

Canadian Spirit Resources Inc. (SPI-V, \$1.40)

Recommendation: Strong Buy

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WELLINGTON WEST
Capital Markets Inc.

April 28, 2011

All values in C\$ unless otherwise noted.

Current Price	\$1.40
Target Price (12-Month)	\$2.25
Target Return	61%

Changes

	Old	New
Production boe/d '11E	671	453
CFPS (FD) '11E	\$0.00	Unch.
Production boe/d '12E	1,750	1,021
CFPS (FD) '12E	\$0.09	\$0.05
Recommendation	Strong Buy	Unch.
Target Price	\$2.25	Unch.

Company Profile

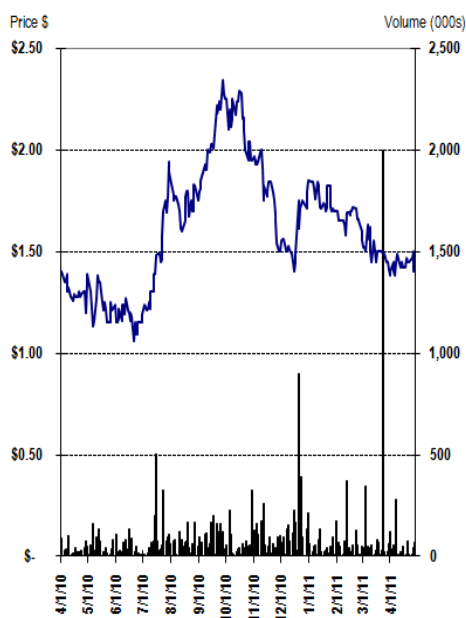
Canadian Spirit (SPI) is a Calgary-based junior natural gas company with extensive Montney & Gething rights in the Farrell Creek area of N.E. British Columbia. An updated independent valuation by Sproule Unconventional Limited estimates SPI's Farrell Creek lands (29.4 sections at year-end 2010) contain TPIIP of 5.0 Tcf to 10.9 Tcf in the Montney alone. In total, SPI owns interest in ~34.4 net sections (48% WI) including 53 sections (16.5 net) in the Canbriam JV.

Low Gas Prices Defer Farrell Creek Spending; Long-term Outlook for Project Remains Positive

- **Capital spending slows in the wake of sub \$4.00/mcf AECO prices**
SPI sets 2011 CapX budget at ~\$17mm which includes completion of the 4th, 5th and 6th Montney wells in Q3/11; new drills contingent on prices.
- **TLM/Sasol has committed \$2.1B to Farrell Creek project next door**
TLM/Sasol is investigating marketing alternative options, including a GTL project, while proceeding with 50% plant expansion to 180mmcf/d.
- **Sproule estimates TPIIP* of 1.8 Tcf in the Upper Montney alone**
Best estimate (P50) recovery factor of ~23% yields 408 Bcf vs. our project model 25% R.F. assumption, yielding ~1 Tcf for U & L Montney.
- **Project model supports our \$2.25 target at ~ \$4/mcf AECO pricing**
Farrell Creek Montney project yields NPV_{10%} of \$2.17/sh based on \$4.16/mcf AECO; which jumps to +\$5.50/shr at \$5/mcf gas pricing.

* Total Petroleum Initially in Place – using a 3% porosity cut-off includes Lower Montney potential and more than doubles gross TPIIP from 5.0 Tcf to 10.9 Tcf.

Price Chart



Source: Thomson One

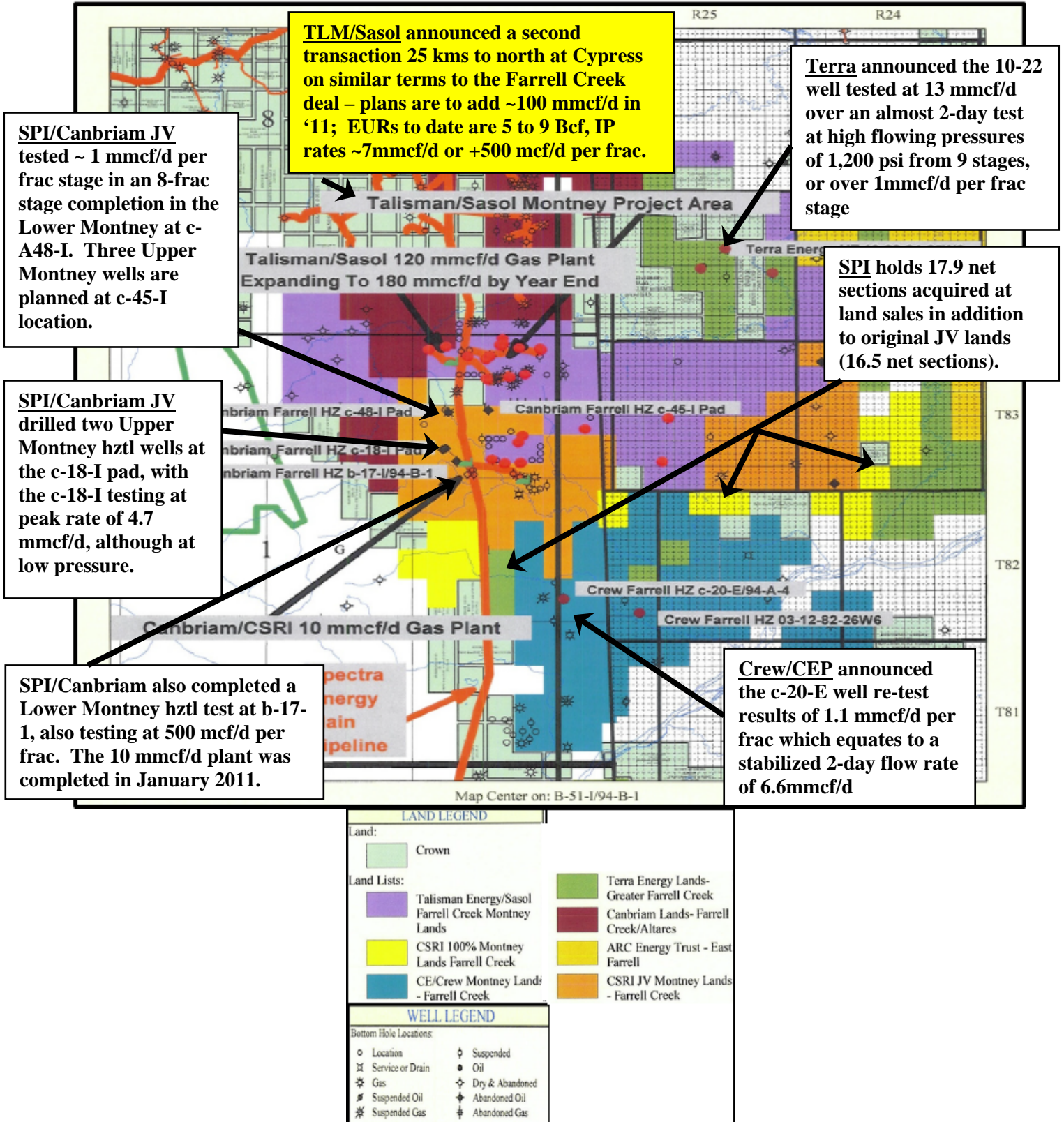
Financial Summary

Shares O/S (M)	74.6	52-Week Trading Range	\$1.06 - \$2.34	
Market Capitalization (M)	\$104	Average Weekly Volume	385,340	
Net Debt - 2011E (M)	-\$5	Market Float (M)	\$102	
Enterprise Value (M)	\$100	NAV/Share - 2011E	\$0.70	
Forecasts	2009	2010	2011E	2012E
Production (BOE/d)	-	-	453	1,021
% Gas	-	-	100%	100%
Oil Price (US\$/bbl - WTI)	\$61.99	\$79.46	\$88.00	\$89.00
Gas Price (\$/mcf - wellhead)	\$3.99	\$3.99	\$4.37	\$4.98
Revenues (M)	\$0	\$0	\$4	\$11
Cash Flow (M)	(\$2)	(\$2)	\$1	\$5
Debt/CF	5.9x	13.3x	(5.8x)	3.3x
CFPS (FD, incl. cap. G&A)	(\$0.04)	(\$0.03)	\$0.00	\$0.05
EPS (FD)	(\$0.04)	(\$0.02)	(\$0.02)	(\$0.02)
Valuation		2010	2011E	2012E
EV/DACF		n/m	n/m	28.5x
EV/BOE/d (per unit production)		n/m	\$219,499	\$97,505
EV/BOE (per unit proven reserves)		n/m	\$43.57	\$16.06
P/E		n/m	n/m	n/m
Target EV/DACF		n/m	n/m	43.6x

Source: WWCM, Company Reports

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Exhibit 1: SPI's Lands are Close to Infrastructure (JV has Secured 50 mmcf/d Firm Transportation Capacity on Spectra's Main-line) & are Immediately Adjacent to Talisman/Sasol's Farrell Creek Acreage

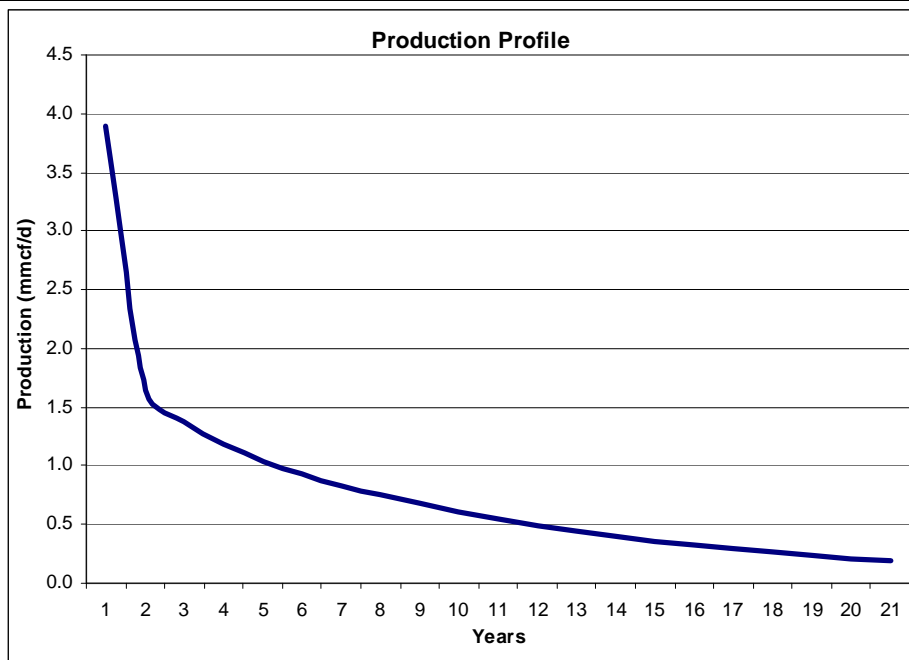


Source: Company Reports, WWCM

Exhibit 2: Talisman (TLM-T) Re-confirms Type-well of 7 Bcf in Recent Corporate presentation Update, Driving an IRR of 23% at \$4.16/mcf AECO

Farrell Creek - Economics of Montney Type Horizontal Gas Wells

	Type Well	Conversion boe @ 6:1	
Well Parameters:			
Well Cost - Drill, Complete & Tie-in (\$mm)*	\$7.5		
Initial Production Rate (mmcf/d)	6.0	1000	
Reserves per spacing unit (Bcf)	7.0	1.16	
Reserve Life Index (years) - 1st year exit production	9.1		
Financial Parameters:			
	<u>AECO</u>	<u>Wellhead</u>	
Wellhead Price (CDN \$/mcf) - + 5% AECO heat content	\$4.16	\$4.37	\$26.21
Royalty Rate (%)		10.4%	
OpX & Transpo Expense (\$/mcf) - CSI's 10 mmcf/d plant		\$1.15	\$6.90
G&A Expense (\$/mcf)		\$0.15	\$0.90
Leverage (\$/mcf)		\$0.00	
Initial Leverage (% of cost)		0%	
Interest Rate (%)		6%	
Tax Rate (%)		31%	
PV Discount Rate		10%	
Result:			
Finding and Development Costs (\$/mcf)		\$1.08	\$6.46
1st Year Production Add Costs (\$/mcf)		\$1,852	\$11,111
Recycle Ratio		2.9x	
P/I Ratio		1.5x	
NPV Per Well		\$3.6	
Internal Rate of Return (IRR)		23.5%	



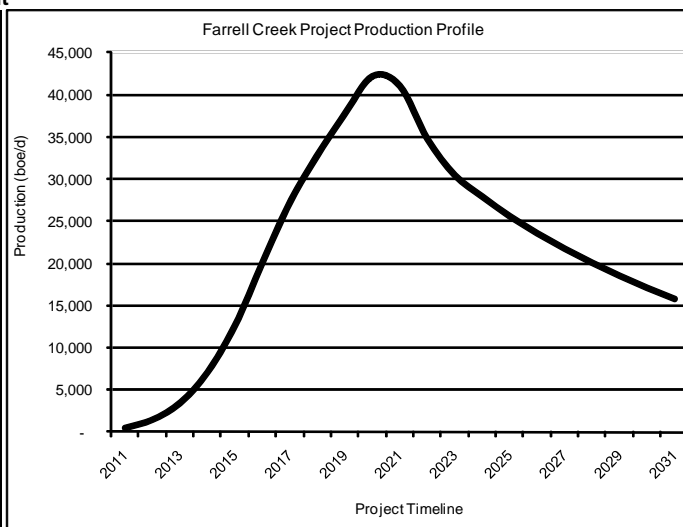
Internal Rate of Return (IRR) Sensitivities					
<u>IRR</u>	<u>Gas Price (CDN \$/mcf)</u>				
		\$3.50	\$4.37	\$6.00	\$8.00
Well	\$6.0	19%	35%	71%	117%
Cost	\$7.5	11%	24%	50%	86%
(\$mm)	\$8.0	9%	21%	45%	78%
	\$9.0	7%	16%	37%	66%

Source: Company Reports, WWCW

Exhibit 3: Project Model With Less Aggressive CapX Program in 2011 Yields Project IRR of ~ 15% at \$4.16/mcf AECO and NAVPS of \$2.17/share (vs. \$2.20/share previously)

Farrell Creek - Potential Economics of Long-term Development

	Type Well	Conversion boe @ 6:1
Well Parameters:		
Well Cost - Drill, Complete & Tie-in (\$mm)	\$7.5	
Initial Production Rate (mmcf/d)	6.0	1000
Reserves (Bcf)	1,013	169
Reserve Life Index (years) - Life of Project Average	7.7	
Average Success Rate	100%	
Financial Parameters:		
Wellhead Price (CDN \$/boe) - + 5% AECO heat content	\$4.37	\$26.21
Royalty Rate (%)	10.4%	
OpX & Transpo Expense (\$/mcf) - own 10 mmcf/d plant	\$1.15	\$6.90
G&A Expense (\$/mcf)	\$0.15	\$0.90
Leverage (\$/mcf)	\$0.00	\$0.00
Interest Rate (%)	6%	
Tax Rate (%)	31%	
PV Discount Rate	10%	
Result:		
F&D Costs (\$/mcf) - Life of Project	\$2.01	\$12.07
Recycle Ratio	1.3x	
NPV per share	\$2.17	
Internal Rate of Return (IRR)	15.3%	



Development Scenario

Year	Net Wells	Start Prod.	Decline Rate	Ending Prod.	Average Production mmcf/d boe/d	Revenues	Royalties	OpX	G&A	Cash Flow	Capital*	Unlevered Cash Flow	PV CF
2010	and prior										Estimated Net Sunk Capital => 35	\$(35)	
2011	1.4	-	n/a	6	3 486	\$5	\$0	\$1	\$0	\$3	\$11	\$(8)	\$(6)
2012	2.5	5.8	42%	12	9 1484	\$14	\$1	\$4	\$0	\$8	\$19	\$(10)	\$(8)
2013	6.5	12.0	42%	29	21 3454	\$33	\$3	\$9	\$1	\$20	\$51	\$(31)	\$(21)
2014	11.3	29.5	42%	56	43 7136	\$68	\$7	\$18	\$2	\$41	\$90	\$(49)	\$(30)
2015	17.8	56.2	41%	96	76 12663	\$121	\$13	\$32	\$4	\$73	\$144	\$(72)	\$(40)
2016	24.6	95.8	40%	146	121 20142	\$193	\$20	\$51	\$7	\$115	\$204	\$(88)	\$(45)
2017	24.6	145.9	38%	182	164 27305	\$261	\$27	\$69	\$9	\$156	\$208	\$(51)	\$(24)
2018	24.6	181.7	35%	213	197 32882	\$315	\$33	\$83	\$11	\$188	\$212	\$(24)	\$(10)
2019	24.6	212.8	33%	241	227 37797	\$362	\$38	\$95	\$12	\$216	\$216	\$0	\$0
2020	24.6	240.7	31%	266	253 42243	\$404	\$42	\$106	\$14	\$242	\$220	\$21	\$8
2021	6.0	266.2	25%	227	247 41102	\$393	\$41	\$104	\$14	\$235	\$55	\$181	\$58
2022	0.0	227.0	16%	191	209 34817	\$333	\$35	\$88	\$11	\$199	\$-	\$199	\$58
2023	0.0	190.8	8%	175	183 30502	\$292	\$30	\$77	\$10	\$175	\$-	\$175	\$46
2024	0.0	175.3	9%	160	168 27953	\$267	\$28	\$70	\$9	\$160	\$-	\$160	\$38
2025	0.0	160.2	8%	147	154 25628	\$245	\$25	\$65	\$8	\$147	\$-	\$147	\$32
2026	0.0	147.4	8%	136	142 23608	\$226	\$23	\$59	\$8	\$135	\$-	\$135	\$27
2027	0.0	135.9	8%	125	131 21782	\$208	\$22	\$55	\$7	\$125	\$-	\$125	\$22
2028	0.0	125.4	8%	116	121 20102	\$192	\$20	\$51	\$7	\$115	\$-	\$115	\$19
2029	0.0	115.8	8%	107	111 18551	\$177	\$18	\$47	\$6	\$106	\$-	\$106	\$16
2030	0.0	106.8	8%	99	103 17121	\$164	\$17	\$43	\$6	\$98	\$-	\$98	\$13
2031	0.0	98.6	8%	91	95 15800	\$151	\$16	\$40	\$5	\$90	\$-	\$90	\$11
Wells	168			Cum reserves	1013								
				Bcf		\$4,425	\$459	\$1,165	\$152	\$2,649	\$1,464	\$1,220	\$162
												Calculated unleveraged IRR ==>	15.3%

* Capital costs escalated at 2% per annum

Source: Company Reports, WWC

Exhibit 4: We Model Farrell Creek Montney Potential of ~645 Bcf at 6% Cut-off & 25% RF
Canadian Spirit Resources - Farrell Creek Montney Potential

	6% cut-off	3% cut-off
Sproule Estimated Potential Resource (Bcf, gross)*	5,024	10,904
Number of Sections in Sproule Report	67	67
TPIIP per Section (Bcf)	75	163
Net TPIIP - SPI/Canbriam Block - net 16.5 sections	1,238	2,690
Net TPIIP - New Lands - net ~17.9 sections^	1,343	2,918
Total Net TPIIP	2,580	5,607
Assumed Recovery Factor	25%	25%
Implied Net Recoverable Resource Potential (Bcf)	645	1,402
Net Recoverable Resource/Section (Bcf)	19	41
Recoverable per well @ 6 wells/Section (Bcf)	3.1	6.8

* Sproule reported as at Dec. 31, 2010 covers 29.4 of SPI's 34.4 net sections held

Source: Company Reports, WWCW

Exhibit 5: Applying "Industry-Norm" Valuation Parameters for Risked Resource Implies \$1.60/sh - \$3.20/sh.
Canada Spirit Resources - Risked Potential Take-out Value of Farrell Creek Asset

Sproule Estimated Net Resource Potential (Bcf - TPIIP)	1,238 - at 6% cut-off in Upper Montney			
Assume Similar Potential on 50% of New Lands (Bcf)	671 - at 50% cos of 77 Bcf/section on 18 net sections			
Recoverable Assuming 25% Recovery Factor (Bcf)	477			
Valuation matrix:	SPI/Canbriam Block		New Lands	
	@ \$0.25/mcf	@ \$0.50/mcf	@ \$0.25/mcf	@ \$0.50/mcf
	(TPIIP, R.F.)	(delineated)	(TPIIP, R.F.)	(delineated)
Potential valuation (\$mm)	77	155	42	84
Per Share (proforma 75.3mm shs o/s)	\$1.04	\$2.07	\$0.56	\$1.12
Total of Both Blocks (\$/share)			\$1.60	\$3.20

Source: Company Reports, WWCW

Exhibit 6: Production/share Gains Positioned to Ramp-up in 2012E

Production	2009	2010	2011E	2012E
Crude Oil & SPIs (bbl/d)	0	0	0	0
Natural Gas (mmcf/d)	0	0	3	6
BOE/d (@ 6:1 conversion rate)	0	0	453	1,021
YoY Per Share Growth	n/m	n/m	n/m	125%
Reserves				
2P reserves (mmBOE)	0.0	0.0	4.8	13.0
Proven reserves (mmBOE)	0.0	0.0	2.3	6.2
Proven RLI (years)*	n/m	n/m	10.7	14.6
Implied all-in F&D Costs	\$0.00	\$0.00	\$11.20	\$8.07
Flow of Funds				
Cash Flow (\$mm)	-\$2	-\$2	\$1	\$5
Capex (\$mm)	\$1	\$20	\$17	\$26
Net Debt (\$mm)	-\$9	-\$21	-\$5	\$16
Debt/CF ratio (x)	5.9	13.3	- 5.8	3.3
Financial Data Per BOE				
Operating & Transpo Costs (\$/BOE)	\$0.00	\$0.00	\$6.50	\$6.00
G&A Costs (\$/BOE)	\$0.00	\$0.00	\$21.45	\$10.06
Cash Flow Netbacks (\$/BOE)	n/m	n/m	\$5.14	\$12.99
Proven Recycle Ratio	n/m	n/m	0.5	1.6

*RLI based on year-end reserves and fourth quarter production

Source: Company Reports, WWCW

Exhibit 7: Despite '12E Revenue Growth, Firmer Gas Prices Are Needed

	2009	2010	2011E	2012E
Operating Income				
Oil and natural gas revenues	0.0	0.1	4.3	11.1
Royalties, net of credits	0.0	0.0	(0.2)	(1.1)
Other	0.0	0.0	0.6	0.3
	0.0	0.1	4.7	10.3
Expenses				
Operating and processing	0.0	0.0	1.1	2.2
General and administrative	1.6	1.7	2.8	3.0
Depletion and depreciation	0.0	0.0	3.3	6.5
Interest on long-term debt	0.0	0.0	0.0	0.3
Provision for site restoration	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0
Other - non-cash	0.4	0.6	0.2	0.2
	2.1	2.3	7.4	12.2
Income Before Income Taxes	(2.0)	(2.2)	(2.7)	(1.9)
Capital taxes	0.0	0.0	0.0	0.0
Current taxes	0.0	0.0	0.0	0.0
Future taxes	0.0	(1.0)	(0.8)	(0.6)
Net Income	(2.0)	(1.2)	(1.8)	(1.3)
Dividends on ordinary shares	0.0	0.0	0.0	0.0
Net Income to Common	(2.0)	(1.2)	(1.8)	(1.3)
Retained earnings, beginning of period	(18.1)	(20.1)	(21.3)	(23.2)
Common shares repurchased	0.0	0.0	0.0	0.0
Adjustment for taxes	0.0	0.0	0.0	0.0
Retained earnings (deficit), end of period	(20.1)	(21.3)	(23.2)	(24.5)
Earnings per Common Share	(\$0.04)	(\$0.02)	(\$0.02)	(\$0.02)
Earnings per Fully Diluted Common Share	(\$0.04)	(\$0.02)	(\$0.02)	(\$0.02)

Source: Company Reports, WWCM

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Company Name	Ticker Symbol	Applicable Disclosure
Canadian Spirit Resources Inc.	SPI-V	1,2,3

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