

CANADIAN SPIRIT RESOURCES INC.

For the three and nine month periods ended September 30, 2005

MANAGEMENT DISCUSSION AND ANALYSIS

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 three and nine month periods ended September 30, 2005 and the audited financial statements and MD&A for the year ended December 31, 2004.

Date

This MD&A includes information up to November 14, 2005.

Reader’s Advisory

The corporate information contained in these pages contains forward-looking forecast information. The reader is cautioned that assumptions used in the preparation of such information, although considered reasonable by Canadian Spirit Resources Inc. at the time of preparation, may prove to be incorrect. The actual results achieved during the forecast period will vary from the information provided herein and the variations may be material. Consequently, there is no representation by Canadian Spirit Resources Inc. that actual results achieved during the forecast period will be the same in whole or in part as those forecast.

Corporate Overview

Canadian Spirit Resources Inc. (“CSRI” or the “Company”) is a natural resources company focusing on the exploration and development of opportunities in the unconventional gas sector of the energy industry (including natural gas from coal “NGC”, also referred to as coalbed methane or “CBM”, shale gas and tight gas sands).

The Company’s strategic advantages are the extensive knowledge and experience of its technical team in coal and NGC exploration and development, the proprietary database of potential NGC resources in western Canada developed during 2002 and early 2003 and the energy development experience of its management and directors. The original evaluation of potential NGC resources in western Canada was conducted in conjunction with a major industry joint venture partner, however, a change in the capital allocation priorities of the joint venture partner in May 2003 resulted in CSRI proceeding to identify targets, assemble a land base, and commence exploration of its prospects on its own.

The Company also holds a 100% undivided interest, subject to a 10% net profit interest, in thirteen mineral claims covering 2,925 hectares of land in the Iskut River area of the Liard Mining Division, British Columbia (the “Isk Wollastonite Mineral Properties”).

Prior to May 2002, the Company’s primary activity was to evaluate its Isk Wollastonite Mineral Properties. The Company determined that this mineral property contains significant reserves, but are uneconomic to produce at current prices due to lack of access and infrastructure. During the exploration and evaluation phase of operations from 1992 through April 2002, the Company incurred approximately \$8.0 million of losses, including an impairment charge of \$4.8 million for this mineral property.

Since May 2002, the Company’s focus has been to evaluate the resource potential of NGC exploration properties and is considered to be in its development stage of operations. Although some preliminary evaluation work was performed on NGC potential prior to May 2002, the decision to change the strategic direction of the Company from evaluation of the Isk Wollastonite Mineral Properties to an evaluation of NGC occurred early in 2002.

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Results of Operations

Farrell Creek, British Columbia:

The focus of the Company's activities is now on the planning and execution of a pilot production project in the Farrell Creek area of northeastern British Columbia. Prior to 2005, the Company had drilled three test wells on its lands to evaluate NGC potential. The first test well was drilled, cored, evaluated and suspended in the eastern portion of its land holdings during 2003. The next two test wells were drilled, cored, evaluated and cased to evaluate a contiguous block of thirty sections in the west side of the Farrell Creek area ("West Farrell") during 2004.

Activities from January 1 to November 14, 2005 include:

1. The Company began stimulation and production testing of the third test well (c-83-H) drilled in West Farrell in preparation for its NGC pilot production project. The Company has perforated fourteen different coal and coal rock seam intervals within the Gething formation in this wellbore. The Company received natural gas and formation water to surface from six of the different Gething intervals that were perforated. The Company is currently production testing selected intervals in order to establish natural gas and water production rates prior to stimulation. In early December the Company plans to fracture stimulate selected intervals within the Gething formation which will be followed by a final test of the well's productive capability. The Company's aim with the December work program is to determine optimum completion stimulation and to support future well design and well spacing requirements. The 2005 work program on this wellbore was designed to evaluate various well completion and production techniques and to determine the productive capability of the Gething coal resources acquired to date. Based upon the positive preliminary test results from the Gething formation and the availability of drilling equipment, the Company plans to drill up to five wells in West Farrell in December 2005 and January 2006. Four of these new wells are planned to be drilled in close proximity to the c-83-H test well.
2. The second cased well in West Farrell (c-48-I) was completed to evaluate the Bluesky formation that was encountered while drilling for NGC on both West Farrell test wells. This well was production tested for a 30 day period and was shut-in with bottom hole pressure gauges for pressure build up analysis to assist in determining productive capability. Following the shut in period the Company installed bottom hole pumps to remove formation water and is currently in a 90 day production testing period. Any production results from this horizon will supplement the economic value of the Farrell Creek properties, which has a primary producing objective of the Gething coal rock package.
3. On August 8, 2005, the Company spud a well at c-A83-H, under the British Columbia test hole regime, to evaluate shale gas potential in the West Farrell area. Logs, cores, and preliminary desorption results from the shale sequence in this fourth test well have been evaluated and indicate the presence of natural gas. Additional evaluation work will be performed over the next three months before any decision is taken regarding this potential resource. This well is a 50 meter offset to the c-83-H well and was further drilled through the Gething formation. The Company has completed and is testing the Bluesky formation in this well and intends to use this wellbore as an observation well during the fracture stimulation of the c-83-H well in December.

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4. The Company acquired a 66.67% interest in five sections, a 33.33% interest in two sections, and a 50% interest on another section of land in the Farrell Creek area. The Company will continue to pursue the remaining interests in these lands from the other working interest partners. In August 2005, the Company acquired an additional 100% interest in 1,667 hectares (six sections) of land in the Farrell Creek area for approximately \$2.1 million. These lands will supplement the 100 percent working interest the Company held in 13,629 hectares of land in the Farrell Creek area at December 31, 2004. The Company also holds one section of land in a second area in British Columbia where there is the potential for farm-in and joint venture opportunities.

Bittern Lake, Alberta:

During 2004 the Company acted as agent in acquiring two sections of land in Alberta under a joint venture with Lynden Ventures Ltd., an independent third party. Under the terms of the joint venture, Lynden Ventures will pay 100% of the initial land acquisition and drilling costs up to \$2.5 million to earn a 50% working interest in the joint venture lands. The area of mutual interest ("AMI") in the proposed joint venture lands covers four townships in central Alberta. The Company acquired an additional section of land in the AMI during the first quarter of 2005. The Company executed this agreement in April 2005 and Lynden Ventures obtained regulatory approvals in August 2005 to commence operations.

In late September and early October the Company drilled and completed one Horseshoe Canyon well on the joint venture lands. Based upon completion results of this first well the Company drilled three additional wells on the same section of land. The Company plans to tie these wells into existing infrastructure and have the wells on production during the first quarter of 2006.

Isk Wollastonite, British Columbia:

No field work was conducted at the Isk Wollastonite mine site during the first nine months of 2005. A development option held by a third party was amended and extended during 2004 and currently expires on December 31, 2005. The option agreement grants the Optionee the sole and exclusive right and option to acquire a 50% undivided interest, subject to a 3% Net Smelter Return, in the Isk Wollastonite Mineral Properties. In order to earn this interest, the Optionee must incur \$3.5 million in exploration expenditures prior to December 31, 2007. Two mineral claims were due to expire in March 2005, seven mineral claims were due to expire in August 2005, with the remaining claims to expire in December 2005. The Company obtained an annual extension on the two mineral claims in February 2005, the seven mineral claims in August 2005, and intends to extend the remaining claims prior to their expiry dates in December. Annual extensions are available to the Company for the next ten years.

Revenue

The Company has had no operating revenue in its history. Non operating revenue consisting of interest earned on surplus funds and management fees recovered from joint venture partners for the three and nine month periods ended September 30, 2005 was \$217,952 and \$346,535 respectively (2004: \$19,235 and \$45,273). These revenues have reduced the cash administration costs required to operate the Company in 2005 compared to 2004.

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General and Administration Expenses

	<u>Three months ended Sept. 30</u>		<u>Nine months ended Sept. 30</u>	
	2005	2004	2005	2004
Consulting fees	\$ 42,782	\$ 76,625	\$ 187,228	\$ 167,885
Salaries and benefits	212,713	78,587	565,469	235,665
Other general administration	115,325	76,084	365,913	250,662
	<u>370,820</u>	<u>231,296</u>	<u>1,118,610</u>	<u>654,212</u>
Less: Capitalized costs	<u>(143,910)</u>	<u>(35,700)</u>	<u>(427,541)</u>	<u>(107,100)</u>
	226,910	195,596	691,069	547,112
Stock-based compensation	<u>448,559</u>	<u>382,751</u>	<u>1,934,904</u>	<u>701,253</u>
	<u>\$ 675,469</u>	<u>\$ 578,347</u>	<u>\$ 2,625,973</u>	<u>\$ 1,248,365</u>

During the nine month period ended September 30, 2005, consultant's fees increased by 12% over the corresponding prior period due to the addition of a land consultant effective January 1, 2005 to April 30, 2005 and additional activities requiring engineering and computer consultants during 2005 compared to 2004. During the three month period ended September 30, 2005, consultant's fees decreased by 44% over the corresponding prior period due to the retention of full time geologists during 2005 that were outsourced in the prior year. During the three and six month periods of 2005, the Company capitalized \$6,893 and \$55,435 respectively (2004: \$Nil and \$Nil) of consulting fees relating to geological, engineering and land related exploration activity. In addition, the Company charged \$Nil during the three month period and \$20,693 during the nine month period ended September 30, 2005 to share issue costs representing the proportion of consulting work performed by a financial advisor on private placements during these periods.

Salary and benefits rose 171% during the three month period and 140% during the nine month period ended September 30, 2005 compared to corresponding periods of 2004. The change is attributed to salary increases to four employees effective January 1, 2005, the retention of an additional full time geologist, engineer and financial officer during January 2005, the retention of a land manager and a junior geologist during May 2005, and salary increases to staff on July 1, 2005. The Company capitalizes salaries and benefits associated with staff directly related to exploration activities. During the three and nine month periods ended September 30, 2005, the Company capitalized \$126,708 and \$322,299 respectively of salary and benefits compared to \$35,700 and \$107,100 during the same periods in 2004. The increase in capitalized costs is due to the addition of staff geologists, an engineer, a land manager, and salary increases and the related benefits of the employees.

Other Administration Costs

Other general and administration costs increased by 52% during the three month period and 46% during the nine month period of 2005 compared to 2004 as indicated in the following table:

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	<u>Three months ended Sept. 30</u>		<u>Nine months ended Sept. 30</u>	
	2005	2004	2005	2004
Professional fees	\$ 21,973	\$ 25,458	\$ 63,728	\$ 77,961
Investor relations & filing fees	6,648	19,717	71,703	87,463
Office premises & insurance	49,302	12,592	116,883	32,697
Office supplies	25,053	3,669	70,023	20,476
Staffing costs	11,169	6,233	25,614	12,411
Other	1,180	8,415	17,962	19,654
	<u>115,325</u>	<u>76,084</u>	<u>365,913</u>	<u>250,662</u>
Less: Capitalized costs	<u>(10,309)</u>	<u>-</u>	<u>(29,114)</u>	<u>-</u>
	<u>\$ 105,016</u>	<u>\$ 76,084</u>	<u>\$ 336,799</u>	<u>\$ 250,662</u>

Professional fees for financing, audit, accounting and legal fees decreased in both the three month period and the nine month period ended September 30, 2005 due to less legal activity in 2005 compared to 2004. Investor relations and filing fees decreased in the three month period ended September 30, 2005 compared to the same period in 2004 due to less filing and transfer agent fees in the current period. The comparative numbers for the nine month period ended September 30, 2004 includes \$43,163 of costs relating to a June 2004 private placement financing. These costs were subsequently reclassified to share issue cost in the fourth quarter of 2004. Office premises and insurance costs increased due to the higher rental rate for the Company's new offices effective January 1, 2005. The higher staffing costs are due to the increase in staffing levels that occurred in during 2005. Office supply costs for 2005 increased due the licensing costs for a new computer mapping program and related exploration mapping costs of which \$10,309 were capitalized to natural gas properties in the three month period ended and \$29,114 were capitalized to natural gas properties in the nine month period ended September 30, 2005. The remaining increase is due to the administrative costs associated with the increased staffing levels in 2005 compared to 2004.

During the three and nine month periods of 2005, professional fees including legal, audit and accounting and investor relations expenditures including listing and transfer agent fees represent 25% and 37% respectively (2004: 60% and 66%) while rent, office supplies, equipment leases and insurance represent 64% and 51% respectively (2004: 21% and 21%) while staffing costs and other costs representing advertising and promotion, and bank charges and interest represent the remaining 11% and 12% respectively (2004: 19% and 13%) of the net other administration costs.

Stock-based compensation increased significantly during the three and nine month periods of 2005 compared to 2004. The compensation cost charged against earnings for stock options granted in 2004 and 2005 for the three and nine month periods ended September 30, 2005 was \$352,559 and \$1,521,904 respectively (2004: \$95,890 and \$358,237). This increase is due to the volatility of the Company's share price, which is a factor used in the computation of stock-based compensation expense; to the increase in the Company's share price; and to additional stock options granted during the past year. Total compensation expense for share appreciation rights for the three and nine month periods ended September 30, 2005 was \$96,000 and \$413,000 respectively (2004: \$286,863 and \$343,016) based on a closing price of \$3.50 per share on the TSX Venture Exchange on

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September 30, 2005. The Company has accrued a long term liability of \$1,258,333 at September 30, 2005 relating to share appreciation rights.

Summary of Quarterly Results

Net losses prior to income taxes and the income tax benefit recorded during December 2003 and December 2004 and for the prior eight quarters were:

<u>Net loss by quarter</u>	2005		2004		2003	
	Amount	Per Share	Amount	Per Share	Amount	Per Share
First Quarter	\$ (1,094,574)	\$ (0.05)	\$ (264,063)	\$ (0.02)	\$ (147,537)	\$ (0.02)
Second Quarter	(745,055)	(0.03)	(383,367)	(0.02)	(153,329)	(0.02)
Third Quarter	(469,598)	(0.02)	(561,720)	(0.03)	(127,625)	(0.02)
Fourth Quarter			(868,870)	(0.05)	(311,772)	(0.05)
Loss before income taxes	(2,309,227)	(0.10)	(2,078,020)	(0.12)	(740,263)	(0.11)
Future income tax benefit	-	-	336,200	0.02	346,200	0.05
Net loss after tax	<u>\$ (2,309,227)</u>	<u>\$ (0.10)</u>	<u>\$ (1,741,820)</u>	<u>\$ (0.10)</u>	<u>\$ (394,063)</u>	<u>\$ (0.06)</u>

For the each period up to and including September 30, 2005, the existence of stock options and warrants affected the calculation of loss per share on a diluted basis. As the affect of this dilution is to reduce the reported loss per share, diluted loss per share information has not been shown.

The Company has financed a portion of its exploration and development activities through the issue of flow-through shares. Under the terms of these share issues, the related resource expenditure deductions for income tax purposes are renounced to investors. The affect of renouncing income tax pools to investors is to reduce tax deductions that are available to offset future taxable income of the Company. Accordingly, when the expenditures are renounced, share capital is reduced and future income tax liabilities are increased by the estimated value of the renounced tax deductions. An issue of flow-through shares in December 2004 and 2003 resulted in a recovery of future income taxes which reduced the reported net loss in these periods by \$336,200 during 2004 (2003: \$346,200).

In the fourth quarter of 2003, the Company adopted new accounting policies regarding stock-based compensation which have had a significant impact on the quarterly results. The increased market price of the Company's shares during this past year resulted in a higher provision for the potential liability associated with share appreciation rights issued in August 2003. Compensation expense attributable to stock options granted during 2004 and 2005 also contributed to the increased losses for the last seven quarters. Excluding the affects of stock-based compensation the Company's pre-tax losses by quarter would have been:

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Net loss by quarter prior to stock-based compensation expense

	2005	2004	2003
First Quarter	\$ (174,539)	\$ (124,615)	\$ (147,537)
Second Quarter	(178,745)	(204,315)	(153,329)
Third Quarter	(21,039)	(178,968)	(127,625)
Fourth Quarter		(32,197)	(134,076)
Loss before income taxes	<u>\$ (374,323)</u>	<u>\$ (540,095)</u>	<u>\$ (562,567)</u>

Liquidity and Capital Resources

The Company has developed a base case capital budget for 2005 of \$14.5 million with an additional \$75,000 for administrative capital equipment. The Company's budget is reviewed and approved by the Board of Directors on a quarterly basis. The \$14.5 million exploration budget includes \$5.8 million for land acquisition, \$1.0 million for geological and geophysical, \$6.4 million for drilling and completion and \$1.3 million for field facilities and tie in costs. Based upon field work commitments as at this date, the Company expects to spend approximately \$8.2 million on capital projects for the 2005 calendar year with fourth quarter projected spending of \$3.3 million. The majority of the fourth quarter capital program will be in the Farrell Creek area of British Columbia. This may be adjusted for participation in land sale postings and as industry activity (such as rig availability and completion equipment) dictates.

Cash administration expenses (G&A excluding stock-based compensation) for 2005 are expected to be approximately \$1.6 million before capitalization of exploration related overhead; a \$717,000 increase from 2004. The net increase can be attributed to: an anticipated increase in salary, benefits and staffing costs of \$440,000 due to the hiring of additional staff during 2005 and salary increases for existing staff; an increase of approximately \$140,000 due to a new lease on the Company's offices effective January 1, 2005; an increase of \$50,000 due to investor relations and filing fees associated with a larger capital base; and a general increase of \$87,000 due to costs associated with increased staffing and activity. The Company expects that interest and other income will increase to approximately \$250,000 and is anticipating recovery of approximately \$180,000 from joint venture participants during 2005. This will reduce the cash administration expense requirements from \$1.6 million to \$1,150,000. The Company's base budget does not include any cash flow from operations during 2005.

The Company is in strong financial condition at September 30, 2005 with working capital of \$12.1 million, consisting of cash in the amount of \$13.1 million, accounts receivable and prepaid expenses of \$357,963, net of accounts payable and accrued trade liabilities of \$1,319,024. The accounts payable and accrued trade liabilities relate primarily to field activities that occurred during September. The Company has no bank indebtedness and has no credit agreements to borrow money in place at this time.

In addition to the March 11, 2005 non-brokered private placement, which generated approximately \$8.8 million of funds, the Company received \$3.4 million from the exercise of options and warrants during the first nine months of 2005. During this period, the Company expended \$2,637,401 on exploration activities, \$2,207,650 on land acquisition and retention related activities, \$406,848 on capitalized overhead and \$67,745 on computers and office equipment.

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The Company has raised a total of \$28.3 million, after share issue costs, through several non-brokered private placements and the exercise of warrants and options since January 1, 2004.

The positive working capital of \$12.1 million is sufficient to cover administration costs and the base case capital budget for the remainder of 2005 and have funding available to carry over to 2006 or fund a more aggressive 2005 capital budget.

Business Risks

The principal risks facing the Company are the productive capabilities of the coal resources acquired to date; the uncertainty of further land acquisitions due to the intense competition for NGC opportunities; the availability of drilling and service equipment in a timely manner; and the extraction of hydrocarbons from reservoirs at economic production rates.

Government incentives, regulations and taxation of the oil and gas industry in Canada have been significant factors affecting industry profitability. The regulatory environment has been relatively stable for several years. However CSRI is unable to predict or control the direction of future public policy. Regulations regarding safety and the environment are strictly adhered to and CSRI sets a high standard of operating practice in order to minimize risks to employees and the environment.

The Company's ability to continue its operations, develop its assets and realize their carrying values is dependent upon continued support of its shareholders, favorable capital market conditions and commodity prices; obtaining additional equity financing and, ultimately, generating revenues sufficient to cover operating costs and capital requirements.

Related Party Transactions

During 2004 and 2005, the Company had transactions with directors of the Company, persons related to them or companies controlled by them in the normal course of business as follows:

	2005	2004
Consulting fees	\$ 58,400	\$ 62,850
Salaries and benefits	\$ 70,500	\$ 63,000
Administration and accounting fees	\$ -	\$ 1,940

Consulting fees in the nine month period ended September 30, 2005 included \$58,400 (2004: \$62,850) paid or payable to a director and senior officer of the Company. Accounts payable includes \$5,816 (2004: \$7,223) due to a director for consulting fees earned during the period.

Salaries and benefits of \$70,500 (2004: \$63,000) was the compensation paid to a director and senior officer of the Company during the nine month period ended September 30, 2005.

Accounting fees of \$Nil (2004: \$1,940) were paid to a company controlled by the spouse of a director and senior officer for accounting services during the nine month period ended September 30, 2005.

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Transactions with related parties are recorded at cost, which represent fair market value for services provided. In addition during 2005, certain directors, relatives of directors, or companies controlled by directors subscribed for 14,354 (2004: 15,000) shares or units in private placement offerings of the Company under the same terms as other investors.

Since September 30, 2005 to the date of this report, the Company has continued to employ a director as a salaried employee and has continued to contract with another director to provide services as a consultant.

Share Capital

The Company has authorized share capital of an unlimited number of common shares of no par value. Since September 30, 2005 to the date of this report, the Company has not issued any common shares for the exercise of warrants or options and has not granted any further stock options. The issued share capital as at November 14, 2005 consists of 25,593,082 common shares. In addition the Company has 1,420,848 warrants outstanding and 2,475,000 stock options outstanding as at November 14, 2005.

Corporate Information

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