it's in the numbers

CELTIC EXPLORATION LTD. 2003 ANNUAL REPORT earnings grew to $4.7

Celtic's capital expenditure program, net of dispositions,

Cash flow per share increased 88

1,941 BOE/d were

Our current debt to cash flow

million in 2003 compared to $27.0 thousand in 2002

totalled $55.1 million

6% to $0.69

produced in 2003 compared to 133 BOE/d in 2002

ratio is 0.5x

performance speaks

Celtic Exploration Ltd. is a growth-oriented oil and gas exploration and production company, based in Calgary, Alberta. The Company was incorporated in April 2002 and began active oil and gas operations in September 2002. Celtic was formed with the objective of building a company that would flourish in today's environment of constant change. In the past decade, dramatic commodity price fluctuations have increased competition for finite resources. With this in mind, Celtic was established with a well-defined yet flexible business plan that allows it to react quickly to opportunities created in today's unique market environment.

Celtic's aim is to achieve profitable growth by generating exploration plays that have multi-zone hydrocarbon potential, and by applying a disciplined fiscal approach towards its capital spending program. The Company's capital program is funded through prudent use of bank debt, share equity offerings and internally generated cash flow from operations. Although there are different ways to measure the growth and success of an oil and gas company, Celtic's primary objectives are to increase net asset value per share and cash flow per share.

In 2003, Celtic achieved significant growth in all of the main criteria as defined by the Company at its inception. As you read our 2003 annual report, we'll let the numbers speak for themselves.

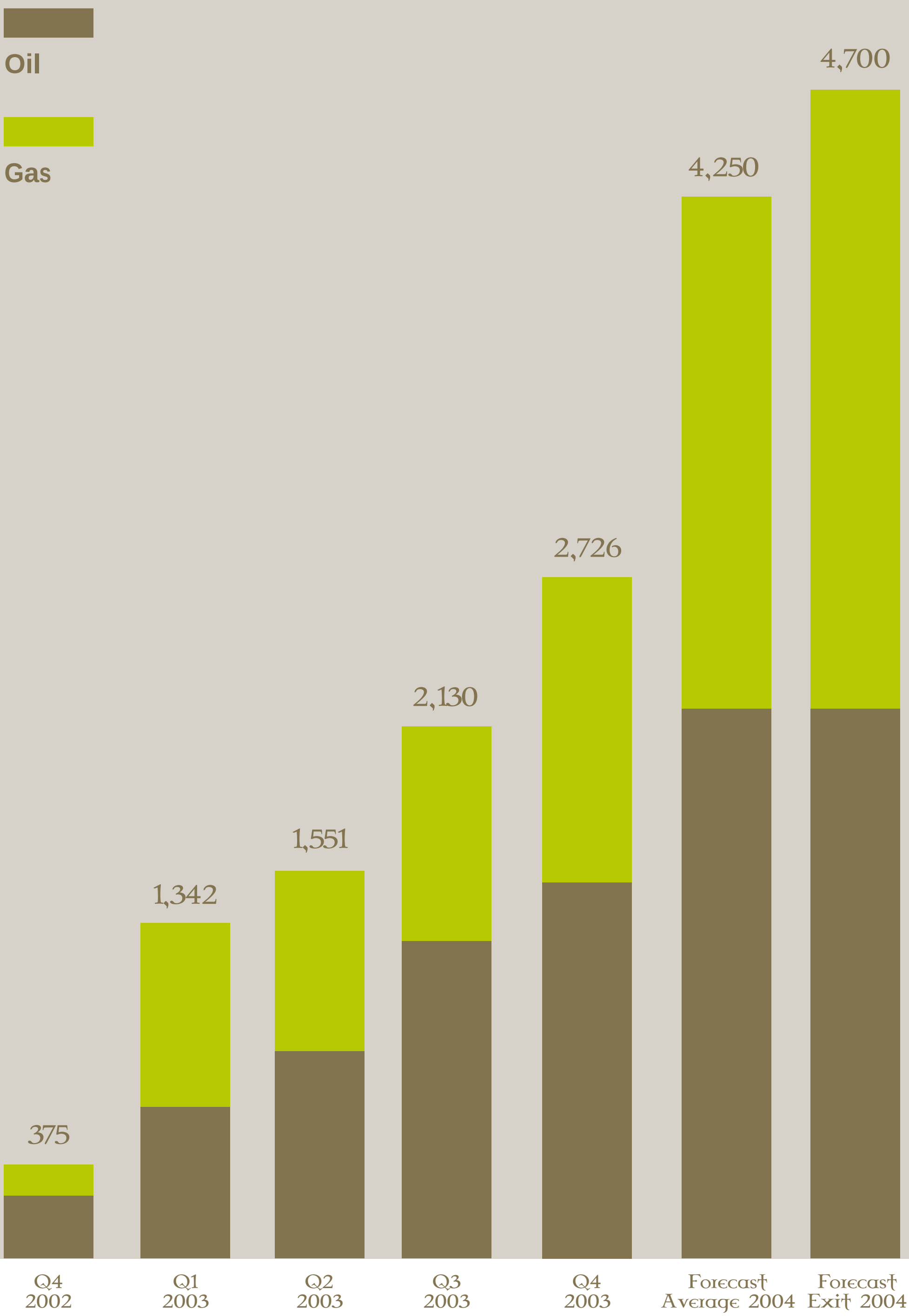
highlights

($000s, except per unit amounts)	Three months ended December 31 2003	2002	% Change	Twelve months ended December 31 2003	Period from April 16 to December 31 2002	% Change
FINANCIAL						
Revenue, net of royalties	**$ 7,081**	$ 1,056	571	**$ 21,755**	$ 1,057	1,958
Cash flow from operations	**$ 4,787**	$ 551	769	**$ 15,314**	$ 538	2,746
Cash flow per share						
Basic	**$ 0.19**	$ 0.08	138	**$ 0.69**	$ 0.07	886
Diluted	**$ 0.18**	$ 0.08	125	**$ 0.68**	$ 0.07	871
Net earnings	**$ 866**	$ 34	2,447	**$ 4,665**	$ 27	17,178
Earnings per share						
Basic	**$ 0.03**	$ 0.00	–	**$ 0.21**	$ 0.00	–
Diluted	**$ 0.03**	$ 0.00	–	**$ 0.21**	$ 0.00	–
Capital expenditures, net of dispositions	**$ 12,532**	$ 26,892	-53	**$ 55,074**	$ 31,109	77
Bank debt, net of working capital				**$ 10,785**	$ 3,399	217
Shareholders' equity				**$ 64,085**	$ 26,084	146
OPERATIONS						
Production						
Oil (bbls/d)	**1,505**	251	500	**1,055**	89	1,085
Natural gas (mcf/d)	**7,324**	745	883	**5,318**	264	1,914
Combined (BOE/d)	**2,726**	375	627	**1,941**	133	1,359
Realized sales prices						
Oil ($/bbl)	**$ 34.87**	$ 37.28	-6	**$ 35.76**	$ 37.28	-4
Natural gas ($/mcf)	**$ 5.73**	$ 5.83	-2	**$ 6.61**	$ 5.83	13
Combined ($/BOE)	**$ 34.64**	$ 36.50	-5	**$ 37.55**	$ 36.50	3
Operating netbacks						
Oil ($/bbl)	**$ 20.85**	$ 19.41	7	**$ 22.22**	$ 19.41	14
Natural gas ($/mcf)	**$ 3.36**	$ 3.22	4	**$ 4.10**	$ 3.22	27
Combined ($/BOE)	**$ 20.54**	$ 19.38	6	**$ 23.33**	$ 19.38	20
Drilling activity						
Total wells	**12**	7	71	**35**	7	400
Working interest wells	**10.4**	6.2	68	**23.3**	6.2	276
Success rate on working interest wells	**100%**	100%		**84%**	100%	
Undeveloped land						
Gross acres				**156,312**	53,890	190
Net acres				**77,912**	26,500	19
Reserves						
Oil (mbbls)				**4,879**	2,071	136
Natural gas (mmcf)				**19,261**	11,721	64
Combined (mBOE)				**8,089**	4,025	101
Reserve life index (years)				**5.8**	7.1	

2 prong strategy

Celtic adheres to a two-prong growth strategy to increase shareholder value. The Company identifies and acquires oil and gas assets with exploitation upside and, at the same time, implements a full-cycle exploration program. The graph on the opposite page demonstrates Celtic's success in implementing its strategy resulting in impressive production growth since inception. Celtic has a large inventory of prospects with exploration and exploitation potential providing a solid platform for future growth.

production (BOE/d)



message to shareholders

In 2003, Celtic enjoyed its first full operating year and we achieved significant growth in all of the main criteria which measure a company's performance. Although the Company started out as a shell with no production in April 2002, production grew quickly to 3,000 barrels of oil equivalent per day by the end of 2003. Currently, with the end of the first quarter of 2004 drawing to a close, we have exceeded 4,000 barrels of oil equivalent per day, with significant first quarter additions yet to be tied-in.

In 2003, Celtic recorded $15.3 million in cash flow from operations or $0.68 per share on a diluted basis. The Company is forecasting cash flow from operations to grow to $29.6 million or $1.15 per share in 2004. Celtic has based this forecast on commodity price assumptions that will result in an average oil price of $33.55 per barrel (determined using an average WTI price of US$30.00 per barrel and an exchange rate of U.S. $0.76 per Canadian dollar), and an average natural gas price of $5.60 per thousand cubic feet. In 2003, Celtic was successful in generating net earnings of $4.7 million or $0.21 per share. On the operating front, the Company's 2003 production averaged 1,941 barrels of oil equivalent per day, equating to 87 equivalent barrels of oil per day per million shares outstanding. Celtic is forecasting average production to grow by 119 percent in 2004 to 4,250 barrels of oil equivalent per day. On a per share basis, this would represent an increase of 90 percent at 165 equivalent barrels per day per million shares outstanding.

Celtic's dual-prong strategy of growth through exploration and exploitation of strategic acquisitions has well-secured the Company in its quest to maximize shareholder value. Celtic drilled a total of 35 (23.3 net) wells with an 83 percent success rate during the year. This activity was complemented with further exploitation of the two acquisitions that were made in 2003, and allowed the Company to continue to achieve growth. Celtic currently has a large inventory of prospects which fall into both the exploration and exploitation categories. This inventory will ensure the Company's future growth without having to rely on one play type. While Celtic has achieved growth in all of its producing areas, the Company has, at the same time, successfully reduced unit operating costs by increasing production and implementing further cost reduction measures. This, along with its quality asset base consisting of light oil and liquids-rich natural gas, allows Celtic to enjoy one of the higher netbacks in the industry.

In 2003, Celtic increased its capital budget several times, starting with a $15.0 million budget and ending the year with a $55.0 million budget. An expanded capital budget allowed us to take advantage of new opportunities as they arose, and was possible due to the Company's clean balance sheet. For 2004, the Company starts the year with less than $11.0 million in debt (including working capital), providing us with the flexibility to once again increase the 2004 capital budget in order to take advantage of opportunities as they arise. The current 2004 capital budget is set at $35.0 million and does not include any acquisitions. The year-end debt is projected to be approximately $15.0 million, resulting in a debt to cash flow ratio of less than 0.5 times, and giving the Company the flexibility to make strategic acquisitions as opportunities arise.

In 2003, Celtic's increasing market capitalization allowed the Company to graduate to the Toronto Stock Exchange in July. During the year, Celtic was able to attract key personnel to its workforce, making it possible for the Company to continue its rapid growth. As always, Celtic management will ensure that this growth is accretive and will use cash flow per share and net asset value per share to gauge growth.

Celtic's production profile remains evenly balanced between oil and gas production, with liquids from natural gas skewing the weighting slightly in favour of oil at approximately 54 percent. The Company's plan is to continue to focus on natural gas and light oil targets, with the main driver for success reflecting a recycle ratio of greater than 2.0 times. With the present commodity price environment looking extremely strong for both oil and gas, the Company's current commodity profile acts as a hedge should one of the commodities lose value. At this time, the Company does not intend to enter into any commodity price hedges unless it is required to guarantee a minimum cash flow in order to allow Celtic to complete a major acquisition.

We would like to thank our shareholders for their continued support, the Board of Directors for their guidance and our employees for their effort and loyalty. We are confident that 2004 will prove to be another successful year for Celtic.

Celtic's Annual and Special Meeting of shareholders is scheduled for Wednesday, May 26, 2004 at 3:00 p.m., to be held at The Metropolitan Centre, 333 Fourth Avenue S.W., Calgary, Alberta.

David J. Wilson

President & CEO
April 2004

4 core areas of operations

SOUTHERN ALBERTA

- Celtic's primary natural gas producing properties in southern Alberta are Michichi, Richdale, Trochu and Twining. The area has multi-zone natural gas potential including the Mannville, Belly River, Ostracod, Basal Quartz, Glauconite and Banff formations. Natural gas discoveries can be connected quickly since Company-owned lands are located close to pipeline and facility infrastructure.

- At Princess/Bantry, the Company produces both oil and natural gas from the Pekisko formation.

- At Bow Island, Celtic increased oil production through the drill bit from the Sawtooth formation.

EAST CENTRAL ALBERTA

- Celtic has increased natural gas production at Ashmont through exploitation.

- The Company expects to continue to grow production at Ashmont with the commencement of new drilling in the first quarter of 2004.

WEST CENTRAL ALBERTA

- Celtic has been active exploring for natural gas at Kakwa/Chime. This area provides deeper/high reward opportunities with multi-zone formations including Cadomin, Gething, Falher, Dunvegan, Cardium and Chinook.

- At Fox Creek, Celtic successfully re-completed a previously shut-in oil well in the Beaverhill Lake formation and recently drilled two high-impact horizontal wells. The Company expects to complete the drilling of a third horizontal well in early 2004.

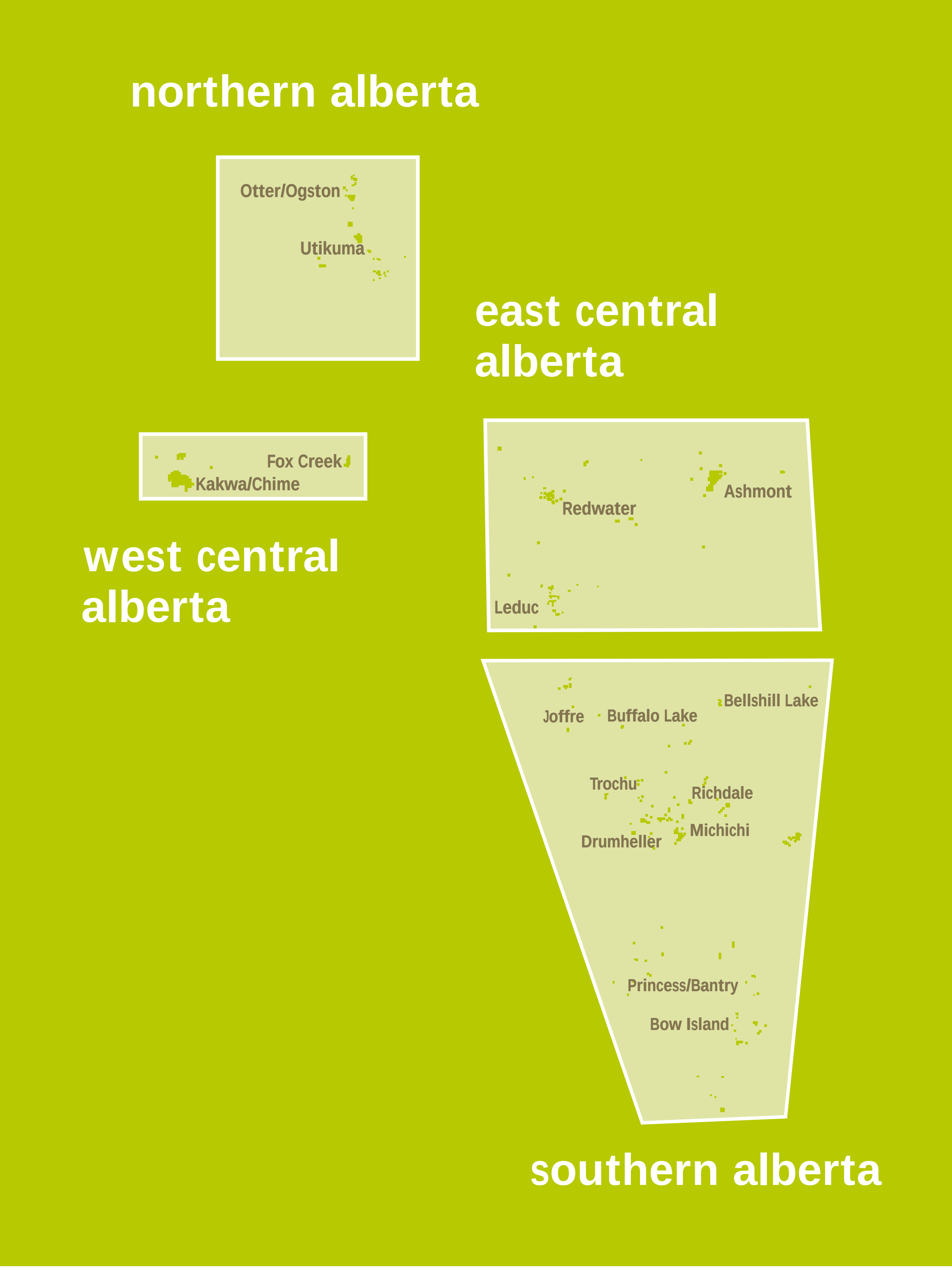
NORTHERN ALBERTA

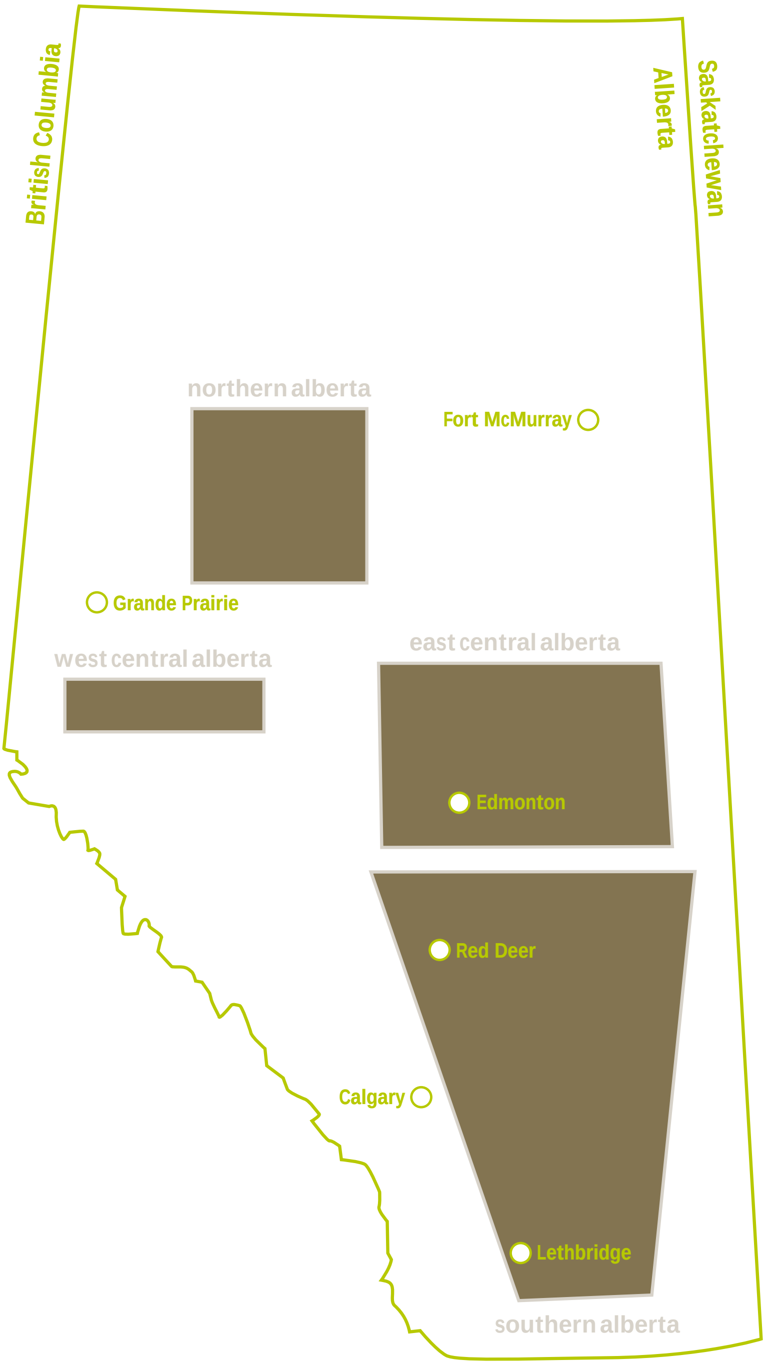
- Celtic expects to be active this winter at Otter/Ogston in northern Alberta drilling wells targeting light gravity crude oil from the Granite Wash and Slave Point formations.

- At Utikuma, the Company has light oil production in the Keg River formation, with uphole exploitation potential in the Gilwood formation.

primary producing areas

	Northern Alberta	East Central Alberta	Southern Alberta	West Central Alberta	Other	Total
Production						
(field estimates for week ending March 6, 2004)						
Oil (bbls/d)	600	50	900	700	–	2,250
Natural gas (mcf/d)	60	2,400	4,500	3,540	–	10,500
Combined (BOE/d)	610	450	1,650	1,290	–	4,000
Undeveloped land						
(as at December 31, 2003)						
Gross acres	17,280	35,774	37,033	60,608	5,617	156,312
Net acres	8,816	25,240	23,499	17,137	3,221	77,913
Average working interest	51%	71%	63%	28%	57%	50%
Reserves						
(as at December 31, 2003)						
Oil (mbbls)	1,182	195	2,026	1,476	–	4,879
Natural gas (mmcf)	144	3,591	10,411	5,115	–	19,261
Combined (mBOE)	1,206	794	3,761	2,329	–	8,089
Capital efficiency						
(incorporation to December 31, 2003)						
Capital expenditures ($000s)	$ 13,228	$ 11,008	$ 42,605	$ 18,286	$ 1,057	$ 86,184
Operating income ($000s)	(2,485)	(2,335)	(10,677)	(1,709)	–	(17,206)
Net investment ($000s)	$ 10,743	$ 8,673	$ 31,928	$ 16,577	$ 1,057	$ 68,978
Net investment/ production ($/BOE/d)	$ 17,600	$ 19,300	$ 19,400	$ 12,900	$ –	$ 17,200
Net investment/reserves ($/BOE)	$ 8.91	$ 10.92	$ 8.49	$ 7.12	$ –	$ 8.53


northern alberta
Otter/Ogston
Utikuma
east central alberta
Redwater
Ashmont
Leduc
west central alberta
Fox Creek
Kakwa/Chime
Joffre
Buffalo Lake
Bellshill Lake
Trochu
Richdale
Michichi
Drumheller
Princess/Bantry
Bow Island
southern alberta


British Columbia
Alberta
Saskatchewan
northern alberta
Fort McMurray
Grande Prairie
west central alberta
east central alberta
Edmonton
Red Deer
Calgary
Lethbridge
southern alberta

operations

DEFINITIONS AND CONVERSION FACTORS

In this annual report, 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. References to oil in this discussion include crude oil and natural gas liquids (“NGLs”). NGLs include condensate, propane, butane and ethane. References to reserves are Gross Company Interest, meaning Celtic’s ownership in reserves before royalties, unless otherwise specified.

LAND

As at December 31, 2003, Celtic owned 77,913 net acres of undeveloped land, representing a 194 percent increase over its land position at the end of 2002. Approximately seven percent will expire in 2004. Celtic holds an average working interest of 50 percent in its undeveloped lands.

During the year, Celtic strengthened its undeveloped land base both through Crown land sales and third-party farm-ins. Crown land sale acquisitions of approximately 14,500 net acres totalled $1.3 million for an average cost of $90 per acre. This land acquisition cost was less than the industry average of $115 per acre. Third-party farm-ins resulted in Celtic earning working interests in over 48,000 gross acres, providing the Company with a tax-effective basis for expanding its landholdings. Through third-party farm-ins, Celtic established two new significant core exploration and operating areas at Kakwa/Chime and Otter/Ogston in Alberta. Both of these areas afford Celtic the opportunity to pursue post-earning drilling, thereby enhancing the Company’s overall farm-in cost structure.

Celtic’s continued land acquisition strategy is prospect driven with emphasis on internally generated opportunities that are in close proximity to facility infrastructure. In comparison to some of its peers, Celtic’s undeveloped land base is relatively small. This is a function of both the geological play types that Celtic is pursuing in its exploration programs, and the Company’s philosophy of technically identifying and acquiring prospect-specific lands that the Company has already evaluated with either a well or seismic.

Our continued long-term goal is to build a large land base of high working interest undeveloped lands with operatorship of the majority of our prospects, ensuring control of program expenditures.

The following table summarizes Celtic's land position as at December 31, 2003:

Landholdings

	Developed		Undeveloped		Total	
Acres, as at December 31, 2003	Gross	Net	Gross	Net	Gross	Net
Alberta	108,367	51,224	150,695	74,692	259,062	125,916
British Columbia	–	–	4,815	2,820	4,815	2,820
Saskatchewan	1,368	285	802	401	2,170	686
Total acreage	109,735	51,509	156,312	77,913	266,047	129,422

DRILLING

During the year ended December 31, 2003, Celtic drilled 35 (23.3 net) wells compared to seven (6.2 net) wells in the previous year, with an overall success rate of 83 percent on net wells drilled. The split between development drilling and exploratory drilling was 73 percent and 27 percent, respectively. The following table summarizes Celtic's drilling activity in 2003:

Drilling Activity

	Development Wells		Exploration Wells		Total Wells	
Year ended December 31, 2003	Gross	Net	Gross	Net	Gross	Net
Oil	15	11.5	2	0.8	17	12.3
Natural gas	6	5.2	5	1.8	11	7.0
Unsuccessful	1	0.4	6	3.6	7	4.0
Total wells	22	17.1	13	6.2	35	23.3
Success rate, based on net wells		98%		42%		83%

RESERVES

Celtic retained an independent qualified reserve evaluator to prepare a report on 100 percent of its oil and gas reserves for both 2003 and 2002. The Company has a Reserves Committee which oversees the selection, qualifications and reporting procedures of the independent engineering consultants. Reserves as at December 31, 2003 were determined using the guidelines and definitions set out under National Instrument 51-101 ("NI 51-101").

The tables on pages 14 and 15 provide summary information contained in Celtic's reserve evaluation as at December 31, 2003 and calculations for finding, development and acquisition costs for 2003 and 2002 (restated to include future capital expenditures required to develop reserves).

Summary of Reserves

As at December 31, 2003	Oil MBBLS	Gas MMCF	Combined MBOE	Reserve Life Index Years	NPV[1] 10% BIT $000s	NPV[1] per BOE $/BOE
Proved developed producing	2,633	10,898	4,449	4.6	54,780	12.31
Total proved	3,513	13,707	5,798	4.5	77,522	13.37
Total proved plus probable	4,879	19,261	8,089	5.8	99,725	12.33

(1) NPV is based on forecast prices shown in the table below under the heading "Reference Prices."

Production Replacement

	Proved			Proved + Probable		
As at December 31, 2003	Oil MBBLS	Gas MMCF	Combined MBOE	Oil MBBLS	Gas MMCF	Combined MBOE
Reserve additions	2,830	8,691	4,280	3,976	11,210	5,844
Revisions	(422)	(1,053)	(598)	(783)	(1,729)	(1,071)
Reserve additions, after revisions	2,408	7,638	3,682	3,193	9,481	4,773
2003 Production	385	1,941	709	385	1,941	709
Production replacement percentage	625%	394%	519%	829%	488%	673%

Reference Prices

		Oil			Natural Gas		
As at December 31, 2003	Currency Exchange Rate US$/CA$	WTI Cushing Oklahoma US$/BBL	Edmonton Light Par CA$/BBL	Celtic Average Oil Price[1] CA$/BBL	Henry Hub Louisiana US$/MMBTU	Alberta AECO-C Spot CA$/MMBTU	Celtic Average Gas Price[2] CA$/MCF
Historical							
2000	0.674	30.30	44.03		3.89	5.07	
2001	0.646	25.94	39.06		4.27	6.23	
2002	0.637	26.09	40.12		3.22	4.04	
2003	0.716	31.13	43.21		5.39	6.66	
Four-year historical average	0.668	28.37	41.61		4.19	5.50	
Future Forecasts							
2004	0.750	29.63	37.99	35.39	5.32	6.04	6.31
2005	0.750	26.80	34.24	31.87	4.81	5.36	5.62
2006	0.750	25.76	32.87	30.46	4.39	4.80	5.06
2007	0.750	26.14	33.37	30.88	4.46	4.91	5.17
2008	0.750	26.53	33.87	31.32	4.52	4.98	5.25
Five-year forecast average	0.750	26.97	34.47	31.98	4.70	5.22	5.48

(1) Celtic's forecasted average oil price is based on total proved plus probable reserves and does not include natural gas liquids.
(2) Celtic's forecasted average gas price is based on proved plus probable reserves and does not include solution gas.

Reserves Reconciliation

	Oil		Natural Gas		Combined	
	Total Proved MBBLS	Proved + Probable MBBLS	Total Proved MMCF	Proved + Probable MMCF	Total Proved MBOE	Proved + Probable MBOE
Balance, December 31, 2002	1,490	2,071	8,010	11,721	2,825	4,025
Discoveries	1,107	1,487	5,353	7,131	2,001	2,675
Acquisitions	1,723	2,489	3,338	4,079	2,279	3,169
Technical and NI 51-101 Revisions[1]	(422)	(783)	(1,053)	(1,729)	(598)	(1,071)
Production	(385)	(385)	(1,941)	(1,941)	(709)	(709)
Balance, December 31, 2003	**3,513**	**4,879**	**13,707**	**19,261**	**5,798**	**8,089**
Percentage increase in reserves	136%	136%	71%	64%	105%	101%

(1) Technical and NI 51-101 revisions are based on the aggregate of December 31, 2002 reserve amounts and 2003 reserve acquisition amounts. As a result, negative revisions for proved reserves were 11.7% and for proved plus probable reserves, revisions were 14.9%.

Finding, Development and Acquisition Costs

	2003		April 16 to December 31, 2002	
	Total Proved	Proved + Probable	Total Proved	Proved + Probable
Capital expenditures ($000s)	**55,074**	**55,074**	31,109	31,109
Future capital required to develop reserves ($000s)	**1,168**	**1,517**	845	1,883
Total capital ($000s)	**56,242**	**56,591**	31,954	32,992
Reserve additions (mBOE)	**4,280**	**5,844**	2,860	4,060
Finding, development and acquisition costs ($/BOE)	**13.14**	**9.68**	11.17	8.13
Cash flow from operations ($/BOE)	**21.61**	**21.61**	15.61	15.61
Recycle ratio	**1.6**	**2.2**	1.4	1.9

3

the team
the technology
the assets

For Celtic Exploration, it's our team, technological expertise and assets that come together to create a dynamic, growing energy company. The triskele, an ancient Celtic symbol, was a representation of the importance of the number three. In the Celtic tradition, the triskele often represented constant motion.

management's discussion and analysis

ADVISORY REGARDING FORWARD-LOOKING STATEMENTS

Certain information with respect to Celtic contained in this annual 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.

INTRODUCTION

The following discussion and analysis of financial results should be read in conjunction with the Company's audited financial statements and related notes for the year ended December 31, 2003, included in this annual report. The financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). All dollar amounts are referenced in Canadian dollars, except when noted otherwise.

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.

GROWTH STRATEGY

Celtic expects to continue to grow at a rapid pace by implementing its dual-prong strategy to acquire assets with exploitation potential and, at the same time, implement its full-cycle exploration program. To complement this strategy, the Company has assembled a team of experienced and qualified personnel and is well positioned financially to act quickly on new opportunities. Celtic believes that its growth strategy will continue to increase cash flow per share, net asset value per share and production per share.

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 are listed and posted for trading on the Toronto Stock Exchange under the symbol "CLT."

The year ended December 31, 2003 was a successful year in the execution of the Company's strategy.

Highlights are as follows:

- Completed an equity financing resulting in gross proceeds of $17.8 million through the issuance of 4.5 million shares at $3.95 per share in May 2003;
- Completed an $18.5 million acquisition of oil and gas assets complementing Celtic's existing core producing areas in June 2003;
- Completed a second equity financing resulting in gross proceeds of $15.6 million through the issuance of 2.5 million shares at $6.25 per share in September 2003;
- Completed the acquisition of an oil and gas property at Fox Creek for $4.4 million in September 2003;
- Drilled 35 (23.3 net working interest) wells during the year, resulting in 17 (12.2 net) oil wells and 11 (7.0 net) natural gas wells, for an overall success rate, based on net wells, of 83 percent;
- Reported net earnings of $4.7 million or $0.21 per share;
- Increased cash flow per share 886 percent from the previous year;
- Increased net asset value per share 76 percent compared to December 31, 2002; and
- Increased average daily production per million shares by 412 percent in 2003.

REVENUE

Oil and gas revenue, before royalties, for the year ended December 31, 2003 was $26.6 million, an increase of 1,946 percent compared to the previous year. For the three months ended December 31, 2003, oil and gas revenue, before royalties, was $8.7 million, up 26 percent from the third quarter of 2003. The breakdown of revenue is summarized in the following table:

Revenue

	Year ended December 31, 2003			April 16 to December 31, 2002		
	$000s	$/Unit	Unit	$000s	$/Unit	Unit
Oil revenue	**13,782**	**35.78**	**Bbl**	861	37.31	Bbl
Natural gas revenue	**12,841**	**6.61**	**Mcf**	408	5.96	Mcf
Royalties	**(4,897)**	**(6.91)**	**BOE**	(242)	(7.02)	BOE
Oil and gas revenue	**21,726**	**30.65**	**BOE**	1,027	29.77	BOE
Other	**29**	**0.04**	**BOE**	31	0.88	BOE
Revenue	**21,755**	**30.69**	**BOE**	1,058	30.65	BOE

Production for the year ended December 31, 2003 averaged 1,941 BOE per day, an increase of 1,359 percent compared to the previous year. For the three months ended December 31, 2003, average production was 2,726 BOE per day, up 28 percent from the third quarter of 2003. The combined average product price received for oil and gas sales for the year ended December 31, 2003 was $37.55 per BOE, an increase of three percent compared to the previous year. For the three months ended December 31, 2003, the average product price received was $34.64 per BOE, down two percent from the average price received in the third quarter of 2003.

OIL OPERATIONS

Oil production for the year ended December 31, 2003 averaged 1,055 bbls per day, an increase of 1,085 percent compared to the previous year. For the three months ended December 31, 2003, average oil production was 1,505 bbls per day, up 19 percent from the third quarter of 2003. The average price received for oil sales for the year ended December 31, 2003 was $35.76 per bbl, a decrease of four percent compared to the previous year. For the three months ended December 31, 2003, the average oil price received was $34.87 per bbl, down one percent from the average price received in the third quarter of 2003. For the year ended December 31, 2003, average oil royalties were 17.4 percent of sales, and production expenses were $7.33 per bbl. In the previous year, average oil royalties were 20.7 percent of sales and production expenses were $10.20 per bbl. The breakdown of oil netbacks are summarized in the following table:

Oil Netback

	Year ended December 31, 2003		April 16 to December 31, 2002	
	BBLS/D	$/BBL	BBLS/D	$/BBL
Daily average production	**1,055**		89	
Sales price		**35.76**		37.28
Other oil revenue		**0.02**		0.03
Royalties		**(6.23)**		(7.70)
Production expense		**(7.33)**		(10.20)
Oil netback		**22.22**		19.41

NATURAL GAS OPERATIONS

Natural gas production for the year ended December 31, 2003 averaged 5,318 mcf per day, an increase of 1,914 percent compared to the previous year. For the three months ended December 31, 2003, average natural gas production was 7,324 mcf per day, up 42 percent from the third quarter of 2003. The average price received for natural gas sales for the year ended December 31, 2003 was $6.61 per mcf, an increase of 13 percent compared to the previous year. For the three months ended December 31, 2003, the average natural gas price received was $5.73 per mcf, down four percent from the average price received in the third quarter of 2003. For the year ended December 31, 2003, average natural gas royalties were 19.5 percent of sales and production expenses were $1.22 per mcf. In the previous year, average natural gas royalties were 16.1 percent of sales and production expenses were $1.80 per mcf. The breakdown of natural gas netbacks are summarized in the following table:

Natural Gas Netback

	Year ended December 31, 2003		April 16 to December 31, 2002	
	MCF/D	$/MCF	MCF/D	$/MCF
Daily average production	**5,318**		264	
Sales price		**6.61**		5.83
Other natural gas revenue		–		0.13
Royalties		**(1.29)**		(0.94)
Production expense		**(1.22)**		(1.80)
Natural gas netback		**4.10**		3.22

GENERAL AND ADMINISTRATIVE EXPENSES

General and administrative expenses for the year ended December 31, 2003 were $0.9 million or $1.23 per BOE. 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

	Year ended December 31, 2003		April 16 to December 31, 2002	
	$000s	$/BOE	$000s	$/BOE
Gross general and administrative expenses	**1,645**	**2.32**	193	5.83
Overhead recoveries	**(771)**	**(1.09)**	(46)	0.13
General and administrative expenses	**874**	**1.23**	147	5.96

Employees

	At December 31, 2003	At December 31, 2002
Head office	**19**	9
Field operations	**2**	–
Total employees	**21**	9

STOCK-BASED COMPENSATION EXPENSE

Effective January 1, 2003, the Company has adopted the Canadian Institute of Chartered Accountants' new accounting standard for stock-based compensation using the fair value method. As a result, compensation costs arising from stock options granted will be included in net earnings. For the year ended December 31, 2003, stock-based compensation expense was $0.2 million. 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 shown in the following table:

Stock-based Compensation Expense

	Year ended December 31, 2003		April 16 to December 31, 2002	
	$000s	$/BOE	$000s	$/BOE
Stock-based compensation expense	**168**	**0.24**	14	0.41
Weighted average assumptions for stock options granted:				
Risk-free interest rate		**3.06%**		4.28%
Expected life in years		**3.0**		3.0
Expected volatility		**37%**		116%
Expected dividend yield		**0.0%**		0.0%

INTEREST EXPENSE

The Company has a demand revolving credit facility with a Canadian chartered bank that provides borrowings with interest payable monthly. Interest expense for the year was $0.2 million.

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 at a rate of 25 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, 2003 was $9.8 million or $13.88 per BOE. The following table provides a summary of the amounts included in depletion and depreciation:

Depletion and Depreciation

	Year ended December 31, 2003		April 16 to December 31, 2002	
	$000s	$/BOE	$000s	$/BOE
Depletion – intangible P&NG assets	**7,555**	**10.65**	389	11.29
Depreciation – tangible P&NG assets	**1,889**	**2.67**	97	2.81
Depreciation – other assets	**42**	**0.06**	5	0.14
Future site restoration provision	**352**	**0.50**	12	0.35
Depletion and depreciation	**9,838**	**13.88**	503	14.59

TAXES

For the year ended December 31, 2003, Celtic provided for a provision of future income taxes in the amount of $0.6 million. This amount differs from the expected provision for income taxes of $2.2 million based on the statutory combined income tax rate of 40.75 percent due to the differences between the resource allowance deduction and non-deductible Crown charges, non-taxable Provincial tax credits ("ARTC") and the recognition of a benefit of $1.1 million related to substantively enacted changes to the federal income tax rate and resource related deductions from income. These changes, which will be phased in over the next four years, will result in a lower corporate income tax rate, provide for the deduction of crown royalties and eliminate the resource allowance deduction. An analysis of the income tax provision is included in Note 7 to the financial statements.

Capital tax for the year ended December 31, 2003 was $0.2 million. This tax is with respect to the federal Large Corporations Tax or Part I.3 Tax and is calculated based on the Company's taxable capital base including debt and shareholders' equity.

At December 31, 2003, Celtic had unused income tax deductions available of approximately $55.1 million. A summary of these deductions with corresponding rate of deductibility is shown in the table below:

Income Tax Deductions

	At December 31, 2003		At December 31, 2002	
	$000s	Deduction Rate	$000s	Deduction Rate
Canadian oil and gas property expense (COGPE)	**23,600**	**10%**	6,900	10%
Canadian development expense (CDE)	**6,200**	**30%**	2,800	30%
Canadian exploration expense (CEE)	**10,700**	**100%**	600	100%
Undepreciated capital cost (UCC)	**12,900**	**4% to 30%**	3,100	4% to 30%
Share issue costs	**1,700**	**5 years**	300	5 years
Income tax deductions	**55,100**		13,700	

NET EARNINGS AND CASH FLOW FROM OPERATIONS

Net earnings for the year ended December 31, 2003 were $4.7 million ($0.21 per share, basic and diluted). During the same period, cash flow from operations was $15.3 million ($0.69 per share, basic and $0.68 per share, diluted).

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

Unit Statistics

	Year ended December 31, 2003		April 16 to December 31, 2002	
	BOE/D	$/BOE	BOE/D	$/BOE
Daily average production	**1,942**		133	
Sales price		**37.55**		36.50
Other oil and gas revenue		**0.01**		0.29
Royalties, net of ARTC		**(6.91)**		(7.02)
Production expense		**(7.32)**		(10.39)
Operating netback		**23.33**		19.38
General and administrative expense		**(1.23)**		(4.25)
Interest expense		**(0.31)**		(0.40)
Capital tax		**(0.22)**		–
Other revenue		**0.04**		0.88
Cash flow from operations		**21.61**		15.61
Depletion and depreciation		**(13.88)**		(14.59)
Stock-based compensation expense		**(0.24)**		(0.41)
Future income tax		**(0.91)**		0.19
Net earnings		**6.58**		0.80

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 late June 2003, Celtic completed the acquisition of certain oil and gas assets located in close proximity to the Company's core producing areas in Alberta for approximately $18.5 million. In September 2003, the Company acquired certain oil and gas assets located at Fox Creek in west central Alberta for $4.4 million. Total expenditures on property acquisitions in 2003 were $23.8 million.

During the year ended December 31, 2003, in addition to property acquisitions, Celtic spent $31.4 million on exploration and development activity. The Company participated in the drilling of 35 (23.3 net) wells resulting in 17 (12.2 net) oil wells and 11 (7.0 net) natural gas wells. The overall success rate on net wells drilled was 83 percent and the average depth of net wells drilled was 1,721 metres. Approximately 73 percent of net wells drilled were development and 27 percent were exploratory.

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

Capital Expenditures

	Year ended December 31, 2003		April 16 to December 31, 2002	
	$000s	% of Total	$000s	% of Total
Property and equipment expenditures				
Lease acquisitions and retention	**1,506**	**3%**	295	1%
Geological and geophysical activity	**1,673**	**3%**	112	0%
Drilling and completion of wells	**21,527**	**39%**	2,689	9%
Facilities, pipeline and well equipment	**6,493**	**12%**	761	2%
Office furniture and equipment	**175**	**0%**	79	0%
	31,374	**57%**	3,936	13%
Property and equipment acquisitions	**23,808**	**43%**	5,907	19%
Property and equipment dispositions	**(108)**	**0%**	–	0%
Corporate acquisitions	**–**	**0%**	21,266	68%
Capital expenditures	**55,074**	**100%**	31,109	100%

LIQUIDITY AND CAPITAL RESOURCES

Funding for capital expenditures in 2003 was provided by equity financing, bank debt and cash flow from operations.

Celtic completed two private placement equity offerings during the year. In May 2003, the Company issued 4.5 million common shares for gross cash proceeds of $17.8 million, before issue costs and in September 2003, Celtic issued 2.5 million common shares for gross cash proceeds of $15.6 million, before issue costs. During the year, an aggregate 0.4 million common shares were issued upon exercise of stock options for cash proceeds to the Company of $0.8 million. In summary, Celtic raised an aggregate $34.2 million in new equity, before issue costs.

The Company has in place a revolving demand loan facility with a Canadian chartered bank. The maximum amount available to be drawn under this facility is $20.0 million. At December 31, 2003, Celtic had drawn $3.4 million, leaving significant unused credit lines available to fund working capital deficiency and future capital expenditures. Celtic expects to increase the maximum amount available under its credit facility after the Company's bankers complete their annual review in May 2004.

In order to fund all capital expenditures incurred in 2003, the Company augmented its equity financings and bank borrowings by generating $15.3 million in cash flow from operations for the year ended December 31, 2003.

Celtic expects to fund future capital expenditures through the use of a combination of cash flow from operations and bank debt, supplemented by new share offerings, 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, intermediate and senior royalty trust organizations, 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 oil and gas reserves in commercial quantities, developing oil and gas reserves at economic costs, estimating amounts of recoverable reserves, 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 for oil and gas is 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 is 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 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 an 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 2004.

SUPPLEMENTAL DISCLOSURE

Net Asset Value

Celtic's net asset value at December 31, 2003 was $136.0 million or $4.96 per share based on constant prices and $104.4 million or $3.81 per share based on forecasted prices. Constant prices were determined using posted index prices at December 31, 2003, adjusted for quality and transportation. The posted index prices at December 31, 2003 were as follows: WTI US$32.56/bbl, Edmonton light $40.68/bbl, and AECO-C $6.88/mcf for natural gas. Forecasted prices are summarized on page 45 in Note 4 to the financial statements. The components of net asset value are summarized in the following table:

Net Asset Value

	At December 31, 2003		At December 31, 2002
	Constant prices ($000s)	Forecast prices ($000s)	Forecast prices ($000s)
Present value of P&NG reserves discounted at 10%, before tax	**131,364**	**99,725**	38,314
Undeveloped land	**7,791**	**7,791**	2,120
Bank debt, net of working capital	**(10,785)**	**(10,785)**	(3,399)
Proceeds from exercise of stock options	**7,659**	**7,659**	2,707
Net asset value	**136,029**	**104,390**	39,742
Diluted common shares outstanding (000s)	**27,432**	**27,432**	18,379
Net asset value per share ($/share)	**4.96**	**3.81**	2.16

QUARTERLY INFORMATION

During 2003, the Company was successful in providing strong growth in cash flow from operations and daily average production. The following tables summarize key financial and operating information by quarter:

Quarterly Financial Information

$000s, except per share amounts	Q1	Q2	Q3	Q4	Total
2003					
Revenue, net of royalties	**4,544**	**4,357**	**5,772**	**7,082**	**21,755**
Cash flow from operations	**3,433**	**3,087**	**4,007**	**4,787**	**15,314**
Cash flow per share – basic	**0.19**	**0.14**	**0.17**	**0.19**	**0.69**
Cash flow per share – diluted	**0.18**	**0.14**	**0.17**	**0.18**	**0.68**
Net earnings	**1,163**	**826**	**1,810**	**866**	**4,665**
Earnings per share – basic	**0.06**	**0.04**	**0.08**	**0.03**	**0.21**
Earnings per share – diluted	**0.06**	**0.04**	**0.08**	**0.03**	**0.21**
2002					
Revenue, net of royalties	–	–	2	1,055	1,057
Cash flow from operations	–	–	(12)	550	538
Cash flow per share – basic	–	–	(0.01)	0.08	0.07
Cash flow per share – diluted	–	–	(0.01)	0.08	0.07
Net earnings	–	–	(7)	34	27
Earnings per share – basic	–	–	–	–	–
Earnings per share – diluted	–	–	–	–	–

Quarterly Operating Information

	Q1	Q2	Q3	Q4	2003
2003					
Production					
Oil (bbls/d)	**605**	**829**	**1,270**	**1,505**	**1,055**
Natural gas (mcf/d)	**4,423**	**4,332**	**5,161**	**7,324**	**5,318**
Combined (BOE/d)	**1,342**	**1,551**	**2,130**	**2,726**	**1,941**
Production per million shares (BOE/d)	**72**	**72**	**89**	**105**	**87**
Realized sales prices					
Oil ($/bbl)	**42.50**	**33.46**	**35.17**	**34.87**	**35.76**
Natural gas ($/mcf)	**8.45**	**7.02**	**5.99**	**5.73**	**6.61**
Combined ($/BOE)	**47.00**	**37.49**	**35.48**	**34.64**	**37.55**
Operating netbacks					
Oil ($/bbl)	**26.73**	**21.06**	**22.48**	**20.85**	**22.22**
Natural gas ($/mcf)	**5.41**	**4.48**	**3.78**	**3.36**	**4.10**
Combined ($/BOE)	**29.86**	**23.77**	**22.56**	**20.54**	**23.33**

	Q1	Q2	Q3	Q4	2002
2002					
Production					
Oil (bbls/d)	–	–	–	251	89
Natural gas (mcf/d)	–	–	–	745	264
Combined (BOE/d)	–	–	–	375	133
Production per million shares (BOE/d)	–	–	–	26	17
Realized sales prices					
Oil ($/bbl)	–	–	–	37.28	37.28
Natural gas ($/mcf)	–	–	–	5.83	5.83
Combined ($/BOE)	–	–	–	36.50	36.50
Operating netbacks					
Oil ($/bbl)	–	–	–	19.41	19.41
Natural gas ($/mcf)	–	–	–	3.22	3.22
Combined ($/BOE)	–	–	–	19.38	19.38

SHARE INFORMATION

The Company is authorized to issue an unlimited number of common shares and an unlimited number of preferred shares. As at December 31, 2003, there were 25.8 million common shares outstanding, compared to 18.4 million at the end of 2002. There were no preferred shares outstanding during these periods. As at December 31, 2003, employees and directors have been granted options to purchase 1.6 million common shares of the Company at an average exercise price of $4.66 per share. Detailed information regarding the Company's stock option plan is contained in Note 6 to the financial statements. The following table outlines Celtic's common share trading activity by quarter during 2002 and 2003:

Share Trading Activity (CLT)

	Q1	Q2	Q3	Q4	2003
High ($)	**4.60**	**5.95**	**6.70**	**8.00**	**8.00**
Low ($)	**3.90**	**3.95**	**5.10**	**5.55**	**3.90**
Close ($)	**4.06**	**5.20**	**6.00**	**8.00**	**8.00**
Volume traded (000s)	**1,264**	**1,680**	**1,259**	**3,106**	**7,309**
Value traded ($000s)	**5,246**	**7,816**	**7,475**	**18,901**	**39,438**
Weighted average trading price ($)	**4.15**	**4.65**	**5.94**	**6.09**	**5.40**

	Q1	Q2	Q3	Q4	2002
High ($)	–	–	3.50	4.60	4.60
Low ($)	–	–	1.01	2.90	1.01
Close ($)	–	–	3.45	4.25	4.25
Volume traded (000s)	–	–	691	853	1,544
Value traded ($000s)	–	–	1,698	3,039	4,737
Weighted average trading price ($)	–	–	2.46	3.56	3.07

OFF BALANCE SHEET ARRANGEMENTS

As a normal course of business, the Company leases office space, vehicles for field personnel and office equipment such as computers, printers and photocopiers. Details regarding obligations on rented office space are provided in Note 11 to the financial statements.

CONTRACTUAL OBLIGATIONS

Celtic has a demand revolving credit facility with a Canadian chartered bank. The authorized borrowing amount under this facility as at December 31, 2003 was $20.0 million, of which $3.4 million was outstanding. Interest under this facility is payable monthly. Additional disclosure relating to bank debt is provided in Note 5 to the financial statements.

From time to time, the Company enters into agreements to transport and market oil and gas production. In addition, the Company has entered into agreements with third parties that provide employees with access to specialized computer software and information including production and reserves data, geological data, accounting systems and land management systems.

The Company has entered into certain operating leases discussed above under the heading "Off Balance Sheet Arrangements."

ACCOUNTING POLICIES AND ESTIMATES

Management is required to make judgements, assumptions and estimates in the application of generally accepted accounting principles that have a significant impact on the financial results of the Company. Details outlining Celtic's accounting policies are contained in Note 1 to the financial statements.

As at December 31, 2003, the Company adopted changes in accounting policies and practices with respect to stock-based compensation and full-cost accounting. Details outlining Celtic's changes in accounting policies and practices are contained in Note 2 to the financial statements.

RELATED-PARTY TRANSACTIONS

The following is a summary of related-party transactions that occurred in 2002 and 2003:

(i) The Company has retained the law firm of Borden Ladner Gervais LLP to provide Celtic with legal services. William C. Guinan, a director, chairman and corporate secretary of Celtic is a partner of this law firm. During the year ended December 31, 2003, the Company paid a total of $0.2 million (2002 – $0.4 million) to this firm for legal fees and disbursements (including GST). The Company expects to continue using the services of this law firm from time to time;

(ii) 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 $0.9 million, before adjustments. The acquisition was financed by a cash payment of $0.9 million. The vendor of the Alderson area properties, Jarrod Oils Ltd., is controlled by Eldon A. McIntyre, a director of Celtic; and

(iii) 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 $4.2 million, before adjustments. The acquisition was financed by a cash payment of $1.5 million and by the issuance of 2.7 million common shares with an assigned value of $2.7 million. The vendor of the Princess area properties, Jarrod Oils Ltd., is controlled by Eldon A. McIntyre, a director of Celtic.

management's report

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.

David J. Wilson
President and Chief Executive Officer

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

March 25, 2004

auditors' report

To the Shareholders of Celtic Exploration Ltd.

We have audited the balance sheets of Celtic Exploration Ltd. as at December 31, 2003 and 2002 and the statements of operations and retained earnings and cash flows for the year ended December 31, 2003 and 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 audits.

We conducted our audits 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, 2003 and 2002 and the results of its operations and its cash flows for the year ended December 31, 2003 and for the period from April 16, 2002 to December 31, 2002 in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants

March 5, 2004

balance sheet

($ thousands)		As at December 31
	2003	2002
ASSETS		
Current assets		
Cash and cash equivalents	$ 37	$ 960
Accounts receivable	6,593	2,031
Prepaid expenses	19	56
Other	204	66
	6,853	3,113
Property and equipment *(Note 4)*	86,835	41,246
	$ 93,688	$ 44,359
LIABILITIES		
Current liabilities		
Accounts payable and accrued liabilities	$ 14,191	$ 4,962
Bank debt *(Note 5)*	3,447	1,550
	17,638	6,512
Future site restoration costs	808	473
Future income taxes *(Note 7)*	11,157	11,290
	29,603	18,275
SHAREHOLDERS' EQUITY		
Share capital *(Note 6)*	59,211	26,043
Contributed surplus *(Note 1g)*	182	14
Retained earnings	4,692	27
	64,085	26,084
	$ 93,688	$ 44,359

See accompanying notes to the financial statements.

On behalf of the Board of Directors:

Director

Director

statement of operations and retained earnings

($ thousands)	Three months ended December 31 2003	Three months ended December 31 2002	Twelve months ended December 31 2003	Period from April 16 to December 31 2002
	Unaudited	*Unaudited*		
Revenue				
Petroleum and natural gas	$ 8,693	$ 1,269	$ 26,623	$ 1,269
Royalties	(1,612)	(242)	(4,897)	(242)
	7,081	1,027	21,726	1,027
Other	–	29	29	30
	7,081	1,056	21,755	1,057
Expenses				
Production	1,929	358	5,188	358
General and administrative	302	133	874	147
Stock-based compensation *(Note 6c)*	168	14	168	14
Interest	23	14	221	14
Depletion and depreciation	3,598	503	9,838	503
	6,020	1,022	16,289	1,036
Earnings before taxes	1,061	34	5,466	21
Capital tax	40	–	158	–
Future income taxes *(Note 7)*	155	–	643	(6)
Net earnings	866	34	4,665	27
Retained earnings (deficit), beginning of period	3,826	(7)	27	–
Retained earnings, end of period	$ 4,692	$ 27	$ 4,692	$ 27

See accompanying notes to the financial statements.

statement of cash flows

($ thousands)	Three months ended December 31 2003	2002	Twelve months ended December 31 2003	Period from April 16 to December 31 2002
	Unaudited	*Unaudited*		
Cash provided by (used in):				
Operating activities				
Net earnings	$ 866	$ 34	$ 4,665	$ 27
Items not affecting cash:				
Depletion and depreciation	3,598	503	9,838	503
Stock-based compensation	168	14	168	14
Future income taxes	155	–	643	(6)
Cash flow from operations	4,787	551	15,314	538
Change in non-cash operating working capital *(Note 9)*	6,727	(2,888)	4,177	(2,981)
	11,514	(2,337)	19,491	(2,443)
Financing activities				
Increase in bank debt	797	1,550	1,897	1,550
Issue of common shares, net of costs	839	9,235	32,391	17,462
	1,636	10,785	34,288	19,012
Investing activities				
Property and equipment expenditures	(12,732)	280	(31,374)	(3,937)
Property and equipment acquisitions	110	(2,953)	(23,808)	(2,953)
Corporate acquisitions *(Note 3a)*	–	(8,389)	–	(8,389)
Property and equipment dispositions	90	–	108	–
Site restoration and abandonment expenditures	(1)	–	(17)	–
Change in non-cash investing working capital *(Note 9)*	(610)	(330)	389	(330)
	(13,143)	(11,392)	(54,702)	(15,609)
Decrease in cash	7	(2,944)	(923)	960
Cash, beginning of period	30	3,904	960	–
Cash, end of period	$ 37	$ 960	$ 37	$ 960

See accompanying notes to the financial statements.

notes to the financial statements

For the year ended December 31, 2003 and for the period from April 16, 2002 to December 31, 2002
(All tabular amounts in thousands, unless otherwise stated.)

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. The Company is an oil and natural gas exploration, development and production company based in Calgary, Alberta, Canada. Celtic's operations are focused in Western Canada, primarily in Alberta.

1. 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 material.

(b) 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.

(c) 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 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 future net cash flows based on proved reserves, which are determined using forecasted future prices, plus the net costs of major development projects and unproved properties, less future site restoration costs and overhead expenses. 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.

(d) 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.

(e) 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.

(f) 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.

(g) Stock-based compensation

The Company has a stock-based compensation plan, as described in Note 6 (c). Effective January 1, 2003, the Company has 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.

(h) 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.

(i) Financial instruments

The fair market value of cash and cash equivalents, receivables, prepaid expenses, other current assets, payables and bank debt approximates 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.

2. CHANGES IN ACCOUNTING POLICIES AND PRACTICES

(a) Stock-based Compensation

The Company has early adopted the Canadian accounting standard as outlined in the CICA Handbook, section 3870, "Stock-based Compensation and Other Stock-based Payments." This policy has been adopted prospectively, meaning all prior years have not been restated.

The adoption of the new accounting standard for stock-based compensation resulted in the Company recognizing an expense of $0.2 million in 2003.

(b) Full-cost accounting

The Company has early adopted the new CICA Accounting Guideline AcG-16, "Oil and Gas Accounting – Full Cost." The new guideline modifies how the ceiling test is performed, and requires cost centres to be tested for recoverability using undiscounted future cash flows from proved reserves which are determined by using forecasted future prices. When the carrying amount of a cost centre is not recoverable, the cost centre would be written down to its fair value.

There is no impact on the Company's reported financial results as a result of applying the new Accounting Guideline AcG-16.

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	$ 5,770
Transaction costs	175
	$ 5,945
Issue of 1,835,436 common shares	5,506
	$ 11,451

Net Assets Acquired	
Petroleum and natural gas properties	$ 25,246
Future income taxes	(7,151)
Future site restoration costs	(398)
	$ 17,697
Bank debt, net of working capital	(6,246)
	$ 11,451

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	$ 2,415
Transaction costs	30
	$ 2,445
Issue of 416,981 common shares	1,251
	$ 3,696

Net Assets Acquired	
Petroleum and natural gas properties	$ 5,414
Future income taxes	(1,782)
Future site restoration costs	(63)
	$ 3,569
Working capital	127
	$ 3,696

(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	$ 1,441
Transaction costs	9
	$ 1,450
Issue of 2,650,000 common shares	2,650
	$ 4,100

Net Assets Acquired	
Petroleum and natural gas properties	$ 5,332
Future income taxes	(1,232)
	$ 4,100

4. PROPERTY AND EQUIPMENT

At December 31, 2003	Cost	Accumulated depletion and depreciation	Net book value
Petroleum and natural gas properties and equipment	$ 96,558	$ 9,930	$ 86,628
Other assets	254	47	207
	$ 96,812	$ 9,977	$ 86,835

At December 31, 2002	Cost	Accumulated depletion and depreciation	Net book value
Petroleum and natural gas properties and equipment	$ 41,658	$ 486	$ 41,172
Other assets	79	5	74
	$ 41,737	$ 491	$ 41,246

At December 31, 2003, petroleum and natural gas properties with a cost of $6.2 million (December 31, 2002 – $1.4 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 $1.2 million (2002 – $0.8 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 2003, the Company capitalized $0.1 million (2002 – Nil) with respect to employee salaries directly relating to exploration and development activities.

At December 31, 2003, the estimated future site restoration costs, net of expected recoveries, to be accrued over the life of the remaining proved reserves are $3.1 million (December 31, 2002 – $1.0 million).

As a result of the ceiling test calculation at December 31, 2003, the Company was not required to record an impairment loss. The future prices used for the next five years in the ceiling test evaluation of the Company's proved reserves as at December 31, 2003 were as follows:

	2004	2005	2006	2007	2008
Oil ($/bbl)	$ 35.34	$ 31.70	$ 30.26	$ 30.70	$ 31.14
Propane ($/bbl)	26.14	20.68	18.69	19.01	19.32
Butane ($/bbl)	30.45	24.87	22.68	23.05	23.41
Pentane plus ($/bbl)	29.65	25.70	24.29	24.80	25.35
Pipeline gas ($/mcf)	6.30	5.61	5.05	5.17	5.25
Solution gas ($/mcf)	6.44	5.74	5.15	5.27	5.35

Prices escalate at approximately 1.5% thereafter.

5. BANK DEBT

	At December 31	
	2003	2002
Demand operating loan	$ 3,447	$ 1,550

Celtic has a demand revolving credit facility with a Canadian chartered bank. The authorized borrowing amount under this facility is $20.0 million. Interest is payable monthly. Borrowing utilizing Bankers' Acceptances is available under the facility. 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, 2004, 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

The following table summarizes the changes in common shares outstanding during the years ended December 31, 2002 and December 31, 2003:

	Common shares	Amount
Balance, April 16, 2002	–	$ –
Issued for cash on incorporation	3,000	450
Issued for cash as initial public offering	1,000	250
Issued for cash through private placement	6,000	14,000
Issued for cash as flow-through shares	3,000	3,000
Income tax benefit renounced on flow-through shares	–	(1,264)
Issued for cash on exercise of stock options	375	94
Issued on acquisition of Dorchester Energy Inc.	1,836	5,506
Issued on acquisition of Denim Energy Corp.	417	1,251
Issued on acquisition of oil and gas assets	2,751	2,954
Share issue costs, after future income taxes	–	(198)
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

At December 31, 2003, 1.9 million (December 31, 2002 – 5.6 million) previously issued common shares of the Company are held in escrow pursuant to four escrow agreements.

(c) Stock options

The following table summarizes the changes in stock options outstanding during the years ended December 31, 2002 and December 31, 2003:

	Number of options	Average exercise price
Balance, April 16, 2002	–	$ –
Granted	1,285	2.16
Granted – Agent options	100	0.25
Exercised – Agent options	(100)	0.25
Exercised	(275)	0.25
Balance, December 31, 2002	1,010	$ 2.68
Granted	1,094	5.53
Exercised	(392)	2.14
Cancelled	(70)	3.72
Balance, December 31, 2003	1,642	$ 4.66

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 $0.014 million is included in stock-based compensation expense and contributed surplus.

Effective January 1, 2003, the Company has 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:

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

The following table summarizes information regarding stock options outstanding at December 31, 2003:

Range of exercise prices per share	Number of options outstanding	Weighted average remaining 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
$ 0.00 to $ 3.00	472	3.8	$ 2.90	25	$ 2.90
$ 3.01 to $ 4.00	117	3.9	$ 3.50	–	–
$ 4.01 to $ 5.00	145	4.1	$ 4.06	–	–
$ 5.01 to $ 6.00	681	4.8	$ 5.71	–	–
$ 6.01 to $ 7.00	227	4.9	$ 6.15	–	–
Total	1,642	4.4	$ 4.66	25	$ 2.90

(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, 2003, all commitments to incur qualifying expenditures had been satisfied.

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:

	2003	2002
Earnings before taxes	$ 5,466	$ 21
Statutory combined federal and provincial income tax rate	40.75%	42.12%
Expected income taxes	2,227	9
Increase (decrease) resulting from:		
Non-deductible Crown payments	1,121	37
Non-taxable provincial royalty credits (ARTC)	(52)	–
Allowable resource allowance deduction	(1,591)	(61)
Benefit relating to changes in future income tax rates	(1,064)	–
Other adjustments	2	9
Provision for (recovery of) future income taxes	$ 643	$ (6)

The components of future income taxes are as follows:

	At December 31	
	2003	2002
Future income tax liabilities:		
Property and equipment	$ 12,079	$ 11,152
Other	–	421
Future income tax assets:		
Site restoration costs	(286)	(149)
Share issue costs	(636)	(129)
Other	–	(5)
Future income taxes	$ 11,157	$ 11,290

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, 0.3 million (2002 – 0.2 million) shares were added to the 22.1 million (2002 – 7.5 million) weighted average number of common shares outstanding during the year for the dilutive effect of stock options.

Earnings per common share are summarized in the table below:

	2003	2002
Earnings per share		
Basic	$ 0.21	$ –
Diluted	$ 0.21	$ –

9. SUPPLEMENTAL CASH FLOW INFORMATION

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

	2003	2002
Accounts receivable	$ (4,562)	$ (2,031)
Prepaid expenses	37	(56)
Other current assets	(138)	(66)
Accounts payable and accruals	9,229	4,961
Working capital deficiency acquired – Dorchester Energy Inc.	–	(6,246)
Working capital surplus acquired – Denim Energy Corp.	–	127
Change in non-cash working capital	$ 4,566	$ (3,311)
Relating to:		
Operating activities	$ 4,177	$ (2,981)
Investing activities	389	(330)
Change in non-cash working capital	$ 4,566	$ (3,311)

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

	2003	2002
Interest expense	$ 221	$ 14
Capital tax	66	–

10. 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, 2003, the Company paid a total of $0.2 million (2002 – $0.4 million) to this firm for legal fees and disbursements (including GST).

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 $0.9 million, before adjustments. The acquisition was financed by a cash payment of $0.9 million. The vendor of the Alderson area properties, Jarrod Oils Ltd., is controlled by Eldon A. McIntyre, a director of Celtic.

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 $4.2 million, before adjustments. The acquisition was financed by a cash payment of $1.5 million and by the issuance of 2.7 million common shares with an assigned value of $2.7 million. The vendor of the Princess area properties, Jarrod Oils Ltd., is controlled by Eldon A. McIntyre, a director of Celtic.

11. COMMITMENTS

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

	Amount
2004	$ 144
2005	144
2006	108
	$ 396

The office lease expires on September 30, 2006.

12. FINANCIAL INSTRUMENTS AND DERIVATIVE CONTRACTS

The fair market value of cash and cash equivalents, receivables, payables and bank debt approximates 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, 2003, Celtic did not have any derivative contracts in place.

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 2003, Celtic's common shares were listed for trading on the Toronto Stock Exchange ("TSX"). The Company is required under TSX policy to disclose on an annual basis its approach to corporate governance. In preparing this disclosure, the Company has provided a complete description of its system of corporate governance with specific reference to each of the 14 guidelines for effective corporate governance applicable to companies listed on the 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 and equity financings;

- 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, who acts as chairman, and Robert J. Dales, and one director from management, David J. Wilson. 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 and has responsibility for fulfilling the Company's duties and obligations under NI 51-101 "Standards of Disclosure for Oil and Gas Activities," to the extent delegated to the Committee by the Board.

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 has responsibility for the Company's human resources and compensation policies. The Compensation Committee has 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 has 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 approach to corporate governance 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.

e) Integrity of internal control and management information systems.

Yes, Celtic aligns with this guideline.

Comments: The Board has established processes designed to confirm the integrity of internal control systems and management information systems. The Board receives an extensive package of information prepared for each Board meeting.

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 making recommendations regarding 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.

11. 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.

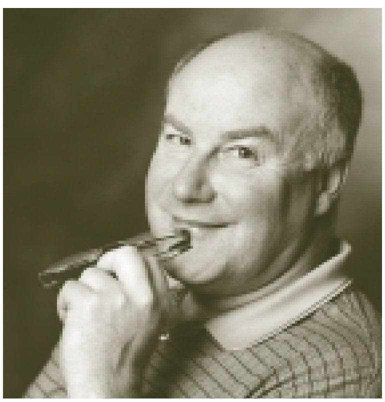
Yes, Celtic aligns with this guideline.

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.



CLOCKWISE FROM TOP

David J. Wilson, Alan G. Franks, Michael R. Shea, Brian A. Skinner, Sadiq H. Lalani.

corporate information

BOARD OF DIRECTORS

Robert J. Dales (2)(3)(4)(5)
President, Valhalla Ventures Inc.

William C. Guinan (1)(4)(5)
Partner, Borden Ladner Gervais LLP

Eldon A. McIntyre (2)(3)
President, Jarrod Oils Ltd.

Neil G. Sinclair (2)(4)
President, Sinson Investments Ltd.

David J. Wilson (3)(5)
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

(1) Chairman of the Board
(2) Member of the Audit Committee
(3) Member of the Reserves Committee
(4) Member of the Compensation Committee
(5) Member of the Corporate Governance Committee

HEAD OFFICE

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Calgary, Alberta
T2P 4H2

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National Bank of Canada
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T2P 5L3

EVALUATION ENGINEERS

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

STOCK EXCHANGE LISTING

Toronto Stock Exchange
Trading symbol "CLT"

ABBREVIATIONS

bbls	barrels
mbbls	thousand barrels
bbls/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 6 mcf = 1 BOE.

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Celtic Exploration Ltd.

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