

# **Canadian Spirit Resources Inc.**

## **MANAGEMENT DISCUSSION AND ANALYSIS**

**For the three and nine months ended September 30, 2008**

This management discussion and analysis (“MD&A”) of the financial conditions and results of operations should be read in conjunction with the unaudited interim financial statements for the three and nine month periods ended September 30, 2008 and the audited financial statements and MD&A for the year ended December 31, 2007.

### **Date**

This MD&A includes information up to November 20, 2008.

### **Quarterly Review**

Neither the interim financial statements for the three and nine month periods ended September 30, 2008 nor this MD&A have been reviewed by the Company’s external auditors.

### **Reader’s Advisory**

The corporate information contained in these pages may contain forward-looking forecast information. The reader is cautioned that assumptions used in the preparation of such information, although considered reasonable by Canadian Spirit Resources Inc. at the time of preparation, may prove to be incorrect. The actual results achieved during the forecast period will vary from the information provided herein and the variations may be material. Consequently, there is no representation by Canadian Spirit Resources Inc. that actual results achieved during the forecast period will be the same in whole or in part as those forecast.

### **Corporate Overview**

Canadian Spirit Resources Inc. (“CSRI” or the “Company”) is a natural resources company focusing on the identification and development of opportunities in the unconventional gas sector of the energy industry.

Since May 2002, the Company’s focus has been to evaluate the resource potential of certain unconventional natural gas exploration properties and is considered to be in its development stage of operations. Although some preliminary evaluation work was performed on coalbed methane prospects prior to May 2002, the decision to change the strategic direction of the Company from the evaluation of the Isk Wollastonite Mineral Property to an evaluation of unconventional natural gas prospects occurred at this time. In 2008, the Company entered into joint venture agreements with Shell Canada Energy (“Shell”) and Canbriam Energy Inc. (“Canbriam”) to explore and further advance the development of its major resource property at Farrell Creek, British Columbia. The joint venture with Canbriam will result in the exploration and evaluation of petroleum and natural gas rights (primarily in the Montney Formation) below the base of the Cadomin/Nikanassin Formation (“Deep Rights”) and the second joint venture with Shell will advance the development of rights (primarily the Gething Formation) from surface to the base of the Cadomin/Nikanassin Formation (“Shallow Rights”).

The Company’s strategic advantages are the extensive knowledge and experience of its technical team in coal, shale and unconventional natural gas exploration and development, the proprietary data base of potential unconventional natural gas resources in western Canada developed since 2002 and early 2003 and the energy development experience of its management, employees and directors.

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### **Results of Operations**

#### ***Farrell Creek, British Columbia:***

The focus of the Company's activities is currently on the evaluation and development of its principal resource property in the Farrell Creek area of northeast British Columbia, located approximately 70 kilometers west of Fort St. John. In September 2006, Sproule Associates issued an in-depth report, subsequently confirmed in updated reports dated April 2007 and April 2008, with an evaluation of 1.8 trillion cubic feet of discovered natural gas resource in the Gething, Moosebar and Gates Formations on the Company's lands at Farrell Creek. Through joint ventures with Canbriam and Shell, the Company is continuing to evaluate and develop the Deep Rights and the Shallow Rights on its Farrell Creek properties. With our joint venture partners currently bearing the exploration costs on these lands, the Company is able to look at new opportunities without immediate need to access our own capital or the equity markets. See **Business Risks** on Page 9 of this MD&A.

#### ***Farrell Creek: Montney***

On March 19, 2008, the Company announced the conclusion of a joint venture and farmout agreement for the Deep Rights with Canbriam, a private energy company based in Calgary, Alberta, that will evaluate certain of the Company's lands for Montney and other deep formation plays covering over 25,000 net acres. Canbriam will earn a 65% working interest in the Deep Rights by drilling and evaluating two commitment wells to at least the Montney Formation, with the Company retaining a 35% working interest. The joint venture agreement with Canbriam also provides for the Company to be credited for its share of the future capital costs, which could result in the CSRI having no capital obligations through an initial \$29 million of gross expenditures including any earning wells. Canbriam has an option to increase its working interest to 70% by increasing the Company's credit amount.

Pursuant to its agreement with the Company, Canbriam has drilled two wells targeting the Montney Formation on the eastern portion of the Farrell Creek lands. As a result of Canbriam drilling these wells, CSRI holds rights from surface to base of the Belloy Formation in seven sections, allowing the joint venture partners to undertake further work on these lands.

Geological and technical data obtained during the evaluation of the Upper Montney Formation in the two wells resulted in a decision not to proceed with a horizontal section at this time. Further evaluation of the Upper Montney Formation on this block of seven sections may be undertaken in the future with the development of infrastructure, technological improvements or higher natural gas prices.

During the drilling of these two wells, other potentially economic gas zones were identified and are expected to be further evaluated. The timing of this evaluation will depend largely on the development of pipeline infrastructure in proximity to these lands. One of the wells has been granted "New Pool Discovery" status.

Canbriam has indicated that it plans to conduct further operations on the western portion of the Farrell Creek lands in 2009.

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### **For the three and nine months ended September 30, 2008**

Land prices for Montney Formation rights in the Farrell Creek area remain strong and drilling by various operators continues to be active. On November 12, 2008, bids ranging from \$5,413 to \$14,878 per hectare for drilling licences in the Farrell Creek area resulted in a total bid of \$105.6 million. The parcels attracting the higher bids are in close proximity to the western portion of the Company's Farrell Creek lands.

At the November 12<sup>th</sup> sale, CSRI continued to add to its land position in this prospective area of northeastern British Columbia. On behalf of the joint venture, CSRI acquired additional rights from surface to base Montney Formation in five sections adjoining the eastern portion of the Farrell Creek lands.

#### ***Farrell Creek: Gething***

On July 17, 2008 the Company announced that it had entered into a second joint venture with Shell to advance the development of the identified unconventional natural gas resource in the Gething Formation on a combined total of approximately 145 contiguous sections or 92,800 acres located in the Farrell Creek area. Following an initial expenditure of approximately \$50 million, Shell may elect to proceed into the development phase resulting in the pooling of each respective party's Shallow Rights. The pooling of these Shallow Rights will result in the joint venture partner holding a 75% working interest in the Farrell Creek project and the Company retaining a 25% interest across approximately 145 sections. Proceeding to the development phase would commit Shell to additional capital spending or a payment to the Company. In effect, the Company would retain significant holdings across a larger project area with our joint venture partner leveraging our ability to evaluate and develop the Gething Formation.

The first phase of the expansion program began with Shell's purchase of approximately 95 sections of Shallow Rights in the Farrell Creek area and is advancing with the drilling of 4 vertical Gething wells and one deep water disposal well, and the construction of facilities to connect the pilot project to the Spectra Energy pipeline. Shell became the operator of these properties in September 2008.

During October two vertical wells were drilled on the east side of the Farrell Creek property followed by two more vertical wells into the Gething Formation in the pilot project area on the western portion of the property. The next well to be drilled is a water disposal well. The joint venture will realize an operational cost saving by eliminating the need to transport water produced from the pilot project to a commercial water disposal facility.

In the first quarter of 2009, the joint venture expects to connect the pilot project into the Spectra Energy pipeline. Once operational, the pilot project will provide the joint venture partners with production information enabling us to make a decision to proceed with development, provide an initial source of revenue and eliminate flaring.

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**For the three and nine months ended September 30, 2008**

### ***General:***

CSRI expects to be one of the first companies to bring a major non-conventional gas resource into production in British Columbia. The Farrell Creek area of northeast British Columbia is generating a significant level of activity from companies targeting unconventional gas prospects with substantial land prices being received by the Government of British Columbia. On November 12, 2008 Montney Formation lands in close proximity to the Company's Farrell Creek project attracted prices of over \$3.8 million per section or \$14,878 per hectare.

In order to accelerate and expand the evaluation and development of the Farrell Creek properties, the Company has leveraged its financial resources through two joint venture arrangements with well capitalized partners while retaining a substantial interest in each project. Success in the Farrell Creek properties will ultimately result in additional investment from the Company and its partners.

The Company has a strong working capital position of approximately \$12.0 million composed primarily of cash and receivables from its joint venture partners. The Company currently has minimal immediate capital commitments requiring additional cash investment.

In recent months, the global financial environment has had an adverse affect on capital markets and commodity prices. This has impacted the ability of many companies to raise equity capital and may represent an increased number of opportunities for well capitalized companies. CSRI may investigate some of these opportunities.

### ***Bittern Lake, Alberta:***

In 2005 and 2006 the Company drilled four and completed two Horseshoe Canyon wells on these 50% joint venture lands. After initial positive indications formation water production increased and the wells were shut in. Effective May 1, 2008 the Company sold its interests in these four wells, including associated abandonment and reclamation liabilities, for a consideration of \$45,000 (gross) and a 5% overriding royalty. The Company has retained a 50% interest in the rights to the Mannville Formation on three sections and is in the process of formulating plans for 2009.

### ***Isk Wollastonite Mineral Property, British Columbia:***

No field work has been conducted at the Isk Wollastonite mine site during 2007 nor the first three quarters of 2008. This asset is available for farm-out or sale.

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### Revenue

Revenues in the first three quarters of 2008 of \$99,181 (2007: \$71,112) represent interest on cash deposits. The Company anticipates natural gas revenues from its Farrell Creek property commencing in the first quarter of 2009.

### General and Administration Expenses

	Three months ended September 30,		Nine months ended September 30,	
	2008	2007	2008	2007
Consulting fees	\$ 81,939	\$ 199,078	\$ 236,195	\$ 352,183
Salaries and benefits	312,463	153,434	762,675	567,290
Other general administration	134,245	105,211	428,029	356,074
	<u>528,647</u>	<u>457,723</u>	<u>1,426,899</u>	<u>1,275,547</u>
Less: Capitalized costs	<u>(168,156)</u>	<u>(217,527)</u>	<u>(457,316)</u>	<u>(494,534)</u>
	<u>360,491</u>	<u>240,196</u>	<u>969,583</u>	<u>781,013</u>
Stock-based compensation	<u>(277,821)</u>	<u>(194,046)</u>	<u>462,425</u>	<u>(299,234)</u>
	<u>\$ 82,670</u>	<u>\$ 46,150</u>	<u>\$ 1,432,008</u>	<u>\$ 481,779</u>

In 2008, the Company continued consulting agreements with a director and senior officer of the Company, a financial advisor, a land consultant, and a computer network maintenance company. During 2008 to date, the Company has entered into additional consulting agreements with a second financial advisor and a business development specialist.

Salaries and benefits, after capitalization, have increased for the nine months ended September 30, 2008 compared with 2007 (\$424,378 and \$298,421 respectively) due to employee bonuses of \$125,000 declared and paid in the third quarter 2008. The Company capitalizes salaries and benefits associated with staff directly related to exploration and development activities.

Consulting fees, after capitalization, have remained relatively constant in the nine months ended September 30, 2008 compared with 2007 (\$154,059 and \$152,087 respectively).

During the three and nine months ended September 30, 2008, the Company capitalized a total of \$163,620 and \$444,441 respectively (2007: \$217,527 and \$490,156 respectively) of general and administration expenses directly related to exploration and development activities, which are therefore included as part of the property, plant and equipment costs recorded by the Company. The remainder of costs capitalized in the three and nine months ended September 30, 2008 of \$4,536 and \$12,875 respectively (2007: \$Nil and \$4,378 respectively) relate to consulting fees incurred in relation to equity instruments issue costs, and are therefore recorded by the Company as a reduction of shareholders' equity.

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Due to an increase in the market price of the Company's shares, stock-based compensation resulted in a net expense in the first nine months of 2008 compared with a net recovery in the same period for 2007. See **Summary of Quarterly Results** on Page 7 for further analysis of the effect on stock-based compensation on the overall results of the Company. The closing price of \$0.89 per share on the TSX Venture Exchange on September 30, 2008 represents a 75% increase from the closing price of \$0.51 per share at December 31, 2007.

### Other General and Administration Costs

	Three months ended September 30,		Nine months ended September 30,	
	2008	2007	2008	2007
Professional fees	\$ 1,273	\$ 6,817	\$ 16,642	\$ 27,362
Investor relations & filing fees	7,776	21,976	64,192	83,496
Office premises & insurance	84,687	52,735	249,990	158,956
Office supplies	29,232	15,590	59,931	47,204
Staffing costs	7,747	7,428	26,771	36,258
Other	3,530	665	10,503	2,798
	<u>134,245</u>	<u>105,211</u>	<u>428,029</u>	<u>356,074</u>
Less: Capitalized costs	<u>(16,374)</u>	<u>(14,087)</u>	<u>(24,008)</u>	<u>(21,191)</u>
	<u>\$ 117,871</u>	<u>\$ 91,124</u>	<u>\$ 404,021</u>	<u>\$ 334,883</u>

Professional fees have declined by 39% in the first three quarters of 2008 compared to 2007 due to a decrease in legal fees, related purely to the number of corporate matters requiring advice or assistance from the Company's legal counsel.

Investor relations and filing fees expense has decreased from the nine months ended September 30, 2007 to the nine months ended September 30, 2008 by 23% due to the termination of an investor relations consulting contract in the fourth quarter of 2007.

Office premises costs were 57% higher in the first three quarters of 2008 compared to 2007 due to higher net rents as well as increases in insurance and office operating costs. Office related expenses are anticipated to continue at current levels pursuant to the terms of the Company's existing sublease agreement.

The increase in office supplies expense of 27% for the first three quarters of 2008 compared to 2007 is due primarily to additional engineering and economic model software rental costs.

Staffing costs in the first three quarters of 2008 were 26% lower compared to the same period in 2007. In the 2008 nine month period, staffing costs were comprised primarily of training expenses and membership dues while the 2007 nine month period included severance related costs associated with a former employee.

Other expense is comprised of advertising and promotion costs, charitable contributions and bank charges.

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### Summary of Quarterly Results

Net results prior to income taxes from the beginning of 2006 were:

<u>Income (loss) by quarter</u>	<u>2008</u>		<u>2007</u>		<u>2006</u>	
	<u>Amount</u>	<u>Per Share (basic &amp; diluted)</u>	<u>Amount</u>	<u>Per Share (basic &amp; diluted)</u>	<u>Amount</u>	<u>Per Share (basic &amp; diluted)</u>
First Quarter	\$ (498,821)	\$ (0.01)	\$ (279,955)	\$ (0.01)	\$ (975,817)	\$ (0.04)
Second Quarter	(824,651)	(0.02)	(150,227)	-	31,536	-
Third Quarter	(35,726)	-	(42,936)	-	174,092	0.01
Fourth Quarter	-	-	(402,446)	(0.02)	(305,026)	(0.01)
Loss before income taxes	<u>\$ (1,359,198)</u>	<u>\$ (0.03)</u>	<u>\$ (875,564)</u>	<u>\$ (0.03)</u>	<u>\$ (1,075,215)</u>	<u>\$ (0.04)</u>

For each period up to and including September 30, 2008, the existence of stock options and warrants affected the calculation of diluted shares outstanding. As the effect of this dilution is to reduce the reported loss per share, diluted loss per share information has not been shown.

In 2007 and 2008, the Company financed a portion of its development activities through the issue of Flow-Through Shares. Under the terms of these share issues, the related resource expenditure deductions for income tax purposes are renounced to investors in the year of issue. When the expenditures are renounced, share capital is reduced and future income tax recoveries are recorded at the estimated value of the renounced tax deductions. The Flow-Through Share issue that occurred in 2007 resulted in a recovery of future income taxes of \$172,925. This recovery was booked in the first quarter of 2008 as that is when the actual renouncement documents were filed with the government authorities. See **Share Capital** on Page 13 for a description of the Flow-Through Share issue concluded in July 2008.

As discussed previously, stock-based compensation expense for stock option grants and SARs has contributed significantly to the variability of the Company's income and losses since the beginning of 2006. Related to the SARs issued to two officers and a senior employee in August 2003, changes in the value of the Company's shares have an immediate impact on the quarterly provision for this potential liability. Subsequent to the end of the third quarter 2008, the Board of Directors of the Company approved a grant of 600,000 stock options to replace all 600,000 existing SARs. As a result, the liability related to the SARs will be discharged and the full recovery of the remaining SARs stock-based compensation expense will be recognized in the fourth quarter 2008. Excluding the effects of stock-based compensation, the Company's pre-tax losses by quarter would have been:

### **Loss by quarter prior to stock-based compensation expense**

	<u>2008</u>	<u>2007</u>	<u>2006</u>
First Quarter	\$ (252,197)	\$ (299,988)	\$ (216,771)
Second Quarter	(331,029)	(235,382)	(277,597)
Third Quarter	(313,547)	(236,982)	(257,468)
Fourth Quarter	-	(300,502)	(318,597)
Loss before income taxes	<u>\$ (896,773)</u>	<u>\$ (1,072,854)</u>	<u>\$ (1,070,433)</u>

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### **Liquidity and Capital Resources**

The Company's capital program for the first nine months of each of the last two years is detailed in the following table:

	Three months ended September 30,		Nine months ended September 30,	
	2008	2007	2008	2007
Geological and geophysical	\$ 2,001	\$ 9,745	\$ 50,419	\$ 18,990
(Recovery of) drilling and completion costs	(5,317,221)	1,494,805	(3,726,673)	2,725,177
Capitalized overhead	163,620	217,527	444,441	490,156
Total petroleum and natural gas	(5,151,600)	1,722,077	(3,231,813)	3,234,323
Lease acquisitions and retentions	37,589	20,134	76,568	72,294
Office equipment and furnishings	51,887	-	62,060	3,251
Total capital expenditures	<u>\$ (5,062,124)</u>	<u>\$ 1,742,211</u>	<u>\$ (3,093,185)</u>	<u>\$ 3,309,868</u>

For the year 2008, the Company has a base case capital budget of \$4.3 million including the Company's portion of the joint venture tie-in of the Farrell Creek pilot program to the Spectra Energy sales pipeline, and an estimated \$560,000 for capitalized overhead. Also included in the base case capital budget for 2008 is the allocation for field testing activities of \$1.1 million. The Company's budget is reviewed and approved by the Board of Directors on a quarterly basis. To September 30, 2008, net capital expenditures before recoveries totaled \$2.4 million.

Offsetting the Company's 2008 base case capital budget is the accrual and receipt in the third quarter 2008 of \$5.5 million of previously expended drilling and completion costs from a joint venture partner in relation to the Farrell Creek pilot program. The recovery of these expenditures has been recorded as a reduction of capitalized drilling and completion costs as at September 30, 2008.

Cash administration expenses (G&A excluding stock based compensation) for 2008 are expected to be approximately \$1.8 million before capitalization of exploration and development related overhead, approximately the same as 2007. Revenue from interest on cash balances is budgeted at \$121,000 for the year but is expected to exceed this figure due to higher than anticipated average cash balances. The Company has not budgeted for any cash flow from operations during 2008.

At September 30, 2008, the Company had working capital of \$12.4 million, consisting of cash in the amount of \$11.9 million, accounts receivable and prepaid expenses of \$1.6 million, net of accounts payable and accrued trade and stock appreciation rights liabilities of \$1.1 million. The accounts payable and accrued trade liabilities relate to field work at Farrell Creek, British Columbia that occurred during the latter part of the third quarter of 2008. The Company has no bank indebtedness and has no credit agreements to borrow money in place at this time.

The Company's working capital of \$12.4 million at September 30, 2008 is considered to be more than sufficient to cover its administrative costs and its base case capital budget remaining through the end of 2008. The additional equity capital required to complete the tie-in of the Company's Farrell Creek pilot program to the Spectra Energy gas pipeline and to complete any further planned capital programs, such as additional drilling activity and the resultant tie-ins are now covered under the terms of the July 17, 2008

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### **For the three and nine months ended September 30, 2008**

joint venture (see **Results of Operations** on Page 2). The Company does not anticipate any significant capital requirements related to this project through the end of 2008.

During the third quarter 2008, the Company increased its net working capital position by \$10.2 million through a) an equity issue which closed on July 16, 2008 raising \$3.1 million; b) the exercise of warrants which expired on July 18, 2008 raising \$1.6 million; and c) the reimbursement of previously expended drilling and completion costs in the amount of \$5.5 million from a joint venture partner.

### **Business Risks**

#### ***Productivity***

A material risk facing the Company is the productive capability of the discovered coal and shale resource in the Gething Formation on the Company's existing land base at Farrell Creek and the Company's ability to extract this discovered natural gas resource economically. The Company has made significant progress in developing an economic well completion and production system. Together with its joint venture partner, the Company will continue to utilize the knowledge, experience and technology available in the service sector to improve the productivity of the Gething Formation in this emerging gas basin in northeast British Columbia.

The Shallow Rights joint venture is expected to accelerate the development of the optimal completion and production methods for the Gething Formation with the Company being carried on costs for a period of time.

#### ***Exploration***

The Company has begun to explore the resource potential of the geological formations below the base of the Cadomin/Nikanassin zone with an initial focus on the Montney Formation. Only a small number of wells have been drilled into these deeper formations in the vicinity of the Company's lands and public information is available on just a small number of these wells. Exploration risk includes both determining the existence of commercial qualities of hydrocarbons and the ability to recover any discovered resource economically. Recognizing the technical expertise, operating capability and financial resources needed to explore these deeper formations, the Company has entered into a joint venture which will result in the initial exploration of its Deep Rights at Farrell Creek, British Columbia with the joint venture partner bearing the initial capital cost of this program.

#### ***Financial Resources and Liquidity***

The Company's ability to continue its operations is highly dependent upon capital markets. Its ability to develop its assets and realize their carrying values is dependent upon the continued support of its shareholders and joint venture partners, favourable capital market conditions and commodity prices, obtaining additional equity financing, converting discovered resources into economically recoverable reserves, and ultimately, generating revenues sufficient to cover operating costs and capital requirements.

To minimize financial risk, the Company pre-funds all capital commitments in the equity markets and does not utilize debt at this early stage of development. Included in commitments is the minimum administrative and operating cost to see the Company through anticipated equity market or commodity price cycles. With \$12.4 million of working capital and minimal capital commitments, the Company is in a strong position to continue with its business plan during the current volatility in equity and commodity markets.

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### ***Commodity Prices***

The Company's exploration and development efforts are targeted principally on natural gas. There exists an efficient and sophisticated market for natural gas in North America which is sensitive to factors affecting the supply of and demand for this commodity. Similar factors outside North America are having a greater influence on natural gas prices in North America through the growth of liquefied natural gas trade internationally. Currently, natural gas prices influence the Company's investment decisions and once natural gas production is established, it will impact the Company's revenue. The Company considers publically available price forecasts for natural gas in its evaluation of investment economics and returns.

### ***Operating Capability***

The Company is pursuing large unconventional natural gas projects that if successful will require operating staff and experience to fully develop. The Company has a technically strong team suitable for its current operations but does not currently possess the skills and staff needed to conduct an efficient large scale development operation. To mitigate the risk inherent in assembling the necessary operating team, the Company has entered into Deep Rights and Shallow Rights joint ventures pursuant to which substantial parties with the necessary experience and skills will assume operatorship.

### ***Land Acquisition and Tenure***

Rights to explore for and extract hydrocarbons, are generally acquired from the Crown or private parties and requires certain work to be performed within a specific time period to retain such mineral rights. Mineral rights acquired from the Crown are usually obtained through a closed bid process. In order to expand its exploration activity, the Company must have the financial resources needed to bid on Crown mineral rights and if successful, must have the additional funds to make the required exploration expenditures. The Company acquired its existing mineral rights primarily from the Province of British Columbia during the last five years and must make drilling expenditures on these lands during 2008 and 2009 in order to retain a substantial portion of these mineral rights. To reduce the risk of losing its current mineral rights, the Company has entered into Deep Rights and Shallow Rights joint ventures in return for drilling expenditures on its lands. This will allow the Company to allocate its financial resources to additional land acquisition rather than drilling and development.

### ***Environment and Public Policy***

The exploration, development and production activities of the Company are highly regulated and the trend of public policy is to provide additional incentives and regulations to reduce the impact of industry activity on the environment. The principal components expected to be produced during production operations that would impact the environment are relatively small amounts of saline water and carbon dioxide. The saline water is currently re-injected into deep geologic formations at a commercial facility and in future, will be re-injected using Company owned facilities. Methods to capture and store or use carbon dioxide in commercial applications are being undertaken by the industry and the Company is monitoring these and regulatory developments in order to plan a mitigating strategy.

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### **Disclosure Controls and Procedures and Internal Controls**

#### ***Disclosure Control Risk***

Disclosure controls and procedures have been designed to ensure that information required to be disclosed by the Company is accumulated and communicated to management as appropriate to allow timely decisions regarding required disclosure. The Company's Chief Executive Officer and Chief Operating Officer have concluded, based on their evaluation of the effectiveness of the Company's disclosure controls and procedures as of September 30, 2008, that disclosure controls and procedures provide reasonable assurance that material information is made known to them by others within the Company subject to the reportable weakness identified below regarding segregation of duties. However, a control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met.

#### ***Internal Control Risks***

Management is responsible for certifying the design of the Company's internal control over financial reporting ("ICFR") as required by Multilateral Instrument 52-109 – "Certification of Disclosure in Issuers Annual and Interim Filings". Our ICFR is intended to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian generally accepted accounting principals (GAAP). ICFR includes those policies and procedures that establish the following:

- maintenance of records in reasonable detail, that accurately and fairly reflect the transactions and dispositions of our assets;
- reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with GAAP;
- receipts and expenditures only being made in accordance with authorizations of management and the Board of Directors; and
- reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements.

Because of its inherent limitations, ICFR may not prevent or detect misstatements. Also, the effectiveness of ICFR is subject to the risk that controls may become inadequate because of changes in condition, or that the degree of compliance with the policies or procedures may deteriorate. Management, including the Chief Executive Officer and Chief Operating Officer, carried out the design of the Company's internal controls over financial reporting and concluded, subject to the inherent limitations noted above, the Company has sufficient controls to meet the requirements as stated above and that one reportable weakness existed, at September 30, 2008, as detailed below.

#### ***Segregation of Duties***

Segregation of duties is a basic, key internal control and one of the most difficult to achieve in a small company. It is used to ensure that errors or irregularities are prevented or detected on a timely basis by employees in the normal course of business. Due to limited resources, a complete segregation of duties within the Company's operating and accounting groups can not be fully achieved. The result is that the Company is highly reliant on the qualifications, experience and integrity of its staff and on the performance of mitigating procedures during its financial close processes in order to ensure the financial statements are presented fairly in all material respects. No significant change in the current control

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process occurred in the first nine months of 2008 nor is any change planned until the Company achieves production and cash flow from operations. Management will continue to review existing mitigating controls and, if appropriate, implement changes to its internal control processes whereby more effective mitigating controls will be adopted.

### **Critical Accounting Policies**

Reference should be made to the Company's significant accounting policies contained in note 2 to the Company's unaudited interim financial statements for the three and nine month periods ended September 30, 2008 and the audited financial statements for the year ended December 31, 2007. These accounting policies can have a significant impact on the financial performance and financial position of the Company.

### **Off Balance Sheet Arrangements**

The Company has not entered into any off balance sheet arrangements.

### **Financial Instruments**

The Company's financial instruments consist of cash and cash equivalents, accounts receivable, accounts payable and accrued expenses. It is management's opinion that the Company is not exposed to significant credit, market or liquidity risk arising from its financial instruments and that, due to their short term nature, their fair values approximate their carrying values as at September 30, 2008.

Effective January 1, 2008, the Company adopted the following new Canadian Institute of Chartered Accountants ("CICA") accounting pronouncements: Section 1535, *Capital Disclosures*; Section 3862, *Financial Instruments – Disclosures*; and Section 3863 *Financial Instruments – Presentation*. The adoption of these new standards results in no significant changes to the unaudited interim financial statements of the Company except for additional note disclosure. See note 2 to the audited financial statements for the year ended December 31, 2007 for a description of the significant accounting policies followed by the Company. See notes 8 and 9 to the unaudited interim financial statements for the three and nine month periods ended September 30, 2008.

### **Future Changes in Accounting Policies**

The following is an overview of accounting standard changes that the Company will be required to adopt in the near future:

CICA Handbook: Section 3064, *Goodwill and Intangible Assets*. This section provides additional guidance on when expenditures qualify for recognition as intangible assets and requires that costs be deferred only when relating to an item meeting the CICA definition of an asset.

This new standard is effective for interim or annual fiscal periods beginning on or after October 31, 2008 and therefore the Company will evaluate the impact of adopting the new standard in conjunction with its next fiscal year beginning on January 1, 2009.

# Canadian Spirit Resources Inc.

## MANAGEMENT DISCUSSION AND ANALYSIS

**For the three and nine months ended September 30, 2008**

### **Related Party Transactions**

During the first nine months of 2008 and 2007, the Company had transactions with directors of the Company, persons related to them or companies controlled by them in the normal course of business as follows:

For the nine month periods ended September 30	2008	2007
Consulting fees	\$ 96,150	\$ 84,150

Consulting fees during the three and nine month periods ending September 30, 2008 comprised of \$28,050 and \$96,150 respectively (2007: \$29,550 and \$84,150 respectively) paid or payable to a director and senior officer of the Company. Accounts payable at September 30, 2008 includes \$4,099 (2007: \$3,716) due to a director and senior officer for consulting fees earned and related costs.

Transactions with related parties are recorded at cost, which represent exchange amounts for services provided. Since September 30, 2008 to the date of this report, the Company has continued to contract with a director to provide management services as a consultant.

### **Share Capital**

The Company has authorized share capital of an unlimited number of common shares of no par value.

On July 16, 2008, the Company issued 2,493,319 Units at \$1.05 per Unit and 400,000 Flow-Through Shares at \$1.20 per share. Each Unit consists of one common share and one-half of one share purchase warrant. Each whole warrant entitles the holder to purchase one share for eighteen months at an exercise price of \$1.40 per share. The fair value of the warrants was estimated at the date of closing, using the Black-Scholes pricing model, under which the Company assigned a value of \$0.49 per whole warrant or \$697,169 of the Unit proceeds to warrants, with the remaining \$1,920,816 of the Unit proceeds assigned to common shares. The Flow-Through Shares entitle the holder to certain income tax benefits in the form of Canadian Development Expense. The full proceeds of the Flow-Through Shares placement, or \$480,000, has been assigned to common shares and is expected to be fully expended on eligible development costs by the end of 2008. As such, the Company has recorded a recovery of future income taxes of \$120,000 due to the issuance of the Flow-Through Shares.

On February 19, 2008 the Company issued 11,220,000 Units at \$0.50 per Unit. Each Unit consists of one common share and one-half of one share purchase warrant. Each whole warrant entitles the holder to purchase one share for two years at an exercise price of \$0.80 per share. Prior to expiry, if the common shares of the Company close at a price of \$1.20 per share or greater for twenty consecutive trading days, then the Company shall have the option upon thirty days written notice to require the exercise of the warrants by the end of such period at which time any unexercised warrants shall expire. The fair value of the warrants was estimated at the date of closing using the Black-Scholes pricing model, under which the Company assigned a value of \$0.18 per whole warrant or \$1,311,618 of the Unit proceeds to warrants, with the remaining \$4,298,382 of the Unit proceeds assigned to common shares.

# **Canadian Spirit Resources Inc.**

## **MANAGEMENT DISCUSSION AND ANALYSIS**

### **For the three and nine months ended September 30, 2008**

Since December 31, 2007 to the date of this report, the Company has issued 465,000 common shares for the exercise of stock options and 1,514,000 common shares for the exercise of share purchase warrants. During this same period, the Company has granted 50,000 options to purchase common shares to a land consultant, 317,000 options to non-executive employees of the Company, 115,000 options to executive employees of the Company, 790,000 options to independent directors and officers who are also directors of the Company and 265,000 options to contract consultants for a total of 1,537,000 options. The issued share capital as at November 20, 2008 consists of 48,675,401 common shares. In addition, the Company has 6,816,660 warrants and 3,057,000 stock options outstanding as at November 20, 2008.

#### **Commitments**

The Company has entered into an office sub-lease agreement which expires on May 30, 2011. Under the terms of the sub-lease agreement, the Company is obligated to pay base annual rent of \$28.00 per square foot on 6,793 square feet as well as its share of the operating costs.

#### **Corporate Information**

Additional information regarding the Company is available on SEDAR at [www.sedar.com](http://www.sedar.com) or the Company's website at [www.csri.ca](http://www.csri.ca).