



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.

REGISTERED & PRINCIPAL OFFICE:

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Quarterly Report – September 2010

Highlights

- The Company's Queensland based Phase 2 and Phase 3 power station developments took a major step forward during the September quarter with the signing of a Power Station Development Agreement with Arcadia Energy Trading, this was announced on 6th September 2010.
- The Power Station Development Agreement provides a clear framework for Carbon Energy and Arcadia to progressively develop both Phase 2 - a 25MW power station and Phase 3 - a 300MW power station based on UCG syngas from Carbon Energy's Bloodwood Creek coal resource near Kogan in Queensland.
- Completed construction of UCG Panel 2 and associated capital works at BWC.
- Completed drilling of Panel 3 for commissioning in 2011.
- In August 2010 Carbon Energy was pleased to advise that its partner in Chile, Antofagasta Minerals S.A. obtained Environmental Approval for the first stage of the parties' joint Underground Coal Gasification (UCG) project in Chile.
- Dr Helen Garnett was appointed as a Non-Executive Director to the Board on 6th September 2010. Dr Garnett is an accomplished Company Director with over 25 years experience. Additionally, Dr Garnett will Chair the Company's Audit Committee.
- The Company retains cash reserves of \$10.0 million as at 30 September 2010.



Resource

1. Expand Coal Resource

Chile

Carbon Energy's Chilean-based project continues to progress well. In August Carbon Energy was pleased to advise that its partner in Chile, Antofagasta Minerals S.A., has 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 scheme that 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 so that detailed design work and equipment selection can be carried out for a major power generation project at that site.

Request For Proposals has been sent to a number of tier 1 international engineering firms to conduct Front End Engineering and Design (FEED) for the first UCG Panel and above ground facilities in Chile. Responses are due early November 2010. Construction is expected to commence in the first quarter of 2011.

Once the initial design plan and FEED processes are completed, the joint venture company will be formed which will see Carbon Energy earn a 30% interest in the Mulpun coal deposit.

Galilee Basin (QLD)

Discussions are ongoing with Liberty Resources in order to formalise a joint venture agreement that will earn Carbon Energy an 80% interest in Liberty's granted EPCs in the Galilee Basin by Carbon Energy funding the early stages of underground development through to a trial project.

Other opportunities

Carbon Energy continues its discussions to identify other potential coal resources suitable for UCG both in Australia and internationally.



Tenement Status at end September 2010

Tenement	Status	Sub-blocks as at June 2010	Sub-blocks as at Sept 2010	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
1741 Kogan West	Application	35	35	119
			TOTAL	1,956

Technology

2. Bloodwood Creek – project update

In July, Carbon Energy advised that the Company had received an Environmental Evaluation request for its Bloodwood Creek Site from the Queensland Government Department of Environment and Resource Management (DERM). The Evaluation related to a release of process water in August 2009, which was immediately cleaned up, but, not reported to DERM in the prescribed timeframe.

The Environmental Evaluation was conducted by third party consultancy company, McCollum Environmental Management Services Pty Ltd, and the initial report was submitted on 20th August 2010. A request for further information was received by the Carbon Energy in late September and this information was submitted to the Department on 19th October 2010.

Capital works have continued to progress at the Company's Queensland site at Bloodwood Creek west of Dalby, with all construction and pre-commissioning activities for the second UCG Panel having been completed. Commissioning of UCG Panel 2 is subject to DERM's satisfactory review of Carbon Energy's Environmental Evaluation and the additional information provided.



Drilling and construction of Carbon Energy's UCG Panel 3 has also been completed on schedule and on budget. 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.

During the September 2010 quarter the following activities were undertaken -

- All of the 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 improved overall installation quality.
- Improved gas and water handling facilities were incorporated as part of the new design.



UCG Panel 2 Ignition well head



UCG Panel 2 production well



The Company commenced a controlled de-commissioning process for Panel 1 which will provide the opportunity to demonstrate and report on operating the complete life cycle of a UCG panel. The results from this process would provide valuable operational data for the planning of the Company's full scale commercial operations which are the subject of a current Mining Lease Application.

Markets

3. Identify and develop commercial opportunities

Power Station Development

As outlined previously, Carbon Energy is currently progressing plans for the staged development of a number of power projects based on syngas produced from its UCG project in Queensland:

Phase 1: 5MW Power Station Development

This project is currently in the final stages of construction at the Company's Bloodwood Creek site, with the electricity 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.

Phase 2: 25MW Power Station Development - to be co-located at the Company's Bloodwood Creek site

The Company's Queensland based Phase 2 and Phase 3 power station developments took a major step forward during the September quarter with the signing of a Power Station Development Agreement with Arcadia Energy Trading (Arcadia) which was announced to the ASX on 6th 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 which provides complementary market knowledge and financial capability, both of which will assist in the successful progression of Carbon Energy's development plans.



Proposed 25MW Power Station Site

Arcadia Energy Trading is affiliated with UK-based Arcadia Petroleum and is part of the Farahead Holdings group of companies owned by Norwegian shipping magnate John Fredriksen that comprises a portfolio of companies including Golar LNG Ltd, Arcadia Petroleum Limited, Frontline Limited and Seadrill, 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

Arcadia will partner with Carbon Energy in the development of the 300MW power station at Carbon Energy’s planned Blue Gum Energy Park near Kogan in Queensland. 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.

Queensland Power Market

The Australian Energy Market Operator (AEMO) in its annual Statement of Opportunities, published 31st 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 will 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.

Discussions are continuing with resource owners in North America and Europe regarding Carbon Energy earning an equity position in coal resources suitable for UCG by providing access to the Company's leading UCG technology.

Corporate

Board Changes

Dr Helen Garnett was appointed to the Board on 6th September 2010 and will Chair the Company's Audit Committee. Dr Garnett is an accomplished Company Director with over 25 years 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.

Substantial Shareholders at 30 September 2010 are as follows:

- Incitec Pivot Limited has notified its holding in CNX as 11.3%
- Pacific Road Resources Fund holds a balance of 5.1%.
- Lujeta Pty Ltd notified its holding in CNX as 5%.

Issued Capital & Cash Funds

- The total issued capital at the end of the September Quarter was 609,497,650 fully paid ordinary shares quoted on the Australian Stock Exchange.
- A total of 49,930,000 unlisted options with exercise prices between 20c and \$1.60 are on issue (with expiry dates ranging between 31 October 2010 and 22 March 2015) and with the vast majority subject to meeting annual performance measures.
- The Company retains cash reserves of \$10.0 million as at 30 September 2010.

Listed Investments

- Carbon Energy held 29 million shares in ASX listed uranium company, Energia Minerals Limited, as at 30 September 2010.

For and on behalf of the Board



A.M. Dash
Managing Director
29 October 2010



Coal Resource Summary – Appendix A

As at 30th September 2010

September 2010 Quarter Resource Statement

Location	Seam Thickness Cut-Off	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 of Carbon Energy Limited who is also 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.

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

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

Appendix 5B

Mining exploration entity quarterly report

Introduced 1/7/96. Origin: Appendix 8. Amended 1/7/97, 1/7/98, 30/9/2001.

Name of entity

CARBON ENERGY LIMITED

ABN

ABN 56 057 552 137

Quarter ended ("current quarter")

30 SEPTEMBER 2010

Consolidated statement of cash flows

	Current Quarter \$A'000	Year to Date (3 months) \$A'000
Cash flows related to operating activities		
1.1 Receipts from product sales and related debtors	-	-
1.2 Payments for		
(a) exploration and evaluation (net)	-	-
(b) development – BWC Operations	(1,199)	(1,199)
(c) technical services	(392)	(392)
(d) administration (net)	(833)	(833)
(e) commercial and business devel.	(202)	(202)
(g) Other projects- UCG panel 1, Project labour support, Project Chile and IT Project	(381)	(381)
1.3 Interest and other items of a similar nature received	135	135
1.4 Interest and other costs of finance paid	-	-
1.5 Income taxes benefit received	-	-
1.6 Other (provide details if material) Fuel tax credits	42	42
Net Operating Cash Flows	(2,830)	(2,830)
Cash flows related to investing activities		
1.7 Payment for purchases of:		
(a) prospects	-	-
(b) equity investments	-	-
(c) other fixed assets	-	-
1.8 Proceeds from sale of:		
(a) prospects	-	-
(b) equity investments	-	-
MMW Shares	-	-
(c) other Gold tenements & fixed assets sales	-	-
1.9 Loans to other entities	-	-
1.10 Loans repaid by other entities	-	-
1.11 Other (provide details if material) –Construction of 5MW Plant, 2 nd & 3 rd UCG Panels	(2,736)	(2,736)
Net investing cash flows	(2,736)	(2,736)
1.12 Total operating and investing cash flows (carried forward)	(5,566)	(5,566)

+ See chapter 19 for defined terms.

Appendix 5B
Mining exploration entity quarterly report

	Current Quarter \$A'000	Year to Date (12 months) \$A'000
1.13 Total operating and investing cash flows (brought forward)	(5,566)	(5,566)
Cash flows related to financing activities		
1.14 Proceeds from issues of shares, options, etc.	-	-
1.15 Proceeds from sale of forfeited shares	-	-
1.16 Proceeds from borrowings	-	-
1.17 Repayment of borrowings	-	-
1.18 Dividends paid	-	-
1.19 Other - Trade Creditors/Debtors	(3,511)	(3,511)
Net financing cash flows	(3,511)	(3,511)
Net increase (decrease) in cash held	(9,077)	(9,077)
1.20 Cash at beginning of quarter/year to date	19,077	19,077
1.21 Exchange rate adjustments to item 1.20	-	-
1.22 Cash at end of quarter	10,000	10,000

Payments to directors of the entity and associates of the directors

Payments to related entities of the entity and associates of the related entities

	Current Quarter \$A'000
1.23 Aggregate amount of payments to the parties included in item 1.2	188
1.24 Aggregate amount of loans to the parties included in item 1.10	-

1.25 Explanation necessary for an understanding of the transactions

Cash outflows noted item 1.19 of \$3.5 million (for the quarter) includes \$3.3 million of creditors and accruals from the June 2010 quarter which were paid during the September 2010 quarter to ascertain the closing cash position at the end of the quarter.

Costs included in item 1.23 above covers Directors' expenses for any services undertaken outside the scope of directors duties, salaries for the Brisbane based executive Directors plus Non-Executive Director's fees and superannuation.

Non-cash financing and investing activities

2.1 Details of financing and investing transactions which have had a material effect on consolidated assets and liabilities but did not involve cash flows

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+ See chapter 19 for defined terms.

- 2.2 Details of outlays made by other entities to establish or increase their share in projects in which the reporting entity has an interest

Nil

Financing facilities available

Add notes as necessary for an understanding of the position.

	Amount available \$A'000	Amount used \$A'000
3.1 Loan facilities	-	-
3.2 Credit standby arrangements/bonds	203	203

Estimated cash outflows for next quarter

	\$A'000
4.1 Exploration and evaluation	0
4.2 Development & Capital work projects	5,900
4.3 Production	0
4.4 Administration	900
Total	6,800

Reconciliation of cash

Reconciliation of cash at the end of the quarter (as shown in the consolidated statement of cash flows) to the related items in the accounts is as follows.

	Current quarter \$A'000	Previous quarter \$A'000
5.1 Cash on hand and at bank	3,797	909
5.2 Deposits at call	6,000	17,965
5.3 Bank overdraft	-	-
5.4 Other (Deposit Bonds)	203	203
Total: cash at end of quarter (item 1.22)	10,000	19,077

+ See chapter 19 for defined terms.

Changes in interests in mining tenements

	Tenement reference	Nature of interest	Interest at beginning of quarter	Interest at end of quarter
6.1	Interests in mining tenements relinquished, reduced or lapsed		Nil	Nil
6.2	Interests in mining tenements acquired or increased	Coal Refer Covering Quarterly Activity Report attached hereto	100%	100%

Issued and quoted securities at end of current quarter

Description includes rate of interest and any redemption or conversion rights together with prices and dates.

	Total number	Number quoted	Issue price per security (cents)	Amount paid up per security (cents)
7.1 Preference + securities (description)	Nil	Nil	-	-
7.2 Changes during quarter				
(a) Increases through issues	-	-	-	-
(b) Decreases through returns of capital, buy-backs, redemptions				
7.3 +Ordinary securities	609,497,650	609,497,650	Various	Fully Paid
7.4 Changes during quarter				
(a) Issue of shares in relation to a service contract	Nil	Nil	-	-
7.5 +Convertible debt securities (description)	Nil	Nil	-	-
7.6 Changes during quarter				
(a) Increases through issues	-	-	-	-
(b) Decreases through securities matured, converted	-	-	-	-

+ See chapter 19 for defined terms.

Appendix 5B
Mining exploration entity quarterly report

7.7	Options			<i>Exercise price</i>	<i>Expiry date</i>
	Unlisted Options 20c	250,000	-	20c	31/10/2010
	Unlisted Options 20c	125,000	-	20c	01/01/2011
	Unlisted Options 30c	500,000	-	30c	30/06/2011
	Unlisted Options 60c	1,000,000	-	60c	30/06/2011
	Unlisted Options 25c	100,000	-	25c	01/04/2012
	Unlisted Options 40c	205,000	-	40c	01/04/2012
	Unlisted Options 25c	5,000,000	-	25c	10/12/2013
	Unlisted Options 35c	7,000,000	-	35c	10/12/2013
	Unlisted Options 70c	8,000,000	-	70c	10/12/2013
	Unlisted Options 80c	7,250,000	-	80c	10/12/2013
	Unlisted Options 80c	1,000,000	-	80c	22/03/2015
	Unlisted Options \$1.00	10,000,000	-	\$1.00	10/12/2014
	Unlisted Options \$1.20	3,750,000	-	\$1.20	10/12/2013
	Unlisted Options \$1.20	1,000,000	-	\$1.20	22/03/2015
	Unlisted Options \$1.60	3,750,000	-	\$1.60	10/12/2013
	Unlisted Options \$1.60	1,000,000	-	\$1.60	22/03/2015
7.8	Options				
	Issued during quarter	-	-	-	-
7.9	Exercised during quarter Unlisted Employee/Other Options	-	-	-	-
7.10	Expired during quarter Unlisted Employee Options - ceased employment	-	-	-	-
7.11	Debentures (totals only)	Nil	Nil		
7.12	Unsecured notes (totals only)	Nil	Nil		

Compliance statement

- 1 This statement has been prepared under accounting policies which comply with accounting standards as defined in the Corporations Act or other standards acceptable to ASX.
- 2 This statement does give a true and fair view of the matters disclosed.



Sign here:

Date: 29 October 2010

Print name: Prem Nair

Title: **Chief Financial Officer &
Company Secretary**

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+ See chapter 19 for defined terms.