

INTERIM REPORT FOR THE SIX MONTHS ENDED **June 30, 2004**
(UNAUDITED)

Q2
highlights

(\$ thousands, unless otherwise indicated)	Three months ended June 30			Six months ended June 30		
	2004	2003	% Change	2004	2003	% Change
FINANCIAL						
Revenue, net of royalties	\$ 11,976	\$ 4,582	161	\$ 23,188	\$ 9,198	152
Cash flow from operations	\$ 8,472	\$ 3,088	174	\$ 16,667	\$ 6,520	156
Cash flow per share						
Basic (\$/share)	\$ 0.33	\$ 0.14	136	\$ 0.65	\$ 0.33	97
Diluted (\$/share)	\$ 0.32	\$ 0.14	129	\$ 0.63	\$ 0.32	97
Net earnings	\$ 2,582	\$ 810	219	\$ 4,629	\$ 1,948	138
Earnings per share						
Basic (\$/share)	\$ 0.10	\$ 0.04	–	\$ 0.18	\$ 0.10	80
Diluted (\$/share)	\$ 0.10	\$ 0.04	–	\$ 0.17	\$ 0.10	70
Capital expenditures, net of dispositions	\$ 12,143	\$ 25,383	-52	\$ 24,924	\$ 31,224	-20
Total assets				\$ 114,246	\$ 75,986	50
Bank debt, net of working capital				\$ 19,023	\$ 11,299	68
Shareholders' equity				\$ 69,059	\$ 45,339	52
OPERATIONS						
Production						
Oil (bbls/d)	2,314	829	179	2,298	718	220
Natural gas (mcf/d)	7,372	4,332	70	7,713	4,377	76
Combined (BOE/d)	3,543	1,551	128	3,584	1,448	148
Production per million shares (BOE/d)	137	72	90	139	72	93
Realized sales prices						
Oil (\$/bbl)	\$ 45.79	\$ 35.54	29	\$ 44.35	\$ 38.45	15
Natural gas (\$/mcf)	\$ 7.29	\$ 7.19	1	\$ 6.91	\$ 7.92	-13
Combined (\$/BOE)	\$ 45.07	\$ 39.08	15	\$ 43.33	\$ 43.03	1
Operating netbacks						
Oil (\$/bbl)	\$ 30.08	\$ 21.06	43	\$ 29.13	\$ 23.45	24
Natural gas (\$/mcf)	\$ 4.00	\$ 4.48	-11	\$ 3.88	\$ 4.95	-22
Combined (\$/BOE)	\$ 27.98	\$ 23.77	18	\$ 27.06	\$ 26.59	2
Drilling activity						
Total wells	9	5	80	26	13	100
Working interest wells	5.3	2.8	89	18.0	6.0	200
Success rate on working interest wells	100%	43%		92%	48%	
Undeveloped land						
Gross acres				168,596	92,432	82
Net acres				88,757	52,559	69

message to shareholders

Celtic Exploration Ltd. ("Celtic" or the "Company") is pleased to report to shareholders on the activities of the Company during the second quarter of 2004.

The Company drilled nine (5.3 net) wells during the second quarter, resulting in four (3.3 net) oil wells, and five (2.0 net) natural gas wells, for an overall success rate of 100 percent. Also, during the quarter, Celtic sold approximately 100 BOE/d of non-core production.

In southern Alberta, Celtic drilled one oil well and four natural gas wells in the second quarter to kick off a 10-well drilling program that will be completed in the third quarter. In addition, the Company has been successful recently in adding natural gas production by completing previously non-producing zones in existing well bores, in the Richdale/Michichi area. The Company is currently taking measures to increase facility capacity in the area to allow for Celtic's increased natural gas producing capacity.

In the Richdale/Michichi area, the Company has entered into an agreement with an experienced operator to farm out 31 (19.5 net) sections of Celtic land prospective for Coal Bed Methane natural gas drilling. Initially, five wells will be drilled, after which the operator has the option to continue drilling additional wells, earning a section per well. Celtic will retain a 50 percent working interest after drilling and completion operations. Drilling operations in this program commenced in early August.

In east central Alberta, the Company recently tied in three new natural gas wells at Ashmont; however, the facility through which Celtic processes its natural gas was recently shut-in. The operator of the facility has restored the facility and the Company's production has re-commenced at Ashmont.

In west central Alberta, Celtic recently put on production two horizontal wells which were drilled in the Morse River Unit at Swan Hills. Initial production rates are encouraging; however, the wells cannot be properly tested without an electrical upgrade, which will take several weeks. At Kakwa/Chime, the Company is participating in the completion of a Dunvegan natural gas well that was drilled on a 3-D seismic anomaly. At Fox Creek, Celtic drilled and cased an exploration test at the southern tip of its existing oil pool. An online test will be performed after the well is pipeline connected in early September.

In northern Alberta, the Company participated in the drilling of a successful light oil well at Red Earth, close to Celtic's active operating area at Otter/Ogston. Three additional wells will be drilled in the Otter/Ogston area in the third quarter. At McLean's Creek, the Company followed up its recent light oil discovery with a second successful well. A third well is planned for this area in the third quarter.

management's discussion and analysis

ADVISORY REGARDING FORWARD-LOOKING STATEMENTS

Certain information with respect to Celtic contained in this interim report, including management's assessment of future plans and operations, contains forward-looking statements. These forward-looking statements are based on assumptions and are subject to numerous risks and uncertainties, some of which are beyond Celtic's control, including the impact of general economic conditions, industry conditions, volatility of commodity prices, currency exchange rate fluctuations, imprecision of reserve estimates, environmental risks, competition from

other explorers, stock market volatility and ability to access sufficient capital. Celtic's actual results, performance or achievement could differ materially from those expressed in, or implied by, these forward-looking statements and, accordingly, no assurance can be given that any events anticipated by the forward-looking statements will transpire or occur. In addition, the reader is cautioned that historical results are not necessarily indicative of future performance.

INTRODUCTION

The following management's discussion and analysis ("MD&A") should be read in conjunction with the Company's unaudited interim financial statements for the six months ended June 30, 2004 and the audited financial statements and MD&A for the year ended December 31, 2003. The accompanying unaudited interim financial statements of Celtic for the six months ended June 30, 2004 have been prepared by management and approved by the Company's Audit Committee and Board of Directors. These financial statements have not been reviewed by Celtic's external auditors. Additional information relating to Celtic, including its Annual Information Form, is on SEDAR at www.sedar.com.

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

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 million shares outstanding.

RESULTS OF OPERATIONS

Selected Quarterly Information

(\$ thousands, unless otherwise indicated)

	2004 Q2	2004 Q1	2003 Q4	2003 Q3	2003 Q2
Revenue, net of royalties	\$ 11,976	\$ 11,212	\$ 7,307	\$ 5,925	\$ 4,582
Cash flow from operations	\$ 8,472	\$ 8,195	\$ 4,787	\$ 4,007	\$ 3,088
Per share – basic (\$/share)	\$ 0.33	\$ 0.32	\$ 0.19	\$ 0.17	\$ 0.14
Per share – diluted (\$/share)	\$ 0.32	\$ 0.31	\$ 0.18	\$ 0.17	\$ 0.14
Net earnings	\$ 2,582	\$ 2,047	\$ 961	\$ 1,789	\$ 810
Per share – basic (\$/share)	\$ 0.10	\$ 0.08	\$ 0.04	\$ 0.08	\$ 0.04
Per share – diluted (\$/share)	\$ 0.10	\$ 0.08	\$ 0.04	\$ 0.07	\$ 0.04
Total assets	\$ 114,246	\$ 106,166	\$ 94,980	\$ 84,703	\$ 75,986
Bank debt, net of working capital	\$ 19,023	\$ 15,372	\$ 10,785	\$ 3,878	\$ 11,299
Production (BOE/d)	3,543	3,623	2,726	2,130	1,551
Production per million shares (BOE/d)	137	140	105	89	72
Realized sales price (\$/BOE)	\$ 45.07	\$ 41.59	\$ 35.55	\$ 36.27	\$ 39.08
Operating netback (\$/BOE)	\$ 27.98	\$ 26.13	\$ 20.54	\$ 22.56	\$ 23.77

Production

For the three months ended June 30, 2004, Celtic's production averaged 3,543 BOE/d, comprised of 2,314 barrels per day of oil and 7.37 million cubic feet per day of natural gas. This represents a 128 percent improvement from the average production of 1,551 BOE/d in the second quarter of 2003. During the second quarter of 2004, the Company sold approximately 100 BOE/d of non-core production. Celtic's growth in production volumes compared to the previous year reflects the successful implementation of its dual-prong growth strategy. Wet weather conditions during the second quarter of 2004 resulted in a significant amount of oil production being temporarily shut-in. As a result, production levels during the quarter were lower than the Company's total capability and production expenses were higher. With additional new production coming on-stream as a result of recent drilling success and production that was temporarily shut-in in the second quarter due to facility constraints, Celtic expects to show further production growth in the third quarter of 2004.

Commodity Prices

Average prices received during the three-month period ended June 30, 2004 were \$45.79 per barrel for oil sales and \$7.29 per thousand cubic feet for natural gas sales. During the three-month period ended June 30, 2003, average prices received for sales were \$35.54 per barrel for oil and \$7.19 per thousand cubic feet for natural gas. Higher commodity prices in the second quarter of 2004 contributed to increases in revenue and cash flow from operations for the period. Celtic is forecasting oil prices to average \$42.00 per barrel and natural gas prices to average \$6.35 per thousand cubic feet in 2004. However, recent strength in both oil and gas prices may warrant the Company to increase its forecasted prices in the near future.

Revenue and Royalties

Oil and gas revenue, before royalties, for the three months ended June 30, 2004 was \$14.5 million, up 164 percent from \$5.5 million during the same period of the previous year. Royalties during the second quarter of 2004 were \$2.6 million, averaging 17.9 percent of sales. During the same period of 2003, royalties were \$1.0 million, averaging 18.2 percent of sales. Celtic is able to achieve lower royalties than industry standard through its participation in royalty incentive programs available for deep drilling and horizontal re-activation wells.

Expenses

For the three-month period ended June 30, 2004, production expenses were \$2.7 million (\$8.30 per BOE), transportation and selling expense was \$0.3 million (\$0.86 per BOE), general and administrative expenses were \$0.3 million (\$1.08 per BOE), interest expense was \$0.2 million, and depletion, depreciation and amortization expenses were \$4.5 million (\$13.85 per BOE). For the three-month period ended June 30, 2003, production expenses were \$1.0 million (\$6.88 per BOE), transportation and selling expense was \$0.2 million (\$1.59 per BOE), general and administrative expenses were \$0.2 million (\$1.52 per BOE), interest expense was \$0.1 million, and depletion, depreciation and amortization expenses were \$1.9 million (\$13.61 per BOE).

Taxes

For the second quarter of 2004, capital taxes were \$0.05 million compared to \$0.04 million in the corresponding period of the previous year. As at June 30, 2004, Celtic has sufficient tax deductions available to allow the Company to not record any current income tax expense. However, a provision for future income taxes in the amount of \$1.2 million was recorded for the three-month period ended June 30, 2004. An analysis of the future income tax provision is included in the notes to the interim financial statements.

Cash Flow from Operations and Net Earnings

Cash flow from operations for the three months ended June 30, 2004 was \$8.5 million (\$26.28 per BOE) or \$0.33 per share (\$0.32 per share diluted). The Company recorded net earnings of \$2.6 million or \$0.10 per share (basic and diluted) during the three-month period ended June 30, 2004. During the same period in the previous year, cash flow from operations was \$3.1 million (\$21.88 per BOE) or \$0.14 per share (basic and diluted). Net earnings for the second quarter of 2003 were \$0.8 million or \$0.04 per share (basic and diluted). The significant increases in cash flow from operations and net earnings in the second quarter of 2004, compared to the same period in 2003, were primarily due to the 128 percent growth in production and the 15 percent higher realized sales price per barrel of oil equivalent.

Weighted average common shares outstanding used to compute per share amounts were 25.8 million basic and 26.5 million diluted.

Capital Expenditures

During the three-month period ended June 30, 2004, Celtic incurred \$12.1 million in capital expenditures, after proceeds from minor property dispositions. Approximately \$7.1 million was spent on drilling and completing wells, \$3.0 million was spent on well equipment and facilities and the balance was spent on land, seismic and other.

Celtic is committed to future growth through its dual-prong strategy to augment strategic oil and gas asset acquisitions with exploration and development drilling activity. As a result, the Company has established a \$50.0 million capital budget for 2004, of which \$25.1 million is expected to be incurred during the second half of the year. The majority of these expenditures are planned for exploration and development activity.

LIQUIDITY AND CAPITAL RESOURCES

Capital expenditures for the second quarter of 2004 were funded by cash flow from operations and bank debt.

The Company currently has a revolving demand loan facility with a Canadian chartered bank, with an authorized borrowing amount of \$36.0 million. At June 30, 2004, Celtic had \$17.2 million outstanding under this facility. Bank debt, including working capital deficiency at June 30, 2004, was \$19.0 million. As a result, the Company has significant unutilized bank lines, remaining in a strong financial position to implement its growth strategy in the near future.

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

OUTLOOK

Celtic recently announced that it had entered into a farm-in agreement whereby Celtic has committed to drill a minimum of four wells in the Ashmont area, in close proximity to the Company's existing acreage and operations. The farm-in area consists of 109 (68 net) sections of land and, under certain conditions, Celtic can continue to drill land-earning option wells until September 1, 2006. Celtic will pay 100 percent of the drilling and completion costs, earning a 65 percent working interest. Prior to entering into this farm-in agreement, Celtic owned a 100 percent interest in over 50 sections of land in the Ashmont area. Celtic has been successful to date at Ashmont, increasing production from 100 BOE/d to approximately 350 BOE/d. The area provides lower risk and shallow depth multi-zone natural gas drilling opportunities with relatively low drilling costs.

As a result of recent drilling success, the large area farm-in agreement mentioned above, and the generation of new exploration and development prospects, Celtic has increased its 2004 capital expenditure budget to \$50.0 million (previously \$40.0 million). The increase in capital spending will be financed by cash flow from operations and existing bank credit lines.

After giving effect to the increased capital expenditure program, the Company expects to exit 2004 with approximately 5,000 BOE/d of production (previous guidance was 4,700 BOE/d). Average production for the year is expected to be approximately 4,100 BOE/d. Cash flow from operations is forecasted to be approximately \$34.5 million (previous guidance was \$32.4 million) in 2004 or \$1.34 per share (previous guidance was \$1.25 per share). Debt, net of working capital, is estimated to reach \$26.3 million (previous guidance was \$18.4 million) by the end of 2004 or 0.8 times 2004 cash flow (previous guidance was 0.6 times 2004 cash flow).

Celtic's capital expenditure budget for 2004 will see the Company participate at high working interests in the drilling of approximately 55 wells during the year. Celtic is excited about its growth prospects and remains optimistic about the Company's ability to deliver continued per share growth in production, cash flow from operations and earnings.

On behalf of the Board of Directors,

[signed]

David J. Wilson
President and Chief Executive Officer
August 12, 2004

balance sheet

(\$ thousands)	As at June 30	As at December 31
	2004	2003
	<i>(Unaudited)</i>	<i>(Restated – Note 2)</i>
ASSETS		
Current assets		
Cash and cash equivalents	\$ 10	\$ 37
Accounts receivable	9,057	6,593
Prepaid expenses	492	19
Other	202	204
	9,761	6,853
Property and equipment <i>(Note 3)</i>	104,485	88,127
	\$ 114,246	\$ 94,980
LIABILITIES		
Current liabilities		
Accounts payable and accrued liabilities	\$ 11,584	\$ 14,191
Bank debt <i>(Note 4)</i>	17,200	3,447
	28,784	17,638
Asset retirement obligation <i>(Notes 2a, 5)</i>	2,813	2,045
Future income taxes	13,590	11,179
	45,187	30,862
SHAREHOLDERS' EQUITY		
Share capital <i>(Note 6)</i>	59,230	59,211
Contributed surplus	475	182
Retained earnings	9,354	4,725
	69,059	64,118
	\$ 114,246	\$ 94,980

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

statement of operations and retained earnings

(\$ thousands, except per share amounts)	Three months ended June 30		Six months ended June 30	
	2004 (Unaudited)	2003 (Restated – Note 2) (Unaudited)	2004 (Unaudited)	2003 (Restated – Note 2) (Unaudited)
Revenue				
Petroleum and natural gas	\$ 14,547	\$ 5,535	\$ 28,273	\$ 11,284
Royalties	(2,571)	(982)	(5,085)	(2,115)
	11,976	4,553	23,188	9,169
Other	–	29	–	29
	11,976	4,582	23,188	9,198
Expenses				
Production	2,678	971	5,088	1,909
Transportation and selling (Note 2b)	279	224	462	296
General and administrative	347	214	668	338
Interest	154	45	206	67
Depletion and depreciation	4,466	1,921	9,230	3,604
Stock-based compensation (Note 2c)	146	42	293	84
Accretion of asset retirement obligation (Note 5)	42	19	82	19
	8,112	3,436	16,029	6,317
Earnings before taxes	3,864	1,146	7,159	2,881
Capital tax	46	40	97	68
Future income taxes (Note 8)	1,236	296	2,433	865
Net earnings	2,582	810	4,629	1,948
Retained earnings, beginning of period				
As previously reported	6,772	1,166	4,692	28
Retroactive adjustment for changes in accounting policies	–	–	33	–
As restated (Note 2)	6,772	1,166	4,725	28
Retained earnings, end of period	\$ 9,354	\$ 1,976	\$ 9,354	\$ 1,976
Earnings per share				
Basic	\$ 0.10	\$ 0.04	\$ 0.18	\$ 0.10
Diluted	\$ 0.10	\$ 0.04	\$ 0.17	\$ 0.10

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

statement of cash flows

(\$ thousands)	Three months ended June 30		Six months ended June 30	
	2004 <i>(Unaudited)</i>	2003 <i>(Restated – Note 2) (Unaudited)</i>	2004 <i>(Unaudited)</i>	2003 <i>(Restated – Note 2) (Unaudited)</i>
Operating activities				
Net earnings	\$ 2,581	\$ 810	\$ 4,629	\$ 1,948
Items not affecting cash:				
Depletion and depreciation	4,466	1,921	9,230	3,604
Stock-based compensation	147	42	293	84
Accretion of asset retirement obligation	42	19	82	19
Future income taxes	1,236	296	2,433	865
Cash flow from operations	8,472	3,088	16,667	6,520
Change in non-cash operating working capital <i>(Note 10)</i>	(2,758)	(3,553)	(9,804)	(2,014)
Cash provided by (used in) operating activities	5,714	(465)	6,863	4,506
Financing activities				
Increase in bank debt	5,300	8,300	13,753	8,850
Issue of common shares, net of costs	20	16,757	19	16,816
Cash provided by financing activities	5,320	25,057	13,772	25,666
Investing activities				
Property and equipment expenditures	(11,259)	(6,341)	(24,030)	(12,182)
Property and equipment acquisitions	(3,262)	(19,060)	(3,562)	(19,060)
Property and equipment dispositions	2,378	18	2,668	18
Site restoration and abandonment expenditures	–	(13)	–	(13)
Change in non-cash investing working capital <i>(Note 10)</i>	1,085	662	4,262	107
Cash used in investing activities	(11,058)	(24,734)	(20,662)	(31,130)
Net change in cash and cash equivalents	(24)	(142)	(27)	(958)
Cash and cash equivalents, beginning of period	34	144	37	960
Cash and cash equivalents, end of period	\$ 10	\$ 2	\$ 10	\$ 2

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

notes to the interim financial statements

*Interim period ended June 30, 2004
(Unaudited)*

1. BASIS OF PRESENTATION

The interim financial statements of the Company have been prepared following the same accounting policies and methods of computation as the financial statements of the Company for the year ended December 31, 2003, with the exception of changes shown in Note 2 below. The disclosure provided below is incremental to that included in the annual financial statements. In this regard, these interim financial statements should be read in conjunction with the financial statements and notes thereto for the year ended December 31, 2003, included in the Company's annual report.

2. CHANGES IN ACCOUNTING POLICIES AND PRACTICES

(a) Asset retirement obligations

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

The Company previously estimated future site restoration and abandonment costs and recorded them into earnings on a unit-of-production basis over the remaining life of proved reserves and accumulated a liability on the Balance Sheet. Prior year financial statements have been restated to reflect the change in accounting treatment. In summary, net earnings for the six months ended June 30, 2003 increased by \$0.013 million, property and equipment assets at June 30, 2003 increased by \$1.107 million and liabilities increased by \$1.094 million.

(b) Transportation and selling expenses

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

(c) Stock-based compensation

The Company has adopted the Canadian accounting standard outlined in the CICA Handbook Section 3870, "Stock-based Compensation and Other Stock-based Payments." This policy has been adopted prospectively effective January 1, 2003. This new section provides for 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.

Prior year financial statements have been restated to reflect the change in accounting treatment. In summary, net earnings for the six months ended June 30, 2003 decreased by \$0.054 million, liabilities at June 30, 2003 decreased by \$0.030 million and contributed surplus increased by \$0.084 million.

(d) Financial instruments and hedging

The Company has adopted new guidelines related to the treatment of financial instruments and hedging as outlined in the CICA Handbook Section 3860, "Financial Instruments." This policy has been adopted prospectively effective January 1, 2004. As at June 30, 2004, the Company had no such instruments, and therefore there was no impact to the financial statements for the six-month period ended June 30, 2004.

3. PROPERTY AND EQUIPMENT

At June 30, 2004 (\$ thousands)	Cost	Accumulated depletion and depreciation	Net book value
Petroleum and natural gas properties and equipment	\$ 124,054	\$ 19,815	\$ 104,239
Other assets	324	78	246
	\$ 124,378	\$ 19,893	\$ 104,485

At December 31, 2003 (As Restated) (\$ thousands)	Cost	Accumulated depletion and depreciation	Net book value
Petroleum and natural gas properties and equipment	\$ 98,515	\$ 10,595	\$ 87,920
Other assets	254	47	207
	\$ 98,769	\$ 10,642	\$ 88,127

At June 30, 2004, petroleum and natural gas properties with a cost of \$7.1 million (December 31, 2003 – \$6.2 million) relating to unproved 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 (2003 – \$1.2 million) are included in the depletion and depreciation calculation.

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

4. BANK DEBT

(\$ thousands)	June 30, 2004	December 31, 2003
Demand operating loan	\$ 7,200	\$ 3,447
Bankers' acceptances	10,000	–
Bank debt	\$ 17,200	\$ 3,447

Celtic has a demand revolving credit facility with a Canadian chartered bank. The authorized borrowing amount under this facility is \$36.0 million. Interest is payable monthly for borrowings through direct advances. Interest rates fluctuate based on a pricing grid. Currently, interest is payable at bank prime. Under the credit facility, borrowings through the use of bankers' acceptances are also available. The Company has a fixed rate bankers' acceptance in the amount of \$10.0 million maturing on May 27, 2005 at an aggregate interest rate of 3.6 percent. Repayments of principal under the credit facility are not required provided that the aggregate borrowings do not exceed the authorized borrowing amount and the Company is in compliance with all covenants, representations and warranties. The credit facility revolves until May 1, 2005, at which time the bank will conduct its annual review.

5. ASSET RETIREMENT OBLIGATION

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

(\$ thousands)	June 30, 2004	December 31, 2003
Asset retirement obligation, beginning of year	\$ 2,045	\$ 947
Liabilities incurred	686	1,010
Accretion expense	82	88
Asset retirement obligation, end of period	\$ 2,813	\$ 2,045

6. SHARE CAPITAL

Authorized:

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

Issued:

(thousands)	Common shares	Amount
Balance, December 31, 2003	25,790	\$ 59,211
Issued for cash on exercise of stock options	5	20
Share issue costs	—	(1)
Balance, June 30, 2004	25,795	\$ 59,230

7. STOCK OPTIONS

The following table summarizes the changes in stock options outstanding during the year, up to June 30, 2004:

(thousands)	Stock options	Average exercise price
Balance, December 31, 2003	1,642	\$ 4.66
Granted	36	7.15
Exercised	(5)	4.05
Balance, June 30, 2004	1,673	\$ 4.72

8. INCOME TAXES

The provision for future 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:

(\$ thousands)	Six months ended June 30, 2004
Earnings before taxes	\$ 7,159
Statutory combined federal and provincial income tax rate	38.87%
Expected income taxes	\$ 2,783
Increase (decrease) resulting from:	
Non-deductible Crown payments	1,135
Non-taxable provincial royalty credits (ARTC)	(95)
Allowable resource allowance deduction	(1,392)
Other adjustments	2
Provision for future income taxes	\$ 2,433

9. 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.

For the six-month period ended June 30, 2004, in computing diluted earnings per share, 0.7 million shares were added to the 25.8 million weighted average number of common shares outstanding during the period for the dilutive effect of stock options.

10. SUPPLEMENTAL CASH FLOW INFORMATION

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

(\$ thousands)	Six months ended June 30, 2004
Accounts receivable	\$ (2,464)
Prepaid expenses	(473)
Other current assets	1
Accounts payable and accruals	(2,606)
Change in non-cash working capital	\$ (5,542)
Relating to:	
Operating activities	\$ (9,804)
Investing activities	4,262
Change in non-cash working capital	\$ (5,542)

Other cash flow information:

(\$ thousands)	Six months ended June 30, 2004
Cash interest paid	\$ 527
Cash capital taxes paid	168

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.

- ⁽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

OFFICERS

David J. Wilson
President & Chief Executive Officer

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

Alan G. Franks
Vice President, Operations

Michael R. Shea
Vice President, Land

HEAD OFFICE

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

REGISTRAR AND TRANSFER AGENT

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

LEGAL COUNSEL

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

BANKERS

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

AUDITORS

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

EVALUATION ENGINEERS

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

STOCK EXCHANGE LISTING

Toronto Stock Exchange
Trading symbol "CLT"