

CANADIAN SPIRIT RESOURCES INC.

TSX: SPI \$1.39

DATE OF ISSUE	MAY 3, 2010
RECOMMENDATION	SPECULATIVE BUY
12-MONTH TARGET	\$2.50

Year	CFPS	P/CF	Bbls/d	MMcf/d	Boe/d	D/CF
2008A	\$0.00	n/m	0	0	0	0
2009A	(\$0.03)	n/n	0	0	0	0
2010F	(\$0.03)	n/m	0	0	0	0
2011F	\$0.19	7.3x	0	7.1	1,250	0

All figures are in Cdn\$ unless otherwise stated

Financial Highlights

52-Week Range	\$0.65-\$2.00
Shares O/S	54.1M
Shares F/D	56.4M
Market Cap.	\$75.2M
Cash	\$12.4M
Enterprise Value	\$62.8M
Dividend	-
Dividend Yield	-

Five-Year Share Price History (Cdn\$)



RESOURCE UPDATE VALIDATES MONTNEY POTENTIAL

- **Event:** Canadian Spirit Resources has released a report by its independent engineering consultants, Sproule Associates Limited, which concluded that there are 3.6-8.4 trillion cubic feet of gross discovered and undiscovered resources in place in the Montney formation at Farrell Creek – very large numbers indeed.
- **Analysis:** The difference between the high and low estimates reflects 6% and 3% porosity cut-offs. Sproule's estimates bracket previous B.C. government estimates of gas-in-place in the Montney. The new resource estimates, combined with a high level of drilling activity in the surrounding area and recent land sale spending, all serve to validate the potential of CSRI's properties at Farrell Creek.
- **Valuation:** Based on those B.C. government estimates, we previously calculated that the stock could be worth \$5.00/share based on the Montney alone. Our **\$2.50** target price represents a 50% discount to NAV because of the early stage of development of the company's properties.
- **Recommendation:** We continue to rate Canadian Spirit a **Speculative BUY**. As ongoing drilling activity confirms the early results, we anticipate that the stock will gravitate toward its net asset value.

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MORE MONTNEY

When Canadian Spirit began to investigate the prospectivity of the Farrell Creek area, it first focused on the sand/silt/shale/coal in the shallow Gething formation, and the deeper Montney formation was considered to be pure upside for some time in the distant future. However with the application of horizontal drilling and multi-stage fracture technology to the Montney shales across Northwest Alberta and Northeast B.C., the Montney has supplanted the Gething as the zone of greatest interest. Talisman Energy, in particular, has been very active at Altares, immediately adjacent to Farrell Creek. It plans to spend \$550M there this year, and expects to be producing 40-60 MMcf/d of gas by year-end.

CSRI entered into a joint venture agreement with privately-owned Canbriam Energy B.C. Partnership, which spent \$28.6M to earn a 65% interest in 44 sections of Montney acreage. Canbriam has the option to spend another \$50.0M to earn an additional 5% interest, and is expected to make that election early in June. Canadian Spirit would then be carried until closer to the end of the year.

As of December 31st, CSRI and Canbriam had only three vertical wells drilled into the Montney formation. A horizontal well drilled this past winter was not considered in Sproule's year-end resource estimates. In keeping with industry practice, Sproule used a 6% porosity cut-off, calculating that there are 77 bcf of gas-in-place per section – less than the 100 bcf estimated by the B.C. government. Upon request, Sproule also worked out that there could be as much as 178 bcf/section, based on a 3% porosity cut-off. That may be slightly aggressive, but future drilling results will give the engineers more data points.

After break-up, the two companies will return to their horizontal well at c-A48-I and conduct a fracture stimulation in the less porous Lower Montney formation to demonstrate its ability to flow gas. That should be completed by mid-July. They will then drill a pair of horizontal wells into the more porous Upper Montney at c-18-I. Each of those takes about eight weeks to drill and test, so they will be completed in time for commissioning of a small gas plant immediately adjacent to the Spectra Energy trunk line in October. The plant will have a capacity of 10-20 MMcf/d. At that point, Canbriam and CSRI will have three horizontal wells drilled into the Upper Montney, plus one vertical well and one horizontal well drilled into the Lower Montney. With that additional information, Sproule will be able to make more precise estimates as to the reserves in place, and beginning in 2011, Canadian Spirit will have its first production and cash flow, albeit small.

RECENT LAND SALE SPENDING

Although an oversupply of natural gas in North America is weighing heavily on the price, enthusiasm for the Montney appears to continue undiminished. At B.C.'s April land sale, five drilling licenses sold for a total of \$85.1M, and a single block accounted for \$24.1M of that amount. Average prices ranged from \$5,072/hectare to \$12,157/hectare. None of those parcels were in the immediate vicinity of Farrell Creek, but the size of the bonuses demonstrates that the industry's appetite for Montney acreage continues unabated.

A high level of drilling activity in the surrounding area by companies like **Talisman Energy (TEM-TSX \$17.29; Not Rated)**, **Progress Energy (PRQ-TSX \$12.17; Not Rated)** and **Husky Energy (HSE-TSX \$28.71; Not Rated)** also provided independent validation of the prospectivity of Farrell Creek.

GETHING FORMATION TOO

Not to forget about the Gething formation where Canadian Spirit now has seven wells tied-in and producing through a 1.1 MMcf/d pilot plant. Shell Canada farmed in on CSRI's 55 sections of shallow rights and spent \$50M to further develop the property. Shell has until the end of June to decide whether or not to spend another \$50M to earn a 75% interest in the property. Its decision will depend on its long-term outlook for natural gas, on the performance of the pilot project, and on its other opportunities. If Shell chooses to proceed, the two companies will pool their combined 150 sections of land and CSRI will retain a 25% working interest. If Shell chooses not to proceed, Canadian Spirit will retain a 100% interest in its 55 sections of land and all the facilities, and will have first right of refusal to purchase Shell's acreage.

2009 FINANCIAL RESULTS

Canadian Spirit reported a net loss of \$2.0M or \$0.04/share for 2009. Because it had no significant production, it had no material revenue during the year. Following the exercise of warrants in February, CSRI now has 54.1M shares outstanding, no debt and \$12.4M or \$0.23/share in cash. It has no significant capital requirements until it learns whether or not Shell Canada and Canbriam Energy intend to exercise their options. The company recently announced its intention to buy back as many as 2.5M shares or 4.6% of the shares outstanding, under a normal course issuer bid.

Having recently reduced our 2011 natural gas price assumption from \$6.25/mcf to \$5.50/mcf at AECO, we have lowered our estimate of 2011 cash flow from \$0.24/share to \$0.19/share. Our estimate of Net Asset Value is less price sensitive and remains unchanged.

SUMMARY: CANADIAN SPIRIT RESOURCES INC.

All figures in C\$ unless otherwise noted

Share Price	\$1.39	Recommendation	SPEC BUY	Major Shareholders (% of shares o/s)	
Shares O/S - Basic (M)	54.10	Target Price (C\$)	\$2.50	Elmag Investments	19%
Shares O/S - Diluted (M)	56.40	Potential Return	66.7%	Pinetree Capital	16%
Market Capitalization (M)	\$75.2	Dividend	0	Sprott Asset Management	10%
Cash & Equivalents (M)	\$12.4	Dividend Yield	0		
Enterprise Value (M)	\$62.8	One-Year Avg. Daily Volume	51,750		
Net Asset Value/Share	\$5.00				

RISK FACTORS

In our view, the single biggest risk factor currently facing oil and gas producers is the price of natural gas, which may render their resources uneconomic to produce. Other significant risks include exchange rates, operational hazards, fiscal regimes and environmental constraints.

Commodity Prices

Our valuation is based on assumptions about short-term and long-term crude oil and natural gas prices. Commodity price volatility may affect the company's cash flow and earnings, as well as its ability to raise development capital and to borrow from banks.

Exchange Rates

Natural gas prices are quoted in both U.S. and Canadian dollars, and prices are determined by continental supply and demand factors, as well as by imports of Liquefied Natural Gas (LNG). The prices received by Canadian producers may be affected by the Canadian/U.S. dollar exchange rate. An increase in the Canadian dollar relative to its U.S. counterpart may negatively affect revenue generated by producing and selling natural gas, as well as the cost of oilfield services.

Operations

Operational risks include, but are not limited to, drilling success, higher-than-anticipated decline rates, reserve evaluation, employee retention and product supply/demand. Along with our knowledge and assumptions, we base our forecasts on past results, technical data, financial models and guidance provided by the company. Additionally, operational difficulties may arise through unanticipated weather, which can delay or cancel business plans. Long-term success depends on a company's ability to find, acquire, develop and commercially produce oil and natural gas reserves, which is subject to various risks and uncertainties.

Fiscal and Regulatory

The petroleum industry is subject to regulation by both federal and provincial governments, and governments and policies change from time-to-time. Policies intended to limit greenhouse gas emissions in both Canada and the United States could have a negative impact on the ability of the petroleum industry to produce hydrocarbons.

Environmental

Oilfield activity is subject to regulations intended to protect communities and the environment. Those regulations change periodically and new regulations are imposed from time to time. They may have the effect of slowing the pace of petroleum development, or preventing exploration and development activity altogether.

CANADIAN SPIRIT RESOURCES INC.

Canadian Spirit Resource Inc. is a Calgary-based company that is focused on unconventional natural gas resources in the Hudson's Hope area of Northeast British Columbia. CSRI owns a large block of land at Farrell Creek and has farmed out both its shallow rights and its deep rights, so it has minimal capital requirements at the present time. It has \$12.4M and no debt.

Share Price and Salman Partners' Investment Recommendation History (Cdn\$)



Date	Target	Rec.	Analyst
1-Mar-10	\$2.50	SPEC BUY	Gordon Currie
3-May-10	\$2.50	SPEC BUY	Gordon Currie

Salman Partners Inc. Disclosure

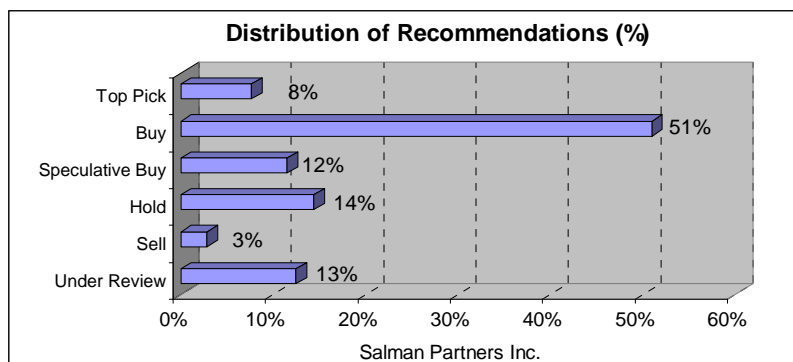
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Top Pick	A recommendation to purchase a stock which represents the best risk/reward ratio within an analyst's coverage list. The analyst expects to realize a minimum 12-month return of 10%, and also has positive near-term catalysts.
Buy	A recommendation to purchase the stock at the current price.
Hold	A recommendation to maintain one’s current position in the company, given the current share price and the outlook for the company, sector or underlying commodity.
Sell	A recommendation to reduce one’s share position, either in part or in whole.
Speculative Buy	A recommendation to purchase shares in a company which is considered speculative because of the risk associated with owning shares. This added risk can be attributed to the company’s size, financial stability, liquidity, the outlook for a commodity or commodities or other factors beyond Salman Partners’ control. Suitable for risk-tolerant investors only.
Under Review	Salman Partners is in the process of an update based on recently released information. The analyst’s recommendation and target price may or may not change upon completion of analysis.

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