



MANAGEMENT DISCUSSION AND ANALYSIS

For the period ended June 30, 2011

This management discussion and analysis (“MD&A”) of the financial conditions and results of operations should be read in conjunction with the unaudited interim financial statements for the period ended June 30, 2011 prepared under International Financial Reporting Standards (“IFRS”), and the audited financial statements and MD&A for the year ended December 31, 2010 prepared under Canadian Generally Accepted Accounting Principles (“previous GAAP”). The financial data presented herein is in accordance with IFRS and all amounts are presented in Canadian dollars, unless otherwise indicated. The unaudited interim financial statements for the period ended June 30, 2011 include certain reconciliations between previous GAAP and IFRS.

Date

This MD&A includes information up to August 25, 2011.

Reader’s Advisories

Non-GAAP Terminology

This MD&A contains important, comparable industry benchmarks such as net working capital and operating netbacks which are not recognized measures under IFRS, hereafter referred to as GAAP. Management believes these measures are useful for reporting purposes, but cautions readers that these measures not be considered as alternatives in accordance with GAAP.

Net working capital is defined as total current assets less total current liabilities. Operating netbacks are calculated by taking revenue net of royalties (after adding back royalty credits applied) less operating and transportation costs GAAP balances from the statement of income / (loss) and comprehensive income / (loss) and dividing by production for the period.

Frequently-used Industry Terminology

The Corporation uses the following frequently recurring industry terms in this MD&A: “boe” refers to barrels of oil equivalent, “Mboe” refers to thousand barrels of oil equivalent, “GJ” refers to gigajoules, “Mcf” refers to thousand cubic feet, “MMcf” refers to million cubic feet, “Bcf” refers to billion cubic feet, “MMbtu” refers to million British thermal units, and “/d” refers to per day. Disclosure provided herein in respect of a boe may be misleading, particularly if used in isolation. The Corporation uses a boe conversion ratio of six Mcf of natural gas to one barrel of crude oil equivalent and a natural gas heating content conversion ratio of one Mcf to 1.05 GJ. These conversion ratios are based on energy equivalency conversion methods primarily applicable at the burner tip and do not necessarily represent a value equivalency at the wellhead.

Forward-looking Statements

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 new accounting policies under GAAP 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

Canadian Spirit Resources Inc.

MANAGEMENT DISCUSSION AND ANALYSIS

For the period ended June 30, 2011

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:

- Delays in oil and gas regulatory approvals;
- CSRI’s ability to raise funds in the available equity markets;
- Fluctuations in natural gas production levels; or
- Volatility in market prices for natural gas.

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 a well capitalized joint venture partner, the Corporation’s principal activity is evaluating and developing the productive capability of its Montney natural gas play in Farrell Creek, British Columbia.

Since early 2002, the Corporation’s focus has been to evaluate the resource potential of certain unconventional natural gas exploration properties and is currently emerging from its development stage of operations. In 2003, CSRI acquired a small land position and drilled its first resource evaluation well 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”) 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 Shell was intended to advance the development of rights (initially the Gething Formation) from surface to the base of the Cadomin/Nikanassin Formation (“Shallow Rights”). In June 2010, Shell elected not to continue to the development stage of the Gething joint venture. The joint venture with Canbriam is exploring and evaluating the petroleum and natural gas rights (primarily in the Montney Formation) below the base of the Cadomin/Nikanassin Formation (“Deep Rights”). On January 28, 2011, the Corporation commenced its first commercial production out of the Montney Formation.

As of June 30, 2011, the Corporation has a strong net working capital position of approximately \$14.9 million (\$0.20 per share) composed primarily of cash and receivables from joint venture partners, offset by payables and accruals related to the Montney joint venture.

Canadian Spirit Resources Inc.

MANAGEMENT DISCUSSION AND ANALYSIS

For the period ended June 30, 2011

CSRI's Board of Directors has approved a total forecasted capital expenditure budget for 2011 of up to \$16.2 million (net), of which \$11.4 million is budgeted for the second half of 2011, with a main focus on the development of the Corporation's Montney joint venture with Canbriam. The budget also includes \$3.4 million (net) for other potential infrastructure and exploration activities.

Natural Gas Properties

Farrell Creek: Montney

On March 19, 2008, the Corporation announced a joint venture and farmout agreement for the Deep Rights with Canbriam, to evaluate certain of the Corporation's lands for Montney and other deep formation plays covering approximately 34,000 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 vertical wells into the Montney Formation in exchange for a 65% working interest. Canbriam also had the option to increase its working interest in the Deep Rights from 65% to 70% in return for increasing its gross capital commitment to \$50.0 million. Canbriam has now fulfilled their \$28.6 million initial funding commitment and in October 2010, advised that they would not exercise the option to increase their working interest. CSRI is now responsible for funding its 35% working interest of the Montney program.

Since conducting evaluation tests on two vertical Montney wells on the eastern block of Farrell Creek in late 2008, Canbriam focused its operations on the western portion of the Farrell Creek lands in close proximity to the Spectra Energy pipeline. Following a successful vertical well test into the lower portion of the Montney Formation at the b-17-I location, the joint venture drilled a horizontal well into the lower Montney at the c-A48-I location. This was the first known horizontal well targeting the lower Montney in the Farrell Creek area and the results significantly exceeded CSRI's expectations. The c-A48-I well was stimulated in 8 stages of the lower portion of the Montney Formation with initial production flow-tested at a rate of approximately 1 MMcf/d per stage. The positive results of this well are significant as it may be an indicator that the lower Montney Formation has the potential to increase ultimate resource estimates and to increase the total productivity of the play.

During 2010, the joint venture drilled and cased three upper Montney horizontal wells on the western block of the Montney lands at c-18-I/94-B-1, c-A18-I/94-B-1, c-45-I/94-B-1 and re-entered the b-17-I/94-B-1 well to drill a short horizontal leg in the lower Montney. At the end of October, Canbriam carried out a production test on the c-18-I well with initial flow rates of up to 4.7 MMcf/d with 8 stages being stimulated. The b-17-I re-entry horizontal well was fracture stimulated in 5 stages in the lower Montney in December with initial production in excess of 3.5 MMcf/d.

The joint venture recently drilled and cased a horizontal well in the upper Montney at the c-B18-I/94-B-1 location. This is the fourth horizontal well in the upper Montney Formation and the sixth well in the west block of lands. The c-B18-I well is scheduled to be fracture stimulated beginning at the end of August. The c-45-I well was fracture stimulated in July and is expected to be brought online at a rate of 1.5 MMcf/d. In addition, the joint venture has approved a well location at 12-7-83-24W6 on its eastern lands. This vertical well is currently being drilled with a view to testing the Montney for liquids potential.

Construction of the joint venture's gas processing facility with an initial capacity of 10 MMcf/d gross (3.5 MMcf/d net), and tie-in to the Spectra Energy sales pipeline, was completed in January 2011. Commissioning of the facility occurred in late January 2011 with natural gas sales commencing on January 28th. The wells currently tied-in to the facility are the c-A48-I and b-17-I lower Montney horizontal wells and the c-18-I upper Montney horizontal well. Initial natural gas sales from these three wells were in excess of 10 MMcf/d gross (3.5 MMcf/d net). Over the last seven months natural gas sales have declined to 3 MMcf/d gross (1.05 MMcf/d net), exhibiting typical Montney Formation production

Canadian Spirit Resources Inc.

MANAGEMENT DISCUSSION AND ANALYSIS

For the period ended June 30, 2011

declines. It is anticipated that the c-B18-I and c-45-I wells will be tied-in to the facility during the third quarter 2011. Initial production from the c-B18-I and c-45-I wells is expected to largely utilize the capacity of the gas plant in the short term. As such, the fracture stimulation of the c-A18-I well will be deferred pending a further investment decision.

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") moved its adjacent Montney shale play into commercial production and expects to be producing 100-120 MMcf/d on average in 2011. Talisman also announced that the capacity of their Farrell Creek Gas Plant will be increased from 180 MMcf/d to 240 MMcf/d during 2011. Talisman has recently formed a strategic partnership with Sasol Limited ("Sasol") which is expected to accelerate the projected multi-billion dollar development of their Farrell Creek play. Total consideration from the two Sasol transactions was \$2.1 billion for a 50% working interest in both of Talisman's Farrell Creek and Cypress A plays. These transactions are comprised of an initial 25% cash payment plus a 75% capital carry on Talisman's share of future expenditures. The partnership will also be examining alternative gas marketing options including the economic feasibility of constructing a gas-to-liquids ("GTL") project in western Canada using Sasol's GTL technology.

Montney Formation Resource Assessment

On April 7, 2011, the Corporation issued a news release disclosing the independent Resource Assessment prepared by Sproule as at December 31, 2010.

The Resource Assessment was based on approximately 29 net sections of Montney acreage. The addition of approximately 12 net sections of Montney land since year-end and planned drilling activity over the next year has the potential to materially increase the natural gas resource figures and the estimated number of well locations required for full development.

Montney Formation Reserves

An independent reserve evaluation covering the Montney Formation at Farrell Creek was prepared by Sproule Unconventional Limited ("Sproule") as at March 31, 2011 (the "Reserve Report") in accordance with National Instrument 51-101: *Standards of Disclosure for Oil and Gas Activities*. The evaluation is based on CSRI's corporate plan to drill and complete 18 Montney wells over the next few years to prove-up its Montney lands at Farrell Creek. This represents 2% of the 900 gross well locations identified in the Sproule December 31, 2010 Resource Assessment. Proceeding with full development will be contingent upon factors such as access to capital, economic and price conditions, infrastructure, and environmental and regulatory matters.

The Reserve Report was based on information provided by the Corporation and Sproule applied an industry standard 6% limestone porosity cut-off consistent with the December 31, 2010 Resource Assessment. The 900 drilling locations identified in the Resource Assessment was based at the time on approximately 29 net sections of the Corporation's Montney acreage which has since increased to 40.8 net sections.

Canadian Spirit Resources Inc.

MANAGEMENT DISCUSSION AND ANALYSIS

For the period ended June 30, 2011

SUMMARY OF RESERVES AS AT MARCH 31, 2011

	Natural Gas ⁽¹⁾		Barrels of Oil Equivalent ⁽⁵⁾	
	Gross ⁽²⁾ (MMcf)	Net ⁽³⁾ (MMcf)	Gross ⁽²⁾ (Mboe)	Net ⁽³⁾ (Mboe)
PROVED ⁽⁶⁾				
Developed Producing	1,536	1,502	256.0	250.3
Undeveloped	11,629	10,413	1,938.2	1,735.5
Total Proved	13,165	11,915	2,194.1	1,985.8
PROBABLE ⁽⁷⁾	6,803	5,403	1,133.8	900.5
TOTAL PROVED PLUS PROBABLE ⁽⁴⁾	19,967	17,317	3,327.9	2,886.2

Notes:

- (1) Estimates of Reserves of natural gas include associated and non-associated gas.
- (2) "Gross Reserves" are the Corporation's working interest share of the remaining reserves, before deduction of any royalties.
- (3) "Net Reserves" are the Corporation's working interest share of remaining reserves less all Crown royalties.
- (4) May not add due to rounding.
- (5) Barrels of Oil Equivalent (boe) have been calculated using a conversion rate of six thousand cubic feet of natural gas per barrel of oil (energy equivalent).
- (6) Proved Resources are those reserves that can be estimated with a high degree of certainty to be recoverable. It is likely that the actual remaining quantities recovered will exceed the estimated proved reserves.
- (7) Probable Reserves are those additional reserves that are less certain to be recovered than proved reserves. It is equally likely that the actual remaining quantities recovered will be greater or less than the sum of the estimated proved plus probable reserves.

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 scalable and currently has a capacity of up to 1.1 MMcf/d. Seven Gething wells were tied into the pilot facility and the facility produced its first gas in June 2009.

Pursuant to the joint venture agreement, Shell could elect to move to the development stage of the Gething joint venture which would include the pooling of the Shell and CSRI lands and an additional capital investment by Shell. On June 18, 2010, Shell elected not to continue to the development stage and as a result shut-in the gas facility in early July 2010. As per the joint venture agreement, the Corporation is now the operator of the Gething project and will retain 100% working interest in its 59 sections (37,760 acres) of Shallow Rights, the gas facility, the additional wells and the related infrastructure at no additional cost. The pilot facility has been properly suspended and winterized. Over the course of the joint venture, Shell invested approximately \$32.0 million in development and infrastructure. As a result, CSRI was able to increase its understanding of the Gething Formation and expects to benefit from the future use of the facilities and infrastructure acquired at no cost to the Corporation. The gas facility is expandable and may be used for other purposes in the immediate area. CSRI holds a right-of-first-refusal on Shell's surrounding 95 sections of Gething lands. The Corporation is currently minimizing its expenditures on the Gething project and is considering several options that include seeking a new joint venture partner to further develop the Gething Rights.

Canadian Spirit Resources Inc.

MANAGEMENT DISCUSSION AND ANALYSIS

For the period ended June 30, 2011

Selected Financial Data

For the six month periods ended or as at June 30	2011	2010
Natural gas sales	\$ 756,576	\$ -
Operating netbacks	\$ 394,249	\$ -
Net loss and comprehensive loss (after income taxes)	\$ (1,702,873)	\$ (1,161,855)
Loss per share (basic & diluted)	\$ (0.02)	\$ (0.02)
Net working capital	\$ 14,927,507	\$ 11,057,845
Total assets	\$ 76,304,148	\$ 52,357,624
Shareholders' capital	\$ 73,658,037	\$ 50,579,490
Common shares outstanding	74,233,761	56,678,901
Net capital expenditures	\$ 3,210,468	\$ 4,875,438

Results from Operations

Revenue and Royalties

The Montney Formation has provided the Corporation with its first natural gas production. On January 28, 2011, the Farrell Creek Montney Gas Plant commenced operations and continues to produce gas into the Spectra Energy Pipeline System. The natural gas is currently being sold on a spot basis at BC Spectra Station 2. The three wells tied into the Farrell Creek Montney Gas Plant are all deep horizontal wells and as such, each of these producing wells qualify for the British Columbia Government's Deep Royalty Credit Program. This Program will generate up to \$2.5 million in royalty credits for each well and the royalty credits will be drawn down over time as the wells produce natural gas. At current rates of production, the Corporation should not have to actually remit any crown royalties to the British Columbia Government for the next two to three years.

Production

	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010
Total production of natural gas (Mcf)	99,193	-	219,956	-
Average production of natural gas				
Mcf/d	1,095	-	1,478	-
boe/d	183	-	246	-
Average sales price of natural gas				
\$/Mcf	\$ 3.52	\$ -	\$ 3.44	\$ -
\$/boe	\$ 21.12	\$ -	\$ 20.64	\$ -
BC Spectra Station 2 Benchmark price ⁽¹⁾				
\$/Mcf	\$ 3.58	N/A	\$ 3.51	N/A

Note:

(1) Source: NGX Natural Gas Exchange website (converted from \$/GJ)

Canadian Spirit Resources Inc.

MANAGEMENT DISCUSSION AND ANALYSIS

For the period ended June 30, 2011

During the most recent quarter, production was adversely impacted as the c-A48 well was shut-in for 45 days. This shut-in was due to remediating a washout plus gaining approval from the British Columbia Oil and Gas Commission for the corresponding sand management program.

Depletion

Depletion of Developed and Producing Cash Generating Units within property, plant and equipment is calculated using the unit of production method based on proved plus probable reserves. The depletion expense for the six months ended June 30, 2011 of \$694,240 equates to \$3.09 per Mcf.

Operating Netbacks

For the three month period ended June 30, 2011	\$	%	\$/Mcf	\$/boe
Natural gas sales	\$ 349,563		\$ 3.52	\$ 21.12
Royalties	(120,980)	34.6%	(1.22)	(7.32)
Net revenue	228,583		2.30	13.80
Royalty credits applied	120,980		1.22	7.32
Operating and production costs	(310,483)		(3.13)	(18.80)
Transportation costs	(9,462)		(0.10)	(0.57)
Operating netbacks	<u>\$ 29,618</u>		<u>\$ 0.29</u>	<u>\$ 1.75</u>

For the six month period ended June 30, 2011	\$	%	\$/Mcf	\$/boe
Natural gas sales	\$ 756,576		\$ 3.44	\$ 20.64
Royalties	(125,352)	16.6%	(0.57)	(3.42)
Net revenue	631,224		2.87	17.22
Royalty credits applied	120,980		0.55	3.30
Operating and production costs	(346,989)		(1.58)	(9.47)
Transportation costs	(10,966)		(0.05)	(0.30)
Operating netbacks	<u>\$ 394,249</u>		<u>\$ 1.79</u>	<u>\$ 10.75</u>

During the six months ended June 30, 2011, the Corporation applied \$120,980 of royalty credits against crown royalties that would otherwise have been payable.

Operating and Production and Transportation Costs

Operating costs relate to the Corporation's share of plant maintenance, supervision and other production expenses in conjunction with the three producing Montney Formation wells at Farrell Creek. Transportation costs represent the cost to transfer the natural gas injected into the pipeline system at Farrell Creek to the sales point at BC Spectra Station 2.

Canadian Spirit Resources Inc.

MANAGEMENT DISCUSSION AND ANALYSIS

For the period ended June 30, 2011

General and Administrative Expenses

	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010
Consulting fees	\$ 23,554	\$ 43,757	\$ 107,672	\$ 61,821
Salaries and benefits	299,121	271,497	595,429	571,759
Other general administration	275,386	178,061	499,994	340,501
	<u>598,061</u>	<u>493,315</u>	<u>1,203,095</u>	<u>974,081</u>
Capitalized and other costs	(118,215)	(113,474)	(246,687)	(231,666)
	<u>479,846</u>	<u>379,841</u>	<u>956,408</u>	<u>742,415</u>
Stock-based compensation	192,002	181,760	501,003	547,327
Capitalized portion of stock-based compensation	(41,148)	(42,011)	(108,753)	(147,248)
	<u>150,854</u>	<u>139,749</u>	<u>392,250</u>	<u>400,079</u>
	<u>\$ 630,700</u>	<u>\$ 519,590</u>	<u>\$ 1,348,658</u>	<u>\$ 1,142,494</u>

In 2011 the Corporation continued the consulting contracts with an investment advisor, a land consultant, a computer network maintenance company and an external IFRS consulting firm. During the first six months of 2011, the Corporation also entered into consulting arrangements with a staffing recruitment firm and an executive compensation firm, resulting in an increase of 90.2% in consulting fees, after capitalization, from \$45,994 for the first half 2010 to \$87,465 for the first half 2011. Consulting fees for the second quarter 2011 decreased by 46.2% compared to the second quarter 2010 due to additional reservoir engineering consulting fees in 2010 related to a resource assessment update.

Salaries and benefits, after capitalization, of \$382,813 for the six months ended June 30, 2011 increased by 3.9% compared with 2010 (\$368,567) due to the hiring of an additional employee in March 2011, but offset by efficiencies gained in the Corporation's group health benefits plan.

The Corporation capitalizes, within both Exploration and Evaluation assets and Property, Plant and Equipment, certain salary and benefit costs associated with staff directly involved in exploration and development activities. During the six months ended June 30, 2011, the Corporation capitalized a total of \$246,087 (2010: \$230,466) of general and administration expenses, including salaries and benefits, directly related to exploration and development activities. Other costs capitalized during the six months ended June 30, 2011 of \$600 (2010: \$1,200) relate to consulting fees incurred as equity instruments issue costs, and are recorded by the Corporation as a reduction of shareholders' capital. For the six months ended June 30, 2011 the Corporation also capitalized \$108,753 (2010: \$147,248) of share-based compensation expense for those employees of the Corporation directly involved in exploration and development activities.

Due to the reduced levels of stock options granted as well as a decrease in the market price of the Corporation's shares, share-based compensation, after capitalization, decreased by 2.0% to \$392,250 for the six months ended June 30, 2011, from \$400,079 for the comparative prior period. The closing price of the Corporation's shares on the Exchange on June 30, 2011 was \$1.28 per share.

Canadian Spirit Resources Inc.

MANAGEMENT DISCUSSION AND ANALYSIS

For the period ended June 30, 2011

Other General and Administrative Expenses

	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010
Professional fees	\$ 96,963	\$ 11,922	\$ 161,985	\$ 11,922
Investor relations and filing fees	56,972	29,357	76,095	61,628
Directors' fees	15,000	15,500	30,500	31,000
Office premises and insurance	75,937	83,350	160,098	166,933
Office supplies	21,798	22,033	44,034	43,214
Staffing costs	5,813	10,618	16,853	19,454
Other	2,903	5,281	10,429	6,350
	<u>275,386</u>	<u>178,061</u>	<u>499,994</u>	<u>340,501</u>
Capitalized office supplies	(6,803)	(6,324)	(13,863)	(12,648)
	<u>\$ 268,583</u>	<u>\$ 171,737</u>	<u>\$ 486,131</u>	<u>\$ 327,853</u>

Professional fees for the first six months of 2011 are comprised of legal counsel fees for joint venture matters, audit related fees for the first and second quarter 2011 interim financial statement reviews, reservoir engineer fees for the first quarter 2011 Reserve Report, and 2011 annual audit and reservoir engineer reserve report fee accruals, none of which were accrued for in the first six months of 2010.

The increase in investor relations and filing fees for the six months ended June 30, 2011 compared to the six months ended June 30, 2010 of 23.5% is largely attributable to investor relations travel and presentations, part of a concerted effort by the Corporation to increase awareness of the Corporation's prospects within the investment community, as well as additional document filing costs in the second quarter 2011 for the Ontario and Manitoba reporting jurisdictions.

Office premises expenses have remained relatively consistent from the second quarter 2010 to the second quarter 2011 due to the terms of the Corporation's prior sub-lease agreement. The sub-lease agreement expired at the end of May 2011. Commencing with June 2011, the Corporation's rent expenses will significantly decrease due to the signing of a subsequent two year main lease at \$12.00 per square foot compared to the prior rate of \$28.00 per square foot.

Office supplies expenses, before capitalization, have remained constant from 2010 to 2011. After capitalization, office supplies expenses have also remained constant for the six months ended June 30, 2011 (\$30,171) compared to 2010 (\$30,566).

Other expenses are comprised of advertising and promotion costs, charitable contributions and bank charges.

Canadian Spirit Resources Inc.

MANAGEMENT DISCUSSION AND ANALYSIS

For the period ended June 30, 2011

Liquidity and Capital Resources

The Corporation's capital expenditures for the six months ended June 30, 2011 and 2010 are detailed in the following table:

	<u>Three months ended June 30,</u>		<u>Six months ended June 30,</u>	
	<u>2011</u>	<u>2010</u>	<u>2011</u>	<u>2010</u>
Lease acquisitions and retentions	\$ 856,795	\$ 3,719,572	\$ 1,578,439	\$ 3,782,237
Geological and geophysical	-	-	-	-
Net expenditure on drilling and completion costs	1,444,047	21,248	3,284,826	708,001
Capitalized overhead	50,610	154,885	246,087	377,714
Total natural gas expenditures	2,351,452	3,895,705	5,109,352	4,867,952
Computer and office equipment, furniture and fixtures	865	1,543	4,708	7,486
Total capital expenditures	2,352,317	3,897,248	5,114,060	4,875,438
Royalty credits earned	(1,903,592)	-	(1,903,592)	-
Net capital expenditures	<u>\$ 448,725</u>	<u>\$ 3,897,248</u>	<u>\$ 3,210,468</u>	<u>\$ 4,875,438</u>

The Corporation's capital budget is reviewed and approved by the Board of Directors on a quarterly basis. The Corporation's Board of Directors has approved a total forecasted capital expenditure in 2011 of up to \$16.2 million, including an estimated \$0.5 million for capitalized overhead. The capital budget through the third quarter 2011 has been approved for a total of up to \$13.9 million, including \$0.4 million for capitalized overhead.

For the six months ended June 30, 2011, gross capital expenditures, including land acquisitions but before the application of British Columbia government incentive Summer Drilling and Deep Royalty Credits of \$1.9 million, totaled \$5.1 million (2010: \$4.9 million), compared to a budgeted capital expenditure of \$4.8 million (2010: \$3.9 million).

Cash administration expenses (general and administrative expenses excluding share-based compensation) for 2011 are expected to total \$2.6 million (2010: \$2.1 million), before capitalization of exploration and development related overhead. Revenue from interest on cash balances is budgeted at \$0.1 million for the 2011 year. The Corporation has budgeted for operating netbacks from the Farrell Creek Montney operations of \$2.1 million during 2011.

At June 30, 2011, the Corporation had a net working capital balance of \$14.9 million, consisting of cash in the amount of \$15.0 million, term deposits of \$1.2 million, accounts receivable and prepaids of \$0.2 million, and net of accounts payable and other accrued liabilities of \$1.5 million. The accounts payable and other accrued liabilities balance at June 30, 2011 relates primarily to horizontal drilling and completion activity in the Montney Project at Farrell Creek in conjunction with the Corporation's joint venture partner, Canbriam. The Corporation has no bank indebtedness and has no credit agreements to borrow money in place at this time.

The Corporation's net working capital as of June 30, 2011 of \$14.9 million is considered by management to be sufficient to cover its general and administrative expenses and its forecasted capital expenditures through at least the fourth quarter of 2011. The capital required to complete the Corporation's share of the Montney joint venture program for the remainder of 2011, plus the currently planned activity during the first half of 2012, is expected to either be drawn from existing cash resources or generated internally from funds from operations and possible borrowings against reserves.

Canadian Spirit Resources Inc.

MANAGEMENT DISCUSSION AND ANALYSIS

For the period ended June 30, 2011

Tax Pools

As at June 30, 2011, the Corporation had estimated tax pools available as deductions against future taxable income of \$68,608,934 (December 31, 2010: \$64,666,470).

Business Risks

Productivity

A material risk facing the Corporation is the productive capability of the discovered and undiscovered coalbed methane and shale natural gas resources on the Corporation's existing land base at Farrell Creek and the Corporation's ability to extract the potential natural gas resources economically. The Corporation will continue to utilize the knowledge, experience and technology available in the service sector to improve the productivity of the resources in this emerging natural gas basin in northeastern British Columbia.

Exploration and Development

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 the Montney Formation 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 entered into a joint venture which has resulted in the exploration, development and production 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 partner, 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 estimated capital commitments is a minimum level of administrative and operating costs to see the Corporation through any potential disruption in the equity market and any commodity price downward cycle. With \$14.9 million of net working capital as at June 30, 2011, the Corporation is in a strong position to continue with its business plan during the current price volatility in North American natural gas 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 now that commercial natural gas production has been 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.

Canadian Spirit Resources Inc.

MANAGEMENT DISCUSSION AND ANALYSIS

For the period ended June 30, 2011

Operating Capability

The Corporation is pursuing large unconventional natural gas projects that if successful will require additional 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 a joint venture pursuant to which a substantial party with the necessary experience and skills has assumed operatorship of the Montney Formation project.

The Corporation has now assumed operatorship of the Gething project. Minimal activity will be conducted on this project until the Corporation attracts a new joint venture partner or natural gas prices improve from current levels. The Corporation believes it has the technical and operating capability to manage the anticipated level of activity associated with the Gething project.

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 nine years, and as a result of drilling expenditures on these lands through June 30, 2011 has retained a substantial portion of these mineral rights. To reduce the risk of losing any of its current mineral rights, the Corporation entered into joint ventures in return for drilling expenditures on its lands. This has allowed the Corporation to allocate a portion of 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 component produced during production operations that would impact the environment are fracture fluids. The fracture fluids are recycled and ultimately re-injected into deep geologic formations at a commercial facility and in future, may be re-injected at Corporation-owned facilities.

Critical Accounting Policies

Reference should be made to the Corporation's significant accounting policies contained in note 2 to the Corporation's unaudited interim financial statements for the period ended June 30, 2011. 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 depletion, depreciation and amortization, the estimated costs associated with the decommissioning liability, the determination of the potential impairment of petroleum and natural gas properties, and the calculations of share-based compensation and deferred 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 petroleum and natural gas properties, the fair value of assets and liabilities, share-based compensation, and deferred income taxes.

Canadian Spirit Resources Inc.

MANAGEMENT DISCUSSION AND ANALYSIS

For the period ended June 30, 2011

Letter of Credit

For operations in British Columbia, the Corporation is required to provide a deposit towards future abandonment and reclamation costs based on the number of wells and facilities for which the Corporation is the primary permit holder. Based on a Liability Management Rating (“LMR”) review performed by the British Columbia Oil and Gas Commission (“BCOGC”), the Corporation was assessed an LMR of \$1,235,829. On June 24, 2011 the Corporation renewed a standby Letter of Credit for the LMR amount with the BCOGC as beneficiary. The standby Letter of Credit is irrevocable, bears a commission rate of 1.0%, expires on June 24, 2012, and renews on an annual basis thereafter.

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 other accrued 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.

International Financial Reporting Standards

In February 2008, the CICA's Accounting Standards Board confirmed that IFRS will replace previous GAAP commencing in 2011 for profit-oriented Canadian publicly accountable enterprises. As such, the Corporation is reporting its 2011 results in accordance with IFRS, commencing with the first quarter 2011 and including 2010 comparative information.

The following accounting and presentation policies represent the most significant changes from previous GAAP to IFRS:

a. **IFRS 1 election for full cost oil and gas entities:**

CSRI elected an IFRS 1 exemption whereby the Corporation's previous Canadian GAAP full cost asset pool consisting of all pre-development costs was reclassified, upon transition to IFRS, to exploration and evaluation assets at the amount that was recorded previously under Canadian GAAP. This resulted in a \$35,214,311 increase in exploration and evaluation assets with a corresponding decrease in property, plant and equipment as of the transition date.

IFRS requires that all pre-exploration costs be expensed. During the six months ended June 30, 2010, the Corporation recognized \$3,166 of exploration and evaluation expense as a result of this change. The amount expensed for the twelve months ended December 31, 2010 as a result of applying this pre-exploration costs policy was \$5,093.

b. **Decommissioning liability:**

Under Canadian GAAP, the Corporation's asset retirement obligations were discounted at a credit-adjusted risk free rate of 9.0%. Under IFRS, the estimated cash flow to abandon and remediate the Corporation's wells and facilities as of the transition date has been calculated at a risk free nominal interest rate of 4.31%. Upon transition to IFRS, this resulted in a \$275,257 increase in decommissioning obligations with a corresponding decrease in retained earnings. The further impact of such change in discount rate to 3.84% for the six months ended June 30, 2010 was a \$265,003 increase in decommissioning obligations. For the twelve months ended December 31, 2010, the impact of such change in discount rate to 3.65% was a \$329,863 increase in decommissioning obligations.

The change in discount rate resulted in an increase in accretion expense for the six months ended June 30, 2010 of \$4,040 and for the twelve months ended December 31, 2010 of \$5,387, respectively, with a corresponding increase to the decommissioning liability.

Canadian Spirit Resources Inc.

MANAGEMENT DISCUSSION AND ANALYSIS

For the period ended June 30, 2011

Under Canadian GAAP accretion was grouped and presented with depletion and depreciation. Under IFRS accretion is presented as a financing cost.

c. Share-based payments:

Under Canadian GAAP, CSRI recognized the expense related to share-based payments on a straight-line basis through the date of full vesting and did not incorporate a forfeiture multiple. Under IFRS, the Corporation is required to recognize share-based compensation expense using graded vesting and an estimated forfeiture rate.

CSRI elected an IFRS 1 exemption for all options issued whereby the share-based compensation expense and contributed surplus for options that had vested prior to the transition date were not required to be restated. As a result of applying graded vesting and a calculated forfeiture rate to options that were not fully vested as of the transition date, an increase of \$44,544 in contributed surplus and a corresponding decrease in retained earnings were recorded.

For the six months ended June 30, 2010, the impact of using graded vesting and a calculated forfeiture rate resulted in an increase in share-based compensation expense and contributed surplus of \$36,062. The impact of graded vesting and a calculated forfeiture rate for the twelve months ended December 31, 2010 was \$9,220.

d. Flow-through Shares:

Under Canadian GAAP, the full proceeds from Flow-through Share issuances were recorded as share capital. Under IFRS, any premium (calculated as the excess of issue price over market price at the time of issue) is recorded as a liability, with the market value of the Flow-through Shares being recorded as share capital. Upon the outlay of the appropriate expenditures and renouncement to investors of the related resource expenditure deductions, the liability is reversed and a Flow-through Shares premium is recorded as an income item in the period.

As of the transition date to IFRS, a premium of \$103,200 was calculated from all prior Flow-through Share issuances and was recorded as a reduction in common shares with a corresponding increase in retained earnings. In relation to the June 2010 Flow-through Share issuance that was renounced in December 2010, a Flow-through Shares premium income amount of \$750,000 (calculated as the excess of issue price over market price) was recorded in the fourth quarter 2010 with the offset being recorded against the Flow-through Shares premium liability and the deferred tax recovery of \$993,821 previously booked under Canadian GAAP was reversed.

e. Income taxes:

In accordance with Canadian GAAP, the Corporation had presented certain future income tax assets and liabilities as current assets or current liabilities. Under IFRS, all deferred tax assets and liabilities are presented as non-current.

Future Changes in Accounting Policies and Practices

Accounting standards in effect as at June 30, 2011 have been adopted as part of the transition to IFRS. Recently, the IASB and IFRIC have issued the following new accounting standards or amendments to standards:

IFRS 7: Financial Instruments, Disclosures

This standard was amended in October 2010 to provide additional disclosure on the transfer of financial assets including the possible effects of any residual risks that the transferring entity retains. These amendments are effective as of July 1, 2011. The Corporation is currently evaluating the impact of these amendments to IFRS 7 on its financial statements.

Canadian Spirit Resources Inc.

MANAGEMENT DISCUSSION AND ANALYSIS

For the period ended June 30, 2011

IFRS 9: Financial Instruments

This standard addresses classification and measurement of financial assets and replaces the multiple category and measurement models in IAS 39: *Financial Instruments, Recognition and Measurement* for debt instruments with a new mixed measurement model having only two categories: amortized cost and fair value through profit or loss. IFRS 9 also replaces the models for measuring equity instruments, and such instruments are either recognized at fair value through profit or loss or at fair value through other comprehensive income. Where such equity instruments are measured at fair value through other comprehensive income, dividends are recognized in profit or loss to the extent not clearly representing a return of investment; however, other gains and losses (including impairments) associated with such instruments remain in accumulated comprehensive income indefinitely. Under the current expected IASB timeline, the Corporation expects to adopt IFRS 9 on or about January 1, 2015. The application of this standard is not expected to have a material impact on the financial statements of the Corporation.

IFRS 10: Consolidated Financial Statements

This standard establishes principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities. IFRS 10 supercedes IAS 27: *Consolidated and Separate Financial Statements* and is effective for annual periods beginning on or after January 1, 2013 with early application permitted. The application of this standard has no current impact on the financial statements of the Corporation.

IFRS 11: Joint Arrangements

This standard establishes principles for financial reporting by parties to a joint arrangement. IFRS 11 supercedes IAS 31: *Interests in Joint Ventures* and is effective for annual periods beginning on or after January 1, 2013 with early application permitted. The Corporation is currently evaluating the impact of this standard on its financial statements.

IFRS 12: Disclosure of Interests in Other Entities

This standard applies to entities that have an interest in a subsidiary, a joint arrangement, an associate or an unconsolidated structured entity. IFRS 12 is effective for annual periods beginning on or after January 1, 2013 with early application permitted. The application of this standard has no current impact on the financial statements of the Corporation.

IFRS 13: Fair Value Measurements

This standard defines fair value, sets out a framework for measuring fair value and requires disclosures about fair value measurements. IFRS 13 applies to other IFRS's that require or permit fair value measurements or disclosures about fair value measurements. This standard is to be applied for annual periods beginning on or after January 1, 2013 with early application permitted. The application of this standard is not expected to have a material impact on the financial statements of the Corporation.

IAS 12: Income Taxes

This standard was amended in December 2010 to remove subjectivity in determining upon which basis an entity measures the deferred tax relating to an asset. The amendment presumes that an entity will assess whether the carrying value of an asset will be recovered through the sale of such asset. The amendment to IAS 12 is effective for reporting periods beginning on or after January 1, 2012. The Corporation is currently evaluating the impact of this amendment to IAS 12 on its financial statements.

Canadian Spirit Resources Inc.

MANAGEMENT DISCUSSION AND ANALYSIS

For the period ended June 30, 2011

IAS 27: Separate Financial Statements

This standard will replace the existing IAS 27: *Consolidated and Separate Financial Statements*. IAS 27 contains accounting and disclosure requirements for investments in subsidiaries, joint ventures and associates when an entity prepares separate financial statements. The amended standard will require an entity preparing separate financial statements to account for those investments at cost or in accordance with IFRS 9: *Financial Instruments*. The amended standard is effective for annual periods beginning on or after January 1, 2013 with early application permitted. The application of this standard has no current impact on the financial statements of the Corporation.

IAS 28: Investments in Associates and Joint Ventures

This standard was amended in 2011 and prescribes the accounting for investments in associates and sets out the requirements for the application of the equity method when accounting for investments in associates and joint ventures. IAS 28 is effective for annual periods beginning on or after January 1, 2013 with early application permitted. The Corporation is currently evaluating the impact of this standard on its financial statements.

Share Capital

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

On June 29, 2010 the Corporation issued 3,000,000 Flow-through Shares at a price of \$1.40 per share. The Flow-through Shares entitled the holder to certain income tax benefits in the form of Canadian Development Expense. The \$4,200,000 of proceeds from the Flow-through Shares placement was allocated between common shares (at the market price on the Exchange of \$1.15 on the date of announcement of the placement) of \$3,450,00 and Flow-through Shares premium liability of \$750,000, and was fully expended on eligible development costs by the end of fiscal 2010. Incurred in relation to the issuance were \$224,716 of share issue costs. Once the expenditures were incurred and upon renouncement of the related resource expenditure deductions to investors in the fourth quarter 2010, the liability was reversed and offset by the recording of a \$750,000 Flow-through Share premium income amount.

On December 14, 2010 the Corporation closed a public offering of common shares of the Corporation by way of a short form prospectus. The offering included 16,670,000 common shares issued on a bought deal basis at \$1.50 per share for gross proceeds of \$25,005,000. The underwriters of the offering also exercised their over-allotment option to purchase an additional 780,500 common shares of the Corporation for gross proceeds of \$1,170,750, thereby bringing the aggregate total to 17,450,500 common shares for total gross proceeds of \$26,175,750. The Corporation paid a fee equal to 6% of the total gross proceeds, or \$1,570,545, to the underwriters of the offering resulting in total net proceeds to the Corporation of \$24,605,205. The Corporation also incurred additional share issue costs of \$232,907 in relation to this public offering.

Since June 30, 2011 to the date of this report, the Corporation had no exercises of stock options. As at August 25, 2011 the Corporation has 73,792,361 common shares, Nil share purchase warrants and 3,009,500 stock options outstanding.

Canadian Spirit Resources Inc.

MANAGEMENT DISCUSSION AND ANALYSIS

For the period ended June 30, 2011

Normal Course Issuer Bids

On April 14, 2010, the Corporation received approval from the Exchange to commence a Normal Course Issuer Bid (the “2010-2011 NCIB”) through the facilities of the Exchange beginning on April 16, 2010. Pursuant to the 2010-2011 NCIB, the Corporation had the ability to acquire up to 2.5 million common shares of the Corporation, representing 4.6% of the total number of common shares outstanding at the commencement of the 2010-2011 NCIB, until April 16, 2011. From January 1, 2011 to April 16, 2011 (2010: April 16, 2010 to December 31, 2010) the Corporation purchased for cancellation a total of 37,800 (2010: 1,269,200) common shares of the Corporation for total cash consideration of \$54,740 (2010: \$1,865,297) at an average price of \$1.45 (2010: \$1.47) per common share, representing 0.07% (2010: 2.34%) of the total number of common shares outstanding at the commencement of the 2010-2011 NCIB. Since the average carrying value of common shares outstanding at the time of repurchase was lower than the actual repurchase price per common share, the calculated difference per common share for the period from January 1, 2011 to April 16, 2011 of \$8,694 (year ended December 31, 2010: \$385,853) was recorded as a decrease to contributed surplus.

On April 18, 2011, the Corporation received approval from the Exchange to commence a further Normal Course Issuer Bid (the “2011-2012 NCB”) through the facilities of the Exchange beginning on April 19, 2011. Pursuant to the 2011-2012 NCIB, the Corporation may acquire up to 3.7 million common shares of the Corporation until April 18, 2012. From April 19, 2011 to June 30, 2011 the Corporation purchased for cancellation a total of 327,300 common shares of the Corporation for total cash consideration of \$432,285 at an average price of \$1.32 per common share, representing 0.44% of the total number of common shares outstanding at the commencement of the 2011-2012 NCIB. Since the average carrying value of common shares outstanding at the time of repurchase was lower than the actual repurchase price per common share, the calculated difference per common share for the period from April 19, 2011 to June 30, 2011 of \$32,731 was recorded as a decrease to contributed surplus.

For each of the Corporation’s Normal Course Issuer Bids, all common shares of the Corporation purchased during any given month are returned to treasury and cancelled in the month subsequent to acquisition.

Commitments

The Corporation had entered into an office sub-lease agreement which expired on May 30, 2011. Under the terms of the sub-lease agreement, the Corporation was obligated to pay base annual rent of \$28.00 per square foot plus operating costs on 6,793 square feet.

In January 2011, the Corporation signed a main office lease agreement for the same premises as described above for a subsequent two year period, expiring May 31, 2013, at a base annual rent of \$12.00 per square foot plus operating costs on 7,187 square feet.

The Corporation also leases a small field office location on a month-to-month basis.

Corporate Information

Additional information regarding the Corporation is available on SEDAR at www.sedar.com or the Corporation’s website at www.csri.ca.