

31 July 2009

QUARTERLY ACTIVITIES REPORT FOR THE PERIOD TO 30 JUNE 2009

The Board of Equatorial Coal Limited (ASX: EQX) provides shareholders with its Quarterly Activities Report for the 3 month period ended 30 June 2009. Also included are subsequent events that have occurred up to the date of the release of this report. The report also provides shareholders with a brief summary of the issues that the Company has been facing with its Indonesian operations as it is these events that have led to the current Voluntary Suspension in trading of EQX securities.

Update on Voluntary Suspension:

As announced to shareholders on 13 July 2009, the Company has placed a Voluntary Suspension on the trading of its securities. The Voluntary Suspension was requested as a result of issues raised by the Company's independent advisors with regards EQX's ability to reopen mining operations at the Alam Duta mine in South Kalimantan. The reopening of Alam Duta had been the cornerstone to EQX's strategy to return the Company to a cash flow positive position, as detailed in the Quarterly Update released to shareholders on 30 April 2009.

Background to the mining of Alam Duta:

In May 2008 EQX entered into a binding terms sheet with PT. Mega Coal Indomine (Mega Coal) pursuant to which EQX would take a 51% interest in the net profits from production of coal from the Alam Duta permit located in the Kabupaten Tanah Laut, Province of South Kalimantan, Indonesia. The permit is held in the company PT. Alam Duta Kalimantan (ADK).




Mega Coal was introduced to EQX by James Dracopoulos (former Managing Director of EQX) and was described to the EQX Board and investors as an organisation, headed by a respected and wealthy Indonesian businessman Nugroho Suksmanto, which had access to a range of coal prospects through Suksmanto and its West Australian expatriate Director Michael Rhodes. It was proposed that Mega Coal could provide a range of coal opportunities to EQX and that EQX, led by the Indonesia based Dracopoulos, would mine these opportunities under terms and conditions outlined in various "Life of Mine" agreements associated with the specific projects. Alam Duta was the first such mine that EQX would take into production.

As part of the due diligence process on the Alam Duta transaction, an independent report on the coal reserves at Alam Duta was required for EQX shareholders and Dracopoulos organised for such a report to be prepared by PT. GMT Indonesia (GMT), an independent consulting firm based in Jakarta. This report concluded that approximately 3.98 million tonnes of coal at a strip ratio of less than 8:1 was within the Alam Duta permit area and that the coal had a minimum calorific value of 5300 GAD (Gross Air Dried). These conclusions were drawn from data obtained from drill holes located within the Alam Duta boundary, as defined by the mapping coordinates detailed in the report and cross checked against the government records supplied by Mega Coal pertaining to confirm the location of the permit.

At around the same time, Dracopoulos recommended the appointment of a mining contractor, PT. GSB Resources (GSB) headed by Australian expatriate Greg Berry, to operate the Alam Duta mine under the supervision of Dracopoulos and his Indonesian based management team.

Initial production was originally estimated to commence in September 2008 but this target was never met and there were ongoing issues with Alam Duta during the second half of 2008. Numerous reports from Dracopoulos and his team blamed the delays on the heavy rainfall in South Kalimantan which was unseasonably high. The rain, it was claimed, had led to delays for GSB in both mining the coal and building the required mine infrastructure including a satisfactory road required to assist in the haulage of coal from the mine site to the nearby port.


In September 2008 Dracopoulos advised the Board that GSB had run into financial difficulties and that there was a need to provide an additional cash injection to them, over and above the initial prepayment that EQX had made when GSB had been hired as the Alam Duta mining contractor in May 2008. Dracopoulos assured the Board that with this additional funding, coal production at Alam Duta would be achieved during the 4th quarter.



Despite this financial rescue, delays in production continued during the fourth quarter of 2008 and in December 2008 it was decided to terminate mining operator GSB and carry out a Board review of the issues facing Alam Duta. On 5 February 2009, operations at the Alam Duta mine site were suspended and Dracopoulos and all his staff employed both at the Alam Duta mine site and in the Jakarta office were terminated. This decision was made for a number of reasons but was principally due to the fact that the conclusion of the Board review was that the existing management team, led by Dracopoulos, did not appear to have the systems and/or team in place to enable Alam Duta to move into economic production in the short term and that a new operator needed to be found and engaged before any further funds were invested by EQX in the mine.

The EQX Board appointed independent advisors to assist in the review of potential new operators for the Alam Duta mine. Numerous discussions were held and a preferred local operator was identified. The EQX Board then asked the independent advisors and the potential new local operator to review the Alam Duta mine site to ensure that moving back into production would provide the economic returns required to satisfy the expectations of all parties.

The EQX Board was provided by its independent advisors, on 9 July 2009, with a written report which outlined the following key findings:

1. The original due diligence report prepared by PT. GMT Indonesia appeared to be erroneous in its conclusions and that the reserve estimate of 3.98m tonnes of coal was based largely data taken from drill holes that appear to have been on land that formed part of an adjoining permit not held by ADK and therefore not part of the Alam Duta mine site. It appears the coordinates used in the PT. GMT Indonesia report were based on false government records and that the real coordinates obtained from legitimate government records show that the area that was drilled was not in fact part of the Alam Duta permit.
 2. There had been a large amount of mining activity already carried out on the Alam Duta permit and, in the opinion of EQX's independent advisors, it was likely that this illegal mining had taken place over the past 12-18 months. As a result of this illegal mining the vast majority of the mineable coal had been removed from the permit and the area had then been backfilled with over burden to disguise the fact that there had been illegal mining taking place.
 3. That some of the illegal mining on the permit had in fact gone over the Alam Duta permit border into the adjoining permit.
 4. That as a result of the illegal mining, it was unlikely that it was economically viable to recommence mining at Alam Duta.
 5. That the Alam Duta permit had no economic coal in place.
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Because of these findings, the local operator withdrew their interest in mining at Alam Duta and the EQX Board requested a Trading Halt (9 July) followed by a Voluntary Suspension of its securities (13 July).

The report and its findings clearly raise a range of potential issues over the conduct of EQX's on ground staff during the period May 2008 to February 2009. EQX staff, headed by Dracopoulos and Alam Duta's mine manager Andrew Kerr, as well as mining operator GSB will be questioned regarding these findings and in particular over the issue of the illegal mining activity that appears to have been taking place whilst, it is claimed from independent advice, EQX management and GSB were on site at Alam Duta during 2008. It is also important to note that one of Mega Coal's responsibilities at the Alam Duta mine during this period was to provide onsite security and in particular to ensure no illegal mining activity was able to take place, so this issue will also need to be further investigated.

The Company has already provided written advice to Dracopoulos covering a range of concerns over his performance during his tenure as Managing Director and advised that these matters will be further investigated. These new findings will now further widen this investigation.

The Company has also already lodged a Statement of Claim against the mining contractor GSB and its President Greg Berry. The Statement of Claim raises a range of questions regarding the use of funds advanced to GSB for the purposes of building infrastructure at the Alam Duta site and questions why this work was not carried out and how the funds were in fact spent by GSB. To date no satisfactory response has been provided by GSB to these questions and the findings of this latest independent report will again serve to widen this investigation into the performance of GSB at Alam Duta.

In addition, the EQX Board has real concerns over the claims made by Mega Coal in relation to the specific location of the Alam Duta permit, and its associated real economic viability, prior to the signing of the Alam Duta Term Sheet in May 2008. There are also concerns that Mega Coal provided EQX with a pledge over 99% of the shares in ADK, the company that holds the Alam Duta permit, as security over a \$US2m refundable deposit whilst being aware that the Alam Duta permit had no real economic value.



Other Issues with Mega Coal:

Whilst the Alam Duta situation was unraveling, EQX had already decided to withdraw from all other potential projects with Mega Coal and had requested the repayment of various deposits that had been made on these projects and were fully refundable under the legal binding terms of the Memorandum of Understandings (MOU's) signed with Mega Coal.

The Mega Coal deposits now total \$US6.5m, and this amount is due for repayment in full. The deposits relate to three specific projects that the Company had contemplated taking into production and that were all subject to successful due diligence. In each case, the results of due diligence did not meet the expectations of the EQX Board and the Company chose to withdraw. Under the terms of each of the MOU's covering the projects, the deposits made by EQX to Mega Coal to secure the right to review the opportunities were fully refundable and repayable within 7 days of EQX notifying Mega Coal of the intent to withdraw from the MOU as a result of unsatisfactory due diligence findings.

The initial deposit amount of \$US2.5 million was due for repayment on 31 December 2008 and to date Mega Coal has neither made the repayment nor has been able to provide any credible guidance on when the monies will be repaid.

The second deposit of \$US2m deposit fell due for repayment on 23 January 2009 and the third deposit of \$US2m fell due for repayment on 12 February 2009. None of these monies have been repaid. Mega Coal has repeatedly acknowledged that all \$US6.5m is due and fully payable and that interest is now accruing on the outstanding amount at an interest rate of 10% per annum. These acknowledgements were confirmed when Mega Coal signed a legally binding document confirming these facts on 26 June 2009.

Despite numerous meetings and discussions with Mega Coal Directors, Nugroho Suksmanto and West Australian expatriate Michael Rhodes, no monies have been forthcoming and the EQX Board is not convinced that any of the claims Mega Coal has made in relation to the short term resolution of this deposit repayment issue are in fact credible.



Summary:

The Board is presently in consultation with the Company's legal advisors in Jakarta and Australia regarding the most appropriate action to take against some or all of the parties referred to in this report.

The Company has also appointed an Indonesian based organization to assist in the area of debt collection.

The Company's securities will remain in Voluntary Suspension until the Board is able to get more clarity on the timing of the recovery of funds from Mega Coal. It is expected that this suspension will be in place for at least another four weeks.

The Equatorial Coal Limited Board

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