

Celtic



Exploration Ltd.

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2002

	<p>APRIL 16 The Company was incorporated as Desco Exploration Ltd.</p>	<p>JUNE 27 Completed its initial public offering of 1.0 million shares at \$0.25 per share</p>
<p>JULY 8 Common shares commenced trading on the TSX Venture Exchange under the symbol "DSX"</p>	<p>SEPTEMBER 30 The Company completed the following transactions:</p> <ul style="list-style-type: none"> ⌘ David J. Wilson was appointed President and Chief Executive Officer ⌘ completed two private placements issuing 5.0 million shares at \$1.00 per share ⌘ acquired oil and gas assets in the Princess area of Alberta for \$4.1 million ⌘ changed the name of the Company to Celtic Exploration Ltd. 	<p>OCTOBER 7 Common shares commenced trading on the TSX Venture Exchange under the new trading symbol "CLT"</p> <p>OCTOBER 20 Acquired oil assets in the Alderson area of Alberta for \$0.8 million</p>
<p>NOVEMBER 12 Completed an equity offering of 4.0 million common shares at \$3.00 per share by way of private placement</p>	<p>DECEMBER 16 Completed three acquisitions as follows:</p> <ul style="list-style-type: none"> ⌘ acquired Dorchester Energy Inc. for \$17.7 million ⌘ acquired Denim Energy Corp. for \$3.6 million 	<ul style="list-style-type: none"> ⌘ acquired oil and gas assets in the Richdale area of Alberta for \$1.0 million

April 16, 2002 to December 31, 2002

Revenue	\$ 1,269,163
Cash flow from operations	\$ 538,376
Per share (Basic and diluted)	\$ 0.07
Net earnings	\$ 27,698
Per share (Basic and diluted)	\$ 0.00
Total assets	\$ 44,395,143
Bank debt, net of working capital	\$ 3,398,707
Shareholders' equity	\$ 26,083,750
Reserves	
Oil (mbls)	2,071
Natural gas (mmcf)	11,721
Combined (mBOE)	4,025
Reserve life index (years)	7.1
Undeveloped Land	
Gross acres	53,890
Net acres	26,500
Drilling Activity	
Gross wells	7
Net wells	6.2
Success rate	100%



In 2002, Celtic Exploration Ltd. was formed with the objective of building an oil and gas exploration and production company that would be able to flourish in today's ever-changing environment. In the past decade, wild commodity price fluctuations have increased competition for the finite resources. With this in mind, the Company was formulated with a clear-cut yet flexible game plan that allows it to react quickly to the opportunities developing in today's fast-changing environment. Although there are different ways to measure the growth and success of an oil and gas company, the primary objectives of Celtic are to increase net asset value per share and cash flow per share.

Celtic was incorporated in April 2002, as a Capital Pool company and commenced trading on the TSX Venture Exchange ("TSX-V") in July. By the end of July, a qualifying transaction was announced which resulted in the Company completing the acquisition of a 200-barrel-per-day oil property in Princess, Alberta, on September 30, 2002. At the same time, \$5.0 million was raised through two private equity placements. In October, Celtic announced its intention to acquire Dorchester Energy Inc., Denim Energy Corp., and certain assets held by the Richdale Partners group. The resulting acquisitions, which closed in December, were financed with 2.4 million shares and \$9.1 million. The cash component was provided for by completing a private placement of 4.0 million shares at \$3.00 per share in November 2002. Production from the three-way deal totalled 940 BOE/day. During the fourth quarter, the Company also completed the acquisition of an oil property at Alderson, Alberta for \$850,000. This added an additional 40 BOE/day of production.

During the last three months of 2002, Celtic was very active on the operational front, drilling seven gross (6.2 net) wells. At Princess, the Company drilled five wells resulting in four oil wells and one natural gas well. At Kakwa, the Company participated in a natural gas well that came on production prior to year-end. At Twining, the Company drilled a natural gas well. The new wells drilled at Princess were put on stream during the first quarter of 2003.

By the end of 2002, Celtic had developed into a self-sufficient oil and gas company with production of 1,200 BOE/day (56 percent natural gas), a land base of over 25,000 net undeveloped acres, a \$12.0 million line of credit (only \$3.4 million of debt outstanding at year-end) and a core group of entrepreneurial people with proven track records. With this base, Celtic is well positioned to enter 2003 and continue to increase shareholder value by exploring and exploiting its expanding prospect inventory.

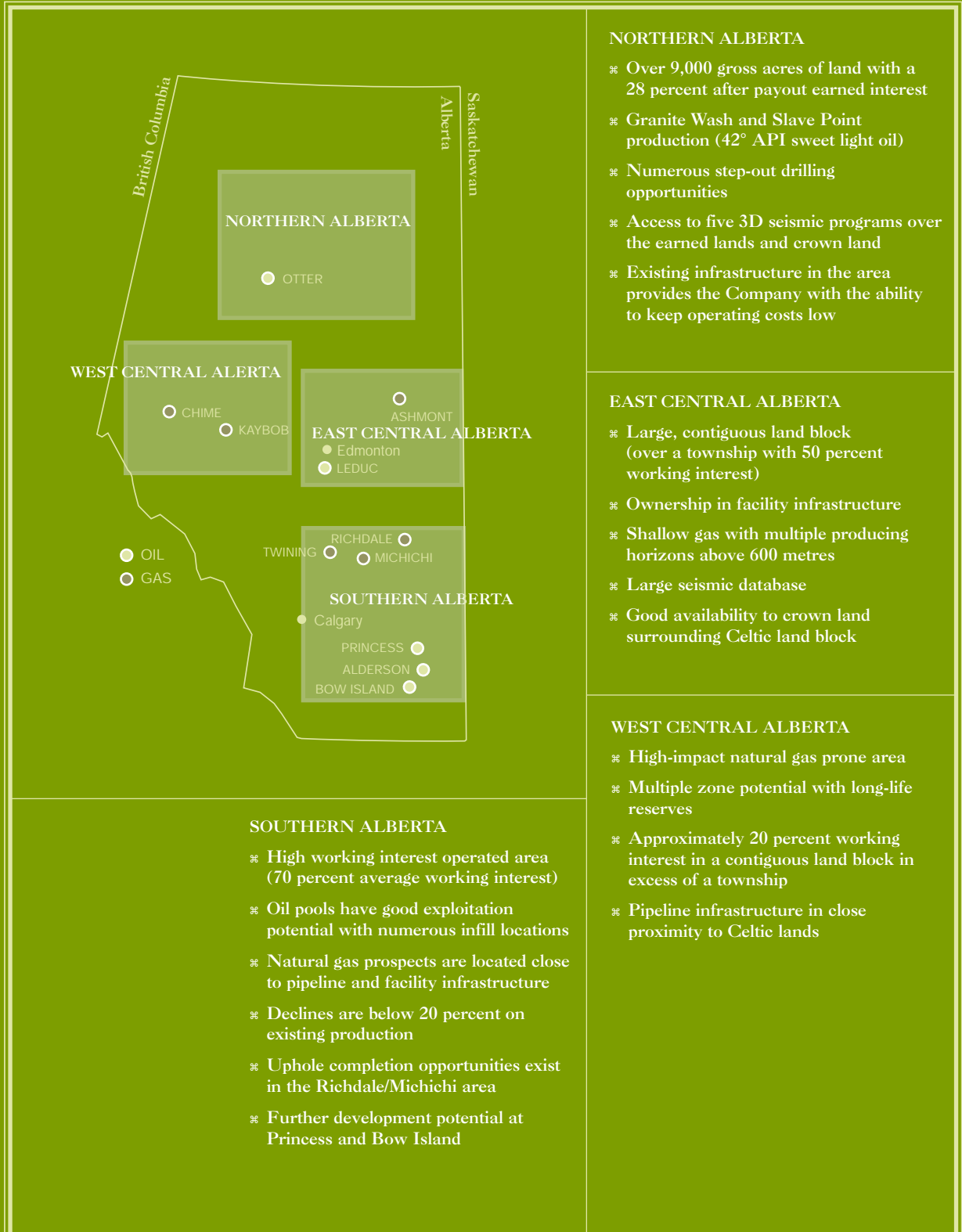
Celtic has set an initial capital budget of \$15.0 million for 2003. However, it has a great deal of flexibility on its balance sheet to increase capital expenditures by adding to the drilling program or through further acquisitions. The current budget will see Celtic drill 27 gross wells (17 net) with approximately 40 percent of the drilling budget going towards exploratory wells. The main focus of the drilling program will be on natural gas, and acquisitions will be made where the Company sees opportunity to exploit existing assets as opposed to buying properties for the sake of increasing production. Finding costs will be a determining factor in Celtic's drilling and acquisition program; however, as stated previously, the main criteria for the program will be to increase cash flow per share and net asset value per share. If these two parameters increase yearly, Celtic shareholders should continue to see their share value increase.

[signed]

David J. Wilson

PRESIDENT & CEO
APRIL 2003

Celtic Exploration Ltd. has a diversified portfolio of high-impact plays augmented by development and exploitation opportunities.



NORTHERN ALBERTA

- ⌘ Over 9,000 gross acres of land with a 28 percent after payout earned interest
- ⌘ Granite Wash and Slave Point production (42° API sweet light oil)
- ⌘ Numerous step-out drilling opportunities
- ⌘ Access to five 3D seismic programs over the earned lands and crown land
- ⌘ Existing infrastructure in the area provides the Company with the ability to keep operating costs low

EAST CENTRAL ALBERTA

- ⌘ Large, contiguous land block (over a township with 50 percent working interest)
- ⌘ Ownership in facility infrastructure
- ⌘ Shallow gas with multiple producing horizons above 600 metres
- ⌘ Large seismic database
- ⌘ Good availability to crown land surrounding Celtic land block

WEST CENTRAL ALBERTA

- ⌘ High-impact natural gas prone area
- ⌘ Multiple zone potential with long-life reserves
- ⌘ Approximately 20 percent working interest in a contiguous land block in excess of a township
- ⌘ Pipeline infrastructure in close proximity to Celtic lands

SOUTHERN ALBERTA

- ⌘ High working interest operated area (70 percent average working interest)
- ⌘ Oil pools have good exploitation potential with numerous infill locations
- ⌘ Natural gas prospects are located close to pipeline and facility infrastructure
- ⌘ Declines are below 20 percent on existing production
- ⌘ Uphole completion opportunities exist in the Richdale/Michichi area
- ⌘ Further development potential at Princess and Bow Island

LAND

As at December 31, 2002, Celtic owned 26,500 net acres of undeveloped land in its core production and exploration areas with an average working interest of 49 percent. Less than two percent will expire in 2003.

A major goal of the Company is to strengthen its undeveloped land base both within its existing core areas and in emerging exploration areas in Alberta. Celtic's land acquisition strategy is prospect driven with emphasis being placed on internally generated opportunities that are in close proximity to infrastructure. Celtic's land acquisition strategy will be primarily accomplished through land sales and farm-in opportunities. Two key objectives in securing third-party farm-ins will be to obtain access to sufficient land bases and adequate 2D or 3D seismic coverage. This affords Celtic the opportunity to pursue post-earning drilling opportunities, thereby enhancing Celtic's overall farm-in cost structure.

As the Company grows, its ultimate objective is to build a large land base of high working interest undeveloped lands, as inventory for its expanding exploration and exploitation capital programs. Celtic aims to operate the majority of its operations, giving the Company control of program expenditures.

LAND HOLDINGS

ACRES	DEVELOPED		UNDEVELOPED		TOTAL	
	GROSS	NET	GROSS	NET	GROSS	NET
Alberta	37,302	16,980	51,000	25,500	88,302	42,480
British Columbia	–	–	2,227	668	2,227	668
Saskatchewan	–	–	663	332	663	332
	37,302	16,980	53,890	26,500	91,192	43,480

DRILLING

During the period ended December 31, 2002, Celtic drilled seven gross (6.2 net) wells. At Princess, the Company drilled four oil wells and one natural gas well. At Kakwa/Chime and at Twining, the Company drilled a natural gas well in each area.

The following table summarizes Celtic's drilling activity in 2002:

	EXPLORATION WELLS		DEVELOPMENT WELLS		TOTAL WELLS	
	GROSS	NET	GROSS	NET	GROSS	NET
Oil	–	–	4	4.0	4	4.0
Gas	3	2.2	–	–	3	2.2
Dry	–	–	–	–	–	–
Total	3	2.2	4	4.0	7	6.2
Success rate	100%	100%	100%	100%	100%	100%
Total metres drilled	5,805	3,373	4,280	4,280	10,085	7,653
Average well depth	1,935	1,505	1,070	1,070	1,441	1,226

PRODUCTION

During the period since incorporation on April 16, 2002 to December 31, 2002, the Company produced 68,502 mcf of natural gas and 23,077 barrels of oil. Realized selling prices were \$5.83 per mcf for natural gas and \$37.28 per barrel for oil.

The Company has grown its production base significantly subsequent to December 31, 2002. Currently, Celtic is producing approximately 1,500 BOE/day, comprising 57 percent natural gas and 43 percent oil.

Note: References to oil in this annual report include oil and natural gas liquids.

RESERVES

The Company successfully added 2.1 million barrels of oil reserves and 11.7 billion cubic feet of natural gas reserves. Total capital expenditures were \$31.1 million, resulting in an acquisition, finding and development cost of \$10.88 per BOE for proved reserves and \$7.66 per BOE for proved plus probable reserves. Finding and development costs for exploration and development expenditures of \$3.9 million were \$7.99 per BOE for proved reserves and \$5.45 per BOE for proved plus probable reserves.

RESERVES RECONCILIATION

	OIL (MMBLS)			NATURAL GAS (MMCF)			COMBINED (MBOE)		
	PDP	TP	P+P	PDP	TP	P+P	PDP	TP	P+P
April 16, 2002	–	–	–	–	–	–	–	–	–
Additions	15	252	310	1,200	1,444	2,469	215	493	722
Acquisitions	1,140	1,261	1,784	4,916	6,635	9,321	1,959	2,367	3,338
Production	(23)	(23)	(23)	(69)	(69)	(69)	(35)	(35)	(35)
December 31, 2002	1,132	1,490	2,071	6,047	8,010	11,721	2,139	2,825	4,025

NOTE: PDP PROVED DEVELOPED PRODUCING
 TP TOTAL PROVEN
 P+P PROVEN PLUS PROBABLE

REFERENCE PRICE FORECASTS

Sproule Associates Limited, January 2003

	CRUDE OIL		NATURAL GAS	
	WTI CUSHING OKLAHOMA (USD/BBL)	EDMONTON PAR PRICE (CAD/BBL)	ALBERTA PLANTGATE (CAD/MMBTU)	NET HENRY HUB (USD/MMBTU)
2003	\$ 25.99	\$ 38.43	\$ 5.72	\$ 4.39
2004	23.60	34.82	5.21	4.05
2005	21.63	32.22	4.60	3.61
2006	21.96	32.78	4.27	3.40
2007	22.29	33.90	4.42	3.45

FINDING AND DEVELOPMENT COSTS

For the period from April 16, 2002 to December 31, 2002

Total capital expenditures	\$ 31,109,460
<i>Reserve additions:</i>	
Proven (BOE)	2,860,000
Cost per BOE	\$ 10.88
Proven plus probable (BOE)	4,060,000
Cost per BOE	\$ 7.66
Exploration and development expenditures	\$ 3,936,414
<i>Reserve additions:</i>	
Proven (BOE)	493,000
Cost per BOE	\$ 7.99
Proven plus probable (BOE)	721,700
Cost per BOE	\$ 5.45

STATEMENT OF CORPORATE GOVERNANCE PRACTICES

The Board of Directors (the “Board”) of Celtic believes that good corporate governance improves corporate performance and benefits all shareholders. In July 2002, Celtic’s common shares were listed for trading on the TSX Venture Exchange (“TSX-V”). The Company is required under TSX-V policy to disclose to its shareholders, on an annual basis, information about its corporate governance practices and processes. In preparing this disclosure, the Company has consulted, as a general reference, the 14 guidelines for effective corporate governance applicable to companies listed on the Toronto Stock Exchange (“TSX”). These guidelines deal with such matters as the constitution and independence of corporate boards, their functions, the effectiveness and education of board members and other items dealing with corporate governance.

RESPONSIBILITIES OF THE BOARD

Celtic’s Board has the statutory responsibility to oversee the conduct of the business of the Company and to supervise management, who are responsible for the daily conduct of the business of the Company. Celtic’s Board is also responsible for establishing the Company’s strategic direction and operating philosophy and then monitoring management’s conduct and performance.

MANDATE OF THE BOARD

The Board has a mandate to oversee the management of the business and affairs of Celtic. The Board reviews the performance of the Company’s major plans and actions, including:

- ⌘ Strategic plans;
- ⌘ Management development and succession;
- ⌘ Business development initiatives;
- ⌘ Integrity of the Company’s internal controls;
- ⌘ Management information systems and systems to identify principal business risks;
- ⌘ Interim and annual financial results and public disclosure; and
- ⌘ Review of the Company’s results of operations, including the evaluation of the general and specific performance of management.

The Board expects management to be responsible for the management of the Company’s day-to-day operations, subject to the Board’s mandate. Management is also expected to fully inform the Board on the business and affairs of the Company, to develop and maintain an effective organization and to ensure management succession. The Board ensures that management develops and maintains a system of internal controls designed to safeguard assets from loss or unauthorized use and to ensure the accuracy of the Company’s financial records.

The Board considers that certain decisions are of sufficient importance that management should seek prior approval of the Board, such as:

- ⌘ The approval of the annual capital and operating budget and any material changes to this budget;
- ⌘ The acquisition or sale of significant oil and natural gas assets;
- ⌘ Significant debt financing;
- ⌘ Changes in management;
- ⌘ All matters as required under the *Business Corporations Act* (Alberta); and
- ⌘ Significant changes in corporate policies, goals or objectives.

The Board meets on a regular quarterly basis and otherwise as required.

COMPOSITION OF THE BOARD

Celtic maintains a policy of having a Board comprised of a majority of independent and unrelated directors.

The Company's Articles provide that the Board is to consist of not fewer than three and not more than 11 members. Currently, the Board is composed of five members who are elected annually by the shareholders. Four members are independent and unrelated directors and one member, the President and Chief Executive Officer of the Company, is a related director.

The Board is presided over by the Chairman, William C. Guinan, an unrelated director. The Board, with the advice of the Corporate Governance Committee, determines whether a majority of the Board is independent and unrelated. The Board has concluded that the number of directors on the Board as presently constituted is appropriate for a company the size of Celtic.

COMMITTEES OF THE BOARD

In order to assist the Board in efficiently carrying out certain of the Board's responsibilities, the Board has established the following four standing committees:

- * Audit Committee
- * Reserves Committee
- * Compensation Committee
- * Corporate Governance Committee

AUDIT COMMITTEE

The *Business Corporations Act* (Alberta) requires that the Company shall have an audit committee which must be composed of not less than three directors, a majority of whom are not officers or employees of the Company. The Company's Audit Committee is comprised of Robert J. Dales, who acts as chairman of the Committee, Eldon A. McIntyre and Neil G. Sinclair. The Audit Committee's responsibilities include reviewing and overseeing the Company's procedures for internal control with the Company's auditors and Chief Financial Officer, as well as: (i) reviewing the engagement of the auditors; (ii) reviewing and recommending to the Board for its approval of annual (and quarterly) financial statements; (iii) assessing the Company's financial and accounting personnel; and (iv) reviewing any significant transactions and any pending litigation involving the Company. The Audit Committee has direct communication channels with the Chief Financial Officer of the Company, as well as with the external auditors of the Company to discuss and review specific issues as appropriate.

RESERVES COMMITTEE

The Reserves Committee is composed of two unrelated directors, Eldon A. McIntyre and Robert J. Dales, and one director from management, David J. Wilson, who acts as chairman of the Committee. Each of these directors has an extensive and diverse background in oil and gas operations. The Committee meets with the Company's independent reserves evaluation engineers, at least annually, to discuss the evaluation of Celtic's reserves.

COMPENSATION COMMITTEE

The Board has established a Compensation Committee consisting of three directors, namely, Neil G. Sinclair, who acts as chairman of the Committee, Robert J. Dales and William C. Guinan. The Compensation Committee will have general responsibility for the Company's human resources and compensation policies. The Compensation Committee will have primary responsibility for: (i) administering the Company's stock option plan; (ii) assessing the performance of the President and Chief Executive Officer of the Company; (iii) reviewing and approving the compensation of

senior management and consultants of the Company; and (iv) reviewing and approving any and all compensation or incentive programs of the Company.

CORPORATE GOVERNANCE COMMITTEE

The Board has established a Corporate Governance Committee consisting of three directors, namely, William C. Guinan, who acts as chairman of the Committee, Robert J. Dales and David J. Wilson. In addition to developing the Company's approach to corporate governance and generally having responsibility for the Company's corporate governance policies, the Corporate Governance Committee will have primary responsibility for: (i) assessing the effectiveness of the Board of Directors; (ii) considering questions of management succession; (iii) participating in the recruitment and selection of candidates to serve as directors of the Company; (iv) organizing an orientation and education program for new recruits to the Board of Directors; and (v) considering and approving proposals by the directors of the Company to engage outside advisors on behalf of the Board of Directors as a whole or on behalf of the independent directors of the Company.

RESPONSIBILITIES OF MANAGEMENT

Management is responsible for the development of overall strategy and the preparation and implementation of related business plans. The role of the Board is to review and ultimately approve the strategies and plans for Celtic. The Board relies significantly on the information and analysis provided by management. It has confidence in management's skills and administrative abilities.

Celtic's corporate governance system is discussed below with specific reference to each of the TSX's 14 guidelines for effective corporate governance. Where Celtic's corporate governance system is different from any of the guidelines or where the guidelines do not apply to Celtic's corporate governance system, Celtic has explained the differences or the inapplicability of the guidelines to Celtic.

CORPORATE GOVERNANCE GUIDELINES

1) **The Board of the Company should explicitly assume responsibility for the stewardship of the Company and specifically for:**

a) **Adoption of a strategic planning process.**

YES, CELTIC ALIGNS WITH THIS GUIDELINE.

Comments: Management is responsible for the development of overall corporate strategies. These strategies are reviewed and approved annually by the Board.

b) **Identification of principal risks and ensuring implementation of appropriate risk managing systems.**

YES, CELTIC ALIGNS WITH THIS GUIDELINE.

Comments: The Board reviews the principal risks of Celtic's business on an ongoing basis and management's recommendations for managing such risks. The Board's participation in the strategic planning process and the approval of the capital and budget involves the identification and consideration of the principal risks of Celtic's business. Specific risk and risk management is also addressed by the Audit and Reserves Committees.

c) **Succession planning including appointment, training and monitoring senior management.**

YES, CELTIC ALIGNS WITH THIS GUIDELINE.

Comments: The Compensation Committee is responsible for reviewing the compensation of senior management of Celtic and for making recommendations to the Board on such matters as management organization and succession plans.

d) Communications policy.

YES, CELTIC ALIGNS WITH THIS GUIDELINE.

Comments: The Board's mandate includes ensuring that systems are in place for open, accurate and timely communication with its shareholders, regulatory agencies and other stakeholders. This communication includes annual reports, quarterly reports, press releases and group meetings.

2) Majority of directors should be unrelated (independent from management and free from conflicting interest).

YES, CELTIC ALIGNS WITH THIS GUIDELINE.

Comments: All members of the Board are unrelated directors other than the President and Chief Executive Officer of the Company. Celtic has adopted a policy that the majority of the directors should be independent and unrelated.

3) Disclose which directors are related

YES, CELTIC ALIGNS WITH THIS GUIDELINE.

Comments: Other than the President and Chief Executive Officer, no members of the Board are related directors.

4) Appoint a committee responsible for appointment and assessment of directors composed of outside directors the majority of whom are unrelated.

NO, CELTIC DOES NOT ALIGN WITH THIS GUIDELINE.

Comments: The Board has not established a committee to recruit and assess the performance of directors. These functions are the responsibility of the Board as a whole.

5) Implement a process for assessing the effectiveness of the Board, its committees and the contribution of individual directors.

YES, CELTIC ALIGNS WITH THIS GUIDELINE.

Comments: The Board is carefully chosen based on the experience and reputation of its nominees. Board members are assessed on similar standards of conduct and performance used in evaluating employees of Celtic.

6) Provide orientation and education programs for new directors.

YES, CELTIC ALIGNS WITH THIS GUIDELINE.

Comments: All directors receive an orientation with respect to Board operations and their duties and obligations as directors prior to assuming their Board duties; however, there is no formal education program presently available for new directors.

7) Review the size of the Board and its effectiveness in making decisions.

YES, CELTIC ALIGNS WITH THIS GUIDELINE.

Comments: The Board consists of five members, a size that requires the full participation of all Board members in committees and in the decision-making process. Given the size of Celtic, the current size and representation of the Board is large enough to permit a diversity of views and to effectively carry out the governance duties and responsibilities of the Board.

8) Review the compensation of the directors and whether it reflects the risks and responsibilities involved in being an effective director.

YES, CELTIC ALIGNS WITH THIS GUIDELINE.

Comments: The mandate of the Compensation Committee includes reviewing and recommending Board compensation.

- 9) **Committees should generally be composed of outside directors, a majority of whom are unrelated directors.**

YES, CELTIC ALIGNS WITH THIS GUIDELINE.

Comments: All of the Board committees are comprised of a majority of outside and unrelated directors. The Audit and Compensation Committees are composed entirely of outside and unrelated directors.

- 10) **Appoint a committee responsible for developing the Company's approach to corporate governance issues.**

YES, CELTIC ALIGNS WITH THIS GUIDELINE.

Comments: The Corporate Governance Committee is responsible for the response and approach to corporate governance issues.

- 11) a) **Define the limits of management's responsibilities by developing mandates for the Board and the CEO.**

YES, CELTIC ALIGNS WITH THIS GUIDELINE.

Comments: The Board has plenary power to manage and supervise the management of the business and affairs of Celtic. The Board established and approved the duties and responsibilities that have been delegated to senior management. Management operates within the parameters established annually by the operating and capital budget.

- b) **The Board should approve the CEO's corporate objectives.**

YES, CELTIC ALIGNS WITH THIS GUIDELINE.

Comments: The Board approves the CEO's corporate objectives on an annual basis.

- 12) **Adopt structures and procedures to ensure that the Board can function independently of management.**

YES, CELTIC ALIGNS WITH THIS GUIDELINE.

Comments: The Board and its committees meet independently of management when warranted. The Board expects management to be responsible for the day-to-day operations of Celtic's business. This includes an ongoing review of Celtic's strategies and their implementation in light of changing business market and competitive conditions, complete and accurate reporting to shareholders; comprehensive annual budgeting process and monitoring financial performance against the budget; and the timely response to any legal actions or changes in any government regulations concerning Celtic's activities. The Board appointed William C. Guinan, an unrelated director, as Chairman of the Board. Mr. Guinan also acts as Corporate Secretary of the Company.

- 13) **Establish an audit committee with a specifically defined mandate, and comprised only of outside directors.**

YES, CELTIC ALIGNS WITH THIS GUIDELINE.

Comments: All of the members of the Audit Committee are unrelated directors. The mandate of the Audit Committee includes overall responsibility for financial statements and related disclosure, reports to shareholders and other related communications, meeting with the external auditors independently of management and the establishment of appropriate financial controls and policies to ensure the integrity of the accounting systems. These matters include ongoing reviews with Celtic's auditors including the scope of the audit and quarterly reviews and the role and fees of external auditors.

- 14) **Implement a system to enable individual directors to engage outside advisors at the Company's expense.**

YES, CELTIC ALIGNS WITH THIS GUIDELINE.

Comments: Any member of the Board is entitled to engage an outside advisor at the expense of Celtic, in appropriate circumstances and with the approval of the Chairman of the Board or the appropriate committee of the Board.

The following discussion and analysis of financial results should be read in conjunction with Celtic's audited financial statements for the period from April 16, 2002 to December 31, 2002 included in this annual report.

Certain information provided herein is based on assumptions regarding future events and is subject to risks and uncertainties that may cause actual results to vary materially from estimates. Where amounts are expressed on a barrel of oil equivalent basis, natural gas volumes have been converted to oil equivalence at six thousand cubic feet per barrel. References to oil in this discussion include crude oil and natural gas liquids ("NGLs"). NGLs include condensate, propane, butane and ethane.

RESULTS OF OPERATIONS

The Company was incorporated on April 16, 2002 as Desco Exploration Ltd. and completed its initial public offering on June 27, 2002. On September 30, 2002, the Company changed its name to Celtic Exploration Ltd. Celtic's head office is based in Calgary, Alberta, Canada. Common shares of the Company were listed and posted for trading on the TSX Venture Exchange on July 8, 2002 under the symbol "DSX." On October 7, 2002, Celtic's shares began trading under the symbol "CLT."

Revenue

Revenue for the period ended December 31, 2002 was \$1,057,523. The breakdown of revenue is summarized in the following table:

REVENUE	
<i>For the period from April 16, 2002 to December 31, 2002</i>	
Oil revenue	\$ 860,932
Natural gas revenue	408,231
Royalties	(242,146)
	1,027,017
Other	30,506
Revenue	\$ 1,057,523

Oil Operations

During the period since incorporation on April 16, 2002 to December 31, 2002, Celtic produced 23,077 barrels of oil, realizing an average price of \$37.28 per barrel. Average royalties were 20.6 percent of sales and production expenses were \$10.20 per barrel.

OIL NETBACK

<i>For the period from April 16, 2002 to December 31, 2002 (\$/bbl)</i>	
Production (bbls/d)	89
Sales price	\$ 37.28
Other revenue	0.03
Royalties	(7.70)
Production expense	(10.20)
Oil netback	\$ 19.41

Natural Gas Operations

During the period ended December 31, 2002, the Company produced 68,502 thousand cubic feet of natural gas, realizing an average price of \$5.83 per thousand cubic feet. Average royalties were 16.2 percent of sales and production expenses were \$1.80 per thousand cubic feet.

NATURAL GAS NETBACK

For the period from April 16, 2002 to December 31, 2002 (\$/mcf)

Production (mcf/d)		264
Sales price	\$	5.83
Other revenue		0.13
Royalties		(0.94)
Production expense		(1.80)
Natural gas netback	\$	3.22

General and Administrative Expenses

General and administrative expenses for 2002 were \$160,758. General and administrative expenses are reduced by overhead recovered on Company-operated properties. The following table provides a breakdown of general and administrative expenses:

GENERAL AND ADMINISTRATIVE EXPENSES

For the period from April 16, 2002 to December 31, 2002

General and administrative expenses before recoveries	\$	206,635
Overhead recoveries		
Capital		(45,877)
General and administrative expenses	\$	160,758
Employees as at December 31		
Head office		9
Field operations		–
Total		9

Interest Expenses

The Company's demand revolving credit facility provides borrowings with interest payable monthly at bank prime plus 0.125 percent and through utilization of Bankers' Acceptances at a stamping fee of 1.25 percent. Interest expense for the period ended December 31, 2002 was \$13,888.

Depletion and Depreciation

The Company follows the full-cost method of accounting whereby all costs relating to the exploration and development of oil and gas reserves are capitalized. 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 oil and gas reserves as evaluated by independent engineers. Depreciation of furniture and office equipment is provided using the declining-balance method based upon estimated useful lives at rates of 15 percent to 35 percent. Estimated future costs relating to site restoration and abandonment are provided for over the life of proved reserves on a unit-of-production basis and the provision is included in depletion and depreciation.

Depletion and depreciation expense for the period ended December 31, 2002 was \$503,060. The following table provides a summary of the amounts included in depletion and depreciation:

DEPLETION AND DEPRECIATION

For the period from April 16, 2002 to December 31, 2002

Depletion – intangible P&NG assets	\$ 388,791
Depreciation – tangible P&NG assets	97,198
Depreciation – other assets	4,937
Future site restoration provision	12,134
Depletion and depreciation	\$ 503,060

Income Taxes

For the period ended December 31, 2002, Celtic recorded a recovery of future income taxes of \$6,382. This amount differs from the expected provision for income taxes of \$9,006 based on the statutory combined income tax rate of 42.25 percent due to the differences between the resource allowance deduction and non-deductible Crown charges. An analysis of the income tax provision is included in the notes to the financial statements.

At December 31, 2002, Celtic had unused income tax deductions available totalling \$13.7 million. A summary of these deductions with corresponding rate of deductibility is shown in the table below:

INCOME TAX DEDUCTIONS

At December 31, 2002

Canadian oil and gas property expense	\$ 6,900,000	10%
Canadian development expense	2,800,000	30%
Canadian exploration expense	600,000	100%
Undepreciated capital cost	3,100,000	4% to 30%
Share issue costs	300,000	5 years
Total	\$ 13,700,000	

Net Earnings and Cash Flow from Operations

Net earnings for the period ended December 31, 2002 were \$27,698 (\$0.00 per share, basic and diluted). During the same period, cash flow from operations was \$538,376 (\$0.07 per share, basic and diluted).

The following table provides detailed unit statistics on a barrel of oil equivalent basis:

UNIT STATISTICS

For the period from April 16, 2002 to December 31, 2002 (\$/BOE)

Production (BOE/d)	133
Sales price	\$ 36.50
Other revenue	0.29
Royalties	(7.02)
Production expense	(10.39)
Operating netback	19.38
General and administrative expense	(4.25)
Interest expense	(0.40)
Other revenue	0.88
Cash flow from operations	15.61
Depletion and depreciation	(14.59)
Compensation costs	(0.41)
Future income tax	0.19
Net earnings	\$ 0.80

Capital Expenditures

Celtic is committed to future growth through its strategy to augment strategic oil and gas asset acquisitions with exploration and development drilling activity. During its first year of operations, the Company completed several corporate and property acquisitions in order to establish a cash flow platform from which Celtic can grow through the drill bit.

On September 30, 2002, Celtic acquired certain oil and gas assets in the Princess area of Alberta for \$4.1 million. This acquisition was financed by a cash payment of \$1.5 million and issuance of equity valued at \$2.6 million. On October 20, 2002, the Company acquired certain oil assets located in the Alderson area of Alberta for \$0.8 million, financed wholly by cash. On December 16, 2002, Celtic completed the acquisition of mostly natural gas assets in the Richdale area of Alberta for \$1.0 million. This acquisition was financed by a cash payment of \$0.7 million and issuance of equity valued at \$0.3 million.

Celtic completed two corporate acquisitions on December 16, 2002. The Company acquired Dorchester Energy Inc. ("Dorchester"), a publicly traded company involved in the exploration, development and production of oil and gas, primarily in southern Alberta. The aggregate cost to acquire Dorchester, after transaction costs, was \$17.7 million, made up of a cash payment of \$5.9 million, issuance of equity valued at \$5.5 million and assumption of bank debt, net of working capital of \$6.3 million. Subsequent to the acquisition and prior to December 31, 2002, Celtic paid the entire amount of Dorchester's bank indebtedness from its cash resources. In addition, on December 16, 2002, Celtic also completed the acquisition of Denim Energy Corp. ("Denim"), a private company involved in the exploration, development and production of oil and gas in southern Alberta. The aggregate cost to acquire Denim, after transaction costs, was \$3.6 million, made up of a cash payment of \$2.4 million and issuance of equity valued at \$1.2 million.

During the period ended December 31, 2002, in addition to property and corporate acquisitions, Celtic spent \$3.9 million on mostly exploration and development activity. The Company drilled seven gross (6.2 net) wells resulting in four oil wells and three natural gas wells.

The Company's capital expenditure program, including acquisitions, is summarized in the following table:

CAPITAL EXPENDITURES

For the period from April 16, 2002 to December 31, 2002

Property and equipment expenditures	
Lease acquisitions and retention	\$ 295,314
Geological and geophysical activity	112,236
Drilling and completion of wells	2,688,445
Facilities and equipment	761,419
Office furniture and equipment	79,000
	<hr/>
	3,936,414
Property and equipment acquisitions	5,906,883
Corporate acquisitions	21,266,163
Capital expenditures	<hr/>
	\$ 31,109,460

LIQUIDITY AND CAPITAL RESOURCES

Funding for capital expenditures in 2002 was primarily provided by new equity issues and bank debt. Celtic completed several equity offerings during the period from April 16, 2002 to December 31, 2002. The Company issued 3.0 million common shares on incorporation for gross cash proceeds of \$450,000. On June 27, 2002, the Company issued 1.0 million shares through an initial public offering for gross proceeds of \$250,000. Celtic completed two private placement equity offerings on September 30, 2002. In one, the Company issued 2.0 million common shares for gross proceeds of \$2.0 million and in the other, Celtic issued 3.0 million common shares on a flow-through basis for gross proceeds of \$3.0 million. On November 12, 2002, the Company completed another private equity placement resulting in the issuance of 4.0 million shares for gross proceeds of \$12.0 million. Celtic issued an aggregate of 5.0 million shares with a deemed value of \$9.7 million towards payment for various property and corporate acquisitions discussed in greater detail earlier. During the year, an aggregate 375,000 shares were issued upon exercise of stock options for proceeds to the Company of \$93,750. In summary, Celtic raised an aggregate \$27.5 million in new equity, before issue costs.

The Company has put in place a revolving demand loan facility with a Canadian chartered bank. The maximum amount available to be drawn under this facility is \$12.0 million. At December 31, 2002, Celtic had drawn \$1.6 million, leaving significant unused credit lines available.

Celtic expects to fund future capital expenditures through the use of a combination of cash flow from operations and bank debt, supplemented by new equity financings, as required.

BUSINESS RISKS

Celtic's exploration and production activities are concentrated in the Western Canadian Sedimentary Basin, where activity is highly competitive and includes a variety of different-sized companies ranging from smaller junior producers to the much larger integrated petroleum companies. Celtic is subject to a number of risks which are also common to other organizations involved in the oil and gas industry. Such risks include finding and developing oil and gas reserves at economic costs, estimating amounts of recoverable reserves, production of oil and gas in commercial quantities, marketability of oil and gas produced, fluctuations in commodity prices, financial and liquidity risks and environmental and safety risks.

In order to reduce exploration risk, Celtic employs highly qualified and motivated professional employees who have demonstrated the ability to generate quality proprietary geological and geophysical prospects. To maximize drilling success, Celtic explores in areas that afford multi-zone prospect potential, targeting a range of shallower low- to moderate-risk prospects with some exposure to select deeper high-risk prospects with high-reward opportunities.

Celtic has retained an independent engineering consulting firm that assists the Company in evaluating recoverable amounts of oil and gas reserves. Values of recoverable reserves are based on a number of variable factors and assumptions such as commodity prices, projected production, future production costs and government regulation. Such estimates may vary from actual results.

The Company mitigates its risk related to producing hydrocarbons through the utilization of the most advanced technology and information systems. In addition, Celtic strives to operate the majority of its prospects, thereby maintaining operational control. The Company does rely on its partners in jointly owned properties that Celtic does not operate.

Celtic is exposed to market risk to the extent that the demand for oil and gas produced by the Company exists within Canada and the United States. External factors beyond the Company's control may affect the marketability of oil and gas produced. These factors include commodity prices and variations in the Canada-United States currency exchange rate, which in turn respond to economic and political circumstances throughout the world. Oil prices are affected by worldwide supply and demand fundamentals, while natural gas prices are affected by North American supply and demand fundamentals. Celtic may periodically use futures and options contracts to hedge its exposure against the potential adverse impact of commodity price volatility.

Exploration and production of oil and gas are very capital intensive. As a result, the Company relies on equity markets as a source of new capital. In addition, Celtic utilizes bank financing to support ongoing capital investment. Cash flow from operations also provides Celtic with capital required to grow its business. Equity and debt capital are subject to market conditions and availability may increase or decrease from time to time. Cash flow from operations also fluctuates with changing commodity prices.

Oil and gas exploration and production can involve environmental risks such as pollution of the environment and destruction of natural habitat, as well as safety risks such as personal injury. The Company conducts its operations with high standards in order to protect the environment and the general public. Celtic maintains current insurance coverage for comprehensive and general liability as well as limited pollution liability. The amount and terms of this insurance are reviewed on an ongoing basis and adjusted as necessary to reflect current corporate requirements, as well as industry standards and government regulations.

BUSINESS PROSPECTS

Celtic is optimistic about its future prospects. The Company was successful in establishing a production base during its first year of 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 grow the Company's production base by adding new core areas to its inventory of 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 doing so, the Company will continue to focus its exploration efforts in areas of multi-zone potential for light gravity crude oil and liquids-rich natural gas. Given the Company's strong financial position, we look forward to continued growth in 2003.

Management has prepared the accompanying financial statements of Celtic Exploration Ltd. in accordance with Canadian generally accepted accounting principles. Financial information presented throughout this Annual Report is consistent with that shown in the financial statements.

Management is responsible for the integrity of the financial information. Where appropriate, management has made informed judgements and estimates in accounting for transactions which affect the current accounting period but cannot be finalized with certainty until future periods. Internal control systems are designed and maintained to provide reasonable assurance that assets are safeguarded from loss or unauthorized use and to produce reliable accounting records for financial reporting purposes.

PricewaterhouseCoopers LLP was appointed by the Company's shareholders to perform an examination of the corporate and accounting records so as to express an opinion on the financial statements. Their examination included a review and evaluation of Celtic's internal control systems and included such tests and procedures, as they considered necessary, to provide reasonable assurance that the financial statements are presented fairly in accordance with Canadian generally accepted accounting principles.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal control. The Board exercises this responsibility with the assistance of the Audit Committee. This Committee, consisting of non-management directors, meets with management and independent auditors to ensure that each group is properly discharging its responsibilities and to discuss adequacy of internal controls, accounting policies and financial reporting matters. The Audit Committee has reviewed the financial statements and has reported thereon to the Board of Directors. The Board has approved the financial statements for issuance to the shareholders.

[signed]

David J. Wilson

PRESIDENT AND CHIEF EXECUTIVE OFFICER

[signed]

Sadiq H. Lalani

VICE PRESIDENT, FINANCE AND CHIEF FINANCIAL OFFICER

AUDITORS' REPORT

March 21, 2003

To the Shareholders of Celtic Exploration Ltd.

We have audited the balance sheet of Celtic Exploration Ltd. as at December 31, 2002 and the statements of operations and retained earnings and cash flows for the period from April 16, 2002 to December 31, 2002. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the company as at December 31, 2002 and the results of its operations and its cash flows for the period from April 16, 2002 to December 31, 2002 in accordance with Canadian generally accepted accounting principles.

[signed]

CHARTERED ACCOUNTANTS

CELTIC EXPLORATION LTD.
CONSOLIDATED BALANCE SHEET

As at December 31

2002

ASSETS

Current assets

Cash and cash equivalents	\$ 960,018
Accounts receivable	2,031,207
Prepaid expenses	55,968
Other	66,000

3,113,193

Property and equipment [NOTE 4] 41,245,950

\$ 44,359,143

LIABILITIES

Current liabilities

Accounts payable and accrued liabilities	\$ 4,961,900
Bank debt [NOTE 5]	1,550,000

6,511,900

Future site restoration costs 473,632

Future income taxes [NOTE 7] 11,289,861

18,275,393

SHAREHOLDERS' EQUITY

Share capital [NOTE 6] 26,056,052

Retained earnings 27,698

26,083,750

\$ 44,359,143

See accompanying notes to the financial statements.

On behalf of the Board of Directors:

[signed]

[signed]

DIRECTOR

DIRECTOR

CONSOLIDATED STATEMENT OF OPERATIONS AND RETAINED EARNINGS

For the period from April 16, 2002 to December 31, 2002

<i>Revenue</i>	
Petroleum and natural gas	\$ 1,269,163
Royalties	(242,146)
	1,027,017
Other	30,506
	1,057,523
<i>Expenses</i>	
Production	358,501
General and administrative	160,758
Interest	13,888
Depletion and depreciation [NOTE 4]	503,060
	1,036,207
<i>Earnings before income taxes</i>	21,316
Future income taxes [NOTE 7]	(6,382)
<i>Net earnings</i>	27,698
<i>Retained earnings, beginning of period</i>	-
<i>Retained earnings, end of period</i>	\$ 27,698
<i>Earnings per common share</i>	
Basic [NOTE 8]	\$ -
Diluted [NOTE 8]	\$ -

See accompanying notes to the financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS

For the period from April 16, 2002 to December 31, 2002

Cash provided by (used in):

Operating activities

Net earnings	\$ 27,698
Items not affecting cash:	
Depletion and depreciation [NOTE 4]	503,060
Stock-based compensation costs	14,000
Future income taxes [NOTE 7]	(6,382)
<i>Cash flow from operations</i>	538,376
Change in non-cash working capital	(2,981,001)
	(2,442,625)

Financing activities

Increase in bank debt	1,550,000
Issue of common shares, net of costs	17,461,559
	19,011,559

Investing activities

Corporate acquisitions [Note 3 (a)]	(8,389,197)
Property and equipment acquisitions [Note 3 (b)]	(2,953,316)
Property and equipment expenditures	(3,936,414)
Change in non-cash working capital	(329,989)
	(15,608,916)

Increase in cash \$ 960,018

Cash, beginning of period –

Cash, end of period \$ 960,018

See accompanying notes to the financial statements.

CELTIC EXPLORATION LTD.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the period from April 16, 2002 to December 31, 2002

1. INCORPORATION

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.

2. SIGNIFICANT ACCOUNTING POLICIES

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles within the framework of the accounting policies summarized below:

(a) Measurement uncertainty

The amounts recorded for depletion and depreciation of petroleum and natural gas properties and equipment and the provision for future site restoration and abandonment 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 significant.

(b) Property 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 based upon estimated useful lives at rates of 15 percent to 35 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 future net revenues using proved reserves and reporting period-end prices, plus the net costs of major development projects and unproved properties, less future site restoration costs, overhead expenses, financing costs and income taxes. If the net carrying costs exceed the ultimate recoverable amount, additional depletion and depreciation is provided.

(c) 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.

(d) Future site restoration and abandonment costs

Estimated future costs relating to site restoration and abandonment are provided for over the life of proved reserves on a unit-of-production basis. Costs are estimated, net of expected recoveries, based upon current prices, legislation,

technology and industry standards. The provision is recorded as additional depletion and depreciation. The accumulated provision is reflected as a non-current liability and actual expenditures are charged against the accumulated provision when incurred.

(e) 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 future income taxes at the time of renunciation and reduce share capital.

(f) Financial instruments

The fair market value of cash and cash equivalents, receivables, prepaid expenses, 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, foreign currency exchange rates and interest 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. Costs and gains on derivative contracts are recognized in income in the same period that the transactions are settled. The fair values of derivative instruments are not recorded in the balance sheet.

(g) Cash and cash equivalents

Cash and cash equivalents include investments in highly liquid money market instruments which are readily convertible to known amounts of cash. Cash and cash equivalents are held to meet operating requirements.

(h) Stock-based compensation

The Company has a stock-based compensation plan, as described in Note 6 (c). The Company does not record compensation costs for stock options granted to officers, directors and employees. The consideration received by the Company on the exercise of share options is recorded as share capital.

(i) 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.

3. ACQUISITIONS

(a) Corporate acquisitions

On December 16, 2002, the Company acquired all of the issued and outstanding shares of Dorchester Energy Inc. ("Dorchester"), a public company involved in the exploration, development and production of oil and natural gas in Western Canada. Results of operations have been included from the date of acquisition. The acquisition has been accounted for by the purchase method of accounting as follows:

CONSIDERATION

Cash	\$ 5,769,405
Transaction costs	175,000
	\$ 5,944,405
Issue of 1,835,436 common shares	5,506,308
	\$ 11,450,713

NET ASSETS ACQUIRED

Petroleum and natural gas properties	\$ 25,246,660
Future income taxes	(7,151,172)
Future site restoration costs	(398,435)
	\$ 17,697,053
Bank debt, net of working capital	(6,246,340)
	\$ 11,450,713

On December 16, 2002, the Company acquired all of the issued and outstanding shares of Denim Energy Corp. ("Denim"), a private Canadian company involved in the exploration, development and production of oil and natural gas in Western Canada. Results of operations have been included from the date of acquisition. The acquisition has been accounted for by the purchase method of accounting as follows:

CONSIDERATION

Cash	\$ 2,414,792
Transaction costs	30,000
	\$ 2,444,792
Issue of 416,981 common shares	1,250,943
	\$ 3,695,735

NET ASSETS ACQUIRED

Petroleum and natural gas properties	\$ 5,414,640
Future income taxes	(1,782,467)
Future site restoration costs	(63,063)
	\$ 3,569,110
Working capital	126,625
	\$ 3,695,735

(b) Property and equipment acquisitions

On September 30, 2002, the Company acquired certain petroleum and natural gas assets located in the Princess area of Alberta. Results of operations have been included from the date of acquisition. The acquisition did not have full tax basis and, accordingly, future income taxes have been provided for. The acquisition has been accounted for as follows:

CONSIDERATION

Cash	\$ 1,440,966
Transaction costs	9,351
	\$ 1,450,317
Issue of 2,650,000 common shares	2,650,000
	\$ 4,100,317

NET ASSETS ACQUIRED

Petroleum and natural gas properties	\$ 5,332,596
Future income taxes	(1,232,279)
	\$ 4,100,317

On October 20, 2002, the Company acquired certain petroleum and natural gas assets located in the Alderson area of Alberta. Results of operations have been included from the date of acquisition. The acquisition has been accounted for as follows:

CONSIDERATION	
Cash	\$ 776,400
Transaction costs	1,669
	\$ 778,069
NET ASSETS ACQUIRED	
Petroleum and natural gas properties	\$ 778,069
	\$ 778,069

On December 16, 2002, the Company acquired certain petroleum and natural gas assets located in the Richdale area of Alberta. Results of operations have been included from the date of acquisition. The acquisition has been accounted for as follows:

CONSIDERATION	
Cash	\$ 721,812
Transaction costs	3,118
	\$ 724,930
Issue of 101,189 common shares	303,567
	\$ 1,028,497
NET ASSETS ACQUIRED	
Petroleum and natural gas properties	\$ 1,028,497
	\$ 1,028,497

4. PROPERTY AND EQUIPMENT

<i>At December 31, 2002</i>	COST	ACCUMULATED DEPLETION AND DEPRECIATION	NET BOOK VALUE
Petroleum and natural gas properties and equipment	\$ 41,657,876	\$ 485,989	\$ 41,171,887
Other assets	79,000	4,937	74,063
	\$ 41,736,876	\$ 490,926	\$ 41,245,950

At December 31, 2002, petroleum and natural gas properties with a cost of \$1,364,336 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 \$813,000 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 2002, the Company did not capitalize any general and administrative costs directly relating to exploration and development activities.

At December 31, 2002, the estimated future site restoration costs, net of expected recoveries, to be accrued over the life of the remaining proved reserves are \$1,016,168.

As a result of the ceiling test calculation at December 31, 2002, the Company was not required to record additional depletion and depreciation on its petroleum and natural gas properties. Future revenue used in this calculation was determined using year-end average prices of \$37.99 per barrel for oil, \$28.39 per barrel for natural gas liquids and \$6.01 per thousand cubic feet for natural gas.

5. BANK DEBT

At December 31

2002

Demand operating loan	\$ 1,550,000
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Celtic has a demand revolving credit facility with a Canadian chartered bank. The authorized borrowing amount under this facility is \$12.0 million. Interest is payable monthly at bank prime plus 0.125 percent. Borrowing utilizing Bankers' Acceptances is available under the facility at a stamping fee of 1.25 percent. Security is provided for by a floating charge debenture over all assets in the amount of \$35.0 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, 2003, at which time the bank will conduct its annual review.

6. SHARE CAPITAL

(a) Authorized:

Unlimited number of common shares.

Unlimited number of preferred shares.

(b) Issued:

	COMMON SHARES	AMOUNT
Balance, April 16, 2002	-	\$ -
Issued for cash on incorporation	3,000,000	450,000
Issued for cash as initial public offering	1,000,000	250,000
Share issue costs, after future income taxes	-	(49,885)
Issued for cash on exercise of stock options	375,000	93,750
Issued for cash through private placement	2,000,000	2,000,000
Issued for cash as flow-through shares	3,000,000	3,000,000
Income tax benefit renounced on flow-through shares	-	(1,263,600)
Issued on acquisition of oil and gas assets	2,650,000	2,650,000
Share issue costs, after future income taxes	-	(80,270)
Issued for cash through private placement	4,000,000	12,000,000
Issued on acquisition of Dorchester Energy Inc.	1,835,436	5,506,308
Issued on acquisition of Denim Energy Corp.	416,981	1,250,943
Issued on acquisition of oil and gas assets	101,189	303,567
Share issue costs, after future income taxes	-	(68,761)
Stock-based compensation costs	-	14,000
Balance, December 31, 2002	18,378,606	\$ 26,056,052

At December 31, 2002, 5,550,000 previously issued common shares of the Company are held in escrow pursuant to four escrow agreements and shall be released as to 1,850,000 shares on April 4, 2003, 2,775,000 shares on October 4, 2003 and 925,000 shares on April 4, 2004.

(c) *Stock options*

The following table summarizes the changes in stock options outstanding during the year, up to December 31, 2002:

	NUMBER OF OPTIONS	AVERAGE EXERCISE PRICE
Balance, April 16, 2002	–	\$ –
Granted	1,285,000	2.16
Granted – Agent options	100,000	0.25
Exercised – Agent options	(100,000)	0.25
Exercised	(275,000)	0.25
Balance, December 31, 2002	1,010,000	\$ 2.68

Pursuant to an agency agreement dated June 14, 2002, a corporation was granted an option to purchase 100,000 common shares at an exercise price of \$0.25 per share. These options were subsequently exercised on July 23, 2002 and September 6, 2002. Stock-based compensation costs relating to these options granted to non-employees in the amount of \$14,000 are included in general and administrative expenses.

The Company does not record compensation costs for stock options granted to officers, directors and employees. As required by Canadian generally accepted accounting principles, the impact on compensation costs of using the fair-value method, whereby compensation costs are included in net earnings, must be disclosed. If the fair value method had been used for options granted during the period ended December 31, 2002, pro forma net earnings and earnings per share would approximate the following amounts:

For the period from April 16, 2002 to December 31, 2002

Compensation costs	\$ 131,272
Net earnings (loss)	
As reported	\$ 27,698
Pro forma	\$ (103,574)
Earnings (loss) per share – Basic	
As reported	\$ –
Pro forma	\$ (0.01)
Earnings (loss) per share – Diluted	
As reported	\$ –
Pro forma	\$ (0.01)

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:

For the period from April 16, 2002 to December 31, 2002

Risk-free interest rate	4.28%
Expected life (years)	3.0
Expected volatility	116%

The following table summarizes information regarding stock options outstanding at December 31, 2002:

RANGE OF EXERCISE PRICES	NUMBER OF OPTIONS OUTSTANDING	WEIGHTED AVERAGE REMAINING TERM (YEARS)	WEIGHTED AVERAGE EXERCISE PRICE	NUMBER OF OPTIONS EXERCISABLE	WEIGHTED AVERAGE EXERCISE PRICE
\$ 0.00 to \$ 2.00	125,000	4.5	\$ 0.25	125,000	\$ 0.25
\$ 2.01 to \$ 3.00	700,000	4.8	\$ 2.90	–	–
\$ 3.01 to \$ 4.00	185,000	4.9	\$ 3.50	–	–
Total	1,010,000	4.8	\$ 2.68	125,000	\$ 0.25

(d) Flow-through shares

On September 30, 2002, the Company issued 3.0 million flow-through common shares at a price of \$1.00 per share for gross proceeds of \$3.0 million. At December 31, 2002, Celtic had remaining commitments to incur \$1.0 million of qualifying expenditures prior to December 31, 2003, to satisfy this flow-through share agreement.

7. INCOME TAXES

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:

For the period from April 16, 2002 to December 31, 2002

Earnings before income taxes	\$ 21,316
Statutory combined income tax rate	42.25%
Expected income taxes	9,006
Increase (decrease) resulting from:	
Non-deductible Crown payments	36,340
Resource allowance	(60,857)
Other adjustments	9,129
Provision for (recovery of) future income taxes	\$ (6,382)

The components of future income taxes are as follows:

At December 31

2002

Future income tax liabilities:	
Property and equipment	\$ 11,152,235
Other	287,246
Future income tax assets:	
Site restoration costs	(149,620)
Future income taxes	\$ 11,289,861

8. PER SHARE AMOUNTS

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 and cash flow from operations per share.

In computing diluted earnings and cash flow from operations per share, 153,583 shares were added to the 7,452,709 weighted average number of common shares outstanding during the year for the dilutive effect of stock options. A total of 185,000 stock options were excluded from the diluted calculation because the respective exercise prices exceeded the average market price of the common shares.

Earnings and cash flow from operations per common share are summarized below:

For the period from April 16, 2002 to December 31, 2002

Earnings per share	
Basic	\$ -
Diluted	\$ -
Cash flow from operations per share	
Basic	\$ 0.07
Diluted	\$ 0.07

9. SUPPLEMENTAL CASH FLOW INFORMATION

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

For the period from April 16, 2002 to December 31, 2002

Interest received	\$ 30,506
Interest paid	\$ 13,888

10. RELATED-PARTY TRANSACTIONS

On September 30, 2002, Celtic completed the acquisition of certain petroleum and natural gas assets located in the Princess area of Alberta for a purchase price of \$4.15 million, before adjustments. The acquisition was financed by a cash payment of \$1.5 million and by the issuance of 2.65 million common shares with an assigned value of \$2.65 million. The vendor of the Princess area properties, Jarrod Oils Ltd., is controlled by Eldon A. McIntyre, a director of Celtic.

On October 20, 2002, Celtic completed the acquisition of certain petroleum and natural gas assets located in the Alderson area of Alberta for a purchase price of \$850,000, before adjustments. The acquisition was financed by a cash payment of \$850,000. The vendor of the Alderson area properties, Jarrod Oils Ltd., is controlled by Eldon A. McIntyre, a director of Celtic.

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, 2002, the Company paid or recorded as a payable a total of \$350,906 to this firm for legal fees and disbursements (including GST).

11. COMMITMENTS

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

	AMOUNT
2003	\$ 132,020
2004	144,022
2005	144,022
2006	108,017
	\$ 528,081

The office lease expires on September 30, 2006.

12. FINANCIAL INSTRUMENTS AND DERIVATIVE CONTRACTS

The fair market values of cash and cash equivalents, receivables, 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, foreign currency exchange rates and interest rates. At December 31, 2002, Celtic did not have any derivative contracts in place.

BOARD OF DIRECTORS

Robert J. Dales
President
Valhalla Ventures Inc.

William C. Guinan
Partner
Borden Ladner Gervais, LLP

Eldon A. McIntyre
President
Jarrod Oils Ltd.

Neil G. Sinclair
President
Sinson Investments Ltd.

David J. Wilson
President & CEO
Celtic Exploration Ltd.

OFFICERS

David J. Wilson
President & CEO

Sadiq H. Lalani
Vice President, Finance &
Chief Financial Officer

Alan G. Franks
Vice President, Operations

Michael R. Shea
Vice President, Land

HEAD OFFICE

Suite 500
505 Third Street SW
Calgary, Alberta
T2P 3E6

REGISTRAR AND TRANSFER AGENT

Valiant Corporate Trust Company
Suite 510
550 Sixth Avenue SW
Calgary, Alberta
T2P 0S2

LEGAL COUNSEL

Borden Ladner Gervais
1000 Canterra Tower
400 Third Avenue SW
Calgary, Alberta
T2P 4H2

BANKERS

National Bank of Canada
401 Eighth Avenue SW
Calgary, Alberta
T2P 1E4

AUDITORS

PricewaterhouseCoopers
Suite 3100
111 Fifth Avenue SW
Calgary, Alberta
T2P 5L3

EVALUATION ENGINEERS

Sproule Associates Limited
Suite 900
140 Fourth Avenue SW
Calgary, Alberta
T2P 3N3

STOCK EXCHANGE LISTING

TSX-Venture Exchange ("TSX-V")
Trading symbol "CLT"

ANNUAL GENERAL MEETING

Tuesday, June 3rd, 2003
3:00 p.m.
The Metropolitan Centre –
Grand Lecture Theatre
333 Fourth Avenue SW
Calgary, Alberta
T2P 0H9

ABBREVIATIONS

bbls	barrels
mbbbs	thousand barrels
bbbs/d	barrels per day
BOE	barrels of oil equivalent
mBOE	thousand barrels of oil equivalent
BOE/d	barrels of oil equivalent per day
mcf	thousand cubic feet
mmcf	million cubic feet
bcf	billion cubic feet
mmcf/d	million cubic feet per day
mmbtu	million British Thermal Units
GJ	gigajoules
AECO-C	Alberta Energy Company "C" Meter Station of the Nova Pipeline System
API	American Petroleum Institute
ARTC	Alberta Royalty Tax Credit
CICA	Canadian Institute of Chartered Accountants
WTI	West Texas Intermediate

CONVERSION OF UNITS

IMPERIAL	=	METRIC
1 acre	=	0.4 hectares
2.5 acres	=	1 hectare
1 bbl	=	0.159 cubic metres
6.29 bbls	=	1 cubic metre
1 foot	=	0.3048 metres
3.281 feet	=	1 metre
1 mcf	=	28.2 cubic metres
0.035 mcf	=	1 cubic metre
1 mile	=	1.61 kilometres
0.62 miles	=	1 kilometre
1 mmbtu	=	1.054 GJ
0.949 mmbtu	=	1 GJ

Natural gas is equated to oil on the basis of
10 mcf = 1 BOE.

