		1,587,994	4,357,467
Total Liabilities		1,587,994	4,357,467
Net Assets		156,734,858	154,557,868
Equity			
Issued Capital	11	198,372,948	188,759,462
Reserves		5,686,845	6,427,014
Accumulated losses		(47,324,935)	(40,628,608)
Total Equity		156,734,858	154,557,868

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

Consolidated Statement of Changes in Equity

FOR THE HALF-YEAR ENDED 31 DECEMBER 2010

Consolidated Group

	Issued Capital $	Share-Based Payments Reserve $	Retained Earnings $	TOTAL $
Balance at 1 July 2009	172,265,745	4,664,569	(29,808,121)	**147,122,193**
Shares issued during the period	12,006,250	-	-	**12,006,250**
Transaction costs	(525,000)	-	-	**(525,000)**
Exercise of options	292,023	(292,023)	-	**-**
Movement in share option reserve on recognition of share based payments	-	1,263,297	-	**1,263,297**
Losses attributable to members of the parent entity	-	-	(1,263,159)	**(1,263,159)**
Shares to be issued on execution of contract with Constellation Energy Pty Ltd	-	3,000,000	-	**3,000,000**
Total comprehensive income / (expense) for the period	-	-	-	**-**
Balance at 31 December 2009	**184,039,018**	**8,635,843**	**(31,071,280)**	**161,603,581**

	Issued Capital $	Share-Based Payments Reserve $	Retained Earnings $	TOTAL $
Balance at 1 July 2010	188,759,462	6,427,014	(40,628,608)	**154,557,868**
Shares issued during the period	10,205,000	-	-	**10,205,000**
Transaction costs	(596,799)	-	-	**(596,799)**
Exercise of options	5,285	(5,285)	-	**-**
Movement in share option reserve (refer note 3)	-	(734,884)	-	**(734,884)**
Losses attributable to members of the parent entity	-	-	(6,696,327)	**(6,696,327)**
Total comprehensive income / (expense) for the period	-	-	-	**-**
Balance at 31 December 2010	**198,372,948**	**5,686,845**	**(47,324,935)**	**156,734,858**

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

Consolidated Cash Flow Statement

FOR THE HALF-YEAR ENDED 31 DECEMBER 2010

	Consolidated Group	
	31 Dec 10 $	31 Dec 09 $
Cash Flows from Operating Activities:		
Payments to suppliers and employees	(7,620,822)	(4,503,092)
BWC Trial construction and operations	(2,214,509)	(1,944,476)
Interest received	260,963	410,281
Net cash used in operating activities	**(9,574,368)**	**(6,037,287)**
Cash Flows from Investing Activities:		
Payments for property, plant and equipment	(11,315)	(715,428)
Payments for Construction in progress	(7,058,551)	(6,630,905)
Proceeds from sale of Magma shares	-	6,464,250
Payment for seed capital in Energia Mineral Ltd	-	(400,000)
Payment for exploration costs	-	(163,628)
Payments for environmental security bonds	(5,000)	-
Part proceeds from sale of Laverton Gold tenements	-	1,000,000
Net cash flows used in investing activities	**(7,074,866)**	**(445,711)**
Cash Flows from Financing Activities:		
Proceeds from issues of shares	10,205,000	12,006,250
Capital raising costs	(596,799)	(525,000)
Net cash flows provided by / (used in) financial activities	**9,608,201**	**11,481,250**
Net (decrease) increase in cash held	(7,041,033)	4,998,252
Cash and cash equivalents at 1 July	**18,874,230**	**21,747,232**
Cash and cash equivalents at 31 December	**11,833,197**	**26,745,484**

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

Notes to the Financial Statements

FOR THE HALF-YEAR ENDED 31 DECEMBER 2010

NOTE 1 – BASIS OF PREPARATION

The half-year consolidated financial statement is a general purpose financial report prepared in accordance with the requirements of the Corporations Act 2001 and AASB 134 Interim Financial Reporting. Compliance with AASB 134 ensures compliance with International Financial Reporting Standard IAS 34 Interim Financial Reporting. The half-year report does not include notes of the type normally included in an annual financial report.

It is recommended that this financial report be read in conjunction with the annual financial report for the year ended 30 June 2010 and any public announcements made by Carbon Energy Limited during the half-year in accordance with continuous disclosure requirements arising under the Corporations Act 2001.

The half-year financial report does not include full disclosures of the type normally included in an annual financial report and therefore cannot be expected to provide as full an understanding of the financial performance, financial position and financing activities of the Consolidated group as the full financial report.

Reporting Basis and Conventions

The half-year report has been prepared on an accruals basis and is based on historical costs modified, by the revaluation of selected non-current assets, financial assets and financial liabilities for which fair value basis of accounting has been applied. Cost is based on the fair values of the consideration given in exchange for assets. All amounts are presented in Australian dollars, unless otherwise noted.

The accounting policies and methods of computation adopted in the preparation of the half-year financial report are consistent with those adopted and disclosed in the Carbon Energy Limited 2010 annual report for the financial year ended 30 June 2010, except for the impact of the Standards and Interpretations described below. These accounting policies are consistent with Australian Accounting Standards and with International Financial Reporting Standards.

The Group has adopted all of the new and revised Standards and Interpretations issued by the Australian Accounting Standards Board (the AASB) that are relevant to their operations and effective for the current reporting period.

New and revised Standards and amendments thereof and Interpretations effective for the current reporting period that are relevant for the Group include:

- Amendments to AASB 5, 8, 101, 107, 117, 118, 136 and 139 as a consequence of AASB 2009-5 Further Amendments to Australian Accounting Standards arising from the Annual Improvements Project

AASB 2009-5 introduces amendments into Accounting Standards that are equivalent to those made by the IASB under its program of annual improvements to its standards. A number of the amendments are largely technical, clarifying particular terms, or eliminating unintended consequences. Other changes are more substantial, such as the current/non-current classification of convertible instruments, the classification of expenditures on unrecognised assets in the statement of cash flows and the classification of leases of land and buildings.

The adoption of these amendments has not resulted in any changes to the Group's accounting policies and has no effect on the amounts reported for the current or prior periods.

NOTE 2 – GOING CONCERN

The financial report has been prepared on a going concern basis. The ability of the Consolidated group to continue as a going concern is dependent upon additional capital being raised to finance continued development of the Bloodwood Creek and other projects and to fund the operations of the Consolidated group. The ability of the Consolidated group to raise additional funds will be dependent upon a number of factors including regulatory approvals, permits, licences, market sentiment, energy prices and results of current exploration and development activities. The Directors are confident of the Consolidated group's ability to undertake such a capital raising based on past demand for previous capital raisings, as demonstrated recently with the December 2010 capital raising being oversubscribed. The receipt of DERM approval as disclosed in note 14 also increases the Directors' confidence with regard to future capital raisings. If conditions existed that hampered required future capital raisings, the level of current cash reserves would enable the Consolidated group to slow development and reduce spending on certain activities for a period of not less than 12 months from the date of signing the financial statements until conditions improved to enable further raisings.

NOTE 3 – LOSS FOR THE PERIOD

The following significant transactions are relevant in explaining the financial performance:

		31 Dec 10 $	31 Dec 09 $
1)	**Share based payments**	734,884	(1,263,297)
	This relates to accounting for share options provided to employees in accordance with the Australian Accounting Standards and are based on a theoretical cost using a 70% volatility factor. The negative expense for the half-year ended 31 December 2010 relates to the cancellation of a number of options during the period.		
2)	**Realised gain on sale of investments**	-	1,956,250
	• 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 gain of $1,956,250		
	• Net Gain/(Loss) on Disposal of Laverton Gold Assets	-	(325,000)
	• Net Gain/(Loss) on Divestment of Uranium Assets	-	3,946,746

NOTE 4 – SEGMENT INFORMATION

AASB 8 requires operating segments to be identified on the basis of internal reports about components of the Group that are regularly reviewed by the chief operating decision maker in order to allocate resources to the segment and to assess its performance. 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 operating segment has been identified.

NOTE 5 – RECEIVABLES

	Notes	Dec '10 $	Jun '10 $
Current			
Trade receivables		10,338	9,073
Other receivables		332,407	119,076
Deposits		17,977	150,263
Total Current Trade and Other Receivables		**360,722**	**278,412**
Non Current			
Deposits		220,426	83,140
Receivable from Crescent Gold Limited		1,175,000	1,175,000
Total Non Current Trade and Other Receivables		**1,395,426**	**1,258,140**

NOTE 6 – INVESTMENT IN ASSOCIATE

During the December 2009 half-year period, Carbon Energy Limited disposed of its Uranium interests and acquired a 42% interest in Energia Minerals Limited.

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 respectively. A gain of $3,946,746 was recognised in the period ending 31 December 2009 representing the difference between the group carrying value of the disposed assets and fair value of consideration received by way of investment in Energia Minerals Limited.

	Dec '10 $	Jun '10 $
Opening Balance	4,324,438	-
Investments made during the period	-	5,400,002
Share of associate's loss after income tax	(820,254)	(1,075,564)
Closing Balance	**3,504,184**	**4,324,438**

NOTE 7 – PROPERTY, PLANT & EQUIPMENT

	Dec '10 $	Jun '10 $
Opening Balance	10,672,036	10,506,605
Additions	59,219	380,523
Depreciation expense	(68,562)	(84,701)
Disposals	-	(130,392)
Closing Balance	**10,662,693**	**10,672,036**

NOTE 8 – CONSTRUCTION WORK IN PROGRESS

	Dec '10 $	Jun '10 $
Opening Balance	14,825,380	-
Additions	7,058,551	14,825,380
Closing Balance	**21,883,931**	**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. As disclosed in the company's ASX announcement dated 14 February 2011, Carbon Energy has received a notice to proceed from the Queensland Government Department of Environment and Resource Management (DERM), accordingly commissioning of the 5MW plant is expected around May 2011.

NOTE 9 – DEFERRED EXPLORATION AND EVALUATION COSTS

	Dec '10 $	Jun '10 $
Opening Balance	89,714,658	101,451,222
Transfer to mine development costs	-	(10,846,579)
Expenditure capitalised during the period	-	163,269
Disposals	-	(1,053,254)
Closing Balance	**89,714,658**	**89,714,658**

NOTE 10 – MINE DEVELOPMENT

	Dec '10 $	Jun '10 $
Opening Balance	16,468,042	3,621,463
Additions	-	2,000,000
Transfer from deferred exploration and evaluation costs	-	10,846,579
Closing Balance	**16,468,042**	**16,468,042**

NOTE 11 – EQUITY SECURITIES ISSUED

2010	Half-Year 2010 No.	Half -Year 2010 $
Balance 30 June 2010	**609,497,650**	**188,759,462**
19 October 2010 exercise of employee options @ 20 cents per share	250,000	50,000
16 December 2010 placement @ 33 cents per share	30,696,970	10,130,000
30 December 2010 exercise of employee options @ 20 cents per share	125,000	25,000
Issue costs	-	(596,799)
Release from option reserve on exercise of options	-	5,285
Balance 31 December 2010	**640,569,620**	**198,372,948**

NOTE 11 – EQUITY SECURITIES ISSUED (CONTINUED)

2009	Half-Year 2009 No.	Half-Year 2009 $
Balance 30 June 2009	**554,704,045**	**172,265,745**
Shares issued during the period:		
22 July 2009 placement @ 43c per share	24,418,605	10,500,000
23 July 2009 consideration on acquisition of Carbon Energy (Operations) at 79c per share	7,407,408	5,814,815
17 August 2009 exercise of Directors options @ 15c per share	1,000,000	150,000
16 September 2009 exercise of employee options @ 60c per share	1,000,000	600,000
2 October 2009 exercise of employee options @ 15c per share	250,000	37,500
10 November 2009 exercise of employee options @ 20c per share	500,000	100,000
15 December 2009 exercise of Directors options @ 15c per share	1,000,000	150,000
17 December 2009 exercise of Directors options @ 15c per share	3,125,000	468,750
Issue Costs	-	(525,000)
Release from option reserve on exercise of options	-	292,023
Balance 31 December 2009	**585,997,650**	**184,039,018**

NOTE 12 – CONTINGENT LIABILITIES

A Rehabilitation policy is currently being developed. As UCG Panel 1 is the first panel being rehabilitated, the costs cannot be reliably measured and therefore no provision has been provided in the accounts relating to this rehabilitation.

NOTE 13 – COMMITMENTS

At 31 December 2010, the company had made commitments of $0.35 million in relation to the 5MW, Panel 2, other site works and in relation to BWC operations.

NOTE 14 – EVENTS SUBSEQUENT TO REPORTING DATE

Capital Raising

In January 2011, the second tranche from the December 2010 Share Placement of $10.0 million (gross) was received. This resulted in the issue of 30,303,030 new ordinary shares.

Environmental Approval

On 14 February 2011, Carbon Energy made an announcement to the market indicating it had received a notice to proceed from the Queensland Government Department of Environment and Resource Management (DERM) enabling the Company to initiate gasification of its new Underground Coal Gasification (UCG) Panel 2, with amended environmental conditions for its Bloodwood Creek site in Queensland.

The amended conditions allow Carbon Energy to commence the operation of Panel 2 and to utilise the syngas produced for testing the Company's 5MW power generator that has been installed at site to trial the commercialisation of Carbon Energy's UCG technology.

NOTE 14 – EVENTS SUBSEQUENT TO REPORTING DATE (CONTINUED)

Adani MOU

On the 18 February 2011, Carbon Energy announced that it had signed a Memorandum of Understanding (MOU) with Adani Enterprises Ltd, a member of the Adani Group of India, for the purpose of establishing a joint venture in India to pursue Underground Coal Gasification.

The Memorandum of Understanding is for a period of 18 months during which it is anticipated that Adani and Carbon Energy will jointly prepare and submit a bid to establish a UCG project on Coal India tenements in India.

If the bid is successful, Adani will bear all costs throughout the exploration phase, including Carbon Energy’s reasonable costs, until exploration has been successfully conducted and a suitable UCG resource established. Adani and Carbon Energy then anticipate forming a joint venture company in India in which Adani will have a 75% share and commitment and Carbon Energy will have a 25% share and commitment.

Overseas Expansion

On the 23 February 2011, Carbon Energy announced that it had executed a Share Sale Agreement to acquire USA-based Clean Coal Inc. and UK-based Clean Coal Amasra Ltd. The key elements of the transaction include the following:

- Consideration of US$10 million of shares (based on 60 day VWAP) which will be issued within the Company’s 15% share issue capacity (ASX Listing Rule 7.1). Two further tranches of US$4.5 million of shares each (based on 30 day VWAP at time of milestone achievement) will be issued subject to meeting key development milestones including the delineation of JORC complaint coal resources in excess of 500Mt at two of the three locations.
- Wyoming Project: includes rights to explore and lease coal tenements with Anadarko Land Corporation over 113 km^2. Carbon Energy is responsible for rents and minimum expenditures and production royalty to Anadarko.
- Montana / North Dakota Project: includes rights to explore and lease coal tenements with Great Northern Properties (subsidiary of the Quintana Capital Group) in an area over 276km^2. Carbon Energy is responsible for rents, minimum expenditures and production royalty to GNP.
- Amasra Project: 50/50 Joint Venture Agreement with Hema Endustri (subsidiary of the diversified Hattat Group) to develop UCG projects in Hema’s coal tenements in Amasra northern Turkey. Carbon Energy is responsible for initial pilot costs, while the joint venture company is responsible for production royalties to state-owned mining company, Turkish Hard Coal Enterprise (“TTK”).

Directors' Declaration

The directors of the company declare that:

a) The financial statements and notes, as set out on pages 14 to 23 comply with the Corporations Act 2001, including compliance with accounting standards and giving a true and fair view of the Consolidated group's financial position as at 31 December 2010 and of its performance for the half-year ended on that date.

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

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

On behalf of the Directors

K. Robinson
Chairman

A.M. Dash
Managing Director

Brisbane, Queensland
11th March 2011

Deloitte.

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

We have reviewed the accompanying half-year financial report of Carbon Energy Limited, which comprises the condensed statement of financial position as at 31 December 2010, and the condensed statement of comprehensive income, the condensed statement of cash flows and the condensed statement of changes in equity for the half-year ended on that date, selected explanatory notes and, the directors' declaration of the consolidated entity comprising the company and the entities it controlled at the end of the half-year as set out on pages 14 to 24.

Directors' Responsibility for the Half-Year Financial Report

The directors of the company are responsible for the preparation of the half-year financial report that gives a true and fair view in accordance with Australian Accounting Standards and the *Corporations Act 2001* and for such internal control as the directors determine is necessary to enable the preparation of the half-year financial report that is free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express a conclusion on the half-year financial report based on our review. We conducted our review in accordance with Auditing Standard on Review Engagements ASRE 2410 *Review of a Financial Report Performed by the Independent Auditor of the Entity*, in order to state whether, on the basis of the procedures described, we have become aware of any matter that makes us believe that the half-year financial report is not in accordance with the *Corporations Act 2001* including: giving a true and fair view of the consolidated entity's financial position as at 31 December 2010 and its performance for the half-year ended on that date; and complying with Accounting Standard AASB 134 *Interim Financial Reporting* and the *Corporations Regulations 2001*. As the auditor of Carbon Energy Limited, ASRE 2410 requires that we comply with the ethical requirements relevant to the audit of the annual financial report.

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

Auditor's Independence Declaration

In conducting our review, we have complied with the independence requirements of the *Corporations Act 2001*. We confirm that the independence declaration required by the *Corporations Act 2001*, which has been given to the directors of Carbon Energy Limited, would be in the same terms if given to the directors as at the time of this auditor's report.

Conclusion

Based on our review, which is not an audit, we have not become aware of any matter that makes us believe that the half-year financial report of Carbon Energy Limited is not in accordance with the *Corporations Act 2001*, including:

(a) giving a true and fair view of the company's financial position as at 31 December 2010 and of its performance for the half-year ended on that date; and

(b) complying with Accounting Standard AASB 134 *Interim Financial Reporting* and the *Corporations Regulations 2001*.

Deloitte Touche Tohmatsu

DELOITTE TOUCHE TOHMATSU

M. Sheerin

Matthew Sheerin
Partner
Chartered Accountants
Brisbane, 11 March 2011