Canadian Spirit Resources Inc. (SPI-V, $1.71)

Recommendation: Strong Buy

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WELLINGTON WEST Capital Markets Inc.

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All values in C$ unless otherwise noted.

Current Price (intra-day)	$1.71
Target Price (12-Month)	$2.25
Target Return	32%

Changes

	Old	New
Production boe/d '11E	1,500	671
CFPS (FD) '11E	$0.06	$0.00
Production boe/d '12E	3,833	1,750
CFPS (FD) '12E	$0.27	$0.09
Recommendation	Strong Buy	Unch.
Target Price	$2.50	$2.25

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 independent valuation by Sproule Unconventional Limited estimates SPI/ Canbriam JV lands contain TPIIP of 3.6 Tcf to 8.4 Tcf in the Montney alone. In total, including original JV lands and high working interest sections surrounding buty outside of the JV, SPI owns interest in 34 net sections (~ 48% WI).

Gas Plant Online and Producing; SPI Scales Back Drill Program, Impacting Prod^n Growth

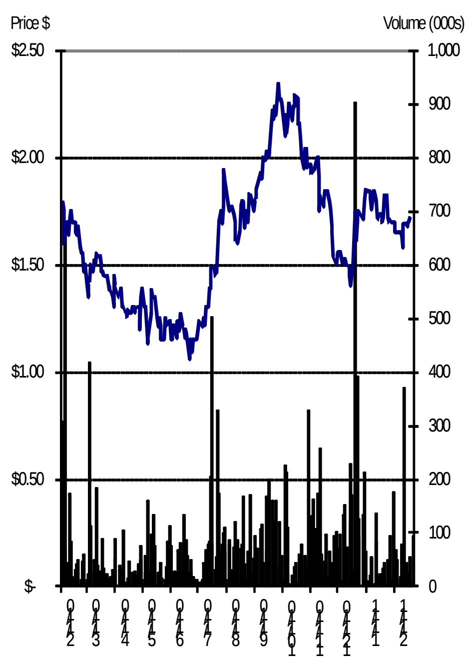
- **Canbriam JV 10 mmcf/d plant construction complete and now online**
  The new plant is now producing at ~8 mmcf/d, and is expandable to 50 mmcf/d (17.5 mmcf/d net) with compression installation as required.

- **Montney horizontal program moving ahead, albeit at a slower pace**
  To cut costs, plans are now to fracture stimulate the 6th Montney well at c-B18-I now drilling along with the c-A18-I & c-45-I hztl wells, all in Q3.

- **Drilling program also diminished in face of weak gas prices**
  JV plans are to drill three additional wells in H2/11 (for a total of 5 wells in 2011), and we expect SPI will initiate a 100% well before year-end.

- **Lowering target to $2.25 from $2.50 on scaled-back drill program**
  Bullishly, the TLM/Sasol JV is accelerating their Farrell Creek project with 8 rigs running in '11 and a 50% gas plant expansion to 180 mmcf/d.

Price Chart



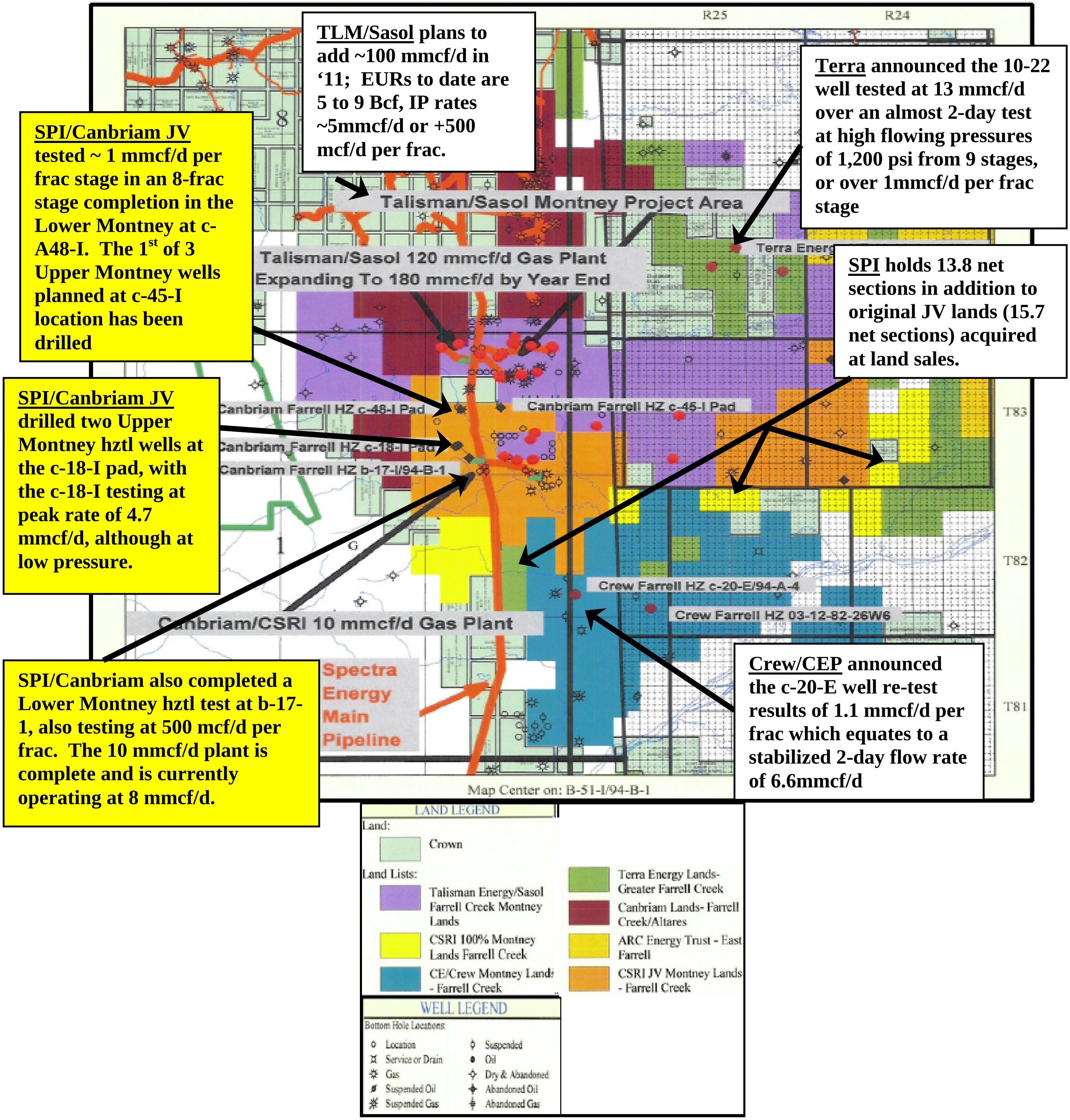
Source: Thomson One

Financial Summary

Shares O/S (M)	75.3	52-Week Trading Range		$1.06 - $2.34
Market Capitalization (M)	$129	Average Weekly Volume		369,086
Net Debt - 2011E (M)	$3	Market Float (M)		$126
Enterprise Value (M)	$131	NAV/Share - 2011E		$0.96
Forecasts	**2009**	**2010E**	**2011E**	**2012E**
Production (BOE/d)	-	-	671	1,750
% Gas	-	-	100%	100%
Oil Price (US$/bbl - WTI)	$61.99	$79.46	$88.00	$89.00
Gas Price ($/mcf - wellhead)	$3.99	$4.39	$4.37	$4.98
Revenues (M)	$0	$0	$6	$19
Cash Flow (M)	($2)	($2)	$1	$8
Debt/CF	5.9x	13.1x	5.2x	3.5x
CFPS (FD, incl. cap. G&A)	($0.04)	($0.04)	($0.00)	$0.09
EPS (FD)	($0.04)	($0.03)	($0.04)	($0.04)
Valuation		**2010E**	**2011E**	**2012E**
EV/DACF		n/m	(614.3x)	22.2x
EV/BOE/d (per unit production)		n/m	$195,950	$75,114
EV/BOE (per unit proven reserves)		$40.24	$15.89	$9.36
P/E		n/m	n/m	n/m
Target EV/DACF		n/m	(804.3x)	28.0x

Source: WWCM, Company Reports

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

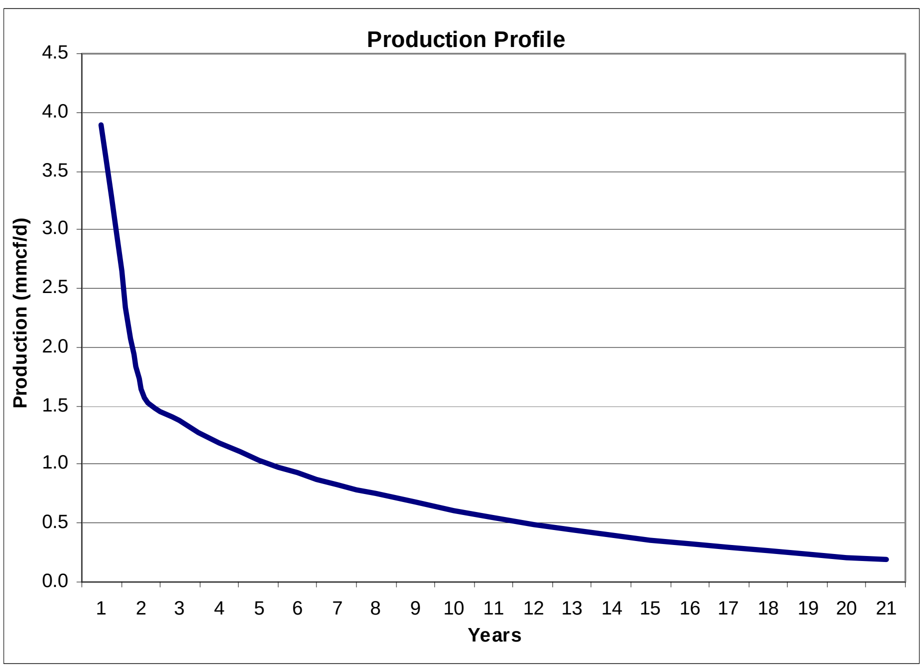


Source: Company Reports, WWCM

Exhibit 2: New Type Well Yields Healthy Returns with IRR of 23% at C$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:	AECO	Wellhead	
Wellhead Price (CDN $/mcfe) - + 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

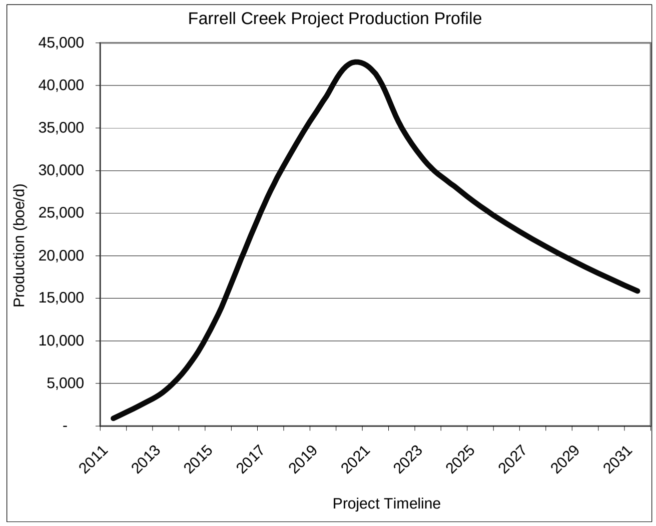
IRR		Gas Price (CDN $/mcf)			
		$3.50	**$4.37**	**$6.00**	**$8.00**
Well	**$6.0**	19%	35%	71%	117%
Cost	**$7.5**	11%	24%	50%	86%
($mm)	**$8.0**	9%	21%	45%	78%
	$9.0	7%	16%	37%	66%

Source: Company Reports, WWCM

Exhibit 3: Revised Project Model With Less Aggressive CapX Program Near-term Yields Project IRR of ~15% at C$4.16/mcf AECO

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)	1,028	171
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	$2.00	$12.02
Recycle Ratio	1.3x	
NPV per share	**$2.20**	
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	**2.8**	-	n/a	11	5	900	$9	$1	$2	$0	$5	$21	$(15)	$(13)
2012	**3.8**	10.8	46%	18	14	2387	$23	$2	$6	$1	$14	$29	$(15)	$(11)
2013	**6.5**	17.8	42%	33	25	4235	$41	$4	$11	$1	$24	$51	$(26)	$(18)
2014	**11.3**	33.0	41%	59	46	7671	$73	$8	$19	$3	$44	$90	$(46)	$(28)
2015	**17.8**	59.1	41%	98	79	13119	$125	$13	$33	$4	$75	$144	$(69)	$(39)
2016	**24.6**	98.3	40%	148	123	20545	$197	$20	$52	$7	$118	$204	$(86)	$(44)
2017	**24.6**	148.2	38%	184	166	27670	$265	$27	$70	$9	$158	$208	$(49)	$(23)
2018	**24.6**	183.8	35%	215	199	33218	$318	$33	$84	$11	$190	$212	$(22)	$(9)
2019	**24.6**	214.8	33%	243	229	38107	$365	$38	$96	$13	$218	$216	$2	$1
2020	**24.6**	242.5	31%	268	255	42529	$407	$42	$107	$14	$244	$220	$23	$8
2021	**6.0**	267.8	25%	229	248	41366	$396	$41	$104	$14	$237	$55	$182	$58
2022	**0.0**	228.6	16%	192	210	35059	$335	$35	$88	$12	$201	$-	$201	$58
2023	**0.0**	192.1	8%	177	184	30725	$294	$30	$77	$10	$176	$-	$176	$46
2024	**0.0**	176.6	9%	161	169	28161	$269	$28	$71	$9	$161	$-	$161	$39
2025	**0.0**	161.4	8%	148	155	25820	$247	$26	$65	$8	$148	$-	$148	$32
2026	**0.0**	148.5	8%	137	143	23785	$228	$24	$60	$8	$136	$-	$136	$27
2027	**0.0**	137.0	8%	126	132	21945	$210	$22	$55	$7	$126	$-	$126	$23
2028	**0.0**	126.4	8%	117	122	20253	$194	$20	$51	$7	$116	$-	$116	$19
2029	**0.0**	116.6	8%	108	112	18690	$179	$19	$47	$6	$107	$-	$107	$16
2030	**0.0**	107.6	8%	99	103	17249	$165	$17	$43	$6	$99	$-	$99	$13
2031	**0.0**	99.3	8%	91	95	15862	$152	$16	$40	$5	$91	$-	$91	$11
Wells	**171**		**Cum reserves**		**1028**		$4,489	$466	$1,182	$154	$2,687	$1,484	$1,239	$165
					Bcf					**Calculated unleveraged IRR ==>**			**15.3%**	

**** Capital costs escalated at 2% per annum***

Source: Company Reports, WWCM

Exhibit 4: Production/share Gains Positioned to Ramp-up in 2012E

Production	2009	2010E	2011E	2012E
Crude Oil & SPIs (bbl/d)	0	0	0	0
Natural Gas (mmcf/d)	0	0	4	11
BOE/d (@ 6:1 conversion rate)	0	0	671	1,750
YoY Per Share Growth	**n/m**	**n/m**	**n/m**	**161%**
Reserves				
2P reserves (mmBOE)	0.0	4.9	12.6	21.5
Proven reserves (mmBOE)	0.0	3.3	8.3	14.0
Proven RLI (years)*	n/m	n/m	19.4	16.5
Implied all-in F&D Costs	**$0.00**	**$10.96**	**$7.96**	**$8.10**
Flow of Funds				
Cash Flow ($mm)	-$2	-$2	$1	$8
Capex ($mm)	$1	$19	$25	$31
Net Debt ($mm)	-$9	-$22	$3	$26
Debt/CF ratio (x)	***5.9***	***13.1***	***5.2***	***3.5***
Financial Data Per BOE				
Operating & Transpo Costs ($/BOE)	$0.00	$0.00	$10.00	$9.00
G&A Costs ($/BOE)	$0.00	$0.00	$14.50	$5.87
Cash Flow Netbacks ($/BOE)	**n/m**	**n/m**	**$2.18**	**$11.86**
Proven Recycle Ratio	**n/m**	**n/m**	**0.3**	**1.5**

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

Source: Company Reports, WWCM

Exhibit 5: Despite '12E Revenue Growth, Firmer Gas Prices Are Needed

	2009	2010E	2011E	2012E
Operating Income				
Oil and natural gas revenues	0.0	0.0	6.4	19.1
Royalties, net of credits	0.0	(0.0)	(0.7)	(2.5)
Other	0.0	0.1	0.1	0.1
	0.0	0.1	5.8	16.7
Expenses				
Operating and processing	0.0	0.0	2.4	5.7
General and administrative	1.6	1.8	2.8	3.0
Depletion and depreciation	0.0	0.0	4.9	11.5
Interest on long-term debt	0.0	0.0	0.0	0.4
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	2.4	10.3	20.8
Income Before Income Taxes	**(2.0)**	**(2.2)**	**(4.6)**	**(4.1)**
Capital taxes	0.0	0.0	0.0	0.0
Current taxes	0.0	0.0	0.0	0.0
Future taxes	0.0	(0.7)	(1.4)	(1.3)
Net Income	**(2.0)**	**(1.6)**	**(3.1)**	**(2.8)**
Dividends on ordinary shares	0.0	0.0	0.0	0.0
Net Income to Common	**(2.0)**	**(1.6)**	**(3.1)**	**(2.8)**
Retained earnings, beginning of period	(18.1)	(20.1)	(21.7)	(24.8)
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)	(21.7)	(24.8)	(27.7)
Earnings per Common Share	**($0.04)**	**($0.03)**	**($0.04)**	**($0.04)**
Earnings per Fully Diluted Common Share	**($0.04)**	**($0.03)**	**($0.04)**	**($0.04)**

Source: Company Reports, WWCM

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