

Canadian Spirit Resources Inc.

MANAGEMENT DISCUSSION AND ANALYSIS

For the year ended December 31, 2009

This management discussion and analysis (“MD&A”) of the financial conditions and results of operations should be read in conjunction with the audited financial statements for the year ended December 31, 2009 (all amounts in Canadian dollars).

Date

This MD&A includes information up to April 22, 2010.

Reader’s Advisory

Information provided herein contains estimates and assumptions which management is required to make regarding future events and may constitute forward-looking statements within the meaning of applicable securities laws. Management’s assessment of future plans and operations, capital expenditures, methods of financing capital expenditures and the ability to fund financial liabilities, expected commodity prices and the impact on Canadian Spirit Resources Inc. (“CSRI” or the “Corporation”), expected increase in royalty rates, and the timing of and impact of adoption of International Financial Reporting Standards and other accounting policies may constitute forward-looking statements under applicable securities laws and necessarily involve risks including, without limitation, risks associated with natural gas exploration, development, exploitation, production, marketing and transportation, loss of markets, volatility of commodity prices, currency fluctuations, imprecision of reserve estimates, environmental risk, competition from other producers, inability to retain drilling rigs and other services, incorrect assessment of the value of acquisitions, failure to realize the anticipated benefits of acquisitions, the inability to fully realize the benefits of the acquisitions, delays resulting from or inability to obtain required regulatory approvals and ability to access sufficient capital from internal and external sources.

Although management believes the expectations reflected in such forward-looking statements are reasonable, it can give no assurance that such expectations will be realized. The use of any of the words “anticipate”, “believe”, “continue”, “estimate”, “expect”, “forecast”, “may”, “intend”, “likely”, “will”, “project”, “plan”, “should”, “possible”, “probable”, “schedule”, “position”, “goal”, “objective”, and similar expressions are intended to identify forward-looking information. These statements are subject to certain risks and uncertainties and may be based on assumptions that could cause actual results to differ materially from those anticipated or implied in the forward-looking statements. The risks associated with these forward-looking statements include, but are not limited to, the following:

- Fluctuations in natural gas production levels
- CSRI’s ability to raise funds in the available equity markets
- Volatility in market prices for natural gas
- Changes in foreign currency exchange and interest rates

The Corporation will endeavor to update all forward-looking statements for any material changes to the circumstances or information and estimates presented herein as feasible or as required by applicable securities laws.

Corporate Overview

Canadian Spirit Resources Inc. is a natural resources company listed on the TSX Venture Exchange (the “Exchange”) focusing on the identification and development of opportunities in the unconventional gas sector of the energy industry. Together, with two well capitalized joint venture partners, the Corporation is currently developing the Montney and Gething Formations on its material land base in northeastern British Columbia.

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Since early 2002, the Corporation's focus has been to evaluate the resource potential of certain unconventional natural gas exploration properties and is considered to be emerging from its development stage of operations. In 2003, CSRI drilled its first resource evaluation well and acquired a small land position in the Farrell Creek area of northeastern British Columbia. In the years following, the Corporation significantly increased its land position in this same area, drilled eight additional wells and by year-end 2007 was evaluating the productive capability of the Gething Formation with a five well pilot project. In 2008, the Corporation entered into joint venture agreements with Shell Canada Energy ("Shell" or the "Operator") and Canbriam Energy BC Partnership ("Canbriam") to explore and further advance the development of its major resource property at Farrell Creek. 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 joint venture with Shell will advance the development of rights (initially the Gething Formation) from surface to the base of the Cadomin/Nikanassin Formation ("Shallow Rights").

Two years ago, the Corporation took several steps to improve its strategic position. In February 2008, during a period of low natural gas prices and difficult equity market conditions the Corporation successfully completed a \$5.6 million private placement. By the middle of 2008, petroleum and natural gas commodity prices had rebounded and the Corporation further strengthened its working capital position by \$4.7 million through a \$3.1 million private placement in July and the exercise of \$1.6 million of previously issued share purchase warrants. During this period, the Corporation also entered into the Deep Rights and Shallow Rights joint ventures that included capital spending commitments by Shell and Canbriam and a \$5.0 million reimbursement to the Corporation to recognize prior capital expenditures in the Gething Formation. Having survived the challenging economic conditions, lower petroleum commodity prices and tight equity market conditions during the latter part of 2008 and the first half of 2009, the Corporation is now well-positioned to further the development of its Farrell Creek property and move forward with additional strategic initiatives. The Corporation expects to have minimal capital requirements through to the third quarter 2010.

In addition, the Corporation recently increased its working capital by \$4.3 million through the exercise of in-the-money warrants prior to their expiry on February 19, 2010. CSRI has the potential to raise a further \$1.7 million through the exercise of 1.2 million warrants with an exercise price of \$1.40 which are due to expire on July 9, 2010.

As of the date of this report, the Corporation has a strong working capital position of approximately \$12.4 million (\$0.23 per share) composed primarily of cash, as well as receivables from its joint venture partners.

CSRI's Board of Directors approved a 2010 capital budget of up to \$18.0 million. The 2010 capital budget may be reduced if Canbriam elects to increase its working interest in the Deep Rights (see *Farrell Creek: Montney* below). The 2010 capital budget is mainly focused on the development of the Corporation's Montney joint venture with Canbriam. The 2010 capital budget also includes \$3.5 million (net) for other opportunities that the Corporation has identified. The Corporation does not have any immediate capital outlays associated with the Gething joint venture as Shell continues to carry CSRI for the project's expenses and capital commitments.

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Results of Operations

Farrell Creek, British Columbia:

The focus of the Corporation's activities is currently on the evaluation and development of its principal resource property in the Farrell Creek area of northeastern British Columbia, located approximately 70 kilometers west of Fort St. John.

Sproule Unconventional Limited ("Sproule"), in their 2009 year-end report, estimated total gross discovered and undiscovered petroleum initially-in-place (resources) associated with the principal geological targets of the Corporation's two joint ventures at Farrell Creek. In the Gething, Moosebar and Gates Formations on the Corporation's lands at Farrell Creek, Sproule estimates the total gross discovered and undiscovered petroleum initially-in-place to be 1.8 trillion cubic feet of natural gas. Based on well data provided by the Corporation, Sproule estimated a range of 21 to 34 bcf per section in the Gething Formation and a range of 6 to 8 bcf per section in the Moosebar and Gates Formations.

In the Montney Formation, Sproule estimated total gross discovered and undiscovered resources to be 3.6 trillion cubic feet of natural gas on the Corporation's lands at Farrell Creek. This estimate was based on well data provided by the Corporation and using an industry standard 6% limestone porosity cutoff. Based on the Corporation's well evaluation work in the lower portion of the Montney Formation, and to investigate the sensitivity of calculated gas-in-place volumes to the porosity cutoff applied to the well logs, the Corporation requested that Sproule also calculate the in-place discovered and undiscovered resources using a 3% limestone porosity cutoff. Using this cutoff, total gross discovered and undiscovered resources were calculated to be 8.4 trillion cubic feet of natural gas on the Corporation's lands at Farrell Creek. On average, this provided a range of 77 (using a 6% cutoff) to 178 (using a 3% cutoff) bcf per section in the Montney Formation.

Through joint ventures with Canbriam and Shell, the Corporation 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 and development costs on these lands, the Corporation is able to look at new opportunities.

The expected future market price of natural gas is an important determinant in the expected future viability and the timing of investment decisions related to resource projects such as Farrell Creek. Over the past five years, natural gas prices have fluctuated widely and are currently recovering from recent lows in September 2009. Historically, natural gas has gone through extended periods of excess supply capability relative to demand resulting in lower average prices and reduced investment in marginal natural gas projects. In addition to commodity prices, factors such as productivity, expected ultimate recoveries, costs and fiscal regimes are considered by industry participants and investors when making capital investment decisions. See **Business Risks** on Page 12 of this MD&A and refer to the Corporation's NI 51-101 filing which forms part of the Annual Information Form.

Farrell Creek: Gething

On July 17, 2008 the Corporation announced that it had entered into a 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 150 contiguous sections or 96,000 acres located in the Farrell Creek area. Shell's \$50.0 million initial capital commitment included the acquisition of additional land, the drilling of five vertical wells and the construction of facilities to tie-in the Pilot Project. The pilot facility is scaleable and currently has a capacity of up to 1.1 mmcf/d.

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The primary purpose of the Pilot Project is to optimize the completion and production techniques that would be used at the Farrell Creek Gething project in a commercial production situation. The pilot facility enables Shell to continuously test Gething wells without the need to flare gases into the atmosphere.

Seven Gething wells are now tied into the pilot facility. Sales volumes of natural gas for the period ended December 31, 2009 totaled approximately 12 mmcf generating gross revenues of approximately \$33,000. Under the terms of the Joint Venture Agreement, the revenues are used by the Operator to offset operating expenses. Prior to construction of the pilot facility, the Corporation produced a total of 86 mmcf of natural gas while testing eight Gething wells but had been required to shut-in these wells due to provincial government flaring limitations.

Should Shell make a decision by mid year to move to the development stage following evaluation of the Pilot Project results to-date, the pooling of Shell (75%) and CSRI (25%) lands would create a combined project of approximately 150 sections (96,000 acres) of Gething rights (37 sections net to CSRI) and a commitment by Shell to carry CSRI through an additional capital investment. Shell will earn a 75 percent working interest in CSRI's approximately 55 sections and CSRI will receive a 25 percent working interest in Shell's approximately 95 sections. To date, Shell has fulfilled its initial \$50.0 million commitment and continues as Operator of the pilot project.

If Shell does not elect to proceed to the development stage in the Gething Formation, CSRI will retain a 100% working interest in its existing 55 sections of Gething lands and would also assume 100% ownership of the pilot facility, wells and infrastructure at no additional cost. CSRI also holds a right-of-first-refusal on Shell's 95 sections of Gething lands. With the current strong working capital position, the Corporation is adequately capitalized to continue operation of the Pilot Project in the event Shell elects not to proceed.

Farrell Creek: Montney

On March 19, 2008, the Corporation announced 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 Corporation's lands for Montney and other deep formation plays covering approximately 28,400 gross acres. Through the joint venture, Canbriam committed to an initial expenditure of up to \$28.6 million for exploration of the Deep Rights including the drilling of at least two wells to the Montney Formation in exchange for a 65% working interest. In 2010, Canbriam has an option to increase its working interest in the Deep Rights from 65 to 70 percent by increasing its gross capital commitment to \$50.0 million. CSRI would be carried through this amount of gross capital expenditures for its remaining 30 percent working interest.

Since conducting evaluation tests on two vertical Montney wells on the eastern block of Farrell Creek in late 2008, Canbriam has focused its operations on the western portion of the Farrell Creek lands in close proximity to the Spectra Energy pipeline. During the past year, other operators' drilling and development activity has significantly de-risked the Montney Formation adjacent to the western portion of the Corporation's Farrell Creek lands. Talisman Energy Inc. ("Talisman") recently moved its adjacent Montney shale play into commercial production and expects to be producing 40-60 mmcf/d by year end with an announced capital investment of \$550 million for the Montney Shale program in 2010. Talisman's horizontal wells to-date have been focused on the higher porosity mid to upper portion of the approximately 300 metre thick Montney Formation.

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The lower portion of the Montney Formation consists of lower porosity shales on average but is believed to contain significant volumes of natural gas. In order to determine whether the lower portion of the Montney Formation could be an economic contributor to the overall productivity of the Montney Formation at Farrell Creek, Canbriam drilled, stimulated and performed a limited test of the lower Montney in a vertical well at the b-17-I/94-B-1 location. This successful test led to the drilling of a horizontal well in the lower portion of the Montney at c-A48-I/94-B-1 during the first quarter of 2010. Stimulation and testing of the horizontal well will commence in June following the removal of spring weight restrictions on roads in the Farrell Creek area (see News Release dated March 4, 2010).

The capital program for the balance of 2010 will include three horizontal wells targeting the upper portion of the Montney Formation at Farrell Creek and the construction of a gas processing facility. Two horizontal wells will be drilled and completed at the c-18-I/94-B-1 location and a horizontal leg will be drilled and completed from the c-A-48-I well. The sweet gas facility is expected to be tied into the Spectra Energy pipeline and commissioned during the fourth quarter of 2010. The facility located near the b-17-I wellsite will be expandable with an initial capacity of 10 to 20 mmcf/d. Three wells are expected to be flowing natural gas through this facility by year-end.

In order to accomplish the above, Canbriam has approved plans for capital investment of up to \$49.0 million (gross) in the Farrell Creek Montney program for 2010. CSRI's share of capital expenditures on the Montney joint venture in 2010 range from \$6.0 million to \$14.5 million conditional upon whether Canbriam exercises their option to increase their working interest from 65 percent to 70 percent in 2010. If Canbriam exercises this option, the Corporation will retain a 30 percent working interest in the Montney joint venture and will be carried through an additional \$21.0 million capital investment. The Montney joint venture development plans are expected to achieve a meaningful level of production, revenue and reserves by the end of 2010. Subject to meeting the necessary listing requirements, the Corporation plans to graduate to a full listing on the Toronto Stock Exchange as soon as possible in 2011.

Bittern Lake, Alberta:

Effective May 1, 2008 the Corporation sold its net interests in four Horseshoe Canyon joint venture wells, including the associated abandonment and reclamation liabilities for cash and a 5% overriding royalty.

Isk Wollastonite Mineral Property, British Columbia:

No field work has been conducted at the Isk Wollastonite mine site since 2002. This asset is available for farm-out or sale.

British Columbia Stimulus Package:

British Columbia continues to be a competitive jurisdiction for gas exploration and production. On August 6, 2009, the Government of British Columbia announced an oil and gas stimulus package that became effective September 1, 2009. The Stimulus Package is expected to benefit CSRI and encourage drilling activity through:

- (a) Royalty incentives including a one year, 2% royalty rate for all wells drilled within a ten month window;
- (b) An increase of 15% in existing royalty deductions for deep natural gas wells drilled;
- (c) The extension of the Deep Royalty Credit Program to horizontal wells drilled between 1900 and 2300 meters;
- (d) Increased funding to the Infrastructure Royalty Credit Program; and
- (e) Certain regulatory initiatives.

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Reserves:

The Corporation has no reserves attributable to its natural gas interests at December 31, 2009. The Corporation's Statement of Reserves Data and Other Oil and Gas Information is incorporated in the Corporation's Annual Information Form dated April 22, 2010.

Selected Annual Information

For the years ended or as at December 31	2009	2008
Total revenues	\$ 45,809	\$ 133,344
Net loss and comprehensive loss (after income taxes)	\$ (2,015,498)	\$ (1,698,232)
Loss and comprehensive loss per share (basic & diluted)	\$ (0.04)	\$ (0.04)
Total current assets	\$ 9,903,175	\$ 12,850,473
Total assets	\$ 45,155,123	\$ 47,535,538
Total current liabilities	\$ 418,095	\$ 1,132,785
Total long term liabilities	\$ 288,095	\$ 211,848
Net working capital	\$ 9,485,080	\$ 11,717,688
Net capital expenditures (recoveries)	\$ 539,548	\$ (2,837,064)

Significant items affecting results over the past two years

For the two years ended December 31, 2009, the Corporation is still considered to be in its development stage of operations. Reported revenue during the two years is interest on cash deposits. The decreased amount of interest revenue reported in 2009 was the result of significantly lower average effective interest rates during the year, despite higher average cash balances than in 2008.

During the second half of 2008, the Corporation received a reimbursement of \$5.0 million of previously expended drilling and completion costs from Shell. The recovery was recorded as a net reduction in unproved natural gas properties capitalized costs, thus resulting in a net recovery of capital expenditures in 2008 of \$2.8 million.

The fair value of stock options is measured at grant date and charged as an expense over the vesting period with a corresponding increase in contributed surplus. The number of stock options issued in a period, the vesting provisions of such options and the historic volatility of the Corporation's share price influence the amount of stock-based compensation expense in current and future periods. The compensation amount for stock options charged against earnings in 2009 was \$372,160 (2008: \$375,595).

In 2003, the Corporation granted share appreciation rights ("SARs") to three senior employees entitling the holders to cash payments equal to the excess of the then current price of the common shares (to a maximum of \$3.65) over the exercise price of the right. The provision for the potential liability associated with SARs was calculated quarterly over the three year vesting period of the rights based on the closing price of the Corporation's shares at the end of each quarter. The compensation cost was charged to stock-based compensation expense on a straight-line basis over the vesting period with a corresponding increase in accrued liabilities, but subsequently has been adjusted upward or downward based on movement of the price of the Corporation's shares. The holders' rights to exercise vested SARs were conditional upon the Corporation achieving certain production or profit thresholds; in the third quarter 2008 the Board of Directors determined that the exercise conditions associated with these SARs had been achieved and extended the expiry date of the SARs from August 28, 2008 to January 28, 2009.

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On October 30, 2008 the Board of Directors then approved a grant of 600,000 stock options, at an exercise price of \$0.50 per share with a term of five months (having an expiry date of March 31, 2009) to replace all the existing outstanding SARs. The difference of \$0.02 between the exercise price of the SARs and the replacement stock options was paid out to the SARs holders in cash in the fourth quarter 2008. All 600,000 stock options granted as replacement of the SARs were exercised prior to expiry. Total compensation recovery for SARs for the year ended December 31, 2008 was \$18,000. As a result of the cancellation of the SARs in the fourth fourth quarter 2008, the Corporation no longer has an accrued liability relating to SARs in 2009.

Revenue/Royalties/Operating Costs

The joint venture Gething pilot project has produced nominal volumes of sales gas since June 2009. Under the terms of the joint venture agreement, operating and transportation costs less 100% of sales revenue are the responsibility of the Operator and are applied against the financial amount committed by the Operator. As of December 31, 2009 no royalties are accrued since the pilot production levels are minimal and sales revenue is less than credits earned under the applicable British Columbia royalty regime. Since the Corporation had no reported production revenues nor proved reserves as at December 31, 2009 and 2008, there was no depletion charge for 2009 nor 2008.

Revenues during the year ended December 31, 2009 of \$45,809 (2008: \$133,344) represents interest on cash deposits and other miscellaneous income.

General and Administration Expenses

For the years ended December 31	2009	2008
Consulting fees	\$ 166,751	\$ 399,294
Salaries and benefits	1,174,465	1,270,532
Other general and administrative	737,306	639,340
	<u>2,078,522</u>	<u>2,309,166</u>
Less: capitalized and other costs	<u>(438,287)</u>	<u>(694,826)</u>
	1,640,235	1,614,340
Stock-based compensation	372,160	357,595
	<u>\$ 2,012,395</u>	<u>\$ 1,971,935</u>

In 2009 the Corporation continued the consulting contracts with a financial advisor, a land consultant, and a computer network maintenance company. During the course of 2009, the Corporation entered into additional consulting agreements with an accounting systems implementation company and a financial investment consulting firm.

Consulting fees, after capitalization, have decreased by 37% for the year ended December 31, 2009 compared with 2008 (\$120,917 and \$192,098 respectively) due to the discontinuation of the consulting agreement with the director and executive officer of the Corporation effective December 31, 2008 upon his full-time employment with the Corporation, but offset by consulting fees relating to the new accounting system implementation and the finance consulting arrangement entered into in 2009.

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Salaries and benefits, after capitalization, have remained relatively constant for the year ended December 31, 2009 compared with 2008 (\$845,056 and \$823,283 respectively). Employee bonuses of \$180,000 awarded and paid in the third and fourth quarters of 2008, as well as severance payments of \$204,212 associated with a former executive officer of the Corporation during the fourth quarter 2008 are offset in 2009 by accrued employee bonuses of \$220,000 and inclusion of a full year of salary for the director and executive officer of the Corporation formerly acting in a consulting role. The Corporation capitalizes salaries and benefits associated with staff directly related to exploration and development activities.

During the twelve months ended December 31, 2009, the Corporation capitalized a total of \$435,887 (2008: \$676,753) 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 Corporation. The other costs capitalized in the twelve months ended December 31, 2009 of \$2,400 (2008: \$18,073) relate to consulting fees incurred in relation to equity instruments issue costs, and are therefore recorded by the Corporation as a reduction of shareholders' equity.

Due to the levels of stock options granted, as well as an increase in the market price of the Corporation's shares, but offset by the exchange of all outstanding SARs for stock options in 2008 as approved by the Board of Directors, stock-based compensation in 2009 increased nominally by 4% from 2008. See **Summary of Quarterly Results** on Page 9 for further analysis of the effect on stock-based compensation on the overall results of the Corporation. The closing price of \$1.50 per share on the Exchange on December 31, 2009 represents a 142% increase from the closing price of \$0.62 per share at December 31, 2008.

Other General and Administration Costs

For the years ended December 31	2009	2008
Professional fees	\$ 91,298	\$ 59,038
Investor relations and filing fees	89,874	76,465
Directors' fees	62,000	15,500
Office premises and insurance	329,547	334,660
Office supplies	112,320	89,695
Staffing costs	42,527	51,291
Other	9,740	12,691
	<u>737,306</u>	<u>639,340</u>
Less: capitalized costs	<u>(63,044)</u>	<u>(40,381)</u>
	<u>\$ 674,262</u>	<u>\$ 598,959</u>

Professional fees have increased by 55% during 2009 compared to 2008 due to a doubling in the year-end accrual for engineering reserve report fees for 2009 over 2008 relating to the addition of resource evaluation work required for the Corporation's Montney Formation.

The 18% increase in investor relations and filing fees from the year ended December 31, 2008 to the year ended December 31, 2009 is attributable to increased investor relations travel and presentations, as well as increased website updates and shareholder communications, due to a concerted effort by the Corporation in 2009 to promote itself more extensively in the investment community.

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The payment of cash fees to the Corporation's five independent directors commenced in the fourth quarter 2008.

Office premises expenses are anticipated to continue at current levels pursuant to the terms of the Corporation's existing sub-lease agreement.

Office supplies expenses, after capitalization, have remained constant for the year ended December 31, 2009 compared to 2008 (\$49,276 and \$49,314 respectively).

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

Summary of Quarterly Results

Net losses prior to income taxes from the beginning of 2007 were:

<u>Loss by quarter</u>	<u>2009</u>		<u>2008</u>		<u>2007</u>	
	<u>Amount</u>	<u>Per Share (basic & diluted)</u>	<u>Amount</u>	<u>Per Share (basic & diluted)</u>	<u>Amount</u>	<u>Per Share (basic & diluted)</u>
First Quarter	\$ (362,906)	\$ (0.01)	\$ (498,821)	\$ (0.01)	\$ (279,955)	\$ (0.01)
Second Quarter	(498,413)	(0.01)	(824,651)	(0.02)	(150,227)	-
Third Quarter	(384,284)	(0.01)	(35,726)	-	(42,936)	-
Fourth Quarter	(769,895)	(0.01)	(513,575)	(0.01)	(402,446)	(0.02)
Loss before income taxes	<u>\$ (2,015,498)</u>	<u>\$ (0.04)</u>	<u>\$ (1,872,773)</u>	<u>\$ (0.04)</u>	<u>\$ (875,564)</u>	<u>\$ (0.03)</u>

For each period up to and including December 31, 2009, 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.

The Corporation finances 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 calculated at the estimated value of the renounced tax deductions. The Flow-Through Share issues that occurred in 2007 resulted in a calculated potential recovery of future income taxes of \$172,925. This recovery was not reflected within the valuation allowance of the Corporation until the first quarter of 2008 however as that is when the actual renouncement documents were filed with the government authorities. See **Share Capital** on Page 17 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 Corporation's income and losses since the beginning of 2007. Related to the SARs issued to three senior employees, changes in the value of the Corporation's shares had an immediate impact on the quarterly provision for this potential liability. In the fourth quarter 2008, the Board of Directors of the Corporation approved a grant of 600,000 stock options to replace all 600,000 existing SARs. As a result, the liability related to the SARs was discharged as of the year ended December 31, 2008 and a recovery of the remaining SARs stock-based compensation liability was recognized in the fourth quarter 2008. Excluding the effects of stock-based compensation, the Corporation's pre-tax losses by quarter would have been:

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Loss by quarter prior to stock-based compensation expense

	2009	2008	2007
First Quarter	\$ (276,443)	\$ (252,197)	\$ (299,988)
Second Quarter	(402,491)	(331,029)	(235,382)
Third Quarter	(342,972)	(313,547)	(236,982)
Fourth Quarter	(621,432)	(618,405)	(300,502)
Loss before income taxes	<u>\$ (1,643,338)</u>	<u>\$ (1,515,178)</u>	<u>\$ (1,072,854)</u>

The larger loss prior to stock-based compensation expense in the fourth quarter 2008 is due to the payment of severance costs of \$204,212 to a former executive officer of the Corporation. The larger loss prior to stock-based compensation expense in the fourth quarter 2009 is due to an accrual for employee bonuses of \$220,000.

Fourth Quarter Results

Fourth quarter results for each of the past two years are as follows:

For the three months ended December 31	2009	2008
Revenue		
Interest and other income	<u>\$ 11,036</u>	<u>\$ 34,163</u>
Expenses		
Consulting fees	9,663	50,914
Salaries and benefits	379,593	398,905
Other general administration	226,204	194,938
Stock-based compensation	148,463	(104,830)
Accretion expense	9,850	1,669
Amortization	7,158	6,142
	<u>780,931</u>	<u>547,738</u>
Loss before income taxes	<u>\$ (769,895)</u>	<u>\$ (513,575)</u>

During the fourth quarter of 2009 the Corporation earned \$12,258 (2008: \$34,013) in interest revenue from cash deposits.

Salaries and benefits were relatively consistent from the fourth quarter 2008 to the fourth quarter 2009. The increased levels of benefit costs in the further quarter of both years are due to total severance costs of \$204,212 paid to a former executive officer of the Corporation upon termination in 2008 compared with an employee bonus accrual of \$220,000 in 2009.

Other general and administration expenses in the fourth quarter of 2009 were 16% higher than the comparative 2008 period due to the increased accrual for fees related to the 2009 engineering reserve report based with the addition this year of the Montney Formation resource evaluation.

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Stock-based compensation is composed of expenses related to the contingent SARs liability and to the amortization of the calculated fair value of stock options granted in current and prior periods. Volatility in stock-based compensation expense from period to period is, in the case of SARs related to share price movements and, in the case of stock options related to the issuance of new options or the cancellation of previously issued options. In the fourth quarter 2009, the stock option component of stock-based compensation resulted in an expense of \$148,463 (2008: \$141,170). The fourth quarter 2008 results included a recovery of stock-based compensation of \$246,000 relating to the cancellation of all outstanding SARs.

Capital expenditures during the fourth quarter of 2009 were \$0.2 million compared to \$0.3 million in the same period of 2008. Field activities in the last quarter of 2009 were conducted via the Corporation's joint venture partners with limited capital commitments required to be outlaid by CSRI.

Liquidity and Capital Resources

The Corporation's capital program for the past two years is detailed in the following table:

For the years ended December 31	2009	2008
Lease acquisitions and retentions	\$ 88,981	\$ 68,133
Geological and geophysical	128,737	50,418
Net recovery of drilling and completion costs	(123,301)	(3,693,002)
Capitalized overhead	435,887	676,753
Total net petroleum and natural gas	530,304	(2,897,698)
Computer and office equipment, furniture	9,244	60,634
Total net capital expenditures (recoveries)	\$ 539,548	\$ (2,837,064)

For the fiscal year 2009, the Corporation approved a base case capital budget of \$1.2 million including the Corporation's portion of the joint venture tie-in of the Farrell Creek pilot program to the Spectra Energy sales pipeline, and including an estimated \$0.5 million for capitalized overhead. In addition, the Corporation provided an allocation for drilling and field testing activities of \$0.6 million in 2009. The Corporation's budget is reviewed and approved by the Board of Directors on a quarterly basis.

For the year ended December 31, 2009, gross capital expenditures before recoveries totaled \$0.7 million (2008: \$2.2 million). Offsetting the Corporation's capital expenditures during the year ended December 31, 2009 are additional reimbursements of \$0.2 million (2008: \$5.0 million) of previously expended drilling and completion costs from joint venture partners in relation to the Farrell Creek operations. The recovery of these expenditures has been recorded as a reduction of capitalized drilling and completion costs for the years ended December 31, 2009 and 2008 respectively. Gross capital expenditures before billings to joint venture partners for the year ended December 31, 2009 totaled \$1.8 million (2008: \$5.8 million).

The Corporation has approved a 2010 base case capital budget of up to \$18.0 million, (of which \$1.4 million has been approved for the first quarter of 2010) and includes an estimated \$0.4 for capitalized overhead. The annual and first quarter 2010 budgets were approved by the Corporation's Board of Directors. Before recoveries from joint venture partners, the Corporation's gross capital expenditures for the first quarter 2010 are projected to be approximately \$1.3 million.

Canadian Spirit Resources Inc.

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Cash administration expenses (G&A excluding stock-based compensation) for 2010 are expected to total approximately \$2.1 million before capitalization of exploration and development related overhead (2009 actual: \$2.1 million). Revenue from interest on cash balances is budgeted at \$0.1 million for the 2010 year. The Corporation has not budgeted for cash flows from operations during 2010 resulting from continued production at the Farrell Creek pilot as the operating costs are borne by the project Operator (Shell) and the Corporation's share of sales revenue is to be offset against deferred development costs within Property, Plant and Equipment.

At December 31, 2009, the Corporation had working capital of \$9.5 million, consisting of cash in the amount of \$9.6 million, accounts receivable and prepaid expenses of \$0.3 million, and net of accounts payable and accrued trade liabilities of \$0.4 million. The accounts payable and accrued trade liabilities balance at December 31, 2009 relates to recompletion and perforation stimulation field work occurring at two Farrell Creek wells during December 2009. The Company has no bank indebtedness and has no credit agreements to borrow money in place at this time.

The Corporation's working capital of \$12.4 million as at the date of this report is considered by management to be sufficient to cover its administrative costs and its base case capital budget through to the third quarter 2010. Any additional equity capital required to complete the Corporation's share of the joint venture planned capital programs for 2010, such as facilities construction and Montney Formation horizontal drilling activity and resultant tie-ins, will either be covered under the terms of the March 19, 2008 "Deep Rights" joint venture (see **Results of Operations** on Page 3) or raised via equity issues in the capital markets.

Since December 31, 2009, up to the date of this report, the Corporation has increased its net working capital position by a total of \$4.4 million through the exercise of \$0.80 warrants prior to expiry and by the exercise of stock options.

Business Risks

Productivity

A material risk facing the Corporation is the productive capability of the undiscovered and unproven coal and shale resource in the Gething Formation on the Corporation's existing land base at Farrell Creek and the Corporation's ability to extract the potential natural gas resource economically. The Corporation has made significant progress in developing an economic well completion and production system. Together with its joint venture partner, the Corporation 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 northeastern 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 Corporation being carried on costs for a period of time. Limited, and at this time uneconomic, production from the Gething pilot project commenced in June 2009.

Joint Venture Election

Following an evaluation of the results of the Gething pilot project in 2010, the joint venture partner may elect to proceed or not to proceed with further development of this project.

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In this event, the Corporation would become operator of the Gething pilot project and be responsible for all future capital, operating and reclamation costs. Title to all facilities and wells on the Corporation's lands would transfer to the Corporation at no cost and the Corporation would hold a right-of-first-refusal to acquire the joint venture partner's approximately 95 sections of Shallow Rights.

Exploration

The Corporation, through a joint venture partner, is exploring the resource potential of the geological formations below the base of the Cadomin/Nikanassin zone with a focus on the Montney Formation. A number of successful vertical and horizontal wells have been drilled into these deeper formations in the vicinity of the Corporation's lands and public information is now available on a number of these wells. This has significantly reduced the exploration risk associated with the Montney Formation in the area. Exploration risk includes both determining the existence of commercial quantities of hydrocarbons and the ability to recover any potential resource economically. Recognizing the technical expertise, operating capability and financial resources needed to explore these deeper formations, the Corporation has entered into a joint venture which will result in the exploration of its Deep Rights at Farrell Creek with the joint venture partner bearing the initial capital cost of this program.

Financial Resources and Liquidity

The Corporation'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 undiscovered and discovered resources into economically recoverable reserves, and ultimately, generating revenues sufficient to cover operating costs and capital requirements. Without the support of any one of these factors, or a number of them together, the Corporation's ability to continue its operations could be compromised.

To minimize financial risk, the Corporation pre-funds all capital commitments in the equity markets and does not utilize debt in these early stages of development. Included in such capital commitments is a minimum level of administrative and operating costs to see the Corporation through the current equity market and commodity price downward cycles. With \$12.4 million of working capital as at the date of this report and minimal immediate capital commitments, the Corporation is in a strong position to continue with its business plan during the current volatility in equity and commodity markets.

Commodity Prices

The Corporation'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 Corporation's investment decisions and once commercial natural gas production is established, it will impact the Corporation's revenue. The Corporation considers publically available price forecasts for natural gas in its evaluation of investment economics and returns.

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Operating Capability

The Corporation is pursuing large unconventional natural gas projects that if successful will require operating staff and experience to fully develop. The Corporation 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 Corporation 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 require 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 Corporation 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 Corporation acquired its existing mineral rights from the Province of British Columbia during the last six years, and through drilling expenditures on these lands through the first quarter 2010 has retained a substantial portion of these mineral rights. To reduce the risk of losing its current mineral rights, the Corporation has entered into Deep Rights and Shallow Rights joint ventures in return for drilling expenditures on its lands. This will allow the Corporation 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 Corporation 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 formation water and carbon dioxide. The formation water is currently re-injected into deep geologic formations at a commercial facility and in future, may be re-injected at Corporation owned facilities. Methods to capture and store or use carbon dioxide in commercial applications are being undertaken by the industry and the Corporation is monitoring these and regulatory developments in order to plan a mitigating strategy.

Critical Accounting Policies

Reference should be made to the Corporation's significant accounting policies contained in note 2 to the Corporation's audited financial statements for the year ended December 31, 2009. These accounting policies may have a significant impact on the financial performance and financial position of the Corporation.

The preparation of the Corporation's financial statements requires management to use estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities as at the date of the financial statements, and the amounts of expenses reported during the period. Such estimates and assumptions affect the calculation of depreciation and amortization, the estimated costs associated with the asset retirement obligation, the determination of the potential impairment of unproved properties, and the calculations of stock-based compensation and future income taxes. Management re-evaluates its estimates and assumptions on an on-going basis, but actual results may differ from those estimates. The most critical accounting policies used by the Corporation upon which estimates and assumptions are required are the impairment of unproved properties, the fair value of assets and liabilities, stock-based compensation, and future income taxes.

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Off Balance Sheet Arrangements

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

Fair Value of Financial Instruments

Financial instruments held-for-trading include cash and cash equivalents, loans and receivables include accounts receivable and other financial liabilities include accounts payable and accrued trade liabilities. The fair value of cash and cash equivalents and accounts receivable approximate their carrying values due to the short term nature of these instruments. The fair value of accounts payable and accrued trade liabilities is significantly less than the carrying value due to the credit risk of the Corporation.

Changes in Accounting Policies and Practices

The following new accounting pronouncements have been adopted with effect from January 1, 2009:

Canadian Institute of Chartered Accountants (“CICA”) Handbook: Section 3064, *Goodwill and Intangible Assets*

Section 3064 revises the definition of an intangible asset by clarifying the criteria for the recognition of intangible assets and providing guidance to help distinguish intangible assets from expenses. The new section provides guidance on the recognition and measurement of internally developed intangible assets.

This new standard was effective for fiscal years beginning on or after October 1, 2008 and therefore the Corporation adopted it effective January 1, 2009, however the adoption of this standard has not had a material effect on its December 31, 2009 annual financial statements.

CICA Handbook: Section 3862, *Financial Instruments – Disclosures*

The amended Section 3862 requires disclosures about the inputs to fair value measurements and became effective for fiscal years ending on or after September 30, 2009. This amended standard establishes a three-tier hierarchy as the framework for disclosing fair value based on inputs used to value the Corporation’s investments.

The hierarchy of inputs is summarized as follows:

Level One - Unadjusted quoted prices in active markets for identical assets or liabilities;

Level Two - Inputs other than quoted prices included in Level One that are observable for the asset or liability, either directly or indirectly; and

Level Three - Inputs for the asset or liability that are not based on observable market data.

The Corporation adopted the amended Section 3862 for its December 31, 2009 annual financial statements. However, the adoption of this standard has no impact on the valuation methods or policies of the Corporation.

The Corporation’s cash and cash equivalent are categorized within Level One.

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International Financial Reporting Standards (“IFRS”)

In February 2008, the CICA's Accounting Standards Board confirmed that IFRS will replace Canadian generally accepted accounting principles in 2011 for profit-oriented Canadian publicly accountable enterprises. As such, the Corporation will be required to report its results in accordance with IFRS beginning in 2011. In the time leading up to the conversion date, some existing Canadian standards will change in order to converge with IFRS. The Corporation's financial statements up to and including the December 31, 2010 financial statements will continue to be reported in accordance with Canadian generally accepted accounting principles (“GAAP”) as it exists on each reporting date. Financial statements commencing with the quarter ended March 31, 2011, including comparative information, will be prepared on an IFRS basis.

The Corporation commenced its IFRS conversion project during 2009 and early in 2010 by purchasing a software tool designed to assist small and medium-sized enterprises through the planning, policy decision-making and implementation processes. In addition, an external consulting firm has been engaged to assist the Corporation with its decision-making and conversion processes. The Corporation's external auditors, as part of the 2010 audit process, will review accounting policy decisions as they are made during the conversion project. The Corporation's Audit Committee will monitor the progress and critical decisions in the transition to IFRS.

The Corporation has developed a changeover plan to complete the transition to IFRS by the first quarter 2011, including the preparation of required comparative information and an assessment of the Corporation's information technology systems.

The Corporation's IFRS conversion plan consists of three stages: Planning, Policy Decision-Making and Implementation. The Corporation has completed the Planning stage which involved an assessment of the differences between Canadian GAAP and IFRS and the potential effects of IFRS on financial accounting and reporting processes, internal control requirements, information technology systems; business processes and required amendments to financial disclosures.

The Policy Decision-Making stage has also begun and involves an analysis and evaluation of the financial impacts of various alternatives available under IFRS, selection of accounting policies, identification of effects on business processes, analysis of financial disclosure requirements, and a review of the optional exemptions and mandatory exceptions of IFRS 1 (First-Time Adoption of International Financial Reporting Standards) for retrospective application upon transition to IFRS in 2011. The Corporation is currently analyzing accounting policy alternatives and identifying implementation options for the corresponding business process changes.

The third, or Implementation stage, has not commenced yet but will involve the preparation of opening IFRS balances as at January 1, 2010 and the compilation of financial information necessary to present comparative IFRS financial statements and reconciliations commencing with the first quarter of 2011 for approval by the Corporation's Audit Committee.

CSRI will update its IFRS changeover plan as necessary to reflect new and amended accounting standards issued by the International Accounting Standards Board. Other than format, classification and additional notes disclosure, the conversion to IFRS is not expected at this time to have a material impact on the Corporation's financial statements. However, as IFRS is expected to change prior to 2011, the full impact of IFRS on the Corporation's financial statements is not fully determinable at this time.

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Related Party Transactions

Transactions with related parties are recorded at exchange amounts for services provided. During the years ended 2009 and 2008, the only transactions the Corporation had with its directors, persons related to them or companies controlled by them in the normal course of business were as follows:

	2009	2008
Consulting fees	\$ -	\$ 188,450

During the year ended December 31, 2009, a total of \$Nil (2008: \$188,450) of consulting fees were paid and accounts payable at December 31, 2009 included \$Nil (2008: \$3,716) of consulting fees payable to a director and executive officer of the Corporation. The consulting contract with a director and executive officer of the Corporation was discontinued effective December 31, 2008, upon his full-time employment with the Corporation. There were no other transactions with directors, persons related to them or companies controlled by them in the normal course of business during 2009 or 2008.

During 2009, certain directors, relatives of directors, or companies controlled by directors subscribed for Nil (2008: Nil) shares or units in private placement offerings of the Corporation under the same terms and conditions as other investors.

Share Capital

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

On July 9, 2008, the Corporation issued 2,493,319 Units at \$1.05 per Unit and 400,000 Flow-Through Shares at \$1.20 per share. Each Unit consisted 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 (extended to two years effective December 23, 2009) at an exercise price of \$1.40. The fair value of the warrants was estimated at the date of closing using the Black-Scholes pricing model under which the Corporation assigned a total of \$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 entitled 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, was assigned to common shares and was fully expended on eligible development costs by the end of 2008. As such, the Corporation calculated a potential recovery of future income taxes of \$120,000 in 2008 due to the issuance of the Flow-Through Shares.

On February 19, 2008 the Corporation issued 11,220,000 Units at \$0.50 per Unit. Each Unit consisted of one common share and one-half of one share purchase warrant. Each whole warrant entitled 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 Corporation closed at a price of \$1.20 per share or greater for twenty consecutive trading days, then the Corporation had the option upon thirty days written notice to require exercise of the warrants. Prior to the February 19, 2010 expiry, all 5,610,000 warrants were duly exercised by holders. The fair value of the warrants was estimated at the date of closing using the Black-Scholes pricing model, under which the Corporation assigned a total of \$1,311,618 of the Unit proceeds to warrants, with the remaining \$4,298,382 of the Unit proceeds assigned to common shares.

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Since December 31, 2009 to the date of this report, the Corporation has issued 147,500 common shares for the exercise of stock options and 5,335,000 common shares upon the exercise of warrants. During this same period, the Corporation has granted 215,000 options to purchase common shares to non-executive employees of the Corporation, 375,000 options to executive officers of the Corporation and 125,000 options to independent directors of the Corporation, for a total of 715,000 options. The issued share capital as at April 22, 2010 consists of 54,135,901 common shares. In addition, the Corporation has 1,231,660 warrants and 2,659,500 stock options outstanding as at April 22, 2010.

Normal Course Issuer Bid

On April 14, 2010, the Corporation received approval from the Exchange to commence a Normal Course Issuer Bid (the "NCIB") through the facilities of the Exchange beginning on April 16, 2010. Pursuant to the NCIB, the Corporation may acquire up to 2.5 million common shares of the Corporation until April 16, 2011. Purchases in the market will be conducted by CIBC World Markets in accordance with the Exchange rules and all common shares acquired under the NCIB will be cancelled. Through April 22, 2010, the Corporation has purchased for cancellation a total of 49,700 common shares of the Corporation for total cash consideration of \$63,803, at an average price of \$1.28 per share.

During the period December 2008 through November 2009, the Corporation purchased 974,500 common shares at an average price of \$0.73 per share pursuant to a prior NCIB.

Commitments

The Corporation has entered into an office sub-lease agreement which expires on May 30, 2011. Under the terms of the sub-lease agreement, the Corporation 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 Corporation is available on SEDAR at www.sedar.com or the Corporation's website at www.csri.ca.