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Equity Research

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Rating: SPECULATIVE BUY
Target Price: $3.25

All figures in C$, unless otherwise noted

Recent Price:	$1.45
52 Week Range	$1.01 – $2.34
Shares O/S basic:	74.3 million
f.d.	78 million
Market Cap:	$107.7 million
Fiscal Year End:	Dec. 31
Cash (Sep 31/10):	$12.8 million

Commodities	2009A	2010A	2011E
WTI (US)	$62	$80	$80
Natural Gas (US)	$3.70	$4.39	$4.50

Company Description: *Canadian Spirit Resources is a Canadian-based resource company focused on exploration and development in the unconventional natural gas sector in NE British Columbia. Its main focus of operations is in the shallow Gething play and the deeper Montney play at Farrell Creek, B.C.*

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Canadian Spirit Resources Inc.
(SPI-TSXV)

Resource Estimate of Montney at Farrell Creek

- **Resource Estimate at Farrell Creek:** Canadian Spirit Resources has announced the results of an independent resource assessment prepared by Sproule Unconventional Limited ("Sproule") of the Montney formation at the company's Farrell Creek lands. Sproule assigned gross discovered and undiscovered natural gas initially-in-place ("GIIP") of 2,654 billion cubic feet ("bcf") and 2,370 bcf, respectively, for a total of 5,024 bcf. Net to Canadian Spirit (after working interest), gross discovered and undiscovered GIIP was 1,028 bcf and 1,294 bcf, respectively, for a total of 2,322 bcf. This is slightly less than the 2,760 bcf estimate we have been using in our valuation of CSRI's land. We note, however, that Sproule's assessment covers 29.4 net sections and does not include 5 net sections recently purchased by CSRI. Sproule also reported a best estimate company interest contingent resource of 134 bcf and a best estimate company interest prospective resource of 274 bcf, for a total potential recoverable resource of 408 bcf, compared to our estimate of recoverable resources of 414 bcf. Sproule's estimate implies a recovery factor of 18%, compared to the 15% recovery factor we use in our valuation. See Exhibit 1 for a summary of the report.

- **Sensitivity:** Sproule used an industry standard 6% limestone porosity cut-off in its assessment. CSRI also asked Sproule to include an assessment of total GIIP resources using a 3% limestone porosity cut-off. The reason for this request was that CSRI and other operators in the area are currently producing from the Lower Montney, which typically has lower porosities than the 6% cut-off level. Using a 3% cut-off, Sproule calculated total GIIP on CSRI's lands to be 10,904 bcf compared to the 5,024 bcf using the 6% cut-off. This calculation produced a range of 75–163 bcf per section. This confirms CSRI's internal estimates of a range of 75–178 bcf per section. In our valuation, we have been using an estimate of 100 bcf per section.

Please see end of this report for important disclosures

Exhibit 1: Summary of Sproule Resource Estimates

Natural Gas Initially in Place				
	Gross GIIP		Company Gross GIIP	
Resource Classification	2009 (bcf)	2010 (bcf)	2009 (bcf)	2010 (bcf)
Discovered GIIP	1,378	2,654	478	1,028
Undiscovered GIIP	2,243	2,370	648	1,294
Total	**3,621**	**5,024**	**1,126**	**2,322**

Resources Within Montney Formation at Farrell Creek				
	Company Contingent Resources (bcf)		Company Prospective Resources (bcf)	
Discovered		**Undiscovered**		**Total**
Low estimate	48	Low estimate	202	250
Best estimate	134	Best estimate	274	408
High estimate	577	High estimate	675	1,252

Source: Canadian Spirit Resources, Byron Capital Markets

- **Valuation:** Using our original estimate of a total company resource of 2,760 tcf and a conservative recovery factor of 15%, we arrive at our estimate of recoverable resources of 414 bcf. As mentioned above, these compare to Sproule's estimates of a gross company GIIP resource of 2,322 tcf, an implied recovery factor of 18% and recoverable resources of 408 bcf. Applying a value of $0.50 per mcf to our estimate of recoverable resources of 414 bcf leads us to a value of $207 million, or $2.65 per share. If we include CSRI's current total net sections of 34.4, our estimates of total company resource and recoverable resources rise to 3,440 bcf and 516 bcf, respectively. Our valuation then rises to $258 million, or $3.31 per share.

- **Conclusion and Recommendation:** The resource assessment estimates prepared by Sproule confirm the parameters that management has been using for its internal estimates and are also in line with our own estimates of CSRI's recoverable resources at Farrell Creek. These numbers could prove to be conservative, however, given that Sproule's porosity cut-off of 6% appears to exclude CSRI's Lower Montney production. **We maintain our SPECULATIVE BUY recommendation and $3.25 target price.**

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1 This company has compensated Byron for investment banking services in the preceding 12 months. If those services were managing or co-managing an initial or secondary offering of securities for this company, the issuance of this report is, at minimum, 40 calendar days from the closing of an initial offering, or 10 calendar days from the closing of a secondary offering.

2 The research analyst(s) and/or associates who prepared our original research report have not viewed the material operations of this company.

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STRONG BUY	The security represents extremely compelling value and is expected to appreciate significantly from the current price over the next 12-18 month time horizon.
BUY	The security represents attractive value and is expected to appreciate significantly from the current price over the next 12-18 month time horizon.
SPECULATIVE BUY	The security is considered a BUY but in the analyst's opinion possesses certain operational and/or financial risks that may be higher than average.
HOLD	The security represents fair value and no material appreciation is expected over the next 12-18 month time horizon.
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