



PRESS RELEASE
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CELTIC REPORTS RECORD EARNINGS OF \$11.5 MILLION IN 2004

Celtic Exploration Ltd. ("Celtic" or the "Company") has released its financial and operating results for the three months and twelve months ended December 31, 2004. Highlights are as follows:

(\$ thousands, unless otherwise indicated)	Three months ended December 31,			Twelve months ended December 31,		
	2004	2003	Change	2004	2003	Change
FINANCIAL						
Revenue, net of royalties	\$ 13,086	\$ 7,308	79%	\$ 50,260	\$ 22,430	124%
Funds from operations	\$ 9,559	\$ 4,787	100%	\$ 36,381	\$ 15,314	138%
Funds from operations per share						
Basic (\$/share)	\$ 0.37	\$ 0.19	95%	\$ 1.41	\$ 0.69	104%
Diluted (\$/share)	\$ 0.36	\$ 0.18	100%	\$ 1.37	\$ 0.68	101%
Net earnings	\$ 3,278	\$ 960	241%	\$ 11,501	\$ 4,697	145%
Earnings per share						
Basic (\$/share)	\$ 0.13	\$ 0.04	225%	\$ 0.45	\$ 0.21	114%
Diluted (\$/share)	\$ 0.12	\$ 0.04	200%	\$ 0.43	\$ 0.21	105%
Capital expenditures, net of dispositions	\$ 18,362	\$ 12,533	47%	\$ 55,145	\$ 55,075	0%
Total assets				\$ 135,984	\$ 94,980	43%
Bank debt				\$ 23,400	\$ 3,447	579%
Working capital deficiency, excluding bank debt				\$ 6,673	7,338	-9%
Bank debt, net of working capital				\$ 30,073	\$ 10,785	179%
Shareholders' equity				\$ 76,436	\$ 64,118	19%

	Three months ended December 31,			Twelve months ended December 31,		
	2004	2003	Change	2004	2003	Change
OPERATIONS						
Production						
Oil (bbls/d)	2,142	1,505	42%	2,283	1,055	116%
Natural gas (mcf/d)	8,292	7,324	13%	7,952	5,318	50%
Combined (BOE/d)	3,524	2,726	29%	3,608	1,941	86%
Production per million shares (BOE/d)	136	105	30%	140	87	61%
Realized sales prices						
Oil (\$/bbl)	\$ 53.08	\$ 35.55	49%	\$ 48.71	\$ 36.60	33%
Natural gas(\$/mcf)	\$ 7.13	\$ 5.92	20%	\$ 6.97	\$ 6.80	3%
Combined (\$/BOE)	\$ 49.04	\$ 35.55	38%	\$ 46.15	\$ 38.51	20%
Operating netbacks						
Oil (\$/bbl)	\$ 34.66	\$ 20.85	66%	\$ 31.88	\$ 22.22	43%
Natural gas (\$/mcf)	\$ 4.48	\$ 3.36	33%	\$ 4.11	\$ 4.10	0%
Combined (\$/BOE)	\$ 31.62	\$ 20.54	54%	\$ 29.20	\$ 23.33	25%
Drilling activity – conventional						
Total wells	15	12	25%	53	35	51%
Working interest wells	10.3	10.4	-1%	37.2	23.3	60%
Success rate on working interest wells	76%	100%		84%	84%	
Drilling activity – coal bed methane						
Total wells	4	-	-	14	-	-
Working interest wells	1.1	-	-	4.3	-	-
Success rate on working interest wells	100%	-		100%	-	
Undeveloped land						
Gross acres				204,535	156,312	31%
Net acres				121,204	77,912	56%
Reserves						
Oil (mmbbls)				6,739	4,879	38%
Natural gas (mmcf)				25,872	19,261	34%
Combined (mBOE)				11,051	8,089	37%
Reserve life index (years)				6.2	5.9	

Production

Oil and gas production in 2004 increased 86% to average 3,608 BOE per day compared to 1,941 BOE per day in 2003. Average production in the fourth quarter of 2004 was 3,524 BOE per day. Production per million shares outstanding in 2004 averaged 140 BOE per day, up 61% from 87 BOE per day in 2003.

Revenue

Revenue, after royalties, for the year ended December 31, 2004 was \$50.3 million, an increase of 124% compared to \$22.4 million in the previous year. For the three months ended December 31, 2004, revenue, after royalties, was \$13.1 million, up 79% from the fourth quarter of 2003.

The combined average product price received for oil and gas sales for the year ended December 31, 2004 was \$46.15 per BOE, an increase of 20% compared to the previous year. For the three months ended December 31, 2004, the average product price received was \$49.03 per BOE, up 38% from the average price received in the fourth quarter of 2003.

Oil Operations

Oil production for the year ended December 31, 2004 averaged 2,283 bbls per day, an increase of 116% compared to the previous year. For the three months ended December 31, 2004, average oil production was 2,142 bbls per day, up 42% from the fourth quarter of 2003.

The average price received for oil sales for the year ended December 31, 2004 was \$48.71 per bbl, an increase of 33% compared to the previous year. For the three months ended December 31, 2004, the average oil price received was \$53.08 per bbl, up 49% from the average price received in the fourth quarter of 2003.

For the year ended December 31, 2004, average oil royalties were 16.8% of sales. In the previous year, average oil royalties were 20.7% of sales. Celtic participated in various royalty incentive programs in 2004, resulting in lower royalties for the year.

Transportation and selling expenses for oil production in 2004 averaged \$0.46 per bbl compared to \$0.83 per bbl in 2003. The lower per unit cost in 2004 reflects the larger percentage of oil production that is pipeline connected in contrast to the previous year.

For the year ended December 31, 2004, production expenses were \$8.28 per bbl. In the previous year, production expenses were \$7.33 per bbl.

Natural Gas Operations

Natural gas production for the year ended December 31, 2004 averaged 7,952 mcf per day, an increase of 50% compared to the previous year. For the three months ended December 31, 2004, average natural gas production was 8,292 mcf per day, up 13% from the fourth quarter of 2003.

The average price received for natural gas sales for the year ended December 31, 2004 was \$6.97 per mcf, an increase of 3% compared to the previous year. For the three months ended December 31, 2004, the average natural gas price received was \$7.13 per mcf, up 20% from the average price received in the fourth quarter of 2003.

For the year ended December 31, 2004, average natural gas royalties were 19.5% of sales, compared to 19.0% in the previous year.

Transportation and selling expenses for the year ended December 31, 2004 were relatively unchanged from the previous year at \$0.19 per mcf.

For the year ended December 31, 2004, production expenses were \$1.31 per mcf. In the previous year, production expenses were \$1.22 per mcf.

Interest Expense

The Company has a demand revolving credit facility with a Canadian chartered bank that provides borrowings with interest payable monthly. Borrowing utilizing Bankers' Acceptances is also available under the facility. Interest expense for the year was \$0.5 million at an average rate of 4.2% compared to \$0.2 million at an average rate of 5.1% in 2003.

General and Administrative Expenses

General and administrative expenses for the year ended December 31, 2004 were \$1.6 million or \$1.17 per BOE. General and administrative expenses are reduced by overhead recovered on Company operated properties. In addition, salaries relating to geological and geophysical personnel are capitalized.

Capital Expenditures

Celtic is committed to future growth through its strategy to augment strategic oil and gas acquisitions with exploitation upside, and at the same time, implement a full cycle exploration program. Since the Company began active oil and gas operations in September 2002, Celtic has completed several corporate and property acquisitions in order to establish a cash flow platform and an inventory of exploration and development prospects from which the Company can grow through the drill bit.

In early April 2004, Celtic completed the acquisition of a 79.98% interest in the Morse River Beaverhill Lake oil unit for \$3.4 million. Subsequent to this acquisition, the Company has acquired a 100% interest in an additional 19,000 acres of undeveloped lands offsetting the Morse River unit and has entered into farm-in agreements giving the Company access to an additional 56,000 acres of undeveloped lands in the Morse River and Swan Hills areas.

During the year ended December 31, 2004, in addition to property acquisitions, Celtic spent \$54.5 million on exploration and development activity. Drilling and completion operations accounted for \$35.9 million and equipment and facility expenditures were \$13.4 million. The balance was spent on land and seismic, building the Company's inventory of prospects for future drilling. Approximately 61% of net wells drilled were development and 39% were exploratory.

In 2004, Celtic disposed of certain non-core oil and gas properties for proceeds of \$2.9 million. The Company's capital expenditure program, including acquisitions, is summarized in the following table:

Undeveloped Land

As at December 31, 2004, Celtic's owned net undeveloped land holdings increased by 56% to 121,204 acres compared to 77,913 net acres at the end of 2003. Approximately 12% of the Company's undeveloped land position will expire in 2005, if not developed. Celtic holds an average working interest of 59% in its undeveloped lands.

During the year Celtic advanced its long-term goal of building a large undeveloped land base with high working interests, as inventory for our expanding exploration and development capital programs. Through Crown land sale acquisitions, Celtic acquired 42,405 net acres of new lands in Alberta, at an average cost of approximately \$50 per acre, substantially less than the industry average of \$145 per acre.

In 2004, third party farm-ins continued to be a dominant factor in Celtic's land acquisition strategy. At year-end Celtic had control over 147,000 gross (119,000 net) acres of undeveloped lands through various farm-in arrangements, predominately in three different play-type areas throughout Alberta.

In the Ashmont/Clay area of north eastern Alberta, Celtic secured a farm-in over a large contiguous land base comprising approximately 70,000 gross acres targeting Mannville natural gas opportunities. The farm-in area is in close proximity and complements Celtic's 100% working interest lands that exceed 32,000 net acres. At year-end, four wells had been drilled and cased under the farm-in and another four option wells had been elected for drilling in the first quarter of 2005. Under certain conditions, Celtic can continue to drill option wells until September 1, 2006.

In the Morse River/Swan Hills area of west central Alberta, Celtic secured several farm-ins covering approximately 56,000 gross acres targeting re-entry and "grass-roots" oil drilling opportunities in the Beaverhill Lake formation. Prior to entering into these farm-ins, Celtic established its initial position in the area through the acquisition of approximately 120 BOE/d for a purchase price of \$3.4 million, in the Morse River Unit. Through the acquisition of an approximate 80% operated interest in the unit, Celtic initiated several re-entry opportunities in the Beaverhill Lake formation, followed-up by an aggressive farm-in acquisition strategy. At year-end, one well had been drilled and cased on the farm-in lands, with an additional three to five wells planned for drilling in the first quarter of 2005.

In the Saddle Hills/Valhalla area of north west Alberta, Celtic participated with another third party in a farm-in of approximately 18,000 gross acres targeting Wabamun natural gas opportunities. One well was drilled and cased prior to year-end, and a second well is expected to be drilled in the first quarter of 2005.

As a result of its third party farm-in arrangements Celtic has gained access to significant land bases; providing the Company with a tax-effective method for expanding its land holdings and minimizing the up-front risk seismic and land acquisition capital associated with its drilling programs.

Drilling

During the year ended December 31, 2004, Celtic drilled 67 (41.5 net) wells compared to 35 (23.3 net) wells in the previous year, with an overall success rate of 86% on net wells drilled. The split between development drilling and exploratory drilling was 61% and 39%, respectively. The average depth of net wells drilled was 1,463 metres

Reserves

Celtic retains an independent qualified reserve evaluator to prepare a report on 100% of its oil and gas reserves. The Company has a Reserves Committee which oversees the selection, qualifications and reporting procedures of the

independent engineering consultants. Reserves as at December 31, 2004 and 2003 were determined using the guidelines and definitions set out under National Instrument 51-101 ("NI 51-101").

Proved plus probable reserves, at December 31, 2004, increased by 37% to reach 11.1 million BOE. This compares to 8.1 million BOE, at the same time a year ago. The following table provides a summary of the reconciliation of proved plus probable reserves:

	Oil	Natural Gas	Combined
	MBBLS	MMCF	MBOE
Balance, December 31, 2003	4,879	19,261	8,089
Discoveries	744	7,898	2,060
Drilling extensions	1,336	1,531	1,591
Improved recovery	686	1,584	950
Technical revisions	(613)	(1,808)	(914)
Acquisitions	621	677	734
Dispositions	(78)	(360)	(138)
Production	(836)	(2,911)	(1,321)
Balance, December 31, 2004	6,739	25,872	11,051

During 2004, the Company's capital expenditures, net of dispositions, resulted in proved plus probable reserve additions, after prior year revisions, of 4.3 million BOE, resulting in finding, development and acquisition ("FD&A") costs of \$14.40 per BOE. Prior to revisions, FD&A costs were \$11.87 per BOE. The recycle ratio is a measure for evaluating the effectiveness of a company's re-investment program. The ratio measures the efficiency of capital investment. It accomplishes this by comparing the operating netback per BOE to that year's reserve FD&A cost per BOE. Since incorporation, Celtic has successfully achieved a recycle ratio of 2.4 times on a proved plus probable basis.

Celtic's 2004 capital investment program replaced production by a factor of 2.0 times on a proved basis and 3.2 times on a proved plus probable basis.

Net Asset Value

Celtic's net asset value at December 31, 2004 increased to \$154.0 million, up 48% from \$104.4 million at December 31, 2003. On a per share basis, net asset value increased 46% to \$5.55 per share.

OUTLOOK AND 2005 FORECAST

Celtic is optimistic about its future prospects. The Company was successful in establishing a production base during the early months since commencing operations that provides a cash flow stream that can be re-invested in Celtic's ongoing exploration and development activity. Celtic is opportunity driven and is confident that it can continue to grow the Company's production base by building on its current inventory of development prospects and by adding new exploration prospects. Celtic will endeavour to maintain a high quality product stream that on a historical basis receives a superior price with reasonably low production costs. In addition, the Company takes advantage of royalty incentive programs in order to further increase netbacks. Celtic will continue to focus its exploration efforts in areas of multi-zone potential for light gravity crude oil and liquids-rich natural gas.

Celtic's Board of Directors has approved an initial capital expenditure budget in the amount of \$60 million for 2005. This capital spending will be financed by funds from operations and bank credit lines.

After forecasting risked production discoveries, timing of production on-stream dates resulting from the Company's planned capital expenditures for 2005 and estimated decline rates on existing volumes, Celtic expects production in 2005 to average 5,500 BOE/d (60% oil and 40% gas). This represents a 52% increase from average production of 3,608 BOE/d in 2004.

World oil demand showed resilient growth in 2004. The response in world oil supply has left major oil exporting nations with limited spare productive capacity. As a result, Celtic expects oil prices to remain strong in 2005. In addition, natural gas demand in North America has also expanded in 2004 resulting in record natural gas drilling in Canada and the United States. However, natural gas prices in North America are expected to remain strong until supply increases

significantly with the introduction of additional volumes of liquefied natural gas ("LNG") expected in two to four years. The Company's commodity price assumptions for 2005 are US\$42.00 per barrel for WTI oil, US\$6.00 per MMBTU for natural gas and a US/Canadian exchange rate of US\$0.816. Currently, the Company has no hedges in place for its oil production. Celtic has fixed the price on physical deliveries of 4,000 GJ per day of natural gas production at \$9.19 per GJ. This contract expires on March 31, 2005.

After giving effect to the aforementioned production and commodity price assumptions, funds from operations for 2005 is forecasted to be approximately \$50.1 million or \$1.94 per share (\$1.87 per share, diluted) and net earnings is forecasted to be approximately \$12.8 million or \$0.50 per share (\$0.48 per share, diluted). Changes in forecasted commodity prices can have a significant affect to estimated funds from operations and net earnings.

Bank debt, net of working capital, is estimated to reach \$41.6 million by the end of 2005 or approximately 0.8 times 2005 funds from operations.

Celtic's capital expenditure budget for 2005 will see the Company participate at high working interests in the drilling of approximately 75 wells during the year. Celtic continues to pursue property acquisitions that would complement its existing asset base and completion of such acquisitions would be over and above the Company's planned capital expenditure budget.

Celtic is excited about the growth prospects being generated in the Company and remains optimistic about the Company's ability to deliver continued per share growth in production, funds from operations and earnings. Given the Company's strong financial position, we look forward to continued growth in 2005.

Common shares of the Company trade on the Toronto Stock Exchange under the symbol "CLT". Celtic's unaudited financial statements for the twelve months ended December 31, 2004 are attached to this press release. Additional information relating to Celtic is available on SEDAR at www.sedar.com.

CAUTIONARY STATEMENTS

Funds from operations, which is determined before changes in non-cash working capital, is used in the oil and gas industry as a key measure of performance. Funds from operations, as used by Celtic, does not have a standardized meaning prescribed by Canadian GAAP and therefore may not be comparable with the calculation of similar measures by other companies. Funds from operations, as presented, is not intended to represent operating profits nor should it be viewed as an alternative to cash flow provided by operating activities, net earnings or other measures of financial performance calculated in accordance with GAAP. The Company calculates funds from operations per share using the same method and shares outstanding which are used in the determination of earnings per share.

Where amounts are expressed on a barrel of oil equivalent ("BOE") basis, natural gas volumes have been converted to oil equivalence at six thousand cubic feet per barrel. The term, BOE, may be misleading, particularly if used in isolation. A BOE conversion ratio of six thousand cubic feet per barrel is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. References to oil in this discussion include crude oil and natural gas liquids ("NGLs"). NGLs include condensate, propane, butane and ethane.

Certain information with respect to Celtic contained in this interim report, including management's assessment of future plans and operations, contains forward-looking statements. These forward-looking statements are based on assumptions and are subject to numerous risks and uncertainties, some of which are beyond Celtic's control, including the impact of general economic conditions, industry conditions, volatility of commodity prices, currency exchange rate fluctuations, imprecision of reserve estimates, environmental risks, competition from other explorers, stock market volatility and ability to access sufficient capital. Celtic's actual results, performance or achievement could differ materially from those expressed in, or implied by, these forward-looking statements and, accordingly, no assurance can be given that any events anticipated by the forward-looking statements will transpire or occur. In addition, the reader is cautioned that historical results are not necessarily indicative of future performance.

For further information, please contact:

CELTIC EXPLORATION LTD., Suite 500, 505 - 3rd Street SW, Calgary, Alberta, Canada T2P 3E6

David J. Wilson, President and Chief Executive Officer (403) 201-5340, or
Sadiq H. Lalani, Vice President, Finance and Chief Financial Officer (403) 215-5310.

Or visit our website site at www.celticex.com.

CELTIC EXPLORATION LTD.

BALANCE SHEET

(\$ thousands)	As at December 31, 2004 <i>[Unaudited]</i>	As at December 31, 2003 <i>[Restated - Note 2]</i>
ASSETS		
Current assets		
Cash and cash equivalents	\$62	\$37
Accounts receivable	10,132	6,593
Prepaid expenses	294	19
	10,488	6,649
Other assets	410	204
Property, plant and equipment <i>[Note 3]</i>	125,086	88,127
	\$135,984	\$94,980
LIABILITIES		
Current liabilities		
Accounts payable and accrued liabilities	\$17,161	\$14,191
Bank debt <i>[Note 4]</i>	23,400	3,447
	40,561	17,638
Asset retirement obligation <i>[Note 5]</i>	3,307	2,045
Future income taxes <i>[Note 7b]</i>	15,680	11,179
	\$59,548	\$30,862
SHAREHOLDERS' EQUITY		
Share capital <i>[Note 6]</i>	\$59,446	\$59,211
Contributed surplus	764	182
Retained earnings	16,226	4,725
	\$76,436	\$64,118
	\$135,984	\$94,980

The accompanying notes form an integral part of these financial statements.

CELTIC EXPLORATION LTD.

STATEMENT OF OPERATIONS AND RETAINED EARNINGS

	Three months ended December 31,		Twelve months ended December 31,	
	2004	2003 <i>[Restated - Note 2]</i>	2004	2003 <i>[Restated - Note 2]</i>
(\$ thousands, except per share amounts)	<i>[Unaudited]</i>	<i>[Unaudited]</i>	<i>[Unaudited]</i>	<i>[Unaudited]</i>
Revenue				
Oil and natural gas	\$15,919	\$8,920	\$61,056	\$27,328
Royalties, net	(2,833)	(1,612)	(10,796)	(4,898)
	\$13,086	\$7,308	\$50,260	\$22,430
Expenses				
Production	\$2,545	\$1,928	\$10,727	\$5,188
Transportation and selling	287	226	954	675
Interest	202	23	540	221
General and administrative	416	304	1,550	874
Stock based compensation <i>[Note 6a]</i>	181	42	605	168
Depletion, depreciation and amortization	5,562	3,538	19,557	9,695
Accretion of asset retirement obligation <i>[Note 5]</i>	58	38	195	89
	\$9,251	\$6,099	\$34,128	\$16,910
Earnings before taxes	\$3,835	\$1,209	\$16,132	\$5,520
Capital tax	77	40	108	158
Future income taxes <i>[Note 7a]</i>	480	209	4,523	665
Net earnings	\$3,278	\$960	\$11,501	\$4,697
Retained earnings, beginning of period				
As previously reported	12,948	3,765	4,692	28
Retroactive adjustment for changes in accounting policies	0	0	33	0
As restated <i>[Note 2]</i>	12,948	3,765	4,725	28
Retained earnings, end of period	\$16,226	\$4,725	\$16,226	\$4,725
Earnings per share				
Basic	\$0.13	\$0.04	\$0.45	\$0.21
Diluted	0.12	0.04	0.43	0.21

The accompanying notes form an integral part of these financial statements.

CELTIC EXPLORATION LTD.

STATEMENT OF CASH FLOWS

(\$ thousands)	Three months ended December 31,		Twelve months ended December 31,	
	2004 <i>[Unaudited]</i>	2003 <i>[Restated - Note 2]</i> <i>[Unaudited]</i>	2004 <i>[Unaudited]</i>	2003 <i>[Restated - Note 2]</i> <i>[Unaudited]</i>
Operating activities				
Net earnings	\$3,278	\$960	\$11,501	\$4,697
Items not affecting cash:				
Depletion, depreciation and amortization	5,562	3,538	19,557	9,695
Accretion of asset retirement obligation	58	38	195	89
Stock based compensation	181	42	605	168
Future income taxes	480	209	4,523	665
Funds from operations	\$9,559	\$4,787	\$36,381	\$15,314
Asset retirement expenditures	(325)	(1)	(325)	(18)
Change in non-cash operating working capital <i>[Note 12]</i>	1,602	6,727	(5,703)	4,177
Cash provided by operating activities	\$10,836	\$11,513	\$30,353	\$19,473
Financing activities				
Increase in bank debt	\$5,950	\$797	\$19,953	\$1,897
Issue of common shares, net of costs	38	840	212	32,393
Cash provided by financing activities	\$5,988	\$1,637	\$20,165	\$34,290
Investing activities				
Property and equipment expenditures	(\$18,300)	(\$12,733)	(\$54,475)	(\$31,375)
Property and equipment acquisitions	(62)	110	(3,617)	(23,808)
Property and equipment dispositions	0	90	2,947	108
Change in other assets	(207)	14	(206)	(138)
Change in non-cash investing working capital <i>[Note 12]</i>	1,762	(624)	4,858	527
Cash used in investing activities	(\$16,807)	(\$13,143)	(\$50,493)	(\$54,686)
Net change in cash and cash equivalents	\$17	\$7	\$25	(\$923)
Cash and cash equivalents, beginning of year	45	30	37	960
Cash and cash equivalents, end of year	\$62	\$37	\$62	\$37

The accompanying notes form an integral part of these financial statements.

CELTIC EXPLORATION LTD.

NOTES TO THE FINANCIAL STATEMENTS

For the years ended December 31, 2004 and December 31, 2003 [Unaudited]

(All tabular amounts in thousands, unless otherwise stated)

1. Significant accounting policies

Nature of business and basis of presentation

Celtic Exploration Ltd. ("Celtic" or the "Company") was incorporated under the Business Corporations Act (Alberta) on April 16, 2002 as Desco Exploration Ltd. The Company changed its name to Celtic Exploration Ltd. on September 30, 2002. Celtic is an oil and natural gas exploration, development and production company based in Calgary, Alberta, Canada. The Company's operations are focused in western Canada, primarily in Alberta.

These financial statements are stated in Canadian dollars and have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the period. Actual results could differ from these estimates.

Measurement uncertainty

The amounts recorded for depletion and depreciation of petroleum and natural gas properties and equipment and the provision for asset retirement obligation costs are based on estimates. In addition, the ceiling test calculation is based on estimates of proved reserves, production rates, oil and gas prices, future costs and other relevant assumptions. By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates in future periods could be material.

Joint interests

A portion of the Company's exploration, development and production activities is conducted jointly with others. These financial statements reflect only the Company's proportionate interest in such activities.

Cash and cash equivalents

Cash and cash equivalents include cash on hand, demand deposits and investments in highly liquid money market instruments which are convertible to known amounts of cash in less than three months.

Financial instruments

The fair market value of cash and cash equivalents, receivables, other current assets, payables and bank debt approximate their carrying value. From time to time, the Company may use derivative financial instruments to manage exposure to fluctuations in commodity prices and foreign currency exchange rates. All transactions of this nature entered into by the Company are related to an underlying financial position or to future petroleum and natural gas production. The Company does not use derivative financial instruments for speculative trading purposes.

Property, plant and equipment

The Company follows the full cost method of accounting whereby all costs relating to the exploration and development of petroleum and natural gas reserves are capitalized. Such costs include land acquisition, geological and geophysical, drilling of productive and non-productive wells, production equipment and facilities, carrying costs directly related to unproved properties and costs related to acquisition of petroleum and natural gas assets directly or by means of a business combination. These capitalized costs along with estimated future capital expenditures to be incurred in order to develop proved reserves, are depleted and depreciated on a unit of production basis using estimated proved petroleum and natural gas reserves as evaluated by independent engineers. For purposes of this calculation, petroleum and natural gas reserves are converted to a common unit of measurement on the basis of their relative energy content where six thousand cubic feet of gas equates to one barrel of oil. Costs of acquiring and evaluating unproved properties are excluded from costs subject to depletion and depreciation until it is determined whether proved reserves are attributable to the properties or impairment occurs.

Gains or losses on the disposition of properties are not recognized unless the proceeds on disposition result in a change of 20 percent or more in the depletion rate.

Depreciation of furniture and office equipment is provided using the declining balance method at a rate of 25 percent.

The net amount at which petroleum and natural gas properties are carried is subject to a cost recovery test (the "ceiling test"). Under this test, an estimate is made of the ultimate recoverable amount from undiscounted future net cash flows based on proved reserves, which are determined by using forecasted future prices, plus unproved properties. If the carrying amount exceeds the ultimate recoverable amount, an impairment loss is recognized in net earnings. The impairment loss is limited to the amount by which the carrying amount exceeds: (i) the sum of the fair value of proved and probable reserves; and (ii) the costs of unproved properties that have been subject to a separate impairment test and contain no probable reserves.

Asset retirement obligations

Estimated future costs relating to retirement obligations associated with oil and gas well sites and facilities are recognized as a liability, at fair value. The asset retirement cost, equal to the fair value of the retirement obligation, is capitalized as part of the cost of the related asset. These capitalized costs are amortized on a unit-of-production basis, consistent with depletion and depreciation. The liability is adjusted at each reporting period to reflect the passage of time, with the accretion charged to earnings. Actual costs incurred upon settlement of the obligations are charged against the liability.

Future income taxes

The Company follows the liability method of accounting for income taxes. Temporary differences arising from the differences between the tax basis of an asset or liability and its carrying amount on the balance sheet are used to calculate future income tax assets or liabilities. Future income tax assets or liabilities are calculated using tax rates anticipated to apply in the periods that the temporary differences are expected to reverse.

Flow-through shares

Resource expenditure deductions for income tax purposes related to exploration and development activities funded by flow-through share issues are renounced to investors in accordance with income tax legislation. The estimated tax benefits transferred to shareholders are recorded as a future income tax liability at the time of renunciation and a reduction in share capital.

Revenue recognition

Revenue from the sale of oil and natural gas is recorded when title passes to an external party.

Stock-based compensation

The Company has a stock-based compensation plan. Effective January 1, 2003, the Company prospectively adopted the fair-value method to record compensation expense with respect to stock options granted. The fair value of each option granted is estimated on the date of grant and a provision for the costs is provided for as contributed surplus over the term of the option agreement. The consideration received by the Company on the exercise of share options is recorded as an increase to share capital together with corresponding amounts previously recognized in contributed surplus. Forfeitures are accounted for as they occur which could result in recoveries of the compensation expense.

Per share amounts

Basic per share amounts are calculated using the weighted average number of shares outstanding during the year. Weighted average number of shares is determined by relating the portion of time within the reporting period that common shares have been outstanding to the total time in that period.

Diluted per share amounts are calculated using the treasury stock method which assumes that any proceeds obtained on exercise of share options or other dilutive instruments would be used to purchase common shares at the average market price during the period. The weighted average number of shares outstanding is then adjusted by the net change.

2. Changes in accounting policies and practices

(a) Asset retirement obligations

The Company has retroactively adopted the Canadian accounting standard outlined in the CICA Handbook Section 3110, "Asset Retirement Obligations". This new section requires liability recognition for retirement obligations associated with oil and gas well sites and facilities, at fair value. The asset retirement cost, equal to the fair value of the retirement obligation, is capitalized as part of the cost of the related asset. These capitalized costs are amortized on a unit-of-production basis, consistent with depletion and depreciation.

The Company previously estimated future site restoration and abandonment costs and recorded them into earnings on a unit-of-production basis over the remaining life of proved reserves and accumulated a liability on the Balance Sheet. Prior year financial statements have been restated to reflect the change in accounting treatment. In summary, net earnings for the twelve months ended December 31, 2003 increased by \$0.033 million, property, plant and equipment assets at December 31, 2003 increased by \$1.292 million and liabilities increased by \$1.259 million.

(b) Transportation and selling expenses

The Company has retroactively adopted the accounting practice to classify transportation and selling expenses incurred to bring petroleum and natural gas production to market as an expense on the Statement of Operations. The Company's previous practice was to reduce petroleum and natural gas revenue. This change does not impact earnings. Information provided for prior periods has been reclassified to conform to the presentation adopted in 2004.

3. Property, plant and equipment

At December 31, 2004	Cost	Accumulated depletion, depreciation and amortization	Net book value
Oil and gas properties and equipment	\$ 154,828	\$ 30,096	\$ 124,732
Other assets	479	125	354
	<u>\$ 155,307</u>	<u>\$ 30,221</u>	<u>\$ 125,086</u>

At December 31, 2003	Cost	Accumulated depletion, depreciation and amortization	Net book value
Oil and gas properties and equipment	\$ 98,515	\$ 10,595	\$ 87,920
Other assets	254	47	207
	<u>\$ 98,769</u>	<u>\$ 10,642</u>	<u>\$ 88,127</u>

At December 31, 2004, oil and gas properties with a cost of \$8.5 million (December 31, 2003 - \$6.2 million) relating to undeveloped properties have been excluded from the depletion and depreciation calculation. Future capital costs required to develop proved reserves in the amount of \$4.8 million (2003 - \$1.2 million) are included in the depletion and depreciation calculation.

Celtic does not capitalize any interest or general and administrative expenses that are not directly related to exploration and development activities. In 2004, the Company capitalized \$0.4 million (2003 - \$0.1 million) with respect to employee salaries directly relating to exploration and development activities.

As a result of the ceiling test calculation at December 31, 2004, the Company was not required to record an impairment loss. The forecasted future prices used for the next ten years in the ceiling test evaluation of the Company's proved reserves as at December 31, 2004 were as follows:

	2005	2006	2007	2008	2009
Light/med. oil (\$/bbl)	\$ 48.82	\$ 45.60	\$ 40.06	\$ 35.74	\$ 33.89
Heavy oil (\$/bbl)	38.25	36.70	33.78	32.22	30.50
Pipeline gas (\$/mcf)	7.37	6.84	6.41	5.97	5.65
Solution gas (\$/mcf)	7.46	7.20	6.68	6.16	5.81

	2010	2011	2012	2013	2014
Light/med. oil (\$/bbl)	\$ 34.47	\$ 35.07	\$ 35.61	\$ 37.30	\$ 37.95
Heavy oil (\$/bbl)	30.90	31.17	31.13	31.22	31.76
Pipeline gas (\$/mcf)	5.77	5.89	6.01	6.13	6.27
Solution gas (\$/mcf)	5.95	6.05	6.16	6.36	6.48

Prices escalate at approximately 1.5% thereafter.

4. Bank debt

At December 31	2004	2003
Demand operating loan	\$ 13,400	\$ 3,447
Bankers' acceptances	10,000	-
	\$ 23,400	\$ 3,447

Celtic has a demand revolving credit facility with a Canadian chartered bank. The authorized borrowing amount under this facility is \$46.0 million. Interest is payable monthly for borrowings through direct advances. Interest rates fluctuate based on a pricing grid and range from bank prime to bank prime plus 1.5%, depending upon the Company's then current debt to cash flow ratio of between less than one times to greater than three times. Currently, interest was payable at bank prime. Under the credit facility, borrowings through the use of bankers' acceptances are also available. The Company has a fixed rate bankers' acceptance in the amount of \$10.0 million maturing on May 27, 2005 at an aggregate interest rate of 3.6%. Security is provided for by a floating charge debenture over all assets in the amount of \$75.0 million, general assignment of book debts and a fixed charge on the Company's major producing petroleum and natural gas properties.

Repayments of principal are not required provided that the borrowings under the facility do not exceed the authorized borrowing amount and the Company is in compliance with all covenants, representations and warranties. The credit facility revolves until May 1, 2005, at which time the bank will conduct its annual review.

5. Asset retirement obligation

The following table provides a reconciliation of the carrying amount of the obligation associated with the retirement of oil and gas properties:

At December 31	2004	2003
Asset retirement obligation, beginning of year	\$ 2,045	\$ 947
Liabilities incurred, net of liabilities disposed	1,218	1,027
Liabilities settled	(325)	(18)
Revisions to estimated liabilities	174	-
Accretion expense	195	89
Asset retirement obligation, end of year	\$ 3,307	\$ 2,045

The key assumptions, on which the carrying amount of the asset retirement obligations is based, include a credit-adjusted risk-free rate of 8%. The total undiscounted amount of the estimated cash flows required to settle the obligations was \$7.7 million. The expected timing of payment of the cash flows required to settle the obligations ranges from 4.1 years to 28.3 years.

6. Share capital

Authorized:

Unlimited number of common shares.
Unlimited number of preferred shares.

Issued:

The following table summarizes the changes in common shares outstanding during the years ended December 31, 2003 and December 31, 2004:

	Common Shares	Amount
Balance, December 31, 2002	18,379	\$ 26,043
Issued for cash through private placement	7,000	33,400
Issued for cash on exercise of stock options	391	840
Other issuances	20	59
Share issue costs, after future income taxes	-	(1,131)
Balance, December 31, 2003	25,790	\$ 59,211
Issued for cash on exercise of stock options	45	214
Amount relating to exercised options previously recorded as contributed surplus	-	23
Share issue costs, after future income taxes	-	(2)
Balance, December 31, 2004	25,835	\$ 59,446

(a) Stock options

Celtic has a stock option plan that provides for granting of stock options to directors, officers, employees and consultants. Stock options granted under the stock option plan have a maximum term of five years to expiry. Vesting is determined by the Company's board of directors. However, the majority of the options granted vest equally over a three year period commencing on the first anniversary date of the grant. The exercise price of each stock option granted is determined as the closing market price of the common shares on the Toronto Stock Exchange on the day of grant. Each stock option granted permits the holder to purchase one common share of the Company at the stated exercise price.

The following table summarizes the changes in stock options outstanding during the years ended December 31, 2003 and December 31, 2004:

	Number of Options	Average Exercise Price
Balance, December 31, 2002	1,010	\$ 2.68
Granted	1,094	5.53
Exercised	(392)	2.14
Forfeited	(70)	3.72
Balance, December 31 2003	1,642	\$ 4.66
Granted	436	7.76
Exercised	(45)	4.75
Forfeited	(105)	6.22
Balance, December 31, 2004	1,928	\$ 5.28

Effective January 1, 2003, the Company adopted the fair-value method to record stock based compensation expense with respect to stock options granted. The fair value of each option granted is estimated on the date of grant using the Black-Scholes option pricing model with weighted average assumptions for grants as follows:

	2004	2003
Risk free interest rate	3.19%	3.06%
Expected life (years)	3.0	3.0
Expected volatility	34%	37%
Expected dividend yield	0%	0%

The following table summarizes information regarding stock options outstanding at December 31, 2004:

Range of exercise prices per share	Number of options outstanding	Weighted average term in years	Weighted average exercise price per share for options outstanding	Number of options exercisable	Weighted average exercise price per share for options exercisable
\$ 2.01 to \$ 3.50	578	2.8	\$ 3.02	297	\$ 3.02
\$ 3.51 to \$ 5.00	140	3.1	\$ 4.06	43	4.06
\$ 5.01 to \$ 6.50	779	3.8	\$ 5.79	104	5.71
\$ 6.51 to \$ 8.00	401	4.6	\$ 7.70	-	-
\$ 8.01 to \$ 9.50	30	4.8	\$ 8.65	-	-
Total	1,928	3.6	\$ 5.28	444	\$ 3.75

7. Income taxes

(a) Future income tax expense

The provision for income taxes differs from the expected amount calculated by applying the combined Federal and Provincial corporate income tax rate as a result of the following:

	2004	2003
Earnings before taxes	\$ 16,132	\$ 5,520
Statutory combined federal & provincial income tax rate	38.87%	40.75%
Expected income taxes	6,271	2,249
Increase (decrease) resulting from:		
Non-deductible Crown payments	2,174	1,121
Non-taxable Provincial royalty credits (ARTC)	(168)	(52)
Allowable resource allowance deduction	(2,990)	(1,591)
Benefit relating to changes in future income tax rates	(775)	(1,064)
Other adjustments	11	2
Provision for (recovery of) future income taxes	\$ 4,523	\$ 665

(b) Future income tax liability

The components of future income taxes are as follows:

At December 31	2004	2003
Future income tax liabilities:		
Property, plant and equipment	\$ 17,564	\$ 12,079
Future income tax assets:		
Asset retirement obligation costs	(1,127)	(264)
Stock based compensation costs	(270)	-
Share issue costs	(442)	(636)
Other income tax assets	(45)	-
Future income taxes	\$ 15,680	\$ 11,179

8. Earnings per share

The Company uses the treasury stock method to determine the dilutive effect of stock options and other dilutive instruments. Under this method, only "in-the-money" dilutive instruments impact the calculations in computing diluted earnings per share.

In computing diluted earnings per share, 0.7 million (2003 – 0.3 million) shares were added to the 25.8 million (2003 – 22.1 million) weighted average number of common shares outstanding during the year for the dilutive effect of stock options.

9. Related party transactions

William C. Guinan, a director and corporate secretary of Celtic is a partner of a law firm which provides legal services to the Company. During the year ended December 31, 2004, the Company paid a total of \$0.1 million (2003 - \$0.2 million) to this firm for legal fees and disbursements (including GST). The transactions were recorded at the exchange amount.

10. Commitments

The Company is committed to payments under a rental agreement for office space as follows:

	Amount
2005	\$ 310
2006	163
	<u>\$ 473</u>

Rental leases relating to office space expire between April 30, 2006 and September 30, 2006.

11. Financial instruments and hedging contracts

(a) Fair values of financial assets and liabilities

Financial instruments of the Company consist mainly of cash and cash equivalents, receivables, payables and bank debt. At December 31, 2004 and 2003 there were no significant differences between the carrying amounts reported on the balance sheets and their estimated fair values. From time to time, the Company may use financial hedging instruments to manage exposure to fluctuations in commodity prices and foreign currency exchange rates. At December 31, 2004, Celtic did not have any hedging contracts in place.

(b) Credit risk

The majority of the Company's accounts receivable is in respect of oil and gas operations. Celtic generally extends unsecured credit to these third parties, and therefore, the collection of accounts receivable may be affected by changes in economic or other conditions and may accordingly impact the Company's overall credit risk. Celtic has not experienced any material credit loss in the collection of receivables in 2004 and 2003.

12. Supplemental cash flow information

Changes in non-cash working capital, excluding bank debt:

	2004	2003
Accounts receivable	\$ (3,539)	\$ (4,562)
Prepaid expenses	(275)	37
Accounts payable and accruals	2,969	9,229
Change in non-cash working capital	<u>\$ (845)</u>	<u>\$ 4,704</u>
Relating to:		
Operating activities	\$ (5,703)	\$ 4,177
Investing activities	4,858	527
Change in non-cash working capital	<u>\$ (845)</u>	<u>\$ 4,704</u>

During the year, the Company made the following cash outlays in respect of interest expense and capital taxes:

	2004	2003
Interest expense	\$ 653	\$ 221
Capital tax	246	66