

Our third quarter results are in, and we are pleased to report that average daily production increased by 30% to a Company quarterly record 11,604 BOE per day, up from 8,914 BOE per day in the third quarter of 2007.

INTERIM REPORT FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2008



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## HIGHLIGHTS

### FINANCIAL

(\$ thousands, unless otherwise indicated)	Three months ended September 30			Nine months ended September 30		
	2008	2007	% Change	2008	2007	% Change
Revenue, before royalties and financial instruments	\$ 73,904	\$ 40,356	83%	\$ 211,495	\$ 105,710	100%
Funds from operations	\$ 34,227	\$ 18,805	82%	\$ 99,312	\$ 60,095	65%
Basic (\$/SHARE)	\$ 0.83	\$ 0.50	66%	\$ 2.50	\$ 1.73	45%
Diluted (\$/SHARE)	\$ 0.83	\$ 0.50	66%	\$ 2.47	\$ 1.70	45%
Net earnings	\$ 31,145	\$ 4,584	579%	\$ 14,654	\$ 4,691	212%
Basic (\$/SHARE)	\$ 0.76	\$ 0.12	533%	\$ 0.37	\$ 0.13	185%
Diluted (\$/SHARE)	\$ 0.75	\$ 0.12	525%	\$ 0.36	\$ 0.13	177%
Capital expenditures, net of dispositions	\$ 40,359	\$ 31,637	28%	\$ 140,703	\$ 154,633	-9%
Total assets				\$ 594,672	\$ 479,026	24%
Bank debt, net of working capital, excluding non-cash financial instruments				\$ 149,588	\$ 131,695	14%
Shareholders' equity				\$ 336,612	\$ 277,294	21%
Weighted average common shares outstanding (thousands)						
Basic	41,107	37,436	10%	39,657	34,837	14%
Diluted	41,435	37,961	9%	40,157	35,275	14%

### OPERATIONS

Production						
Oil (BBL/D)	3,386	3,102	9%	3,354	3,065	9%
Natural gas (MCF/D)	49,310	34,871	41%	44,311	26,140	70%
Combined (BOE/D)	11,604	8,914	30%	10,739	7,422	45%
Production per million shares (BOE/D)	282	238	18%	271	213	27%
Realized sales prices, after financial instruments						
Oil (\$/BBL)	\$ 90.28	\$ 69.84	29%	\$ 87.36	\$ 67.40	30%
Natural gas (\$/MCF)	\$ 8.28	\$ 6.20	34%	\$ 8.77	\$ 7.97	10%
Operating netbacks (\$/BOE)						
Oil and gas revenue, before hedging	\$ 69.21	\$ 47.00	47%	\$ 71.89	\$ 51.06	41%
Increased price from physical fixed price contracts	-	2.21		-	1.12	
Realized gain (loss) on financial instruments	(7.70)	(0.66)		(8.43)	3.73	
Realized sales price, after hedging	\$ 61.51	\$ 48.55	27%	\$ 63.46	\$ 55.91	14%
Royalties	(16.03)	(10.25)	56%	(16.20)	(10.67)	52%
Production expense	(10.87)	(11.55)	-6%	(10.31)	(11.34)	-9%
Transportation expense	(0.41)	(0.97)	-58%	(0.56)	(0.90)	-38%
Operating netback	\$ 34.20	\$ 25.78	33%	\$ 36.39	\$ 33.00	10%
Drilling activity						
Total wells	15	18	-17%	40	57	-30%
Working interest wells	10.0	12.6	-21%	30.9	48.0	-36%
Success rate on working interest wells	91%	76%	20%	88%	78%	13%
Undeveloped land						
Gross acres				312,132	324,002	-4%
Net acres				243,563	245,406	-1%

**Celtic Exploration Ltd. ("Celtic" or the "Company") is pleased to report to shareholders the Company's activities in the third quarter of 2008. During the quarter, Celtic drilled 15 (10.0 net) wells with an overall success rate of 91%. Production during the quarter averaged a record high 11,604 BOE per day, an increase of 30% from the third quarter of 2007. In the third quarter of 2008, Celtic recorded funds from operations of \$34.2 million (\$0.83 per share, diluted), an increase of 82% from \$18.8 million (\$0.50 per share, diluted) reported in the same period of the previous year.**

In Southern Alberta, the Company participated in the drilling of a successful horizontal natural gas well in the Michichi area. Celtic's working interest in this well is 28.6%.

During the third quarter, Celtic drilled a successful oil well at Virginia Hills. The well has been completed and put on production. In addition, the Company drilled a well at Edwand that has been cased and is awaiting completion. Celtic's working interest in both these wells are 100%.

The remainder of Celtic's drilling activity in the third quarter of 2008 took place in the Greater Kaybob area of West Central Alberta, where 12 (7.7 net) wells were drilled with an overall success rate of 88%. Seven of these wells were horizontals with multi-fracture completions.

At Kaybob South, Celtic drilled one horizontal re-entry well (100% working interest) and two horizontal wells (25.5% working interest). All three wells have been completed in the Montney formation and are currently on-stream.

At KayFox, Celtic drilled three horizontal wells (100% working interest). All three wells were successfully completed in the Montney formation and are currently on-stream.

At Lower Kaybob South, Celtic drilled a Montney horizontal well (83.7%) on newly acquired lands. This well was successfully completed and is now on production. As a result, the Company believes it has validated an eleven section land block to the south of this well where Celtic recently entered into a farm-in arrangement. The first well on the farm-in lands is currently being drilled. In addition, the Company drilled three vertical wells at Lower Kaybob South, testing shallower horizons and resulting in two successful Cretaceous wells (100% and 25% working interests) and one unsuccessful well (91.7% working interest).

In the Kaybob South BHL Unit No. 1, Celtic participated in the drilling of two successful Devonian wells (9.3% working interest). The first well has been put on production and the second well is expected to be put on production in the fourth quarter.

Celtic expects to resume drilling operations at Chickadee during the winter, where it has discovered an additional Montney natural gas pool.

The Company was pleased to report significant production growth in the third quarter of 2008 despite having approximately 800 BOE per day off-line as a result of an unscheduled shut-down for repair of a third-party operated gas plant in Kaybob South from September 20, 2008 to October 9, 2008.

At September 30, 2008, the Company had 312,132 (243,563 net) acres of undeveloped land. With this inventory of land and with plans to continue developing the Kaybob prospects, Celtic continues to generate numerous drilling locations that will provide continued growth over the next few years.

Oil and gas producers, like Celtic, are continually exposed to fluctuations in commodity prices that are beyond the control of the companies that produce hydrocarbons. In order to mitigate this risk and provide certainty to a portion of its cash flow supporting its capital investment program, Celtic employs an active risk management program. The Company's outstanding financial derivative contracts relating to its hedged oil production is disclosed in detail in the accompanying notes to the financial statements.

**INTRODUCTION**

Celtic Exploration Ltd. ("Celtic" or the "Company") was incorporated on April 16, 2002. 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 ("TSX") under the symbol "CLT".

The following management's discussion and analysis ("MD&A") should be read in conjunction with the Company's audited financial statements and related notes for the year ended December 31, 2007 and unaudited financial statements and related notes for the interim period ended September 30, 2008. This MD&A is effective November 6, 2008. The accompanying financial statements of Celtic have been prepared by management and approved by the Company's Audit Committee and Board of Directors. These financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). Additional information relating to Celtic can be found on the SEDAR website at [www.sedar.com](http://www.sedar.com).

**Non-GAAP Financial Measurements**

This document contains the terms "funds from operations", "operating netbacks" and "production per share" which do not have a standardized meaning prescribed by Canadian GAAP and therefore may not be comparable with the calculation of similar measures by other companies. Funds from operations and operating netbacks are used by Celtic as key measures of performance. Funds from operations and operating netbacks are not intended to represent operating profits nor should they 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 reconciliation between net earnings and funds from operations can be found in the statement of cash flows included in the audited financial statements. Operating netbacks are determined by deducting royalties, production expenses and transportation and selling expenses from oil and gas sales revenue. The Company calculates funds from operations per share using the same method and shares outstanding which are used in the determination of earnings per share.

**Other Measurements**

All dollar amounts are referenced in Canadian dollars, except when noted otherwise. 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 and sulphur volumes have been converted to oil equivalence at 0.6 long tons per barrel. The term BOE may be misleading, particularly if used in isolation. A BOE conversion ratio of six thousand cubic feet per barrel is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. References to oil in this discussion include crude oil and natural gas liquids ("NGLs"). NGLs include condensate, propane, butane and ethane. References to gas in this discussion include natural gas and sulphur.

**Critical Accounting Estimates**

Management is required to make judgments, assumptions and estimates in the application of generally accepted accounting principles that have a significant impact on the financial results of the Company.

Capitalized costs relating to the exploration and development of oil and gas reserves, along with estimated future capital expenditures required in order to develop proved reserves, are depleted and depreciated on a unit-of-production basis using estimated proved reserves.

The carrying value of property, plant and equipment is reviewed annually for impairment. Impairment occurs when the carrying value of the assets is not recoverable by the future undiscounted cash flows. The cost recovery ceiling test 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 impact on the financial statements could be material.

Liability recognition for asset retirement obligations associated with oil and gas well sites and facilities are determined using estimated costs discounted based on the estimated life of the asset. These capitalized costs are amortized on a unit-of-production basis, consistent with depletion and depreciation. Over time, the liability is accreted up to the actual expected cash outlay to perform the abandonment and reclamation.

In order to recognize stock based compensation expense, the Company estimates the fair value of stock options granted using assumptions related to interest rates, expected life of the option, volatility of the underlying security and expected dividend yields. These assumptions may vary over time.

The determination of the Company's income and other tax liabilities requires interpretation of complex laws and regulations often involving multiple jurisdictions. All tax filings are subject to audit and potential reassessment after the lapse of considerable time. Accordingly, the actual income tax liability may differ significantly from that estimated and recorded on Celtic's financial statements.

**Changes in Accounting Policies and Practices**

Effective January 1, 2008, the Company has adopted the following new Canadian Institute of Chartered Accountants ("CICA") Handbook sections:

- (i) Section 1535, Capital Disclosures;
- (ii) Section 3862, Financial Instruments – Disclosures; and
- (iii) Section 3863, Financial Instruments – Presentation;

Section 1535 establishes disclosure requirements about an entity's capital and how it is managed. The purpose will be to enable users of the financial statements to evaluate the entity's objectives, policies and processes for managing capital.

Sections 3862 and 3863 replaced section 3861, Financial Instruments – Disclosure and Presentation, revising and enhancing its disclosure requirements, and carrying forward unchanged its presentation requirements. These new sections places increased emphasis on disclosures about the nature and extent of risks arising from financial instruments and how the entity manages those risks.

**Future Changes in Accounting Policies**

On February 13, 2007, the Accounting Standards Board ("AcSB") confirmed that publicly accountable profit-oriented enterprises will be required to use International Financial Reporting Standards ("IFRS") in interim and annual financial statements for fiscal years beginning on or after January 1, 2011. Comparatives must be prepared on the same basis. IFRS will replace Canada's current GAAP for these enterprises. Celtic is currently reviewing the requirements of IFRS and expects to adopt the new standards by the applicable dates.

**Disclosure Controls and Procedures**

Disclosure controls and procedures are designed to provide reasonable assurances that all relevant information is gathered and reported to senior management, including the Chief Executive Officer ("CEO") and the Chief Financial Officer ("CFO"), on a timely basis in order that appropriate decisions can be made regarding public disclosure. As at September 30, 2008, the CEO and the CFO have evaluated the effectiveness of Celtic's disclosure controls and procedures as defined in Multilateral Instrument 52-109 of the Canadian Securities Administrators and have concluded that such disclosure controls and procedures are effective.

**Internal Controls over Financial Reporting**

The CEO and CFO are responsible for designing internal controls over financial reporting or causing them to be designed under their supervision in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP. Management, including the CEO and the CFO, has designed Celtic's internal controls over financial reporting as required by Multilateral Instrument 52-109 of the Canadian Securities Administrators.

During the review of the design of internal controls over financial reporting, it was noted that, due to the limited number of staff at Celtic, it is not feasible to achieve complete segregation of incompatible duties. However, other internal controls over financial reporting have been designed which provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements.

Due to its inherent limitations, internal controls over financial reporting may not prevent or detect misstatements. In addition, projections of any evaluation relating to the effectiveness in future periods are subject to the risk that controls may become inadequate as a result of changes in conditions, or that the degree of compliance with policies and procedures may deteriorate.

### GROWTH STRATEGY

Celtic growth strategy is dual-pronged. The Company seeks to acquire assets with exploitation potential and, at the same time, implements its full cycle exploration and development program. This strategy has proved successful to date as is evidenced by Celtic's rapid growth since commencing active oil and gas operations in September 2002. 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 funds from operations per share, net asset value per share and production per share.

### RESULTS OF OPERATIONS

**HIGHLIGHTS – THIRD QUARTER 2008** The three months ended September 30, 2008 was another successful quarter in the execution of the Company's growth strategy. Highlights for the third quarter of 2008 are as follows:

- Drilled 15 (10.0 net working interest) wells during the quarter resulting in 12 (7.1 net) natural gas wells and 2 (2.0 net) oil wells, for an overall success rate, based on net wells, of 91%;
- Increased average daily production by 30% to a Company quarterly record 11,604 BOE per day, up from 8,914 BOE per day in the third quarter of 2007 and achieved daily average production per million shares outstanding of 282 BOE per day, up 18% in 2008 compared to 238 BOE per day in the corresponding period of the previous year;
- Generated \$34.2 million in funds from operations for the three month period ended September 30, 2008, up 82% from \$18.8 million in the same period of the previous year. Reported funds from operations per share, diluted, of \$0.83, an increase of 66% from \$0.50 per share in the third quarter of the previous year;
- Received an average operating netback of \$34.20 per BOE, up 33% from \$25.78 per BOE in the same period of 2007.

**PRODUCTION** Oil and gas production in the third quarter of 2008 increased 30% to average 11,604 BOE per day compared to 8,914 BOE per day in the same period of 2007. Production per million shares outstanding for the three months ended September 30, 2008 averaged 282 BOE per day, up 18% from 238 BOE per day in the corresponding period of the previous year.

Oil and gas production for the nine months ended September 30, 2008 increased 45% to average 10,739 BOE per day compared to 7,422 BOE per day in the same period of 2007. Production per million shares outstanding for the nine months ended September 30, 2008 averaged 271 BOE per day, up 27% from 213 BOE per day in the corresponding period of the previous year.

Celtic's production is entirely based in Alberta and is divided into four core areas. In Southern Alberta, the Company's primary natural gas producing properties are located at Drumheller and Michichi and its primary oil producing properties are located at Princess and Bantry. In East Central Alberta, the principal producing asset is a shallow natural gas property at Ashmont and Figure Lake. In Northern Alberta, the Company produces light oil primarily from Utikuma Lake. In West Central Alberta, Celtic has both natural gas and light oil production at Kaybob, Fox Creek and Swan Hills. West Central Alberta was the Company's most active drilling area in the first nine months of 2008.

**REVENUE** Revenue, before royalties, and before realized and unrealized gains or losses on financial derivatives, for the three months ended September 30, 2008 was \$73.9 million, an increase of 83% compared to \$40.4 million in the same period of the previous year. Revenue, before royalties, and before realized and unrealized gains or losses on financial derivatives, for the nine months ended September 30, 2008 was \$211.5 million, an increase of 100% compared to \$105.7 million in the same period of the previous year.

The combined average product price received for oil and gas sales, adjusted for realized gains or losses on financial derivatives for the three months ended September 30, 2008 was \$61.51 per BOE, an increase of 27% compared to the corresponding three month period of the previous year. The combined average product price received for oil and gas sales, adjusted for realized gains or losses on financial derivatives for the nine months ended September 30, 2008 was \$63.46 per BOE, an increase of 14% compared to the corresponding nine month period of the previous year.

**OIL OPERATIONS** Oil production for the third quarter ended September 30, 2008 averaged 3,386 barrels per day, an increase of 9% compared to the same quarter of the previous year. Oil production for the nine months ended September 30, 2008 averaged 3,354 barrels per day, an increase of 9% compared to the same nine month period of the previous year. Growth in oil production in 2008 reflects the addition of NGLs generated from the associated natural gas production additions at Kaybob South.

The average price received for oil sales, after realized financial derivatives, for the third quarter ended September 30, 2008 was \$90.28 (\$110.22 before financial derivatives) per barrel, up 29% from the average price of \$69.84 (\$71.73 before financial derivatives) per barrel received in the third quarter of 2007. The average price received for oil sales, after realized financial derivatives, for the nine months ended September 30, 2008 was \$87.36 (\$103.88 before financial derivatives) per barrel, up 30% from the average price of \$67.40 (\$65.40 before financial derivatives) per barrel received in the first nine months of 2007.

For the quarter ended September 30, 2008, average oil royalties were 31.4% of revenue, after realized financial derivatives (25.7% of sales, before financial derivatives). In the third quarter of the previous year, average oil royalties were 22.7% of revenue, after realized financial derivatives (22.1% of sales, before financial derivatives). For the nine months ended September 30, 2008, average oil royalties were 30.1% of revenue, after realized financial derivatives (25.3% of sales, before financial derivatives). In the corresponding nine month period of the previous year, average oil royalties were 21.0% of revenue, after realized financial derivatives (21.6% of sales, before financial derivatives). Higher royalty rates, before financial derivatives, in 2008 were primarily a result of higher oil prices received, compared to the previous year.

Transportation expenses for oil production in the third quarter of 2008 averaged \$0.50 per barrel compared to \$0.71 per barrel in the third quarter of 2007. Transportation expenses for oil production in the first nine months of 2008 averaged \$0.57 per barrel compared to \$0.68 per barrel in the same period of 2007. Lower per unit transportation expenses in 2008 reflect the larger portion of newer liquids production which is mostly pipeline connected and therefore less expensive to transport compared to trucking.

For the third quarter ended September 30, 2008, production expenses were \$15.06 per barrel. In the same period of the previous year, production expenses were \$15.08 per barrel. For the nine months ended September 30, 2008, production expenses were \$14.05 per barrel. In the same period of the previous year, production expenses were \$13.80 per barrel.

**NATURAL GAS OPERATIONS** Natural gas production for the third quarter ended September 30, 2008 averaged 49,310 mcf per day, an increase of 41% compared to the corresponding period of the previous year. Natural gas production for the nine months ended September 30, 2008 averaged 44,311 mcf per day, an increase of 70% compared to 26,140 mcf per day in the corresponding period of the previous year. Increases in natural gas production in 2008 were primarily a result of Celtic's successful drilling results in its resource development prospect located at Kaybob, Alberta.

The average price received for natural gas sales, after realized financial derivatives, for the third quarter ended September 30, 2008 was \$8.28 (\$8.72 before financial derivatives) per mcf, up 34% from the average price of \$6.20 (\$5.64 before financial derivatives and physical fixed price contracts) per mcf received in the third quarter of 2007. The average price received for natural gas sales, after realized financial derivatives, for the nine months ended September 30, 2008 was \$8.77 (\$9.56 before financial derivatives) per mcf, up 10% from the average price of \$7.97 (\$6.83 before financial derivatives and physical fixed price contracts) per mcf received in the same period of 2007.

For the quarter ended September 30, 2008, average natural gas royalties were 22.1% of revenue, after realized financial derivatives (21.3% of sales, before financial derivatives). In the third quarter of the previous year, average natural gas royalties were 19.5% of revenue, after realized financial derivatives (22.1% of sales, before financial derivatives). For the nine month period ended September 30, 2008, average natural gas royalties were 22.1% of revenue, after realized financial derivatives (20.5% of sales, before financial derivatives). In the first nine months of the previous year, average natural gas royalties were 17.2% of revenue, after realized financial derivatives (19.3% of sales, before financial derivatives). Lower royalty rates, after realized financial derivatives, in 2007 were primarily a result of significant increases in revenue resulting from physical fixed price contracts and realized gains on financial derivatives. Actual Crown natural gas royalties payable are based on an Alberta reference price and not on actual corporate realized prices.

Transportation expenses for the third quarter ended September 30, 2008 were \$0.06 per mcf, a decrease of 68% compared to \$0.19 per mcf for the same period in the previous year. Transportation expenses for the nine months ended September 30, 2008 were \$0.09 per mcf, a decrease of 50% compared to \$0.18 per mcf for the same period in the previous year. Lower transportation expenses in 2008 reflect the Company's ownership in the majority of the pipeline infrastructure at its main producing area of Kaybob, Alberta.

For the third quarter ended September 30, 2008, production expenses of \$1.52 per mcf were 6% lower than \$1.61 per mcf in the corresponding period of the previous year. For the nine months ended September 30, 2008, production expenses of \$1.43 per mcf were 11% lower than \$1.60 per mcf in the corresponding period of the previous year. Lower production expenses in 2008 reflect the increasing portion of Kaybob production as a percentage of the Company's total production base, where costs are lower than the corporate average.

**OTHER EXPENSES** For the quarter ended September 30, 2008, general and administrative expenses were \$0.9 million (\$0.80 per BOE), interest expense was \$1.4 million, and depletion, depreciation and accretion expenses were \$21.8 million (\$21.18 per BOE). In the previous year, for the quarter ended September 30, 2007, general and administrative expenses were \$0.6 million (\$0.76 per BOE), interest expense was \$1.7 million, and depletion, depreciation and accretion expenses were \$17.8 million (\$21.75 per BOE).

For the nine month period ended September 30, 2008, general and administrative expenses were \$2.9 million (\$0.99 per BOE), interest expense was \$4.8 million, and depletion, depreciation and accretion expenses were \$62.3 million (\$21.18 per BOE). In the previous year, for the nine month period ended September 30, 2007, general and administrative expenses were \$2.2 million (\$1.10 per BOE), interest expense was \$4.5 million, and depletion, depreciation and accretion expenses were \$44.6 million (\$22.02 per BOE).

**TAXES** For the quarter ended September 30, 2008, Celtic provided for a provision of future income taxes in the amount of \$13.4 million, compared to a provision of \$1.2 million in the third quarter of 2007. For the nine months ended September 30, 2008, Celtic provided for a provision of future income taxes in the amount of \$6.8 million, compared to a provision of \$1.3 million in the first nine months of 2007. For the nine months ended September 30, 2008, Celtic is not required to pay current income taxes as it has sufficient income tax deductions available to shelter taxable income for the period. The Company does not anticipate paying current income taxes in 2008.

**EARNINGS AND FUNDS FROM OPERATIONS** Net earnings for the quarter ended September 30, 2008 was \$31.1 million (\$0.76 per share, basic and \$0.75 per share, diluted). During the same period, funds from operations were \$34.2 million (\$0.83 per share, basic and diluted). On a barrel of oil equivalent basis, funds from operations in the third quarter of 2008 were \$32.05 per BOE, up 40% from \$22.93 per BOE in the same period of 2007. The main reasons for the increase in 2008 were higher commodity prices and lower production and transportation expenses during the period.

Net earnings for the nine months ended September 30, 2008 was \$14.7 million (\$0.37 per share, basic and \$0.36 per share, diluted). During the same period, funds from operations were \$99.3 million (\$2.50 per share, basic and \$2.47 per share, diluted). On a barrel of oil equivalent basis, funds from operations in the first nine months of 2008 were \$33.77 per BOE, up 14% from \$29.66 per BOE in the same period of 2007.

**CAPITAL EXPENDITURES** During the quarter ended September 30, 2008, Celtic spent \$40.4 million on capital projects. Drilling and completion operations accounted for \$26.9 million, equipment and facility expenditures were \$7.3 million and \$2.3 million was spent on land and seismic. In addition, the Company spent \$3.9 million on acquisitions. In the third quarter of the previous year, capital expenditures were \$31.6 million.

During the nine months ended September 30, 2008, Celtic spent \$140.7 million on capital projects. Drilling and completion operations accounted for \$68.6 million, equipment and facility expenditures were \$21.4 million and \$4.4 million was spent on land and seismic. In addition, the Company spent \$49.7 million on acquisitions and received proceeds of \$3.7 million from dispositions. In the first nine months of the previous year, capital expenditures were \$154.6 million, including acquisitions of \$45.6 million.

At September 30, 2008, the Company had 312,132 (243,563 net) acres of undeveloped land. The Company continues to build on its inventory of prospects for future drilling.

**DRILLING ACTIVITY** During the third quarter of 2008, the Company drilled 15 (10.0 net) wells resulting in 12 (7.1 net) natural gas wells and 2 (2.0 net) oil wells, for an overall success rate, based on net wells, of 91%. During the third quarter ended September 30, 2007, Celtic drilled 18 (12.6 net) wells, with an overall success rate of 76%. The average measured depth of net wells drilled in the third quarter of 2008 was 2,898 metres, an increase of 40% compared to the average drilling measured depth of 2,076 metres in the third quarter of 2007.

During the nine month period ended September 30, 2008, the Company drilled 40 (30.9 net) wells resulting in 29 (22.5 net) natural gas wells, 6 (4.6 net) oil wells and 1 (0.1 net) coal bed methane wells, for an overall success rate, based on net wells, of 88%. During the first nine months of 2007, Celtic drilled 57 (48.0 net) wells, with an overall success rate of 78%. The average measured depth of net wells drilled in the nine month period ended September 30, 2008 was 2,845 metres, an increase of 38%, compared to the average drilling depth of 2,055 metres in the first nine months of 2007.

**CAPITAL RESOURCES AND LIQUIDITY**

**SOURCE OF FUNDS** Investment funding for capital expenditures incurred in the first nine months of 2008 was provided by proceeds from issuance of common shares, bank debt and cash provided by operating activities.

At September 30, 2008, Celtic had drawn \$137.5 million on its bank credit facility, leaving sufficient unused credit lines available to fund on-going capital expenditures and working capital deficiencies. 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.

Celtic expects to fund future capital expenditures through the use of a combination of cash provided by operating activities and bank debt, supplemented by new equity share offerings, as required. In the current environment, while access to capital has constricted due to the global credit crisis, Celtic plans to manage its future capital expenditures by spending amounts that match forecasted cash provided by operating activities.

**WORKING CAPITAL** The capital intensive nature of Celtic's activities may create a working capital deficiency position during periods with high levels of capital investment. However, during such periods, the Company maintains sufficient unused bank credit lines to satisfy such working capital deficiencies. At September 30, 2008, the working capital amount, excluding non-cash financial instruments, plus outstanding bank debt represented 75% of the Company's maximum authorized bank borrowing credit limit.

Celtic has a potential financial exposure of approximately \$31.4 million relating to natural gas and associated by-product sales, net of processing costs. During the third quarter of 2008, the Company has expensed \$18.0 million of this amount as a bad debt expense. The amount receivable on the balance sheet at September 30, 2008 is approximately \$13.4 million. The exposure relates to the announcement by SemCAMS ULC ("SemCAMS"), a Canadian subsidiary of U.S. based SemGroup LP ("SemGroup"), whereby SemGroup filed a voluntary petition for reorganization under Chapter 11 of the U.S. Bankruptcy Code and SemCAMS filed an application to obtain an order under the *Companies' Creditors Arrangement Act (Canada)* in the Court of Queen's Bench of Alberta Judicial District of Calgary. The full amount of the potential financial exposure relates to the marketing of a portion of the Company's natural gas and associated by-products production. Effective July 22, 2008, the Company began marketing its natural gas through an alternative purchaser, with the agreement of SemCAMS. At this time, Celtic cannot determine the period within which or the amount of the financial exposure that will ultimately be collected. As at September 30, 2008, Celtic has sufficient available bank credit lines to finance the potential financial exposure.

**SHARE INFORMATION** The Company is authorized to issue an unlimited number of common shares and an unlimited number of preferred shares. As at September 30, 2008, there were 41.1 million common shares outstanding (as at November 6, 2008, there were 41.1 million common shares outstanding). There are no preferred shares outstanding.

As at September 30, 2008, directors, employees and consultants have been granted options to purchase 3.0 million common shares of the Company at an average exercise price of \$12.66 per share.

The Company's common shares trade on the Toronto Stock Exchange ("TSX") under the symbol "CLT".

**FUTURE COMMITMENTS - FINANCIAL INSTRUMENTS** The Company may, from time to time, enter into fixed price contracts and derivative financial instruments with respect to oil and gas sales, in order to secure a certain amount of cash flow to protect a level of capital spending. As at September 30, 2008, Celtic has the following fixed price commitments, in place, to sell oil and gas production:

Summary of oil sales price derivative contracts in effect as at September 30, 2008, that have fixed future sales prices (fixed oil prices are based on the West Texas Intermediate ("WTI") Index):

Daily quantity	Remaining term of contract	Fixed price per barrel (bbl)
300 bbls/d	October 1 to October 31, 2008	US\$92.50
500 bbls/d	October 1 to October 31, 2008	US\$70.00
800 bbls/d	November 1 to December 31, 2008	CA\$90.00
500 bbls/d	October 1 to December 31, 2008	CA\$88.00
500 bbls/d	October 1 to December 31, 2008	CA\$89.00
500 bbls/d (put-call spread)	October 1 to October 31, 2008	US\$100.00 (floor) US\$142.50 (cap)
500 bbls/d (put-call spread)	November 1 to December 31, 2008	CA\$113.00 (floor) CA\$140.00 (cap)
2,000 bbls/d (put-call spread)	January 1 to December 31, 2009	CA\$115.00 (floor) CA\$145.00 (cap)

**CONTRACTUAL OBLIGATIONS** Celtic has a committed term credit facility with Canadian financial institutions. The authorized borrowing amount under this facility as at September 30, 2008 was \$200.0 million, of which \$137.5 million was outstanding. Interest under this facility is payable monthly. The Company is exposed to fluctuations in interest rates on its bank debt. Interest rate risk is mitigated through short-term fixed rate borrowings using bankers' acceptances. The Company has entered into interest rate swap transactions whereby borrowings through bankers' acceptances in the amounts of \$80.0 million maturing on April 22, 2010 have been fixed at an aggregate interest rate of approximately 4.4% and \$20.0 million maturing on April 22, 2010 have been fixed at an aggregate interest rate of approximately 3.6%.

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 provides employees with access to specialized computer software and information including production and reserves data, geological data, accounting systems and land management systems.

As a normal course of business, the Company leases office space, vehicles for field personnel and office equipment such as computers, printers and photocopiers.

**RELATED PARTY AND OFF-BALANCE SHEET TRANSACTIONS** The Company has retained the law firm of Borden Ladner Gervais LLP ("BLG") to provide Celtic with legal services. William C. Guinan, a director, chairman and corporate secretary of Celtic is a partner of this law firm. The Company expects to continue using the services of this law firm from time to time.

Celtic was not involved in any off-balance sheet transactions in the nine month periods ended September 30, 2008 and 2007.

#### **SUPPLEMENTAL QUARTERLY INFORMATION**

The Company has been successful in providing strong growth in funds from operations and daily average production. The following tables summarize key financial and operating information by quarter:

<i>(\$ thousands, except per unit amounts)</i>	<b>2008</b>	2008	2008	2007	<b>2007</b>	2007	2007	2006
	<b>Q3</b>	Q2	Q1	Q4	<b>Q3</b>	Q2	Q1	Q4
Gross oil and gas revenue (\$)	<b>73,904</b>	80,220	57,371	45,734	<b>40,356</b>	34,556	30,798	31,241
Funds from operations (\$)	<b>34,227</b>	36,787	28,298	23,246	<b>18,805</b>	19,244	22,045	19,183
Per share – basic (\$/SHARE)	<b>0.83</b>	0.92	0.75	0.62	<b>0.50</b>	0.56	0.67	0.60
Per share – diluted (\$/SHARE)	<b>0.83</b>	0.90	0.74	0.61	<b>0.50</b>	0.55	0.66	0.58
Net earnings (loss) (\$)	<b>31,145</b>	(9,116)	(7,375)	3,507	<b>4,584</b>	2,957	(2,850)	6,599
Per share – basic (\$/SHARE)	<b>0.76</b>	(0.23)	(0.20)	0.09	<b>0.12</b>	0.09	(0.09)	0.21
Per share – diluted (\$/SHARE)	<b>0.75</b>	(0.23)	(0.19)	0.09	<b>0.12</b>	0.09	(0.08)	0.20
Total assets (\$)	<b>594,672</b>	572,691	511,705	490,431	<b>479,026</b>	465,151	405,249	373,882
Bank debt, net of working capital (\$)	<b>149,588</b>	124,179	145,360	136,901	<b>131,695</b>	119,362	117,755	107,669
Production (BOE/D)	<b>11,604</b>	10,842	9,762	9,213	<b>8,914</b>	7,013	6,310	6,290
Production per million shares (BOE/D)	<b>282</b>	270	259	245	<b>238</b>	213	192	196
Sales price, after derivatives (\$/BOE)	<b>61.51</b>	67.49	61.26	54.13	<b>48.55</b>	55.64	66.81	59.59
Operating netback (\$/BOE)	<b>34.20</b>	39.94	35.02	30.44	<b>25.78</b>	33.72	42.60	35.79
Netback as a percentage of sales	<b>56%</b>	59%	57%	71%	<b>53%</b>	61%	64%	60%

#### **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 producers and 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 and developing oil and gas reserves at economic costs, estimating amounts of recoverable reserves, production of oil and gas in commercial quantities, marketability of oil and gas produced, fluctuations in commodity prices, financial and liquidity risks and environmental and safety risks.

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

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

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

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

The majority of the Company's accounts receivable is in respect of oil and gas operations. Celtic generally extends unsecured credit to these third parties, and therefore, the collection of accounts receivable may be affected by changes in economic or other conditions and may accordingly impact the Company's overall credit risk.

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 on-going capital investment. Funds from operations also provide 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. Funds from operations also fluctuate 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 OUTLOOK

**ADVISORY REGARDING FORWARD-LOOKING STATEMENTS** Certain information with respect to Celtic contained herein, 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, certain 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. As a result, 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. Celtic does not intend, and does not assume any obligation, to update or revise these forward-looking statements except as required pursuant to applicable securities laws.

**2008 OUTLOOK** Celtic plans to spend \$184.0 million (net) in 2008 on capital investment activities. The Company expects production in 2008 to average in a range from 11,000 to 11,400 BOE per day. Celtic expects to exit 2008 with production of approximately 13,000 BOE per day.

Celtic's forecasted commodity price assumptions for 2008 include oil prices that are estimated to average US\$102.00 per barrel for WTI and natural gas prices are forecasted to average US\$8.90 per MMBTU for NYMEX and \$7.87 per GJ for AECO. The Company's forecasted 2008 average US/Canadian exchange rate is US\$0.9390. In order to achieve these prices, WTI oil and NYMEX gas are forecasted to average US\$68.37 per barrel and US\$6.67 per MMBTU respectively in the fourth quarter of 2008.

After giving effect to the production and commodity price assumptions, funds from operations for 2008 is estimated to be approximately \$134.5 million or \$3.35 per share (\$3.27 per share, diluted). Net earnings for 2008 are estimated to be approximately \$34.0 million or \$0.85 per share (\$0.83 per share, diluted). Bank debt, net of working capital, excluding non-cash financial instruments is expected to be \$157.7 million at December 31, 2008. Changes in forecasted commodity prices and variances in production estimates can have a significant impact to estimated funds from operations and net earnings. Please refer to the advisory regarding forward-looking statements shown above.

**2009 GUIDANCE** Celtic has established an initial capital expenditure budget for 2009 at \$150.0 million. The Company expects production in 2009 to average in a range from 13,800 to 14,200 BOE per day. This estimated average production range takes into account the planned turnaround at the KA Gas Plant that is scheduled to take place during May 2009. As a result, Celtic expects to shut-in approximately 10,000 BOE per day during the month of May 2009. Celtic expects to exit 2009 with production of approximately 16,500 BOE per day.

Celtic's forecasted commodity price assumptions for 2009 include oil prices that are estimated to average US\$65.00 per barrel for WTI and natural gas prices are forecasted to average US\$7.00 per MMBTU for NYMEX and \$6.54 per GJ for AECO. The Company's forecasted 2009 average US/Canadian exchange rate is US\$0.8696.

After giving effect to the production and commodity price assumptions, funds from operations for 2009 is estimated to be approximately \$157.0 million or \$3.82 per share (\$3.74 per share, diluted). Net earnings for 2009 are estimated to be approximately \$18.0 million or \$0.44 per share (\$0.43 per share, diluted). Bank debt, net of working capital, excluding non-cash financial instruments is expected to be \$150.7 million at December 31, 2009. Changes in forecasted commodity prices and variances in production estimates can have a significant impact to estimated funds from operations and net earnings. Please refer to the advisory regarding forward-looking statements shown above.

Celtic's capital expenditure budget for 2009 will see the Company participate at high working interests in the drilling of approximately 45 to 50 wells during the year, of which approximately 80% will be horizontal wells with multi-fracture completions. Celtic continues to pursue property acquisitions that would complement its existing asset base and completion of any future acquisitions would be over and above the Company's planned capital expenditure budget.

In the current environment, where access to capital has constricted due to the global credit crisis, Celtic has planned its 2009 capital expenditures to be less than forecasted funds from operations. Included in forecasted 2009 funds from operations is a gain on oil related financial instruments in the amount of \$29.4 million. These contracts provide the Company with insurance during a period of volatile oil prices. Celtic has the drilling inventory to expand its capital budget in the future, subject to stability in global financial markets and more favourable financing terms than is currently available.

Celtic is excited about the growth prospects being generated in the Company and remains optimistic about the Company's ability to deliver continued per share growth in production, reserves, net asset value, earnings and funds from operations. Given the Company's strong inventory of drilling locations, we look forward to continued growth in 2009 and beyond.

#### **ADDITIONAL INFORMATION**

Additional information relating to Celtic, including the Company's Annual Information Form ("AIF") is filed on SEDAR and can be viewed on their website at [www.sedar.com](http://www.sedar.com). Copies of the AIF can also be obtained by contacting Sadiq H. Lalani, Vice President, Finance and Chief Financial Officer at Celtic Exploration Ltd., Suite 500, 505 Third Street SW, Calgary, Alberta, Canada, T2P 3E6. Further information relating to the Company is also available on its website at [www.celticex.com](http://www.celticex.com).

On behalf of the Board of Directors,



DAVID J. WILSON  
President and Chief Executive Officer

NOVEMBER 6, 2008.

# FINANCIAL STATEMENTS

## BALANCE SHEET

<i>(Unaudited) (\$ thousands)</i>	As at September 30, 2008	As at December 31, 2007
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	\$ 823	\$ 3,082
Accounts receivable	46,661	25,751
Prepaid expenses and deposits	4,165	646
Fair value of financial instruments [NOTE 8]	5,028	925
Future income tax asset	70	0
	56,747	30,404
Other assets	3,078	4,281
Property, plant and equipment [NOTE 2]	534,847	455,746
	\$ 594,672	\$ 490,431
<b>LIABILITIES</b>		
Current liabilities		
Accounts payable and accrued liabilities	\$ 63,787	\$ 46,480
Fair value of financial instruments [NOTE 8]	238	0
Future income taxes	1,483	273
Bank debt [NOTE 3]	137,450	119,900
	202,958	166,653
Asset retirement obligation [NOTE 4]	6,453	5,719
Future income taxes	48,649	36,596
	\$ 258,060	\$ 208,968
<b>SHAREHOLDERS' EQUITY</b>		
Share capital [NOTE 5]	\$ 240,249	\$ 200,180
Contributed surplus [NOTE 5]	3,790	3,364
Retained earnings and accumulated other comprehensive income	92,573	77,919
	\$ 336,612	\$ 281,463
	\$ 594,672	\$ 490,431

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

**ON BEHALF OF THE BOARD OF DIRECTORS:**



Director



Director

## FINANCIAL STATEMENTS

### STATEMENT OF OPERATIONS, RETAINED EARNINGS AND ACCUMULATED OTHER COMPREHENSIVE INCOME

<i>(Unaudited) (\$ thousands, except per share amounts)</i>	Three months ended September 30,		Nine months ended September 30,	
	2008	2007	2008	2007
<b>STATEMENT OF OPERATIONS</b>				
<b>REVENUE</b>				
Oil and gas	\$ 73,904	\$ 40,356	\$ 211,495	\$ 105,710
Royalties	(17,115)	(8,407)	(47,677)	(21,626)
Realized gain (loss) on financial instruments	(8,235)	(540)	(24,841)	7,561
Unrealized gain (loss) on financial derivatives [NOTE 8]	50,612	5,255	3,866	(8,386)
	\$ 99,166	\$ 36,664	\$ 142,843	\$ 83,259
<b>EXPENSES</b>				
Production	\$ 11,604	\$ 9,469	\$ 30,323	\$ 22,971
Transportation	439	799	1,651	1,819
Interest and financing	1,428	1,715	4,779	4,534
General and administrative	856	621	2,912	2,226
Stock based compensation [NOTE 5D]	592	406	1,384	1,095
Depletion, depreciation and accretion [NOTE 2]	21,755	17,828	62,336	44,635
Provision for bad debt [NOTE 8]	17,986	-	17,986	-
	\$ 54,660	\$ 30,838	\$ 121,371	\$ 77,280
Earnings before taxes	\$ 44,506	\$ 5,826	\$ 21,472	\$ 5,979
Provision for future income taxes	13,361	1,242	6,818	1,288
Net earnings and comprehensive income	\$ 31,145	\$ 4,584	\$ 14,654	\$ 4,691
<b>Earnings (loss) per share</b>				
Basic	\$ 0.76	\$ 0.12	\$ 0.37	\$ 0.13
Diluted [NOTE 6]	0.75	0.12	0.36	0.13

### STATEMENT OF RETAINED EARNINGS AND ACCUMULATED OTHER COMPREHENSIVE INCOME

Retained earnings and accumulated other comprehensive income, beginning of period	\$ 61,428	\$ 69,828	\$ 77,919	\$ 69,721
Net earnings and comprehensive income	31,145	4,584	14,654	4,691
Retained earnings and accumulated other comprehensive income, end of period	\$ 92,573	\$ 74,412	\$ 92,573	\$ 74,412

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

## FINANCIAL STATEMENTS

### STATEMENT OF CASH FLOWS

<i>(Unaudited) (\$ thousands)</i>	Three months ended September 30,		Nine months ended September 30,	
	2008	2007	2008	2007
<b>OPERATING ACTIVITIES</b>				
Net earnings	\$ 31,145	\$ 4,584	\$ 14,654	\$ 4,691
Items not affecting cash:				
Depletion, depreciation and accretion	21,755	17,828	62,336	44,635
Provision for bad debt	17,986	-	17,986	-
Stock based compensation	592	406	1,384	1,095
Unrealized loss (gain) on financial instruments	(50,612)	(5,255)	(3,866)	8,386
Future income taxes	13,361	1,242	6,818	1,288
Funds from operations	\$ 34,227	\$ 18,805	\$ 99,312	\$ 60,095
Change in non-cash operating working capital [NOTE 10]	(20,549)	9,262	(33,104)	(5,329)
Cash provided by operating activities	\$ 13,678	\$ 28,067	\$ 66,208	\$ 54,766
<b>FINANCING ACTIVITIES</b>				
Increase (decrease) in bank debt	\$ 21,400	\$ (9,350)	\$ 17,550	\$ 14,300
Issue of common shares, net of costs	352	346	45,487	70,358
Cash provided by financing activities	\$ 21,752	\$ (9,004)	\$ 63,037	\$ 84,658
<b>INVESTING ACTIVITIES</b>				
Property, plant and equipment expenditures	\$ (36,420)	\$ (31,817)	\$ (94,691)	\$ (109,002)
Property, plant and equipment acquisitions	(3,914)	180	(49,722)	(45,634)
Property, plant and equipment dispositions	(25)	0	3,710	3
Change in other assets	(1,643)	152	1,204	155
Change in non-cash investing working capital [NOTE 10]	5,179	12,056	7,995	18,310
Cash used in investing activities	\$ (36,823)	\$ (19,429)	\$ (131,504)	\$ (136,168)
Net change in cash and cash equivalents	\$ (1,393)	\$ (366)	\$ (2,259)	\$ 3,256
Cash and cash equivalents, beginning of period	2,216	4,446	3,082	824
Cash and cash equivalents, end of period	\$ 823	\$ 4,080	\$ 823	\$ 4,080

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

NOTES TO THE INTERIM FINANCIAL STATEMENTS

For the interim period ended September 30, 2008 (Unaudited)  
 (ALL TABULAR AMOUNTS IN THOUSANDS, UNLESS OTHERWISE STATED)

**[NOTE 1] NATURE OF BUSINESS AND BASIS OF PRESENTATION**

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

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, 2007, with the exception of the changes in accounting policies noted below. The disclosure herein 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, 2007.

These financial statements are stated in Canadian dollars and have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). The interim financial statements have not been reviewed by the Company's external auditors. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements as well as the reported amounts of revenues, expenses and cash flows during the period. Actual results could differ from these estimates.

**CHANGES IN ACCOUNTING POLICIES AND PRACTICES** Effective January 1, 2008, the Company has adopted the following new Canadian Institute of Chartered Accountants ("CICA") Handbook sections:

- (i) Section 1535, *Capital Disclosures*;
- (ii) Section 3862, *Financial Instruments – Disclosures*; and
- (iii) Section 3863, *Financial Instruments – Presentation*;

Section 1535 establishes disclosure requirements about an entity's capital and how it is managed. The purpose will be to enable users of the financial statements to evaluate the entity's objectives, policies and processes for managing capital.

Sections 3862 and 3863 replaced section 3861, *Financial Instruments – Disclosure and Presentation*, revising and enhancing its disclosure requirements, and carrying forward unchanged its presentation requirements. These new sections place increased emphasis on disclosures about the nature and extent of risks arising from financial instruments and how the entity manages those risks.

**[NOTE 2] PROPERTY, PLANT AND EQUIPMENT**

	Cost	Accumulated depletion, depreciation and amortization	Net book value
<b>At September 30, 2008</b>			
Oil and gas properties, plant and equipment	\$ 761,035	\$ 227,013	\$ 534,022
Head office assets	1,467	642	825
	<b>\$ 762,502</b>	<b>\$ 227,655</b>	<b>\$ 534,847</b>
<b>At December 31, 2007</b>			
Oil and gas properties, plant and equipment	\$ 620,274	\$ 165,194	\$ 455,080
Head office assets	1,165	499	666
	<b>\$ 621,439</b>	<b>\$ 165,693</b>	<b>\$ 455,746</b>

At September 30, 2008, oil and gas properties with a cost of \$34.1 million (December 31, 2007 – \$34.9 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 \$34.0 million (2007 – \$15.0 million) are included in the depletion and depreciation calculation.

During the nine months ended September 30, 2008, the Company capitalized \$0.3 million (2007 – \$0.4 million) with respect to employee salaries directly relating to exploration and development activities.

## FINANCIAL STATEMENTS

### NOTES TO THE INTERIM FINANCIAL STATEMENTS

*For the interim period ended September 30, 2008 (Unaudited)*  
 (ALL TABULAR AMOUNTS IN THOUSANDS, UNLESS OTHERWISE STATED)

#### [NOTE 3] BANK DEBT

	September 30, 2008	December 31, 2007
Bank loan	\$ 27,450	\$ 19,900
Bankers' acceptances	110,000	100,000
	\$ 137,450	\$ 119,900

Celtic has a committed term credit facility with a syndicate of Canadian financial institutions. The authorized borrowing amount under this facility as at September 30, 2008 is \$200.0 million. The facilities are available for a period of 364 days, maturing on June 30, 2009. 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 authorized borrowing amount is subject to interim reviews by the financial institutions. Security is provided for by a first fixed and floating charge debenture over all assets in the amount of \$500.0 million and general assignment of book debts.

Interest is payable monthly for borrowings through direct advances. Interest rates fluctuate based on a pricing grid and range from bank prime to bank prime plus 1.50%, depending upon the Company's then current debt to cash flow ratio of between less than one and a half times to greater than three times. Under the credit facility, borrowings through the use of bankers' acceptances are also available. The Company has entered into interest rate swap transactions whereby borrowings through bankers' acceptances in the amounts of \$80.0 million maturing on April 22, 2010 have been fixed at an aggregate interest rate of approximately 4.4% and \$20.0 million maturing on April 22, 2010 have been fixed at an aggregate interest rate of approximately 3.6%.

#### [NOTE 4] ASSET RETIREMENT OBLIGATION

Celtic's total future asset retirement obligation was estimated based on the Company's net ownership in all wells and facilities, the estimated costs to abandon and reclaim the wells and facilities and the estimated timing of the costs to be incurred in future periods. The following table provides a reconciliation of the carrying amount associated with the Company's asset retirement obligations:

	September 30, 2008	December 31, 2007
Asset retirement obligation, beginning of period	\$ 5,719	\$ 4,885
Liabilities incurred, net of liabilities disposed	359	864
Liabilities settled	-	(1,021)
Revisions to estimated liabilities	-	671
Accretion expense	375	320
Asset retirement obligation, end of period	\$ 6,453	\$ 5,719

The key assumptions, on which the carrying amount of the asset retirement obligations is based, include a credit-adjusted risk-free rate of 8.5% and an inflation rate of 3.0%. The total undiscounted amount of the estimated cash flows required to settle the obligations is \$27.4 million (December 31, 2007 - \$23.9 million). The inflated value of estimated cash flows required to settle the obligations at a future period at the time the asset is retired is \$74.0 million (December 31, 2007 - \$63.8 million). The expected timing of payment of the cash flows required to settle the obligations ranges from 1 year to 50 years.

## FINANCIAL STATEMENTS

### NOTES TO THE INTERIM FINANCIAL STATEMENTS

*For the interim period ended September 30, 2008 (Unaudited)*  
 (ALL TABULAR AMOUNTS IN THOUSANDS, UNLESS OTHERWISE STATED)

#### [NOTE 5] 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 for the period ended September 30, 2008:

	Common Shares	Amount
Balance, December 31, 2007	37,666	\$ 200,180
Issued for cash on exercise of stock options	573	4,478
Issued for cash through prospectus offering	2,875	43,125
Amount relating to exercised options previously recorded as contributed surplus	–	958
Future income tax benefit transferred on flow-through share issue	–	(6,968)
Share issue costs, after future income taxes	–	(1,524)
Balance, September 30, 2008	41,114	\$ 240,249

**(C) FLOW-THROUGH SHARES** On February 27, 2007, Celtic issued 1.5 million common shares on a flow-through basis at an issue price of \$16.65 per share for gross proceeds of \$25.0 million. At September 30, 2008, the Company had an estimated \$1.9 million remaining obligation to incur Canadian Exploration Expenditures (“CEE”), which must be completed by December 31, 2008.

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

The following table summarizes the changes in stock options outstanding during for the period ended September 30, 2008:

	Number of Options	Average Exercise Price
Balance, December 31, 2007	2,826	\$ 10.69
Granted	750	16.40
Exercised	(573)	7.82
Forfeited	–	–
Balance, September 30, 2008	3,003	\$ 12.66

## FINANCIAL STATEMENTS

### NOTES TO THE INTERIM FINANCIAL STATEMENTS

*For the interim period ended September 30, 2008 (Unaudited)*  
 (ALL TABULAR AMOUNTS IN THOUSANDS, UNLESS OTHERWISE STATED)

The Company uses 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:

<i>Nine months ended September 30,</i>	2008	2007
Risk free interest rate	3.40%	4.50%
Expected life (YEARS)	3.0	3.0
Expected volatility	20%	20%
Expected dividend yield	–	–
Fair value of options granted during the period (\$/SHARE)	2.99	2.54

The following table summarizes information regarding stock options outstanding at September 30, 2008:

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
\$ 4.01 to \$ 6.00	192	0.2	\$ 5.90	192	\$ 5.90
\$ 6.01 to \$ 8.00	182	0.9	7.74	182	7.74
\$ 8.01 to \$10.00	25	1.1	8.65	25	8.65
\$10.01 to \$12.00	448	2.1	11.23	299	11.12
\$12.01 to \$14.00	1,436	3.4	12.62	491	12.58
\$14.01 to \$16.00	125	4.2	14.73	16	14.70
\$16.01 to \$18.00	562	4.8	17.04	–	–
\$18.01 to \$22.00	33	4.7	20.65	–	–
Total	3,003	2.2	\$ 12.66	1,205	\$ 10.37

#### **[NOTE 6] 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, 0.5 million (2007 – 0.4 million) shares were added to the 39.7 million (2007 – 34.8 million) weighted average number of common shares outstanding during the nine month period for the dilutive effect of stock options.

## FINANCIAL STATEMENTS

### NOTES TO THE INTERIM FINANCIAL STATEMENTS

*For the interim period ended September 30, 2008 (Unaudited)*  
 (ALL TABULAR AMOUNTS IN THOUSANDS, UNLESS OTHERWISE STATED)

#### [NOTE 7] COMMITMENTS

The Company is committed to future payments under the following agreements:

	Oct-Dec 2008	2009	2010	2011	Total
Operating lease – office building	\$ 142	\$ 568	\$ 568	\$ 189	\$ 1,467
Operating lease – vehicles	30	57	30	–	117
Firm transportation agreements	77	248	296	321	942
Exploration and development	1,860	–	–	–	1,860
	\$ 2,109	\$ 873	\$ 894	\$ 510	\$ 4,386

Rental leases relating to office space expire on April 30, 2011. Exploration and development commitments relate to the Company's obligation pursuant to a flow-through share issue (see Note 5(c)).

#### [NOTE 8] FINANCIAL INSTRUMENTS

**(A) FAIR VALUES OF FINANCIAL ASSETS AND LIABILITIES** Financial instruments of the Company consist mainly of cash and cash equivalents, receivables, payables, bank debt and financial derivative contracts, all of which are included in these financial statements. At September 30, 2008, the classification of financial instruments and the carrying amounts reported on the balance sheet and their estimated fair values are as follows:

Classification	Carrying Amount	Fair Value
Cash and cash equivalents	\$ 823	\$ 823
Loans and receivables (accounts receivable)	46,661	46,661
Held-to-maturity investments	–	–
Held-for-trading instruments (financial derivative contracts)	4,790	4,790
Available-for-sale financial assets	–	–
Other financial liabilities (accounts payable and bank debt)	(201,237)	(201,237)
Total	\$ (148,963)	\$ (148,963)

**(B) CREDIT RISK** The majority of the Company's accounts receivable is in respect of oil and gas operations. Celtic generally extends unsecured credit to these third parties, and therefore, the collection of accounts receivable may be affected by changes in economic or other conditions and may accordingly impact the Company's overall credit risk. Celtic has not experienced any material credit loss in the collection of receivables during the nine months ended September 30, 2008, except as noted below.

Celtic has a potential financial exposure of approximately \$31.4 million relating to natural gas and associated by-product sales, net of processing costs. During the third quarter of 2008, the Company has expensed \$18.0 million of this amount as a bad debt expense. The amount receivable on the balance sheet at September 30, 2008 is approximately \$13.4 million. The exposure relates to the announcement by SemCAMS ULC ("SemCAMS"), a Canadian subsidiary of U.S. based SemGroup LP ("SemGroup"), whereby SemGroup filed a voluntary petition for reorganization under Chapter 11 of the U.S. Bankruptcy Code and SemCAMS filed an application to obtain an order under the *Companies' Creditors Arrangement Act (Canada)* in the Court of Queen's Bench of Alberta Judicial District of Calgary. The full amount of the potential financial exposure relates to the marketing of a portion of the Company's natural gas and associated by-products production. Effective July 22, 2008, the Company began marketing its natural gas through an alternative purchaser, with the agreement of SemCAMS. At this time, Celtic cannot determine the period within which or the amount of the financial exposure that will ultimately be collected. As at September 30, 2008, Celtic has sufficient available bank credit lines to finance the potential financial exposure.

## FINANCIAL STATEMENTS

### NOTES TO THE INTERIM FINANCIAL STATEMENTS

For the interim period ended September 30, 2008 (Unaudited)  
(ALL TABULAR AMOUNTS IN THOUSANDS, UNLESS OTHERWISE STATED)

**(C) INTEREST RATE RISK** The Company is exposed to fluctuations in interest rates on its bank debt. Interest rate risk is mitigated through short-term fixed rate borrowings using bankers' acceptances.

The Company has entered into interest rate swap transactions whereby borrowings through bankers' acceptances in the amounts of \$80.0 million maturing on April 22, 2010 have been fixed at an aggregate interest rate of approximately 4.4% and \$20.0 million maturing on April 22, 2010 have been fixed at an aggregate interest rate of approximately 3.6%. The fair value of these contracts, mark-to-market at September 30, 2008 is a liability resulting in an unrealized loss of \$0.2 million.

**(D) FOREIGN EXCHANGE RATE RISK** The Company is exposed to the risk of changes in the Canadian/U.S. dollar exchange rate on sales of commodities that are denominated in U.S. dollars or directly influenced by U.S. dollar benchmark prices.

**(E) COMMODITY PRICE RISK MANAGEMENT** The following is a summary of oil sales price derivative contracts in effect as at September 30, 2008, that have fixed future sales prices (fixed oil prices are based on the West Texas Intermediate (WTI) Index):

Daily quantity	Remaining term of contract	Fixed price per barrel (bbl)
300 bbls/d	October 1 to October 31, 2008	US\$92.50
500 bbls/d	October 1 to October 31, 2008	US\$70.00
800 bbls/d	November 1 to December 31, 2008	CA\$90.00
500 bbls/d	October 1 to December 31, 2008	CA\$88.00
500 bbls/d	October 1 to December 31, 2008	CA\$89.00
500 bbls/d (put-call spread)	October 1 to October 31, 2008	US\$100.00 (floor) US\$142.50 (cap)
500 bbls/d (put-call spread)	November 1 to December 31, 2008	CA\$113.00 (floor) CA\$140.00 (cap)
2,000 bbls/d (put-call spread)	January 1 to December 31, 2009	CA\$115.00 (floor) CA\$145.00 (cap)

The fair value of the above oil contracts, mark-to-market at September 30, 2008 is an asset resulting in an unrealized gain of \$5.0 million.

#### [NOTE 9] CAPITAL STRUCTURE

The Company's capital structure is comprised of shareholders' equity, bank debt and working capital. Celtic's objectives when managing its capital structure is to maintain financial flexibility in order to meet financial obligations, as well as to finance future growth through capital expenditures relating to exploration, development and acquisition activities.

The Company monitors its capital structure and short-term financing requirements using a net debt to trailing funds from operations ratio, a non-GAAP financial measure.

	September 30, 2008	December 31, 2007
Bank debt	\$ 137,450	\$ 119,900
Working capital deficiency <sup>(1)</sup>	12,138	17,001
Net debt	\$ 149,588	\$ 136,901
Trailing funds from operations <sup>(2)</sup>	\$ 136,908	\$ 92,984
Net debt to trailing funds from operations ratio	1.09	1.47

<sup>(1)</sup> Working capital excludes unrealized gains or losses on financial instruments and associated income taxes.

<sup>(2)</sup> Trailing funds from operations is annualized based on the most recent quarter's funds from operations which is calculated as cash provided by operating activities before settlement of asset retirement obligations and change in non-cash operating working capital.

Celtic targets a net debt to trailing funds from operations ratio of less than 2.0 times. The Company manages its capital structure and makes adjustments according to market conditions in order to maintain flexibility to achieve its objectives stated above. To adjust its capital structure, the Company may increase or decrease capital expenditures, issue new shares, issue new debt or repay existing debt.

## FINANCIAL STATEMENTS

### NOTES TO THE INTERIM FINANCIAL STATEMENTS

*For the interim period ended September 30, 2008 (Unaudited)*  
 (ALL TABULAR AMOUNTS IN THOUSANDS, UNLESS OTHERWISE STATED)

#### **[NOTE 10] SUPPLEMENTAL CASH FLOW INFORMATION**

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

<i>Nine months ended September 30,</i>	2008	2007
Accounts receivable	\$ (38,897)	\$ 341
Prepaid expenses and deposits	(3,519)	186
Accounts payable and accruals	17,307	12,454
Change in non-cash working capital	\$ (25,109)	\$ 12,981
Relating to:		
Operating activities	\$ (33,104)	\$ (5,329)
Investing activities	7,995	18,310
Change in non-cash working capital	\$ (25,109)	\$ 12,981

During the reporting period, the Company made the following cash outlays in respect of interest expense:

<i>Nine months ended September 30,</i>	2008	2007
Interest	\$ 5,018	\$ 4,723

## BOARD OF DIRECTORS

### ROBERT J. DALES<sup>2, 3, 4</sup>

President, Valhalla Ventures Inc.

### WILLIAM C. GUINAN<sup>1, 5</sup>

Partner, Borden Ladner Gervais LLP

### ELDON A. MCINTYRE<sup>2, 3, 4</sup>

President, Jarrod Oils Ltd.

### NEIL G. SINCLAIR<sup>2, 4, 5</sup>

President, Sinson Investments Ltd.

### DAVID J. WILSON<sup>3, 5</sup>

President & Chief Executive Officer,  
Celtic Exploration Ltd.

## OFFICERS

### DAVID J. WILSON

President & Chief Executive Officer

### SADIQ H. LALANI

Vice President, Finance  
& Chief Financial Officer

### MICHAEL R. SHEA

Vice President, Land

### DAVID C. MORGENSTERN

Vice President, Exploration

### ALAN G. FRANKS

Vice President, Operations

<sup>1</sup> Chairman of the Board

<sup>2</sup> Member of the Audit Committee

<sup>3</sup> Member of the Reserves Committee

<sup>4</sup> Member of the Compensation Committee

<sup>5</sup> Member of the Disclosure Committee

## HEAD OFFICE

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### VALIANT TRUST COMPANY

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Calgary, Alberta T2P 1T1

## LEGAL COUNSEL

### BORDEN LADNER GERVAIS LLP

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Calgary, Alberta T2P 4H2

## BANKERS

### NATIONAL BANK OF CANADA

Suite 2700, 530 Eighth Avenue S.W.

Calgary, Alberta T2P 3S8

## AUDITORS

### PRICEWATERHOUSECOOPERS LLP

Suite 3100, 111 Fifth Avenue S.W.

Calgary, Alberta T2P 5L3

## EVALUATION ENGINEERS

### SPROULE ASSOCIATES LIMITED

Suite 900, 140 Fourth Avenue S.W.

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
BIT	before income taxes
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.

Sulphur is equated to oil on  
the basis of 0.6 lt = 1 BOE.

