

January 6, 2011

Rating: SPECULATIVE BUY
Target Price: \$3.25

All figures in C\$, unless otherwise noted

Recent Price:		\$1.84
52 Week Range		\$1.01 – \$2.34
Shares O/S	basic:	74.9 million
	f.d.	76.7 million
Market Cap	basic:	\$137.8 million
Fiscal Year End:		Dec. 31
Cash (Dec. 31/10):		\$26.2 million

Commodities	2009A	2010E	2011E
WTI (US)	\$62	\$75	\$80
Natural Gas (US)	\$3.70	\$4.25	\$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.*

Canadian Spirit Resources Inc. (SPI-TSXV)

Talisman/Sasol Deal Indicates Potential Value

- ▶ **Transaction Terms:** On December 20, 2010 Talisman Energy (TLM –TSX) announced it had agreed to a transaction with Sasol Limited (SSL(ADR) – NYSE) whereby Sasol will acquire a 50% working interest in Talisman’s Farrell Creek assets for a total consideration of \$1.05 billion. Sasol will pay \$260 million in cash at closing. Farrell Creek represents about 22% of Talisman’s Montney shale gas play located in northeast B.C. The assets include a 120 mmcf/d processing facility and 80 net sections (51,200 net acres) of land. At the time of the announcement, Talisman expected to produce between 40 and 60 mmcf/d at year end 2010 from Farrell Creek. Talisman estimates the contingent resource potential of its Farrell Creek lands is 9.6 tcf of gas, which on its total 80 net sections of land means that Talisman is estimating a potential contingent resource of 120 bcf per section.
- ▶ **Transaction Metrics:** We make the simplistic assumption that the \$260 million upfront cash payment represents a reasonable value for the facility and current production, based on \$20 million for 50% of the processing facility and \$240 million for 50% of current production (approximately \$48,000 per flowing barrel of 5,000 boe/d using the high end of the range of estimated gas production of 60 mmcf/d). The remaining \$790 million can then be allocated to the value of the land and potential resource acquired by Sasol. Paying \$790 million for Sasol’s net 25,500 acres and net 4.8 tcf of gas resource yields costs of approximately \$31,000 per acre and \$0.16 per mcf.
- ▶ **Significance to Canadian Spirit:** Canadian Spirit has a land position of 30.8 net sections, or 19,700 acres, with a contingent resource estimate of 1.2 tcf. Applying the transaction metrics to Canadian Spirit’s land and potential resource, therefore, yields values for the company of \$611 million, or \$8.20 per share and \$192 million, or \$2.56 per share, respectively. Of importance in this calculation is that Canadian Spirit conservatively uses approximately 40 bcf per section in its estimate of potential contingent resource compared to Talisman’s 120 bcf per section.

Please see end of this report for important disclosures

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If we applied 120 bcf per section to Canadian Spirit's 30.8 net sections, we arrive at a potential contingent resource of 3.7 tcf. At the transaction metric of \$0.16 per mcf, the resulting value to Canadian Spirit would be \$592 million, or \$7.90 per share.

- ▶ **Conclusion:** The terms of the Talisman/Sasol transaction confirm our view that Canadian Spirit is undervalued and the shares have significant upside potential from current levels. While Talisman's land is currently producing and is more developed, the metrics of the deal indicate that companies like Canadian Spirit could receive substantial upward revaluations with increased attention and corporate activity in the Montney area.
- ▶ **Recommendation: We maintain our SPECULATIVE BUY recommendation and price target of \$3.25 per share.**

IMPORTANT DISCLOSURES

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Company Specific Disclosures: N/A

Investment Rating Criteria

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.
SELL	The security represents poor value and is expected to depreciate over the next 12-18 month time horizon.

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