

Canadian Spirit Resources Inc.

MANAGEMENT DISCUSSION AND ANALYSIS

For the year ended December 31, 2007

This management discussion and analysis (“MD&A”) of the financial conditions and results of operations should be read in conjunction with the audited financial statements for the year ended December 31, 2007.

Date

This MD&A includes information up to April 22, 2008.

Reader’s Advisory

The corporate information contained in these pages may contain 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 exploration company currently focusing on the identification and development of unconventional natural gas opportunities in western Canada.

Since May 2002, the Company’s focus has been to evaluate the resource potential of certain unconventional natural gas exploration properties and is considered to be in its development stage of operations. Although some preliminary evaluation work was performed on coalbed methane prospects prior to May 2002, the decision to change the strategic direction of the Company from the evaluation of the Isk Wollasonite Mineral Property to an evaluation of unconventional natural gas prospects occurred at this time. The Company’s strategic advantages are the extensive knowledge and experience of its technical team in coal, shale and unconventional natural gas exploration and development, the proprietary data base of potential unconventional natural gas resources in western Canada developed during 2002 and early 2003 and the energy development experience of its management, employees and directors.

On February 14, 2008, the Company announced that Mr. Donald R. Gardner, Chief Financial Officer and Secretary was also appointed as Chief Executive Officer.

Results of Operations

Farrell Creek, British Columbia:

The focus of the Company’s activities is currently on the execution of a pilot production project in the Farrell Creek area of northeastern British Columbia, located approximately 70 kilometres west of Fort St. John. In September of 2006, Sproule Associates issued an in-depth report, subsequently confirmed in updated reports dated April 2007 and April 2008, with an evaluation of 1.8 trillion cubic feet of discovered natural gas resource in the Gething, Moosebar and Gates Formations on the Company’s lands at Farrell Creek. See **Business Risks** on Page 9 of this MD&A.

On January 31, 2007, the Company’s “Experimental Scheme Application” covering a six section block which incorporates the Company’s pilot production project at Farrell Creek was approved by the British Columbia Oil & Gas Commission. The scheme will facilitate the orderly development of the pilot project and enable the Company to continue to keep pertinent engineering data confidential for up to three years.

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Four test wells that were completed in the Gething Formation during 2005 and 2006 flowed natural gas and formation water. The Company believes these results are encouraging given the early stage of evaluating this new unconventional basin. Activity in 2007 has concentrated on achieving consistent production of natural gas and water from these four test wells with improved reliability of equipment and the reduction of operating costs. In the fourth quarter of 2007, the Company fracture stimulated the d-093 location, the fifth well in the pilot program.

During 2007, the Company conducted an active capital program that included workovers, equipment changes and further production testing of three of the initial four wells in the pilot project. In addition, new production techniques were applied with the objective of increasing and stabilizing the rate of natural gas production. In the third quarter of 2007, the Company fracture-stimulated the upper portion of the Gething Formation in the b-003 well. The fracture stimulation of the d-093 well occurred in the fourth quarter of 2007 and is now under de-watering and production testing. The Company utilized a more controlled flowback approach on the d-093 well. All wells in the pilot program, except d-093, reached their regulatory flaring limit during 2007 and were shut in. Further production testing will therefore require facilities, including gas processing and compression, and a pipeline connection to the Spectra Energy sales pipeline. As such, in March and April of 2008, the Company commenced with the initial stages of its pilot program tie-in to the Spectra Energy pipeline. The planned gas production facility and gas gathering system for the six well project is expected to be completed by the summer of 2008, at which time the Company plans to resume production testing with the further objective of maximizing production capability and deliverability.

In the first quarter of 2008, the Company drilled and cased the b-091 well location. This sixth well in the pilot program will be completed in the summer of 2008 in conjunction with the tie-in of the Farrell Creek pilot project.

On March 19, 2008, the Company announced the conclusion of a joint venture and farmout agreement with a private energy company based in Calgary, Alberta that will evaluate certain of the Company's lands for Montney and other deep formation plays. Exploration and drilling activity will commence immediately following regulatory approval with two wells expected to reach target depth by the end of July. The unconventional Montney gas play is a large regional trend from west central Alberta into northeast British Columbia. Recent drilling success has occurred mostly in British Columbia and has been enhanced with the application of new horizontal technology. Land acquisition, land transactions and the drilling of Montney prospects has been moving in a northwesterly direction. One Montney well and two deeper prospects have been drilled in the immediate area of the Company's Farrell Creek lands and all three appear to be successful. Additional deep test wells in the area have recently been licensed.

In order to accelerate the drilling and evaluation of the Gething Formation on the Company's lands, the Company is pursuing a similar joint venture arrangement covering its shallow rights to the base of the Cadomin/Nikanassin Formation.

Bittern Lake, Alberta:

In 2005 and 2006 the Company drilled four and completed two Horseshoe Canyon wells on these 50% joint venture lands. After initial positive indications formation water production increased and the wells were shut in. The Company has had no activity in the Bittern Lake area in 2007. Due to the lack of availability of a sizable land base for development on reasonable terms, the Company plans to farm out or dispose of these lands.

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Isk Wollastonite, British Columbia:

The Company holds a 100% undivided interest, subject to a 10% net profit interest, in a mineral claim covering 450 hectares of land in the Iskut River area of the Liard Mining Division, British Columbia (the "Isk Wollastonite Mineral Property"). The Company determined that the Isk Wollastonite Mineral Property contains significant reserves, but is 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 the impairment of the Isk Wollastonite Mineral Property to \$1.

No field work has been conducted at the Isk Wollastonite mine site during 2007. The Company will continue to pursue farming out the mineral claim to third parties.

Reserves

The Company has no proved or probable natural gas reserves at December 31, 2007. The Company's Statement of Reserves Data and Other Oil and Gas Information is incorporated in the Company's Annual Information Form dated April 22, 2008.

Selected Annual Information

For the years ended or as at December 31	2007	2006	2005
Total revenues	\$ 90,522	\$ 277,305	\$ 499,089
Net loss after income taxes	\$ (875,564)	\$ (1,075,215)	\$ (3,806,416)
Net loss per share (basic & diluted)	\$ (0.03)	\$ (0.04)	\$ (0.16)
Total current assets	\$ 1,205,479	\$ 3,455,043	\$ 11,764,255
Total assets	\$ 38,748,627	\$ 36,249,029	\$ 34,011,298
Total current liabilities	\$ 872,444	\$ 857,202	\$ 3,722,768
Total long term liabilities	\$ 198,685	\$ 692,650	\$ 1,260,395

Significant items affecting results over the past three years

During the three year period ended December 31, 2007, the Company had no operating revenue and is considered to be in its development stage of operations. Reported revenue during the three years includes interest on cash deposits and management fees under a former joint venture agreement. The greater amount of reported revenue in 2005 was the result of significantly higher average cash balances during that year plus management fees from a joint venture which commenced in 2005. In 2006 and 2007, average cash balances were lower and the management fee arrangement terminated at the end of the first quarter 2006.

The fair value of stock options is measured at the grant date and charged to earnings over the vesting period with a corresponding increase in contributed surplus. The number of stock options issued in a period, the vesting provisions of such options and the historic volatility of the Company's share price influence the amount of stock-based compensation expense in current and future periods. The compensation amount for stock options charged against earnings in 2007 was \$318,710 (2006: \$642,890 and 2005: \$1,845,184).

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In 2003, the Company granted share appreciation rights (“SARs”) entitling the holders to cash payments equal to the excess of the then current price of the common shares (to a maximum of \$3.65) over the exercise price of the right. The provision for the potential liability associated with SARs was calculated quarterly over the three year vesting period of these rights based on the closing price of the Company’s shares. The compensation cost was charged to stock-based compensation expense on a straight-line basis over the vesting period with a corresponding increase in accrued liabilities and subsequently has been adjusted upward or downward based on movement of the price of the Company’s shares during the period. The holder’s right to exercise vested SARs is conditional upon the Company achieving certain production or profit thresholds. Total compensation recovery for SARs for 2007 was \$516,000 (2006: recovery of \$642,000 and 2005: expense of \$330,667).

During the fourth quarter of 2005, the Company expended \$1,121,164 completing and production testing two test wells at Farrell Creek for conventional gas in the Bluesky Formation and expended a further \$51,744 in early 2006 to conclude these activities. Although these wells continue to be prospective for shale gas in the Gates and Moosebar Formations and natural gas from coal and shale in the Gething Formation, it was determined that the Bluesky Formation does not contain commercially recoverable quantities of hydrocarbons, thus the Company recorded an impairment charge equal to the above amounts in 2005 and 2006. The Company has made no further impairment provision for 2007 relating to the Bluesky completion costs.

Revenue

Revenues represent interest on cash deposits and management fees under a former joint venture agreement. Revenues earned from management fees during 2007 were \$Nil (2006: \$45,000 and 2005 \$180,000). The Company does not have any natural gas revenue at this time.

General and Administration Expenses

For the years ended December 31	2007	2006	2005
Consulting fees	\$ 470,540	\$ 284,089	\$ 245,452
Salaries and benefits	775,907	931,467	861,460
Other general and administrative	519,738	638,058	508,151
	<u>1,766,185</u>	<u>1,853,614</u>	<u>1,615,063</u>
Less: capitalized and other costs	(660,674)	(621,222)	(648,911)
	<u>1,105,511</u>	<u>1,232,392</u>	<u>966,152</u>
Stock-based compensation	(197,290)	4,782	2,175,851
	<u>\$ 908,221</u>	<u>\$ 1,237,174</u>	<u>\$ 3,142,003</u>

Consulting fees for 2007 increased by 66% from 2006 due to additional engineering work relating to the enhancement of the Gething Formation at Farrell Creek. In 2007, the Company continued consulting agreements with a senior officer of the Company, a financial advisor, a land consultant, and a computer network maintenance company.

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Salary and benefits declined by 17% during 2007 compared with 2006, with the decrease being attributable to reductions in drilling and completion staff, offset by the increase noted above in outside engineering consulting fees. The Company capitalizes salaries and benefits associated with staff directly related to exploration activities.

During 2007, the Company capitalized a total of \$644,675 (2006: \$604,174 and 2005: \$628,218) of general and administration expenses directly related to exploration activities, thus included as part of the property, plant and equipment costs recorded by the Company. The other costs in 2007 of \$15,999 (2006: \$17,048 and 2005: \$20,693) relate to consulting fees incurred in relation to equity instruments issue costs, and are therefore recorded by the Company as a reduction of shareholders' equity.

As discussed above in Selected Annual Information beginning on Page 3, stock-based compensation resulted in a net recovery in 2007 compared with net expense charges in the same periods for both 2006 and 2005. See Summary of Quarterly Results on Page 6 for further analysis of the effect on stock-based compensation on the overall results of the Company. The closing price of \$0.51 per share on the TSX Venture Exchange on December 31, 2007 was down significantly from \$1.37 per share at December 29, 2006. Stock-based compensation is expected to return to a net expense position in the first half of 2008, in part due to a recovery in the Company's stock to a closing price of \$1.09 per share at April 22, 2008.

Other General and Administration Costs

For the years ended December 31	2007	2006	2005
Professional fees	\$ 90,071	\$ 129,186	\$ 127,966
Investor relations & filing fees	96,466	184,276	74,866
Office premises & insurance	214,095	162,110	166,297
Office supplies	65,446	88,960	87,472
Staffing costs	49,720	43,564	30,754
Other	3,940	29,962	20,796
	<u>519,738</u>	<u>638,058</u>	<u>508,151</u>
Less: capitalized costs	<u>(28,235)</u>	<u>(44,960)</u>	<u>(39,381)</u>
	<u>\$ 491,503</u>	<u>\$ 593,098</u>	<u>\$ 468,770</u>

Professional fees have declined by 30% in 2007 compared to 2006 due to a decrease in legal fees, related purely to a decline in the number of corporate matters requiring advice or assistance from the Company's legal counsel.

Investor relations fees were higher in 2006 compared with 2007 due to \$67,136 of additional design and investor relations services commissioned by the Company.

Office premises costs were 32% higher in 2007 compared to 2006 due to higher net rents and increases in insurance and office operating costs. Office related expenses are anticipated to continue to increase over the next three years due to the tight office market rental conditions in Calgary and the terms of the Company's existing sublease agreement.

Staffing costs increased in 2007 and 2006 due principally to severance-related costs associated with former employees.

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Other expenses for 2007 are negligible. In 2006 and 2005, other costs included non-deductible (for tax purposes) interest related to the timing of exploration expenditures required under flow-through share look-back rules.

Summary of Quarterly Results

Net results prior to income taxes from the beginning of 2005 were:

<u>Earnings (loss) by quarter</u>	<u>2007</u>		<u>2006</u>		<u>2005</u>	
	<u>Amount</u>	<u>Per Share (basic & diluted)</u>	<u>Amount</u>	<u>Per Share (basic & diluted)</u>	<u>Amount</u>	<u>Per Share (basic & diluted)</u>
First Quarter	\$ (279,955)	\$ (0.01)	\$ (975,817)	\$ (0.04)	\$ (1,094,574)	\$ (0.05)
Second Quarter	(150,227)	-	31,536	-	(745,055)	(0.03)
Third Quarter	(42,936)	-	174,092	0.01	(469,598)	(0.02)
Fourth Quarter	(402,446)	(0.02)	(305,026)	(0.01)	(1,497,189)	(0.06)
Loss before income taxes	<u>\$ (875,564)</u>	<u>\$ (0.03)</u>	<u>\$ (1,075,215)</u>	<u>\$ (0.04)</u>	<u>\$ (3,806,416)</u>	<u>\$ (0.16)</u>

For each period up to and including December 31, 2007, the existence of stock options and warrants affected the calculation of diluted shares outstanding. As the effect of this dilution is to reduce the reported loss per share, diluted loss per share information has not been shown.

In 2007, the Company 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 were renounced to investors in the year of issue. At December 31, 2007, the Company had estimated tax assets of \$2,400,073 (2006: \$2,865,567; and 2005: \$2,800,864) against which a valuation allowance has been applied. The tax assets are based upon estimated income tax pools at December 31, 2007 of \$46,926,747 (2006: \$41,022,783; and 2005: \$29,314,160). When the expenditures are renounced, share capital is reduced and future income tax recoveries are increased by the estimated value of the renounced tax deductions. The Flow-Through Share issues that occurred in 2007 will result in a recovery of future income taxes, however such recovery will not be booked until 2008 as that is the date of the actual renouncement filings with the government authorities.

As discussed previously, stock-based compensation expense for stock option grants and SARs contributed significantly to the variability of the Company's income and losses during the last twelve quarters. The SARs issued to two officers and a senior employee in August 2003 are now fully vested and changes in the value of the Company's shares have an immediate impact on the quarterly provision for this conditional liability. Excluding the effects of stock-based compensation, the Company's pre-tax losses by quarter would have been:

Loss by quarter prior to stock-based compensation expense

	<u>2007</u>	<u>2006</u>	<u>2005</u>
First Quarter	\$ (299,988)	\$ (216,771)	\$ (174,540)
Second Quarter	(235,382)	(277,597)	(178,745)
Third Quarter	(236,982)	(257,468)	(21,039)
Fourth Quarter	(300,502)	(318,597)	(1,256,241)
Loss before income taxes	<u>\$ (1,072,854)</u>	<u>\$ (1,070,433)</u>	<u>\$ (1,630,565)</u>

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Also, as discussed previously, the fourth quarter of 2005 includes an impairment charge of \$1,121,164 relating to completion work on the Bluesky Formation at Farrell Creek that proved to be uneconomic.

Fourth Quarter Results

Fourth quarter results for each of the past three years are as follows:

For the three months ended December 31	2007	2006	2005
Revenue			
Interest and other income	<u>\$ 19,410</u>	<u>\$ 41,545</u>	<u>\$ 152,554</u>
Expenses			
Consulting fees	38,955	50,104	46,741
Salaries and benefits	128,923	127,266	96,371
Other general administration	156,620	165,194	131,971
Stock-based compensation	101,944	(13,571)	240,947
Accretion expense	(16,144)	4,931	1,192
Impairment of completion costs	-	-	1,121,164
Amortization	<u>11,558</u>	<u>12,647</u>	<u>11,357</u>
	<u>421,856</u>	<u>346,571</u>	<u>1,649,743</u>
Net Loss	<u>\$ (402,446)</u>	<u>\$ (305,026)</u>	<u>\$ (1,497,189)</u>

During the fourth quarter of 2007 the Company earned \$19,859 (2006: \$56,179 and 2005: \$80,935) in interest revenue from cash deposits. Revenues earned from management fees during the fourth quarter of 2007 were \$Nil (2006: \$Nil and 2005: \$45,000).

Consulting fees, prior to capitalization, in the fourth quarter of 2007 were comprised principally of \$59,445 for additional engineering work on the Gething Formation completion techniques and designs; \$33,633 in financial consulting expenses; and \$21,827 relating to land and investor relations consulting services.

Other general and administration expenses in the fourth quarter of 2007 were 5% lower than the comparative 2006 period due to a decrease in investor relations fees and shareholder costs, offset by nominal increases in office supplies expense and staffing costs.

Stock-based compensation is composed of expenses related to the contingent SARs liability and amortization of the calculated fair value of stock options granted in current and prior periods. In the fourth quarter of 2007, the SARs and stock option components were a recovery of \$228,000 and expense of \$329,944 respectively (2006: recovery of \$156,000 and expense of \$146,115 respectively, plus a recovery of \$3,686 relating to Performance Units stock-based compensation; and 2005: recovery of \$82,333 and expense of \$323,280 respectively). Volatility in stock-based compensation expense from period to period is, in the case of SARs related to share price movements and, in the case of stock options related to the issuance of new options or the cancellation or modification of previously issued options.

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The net loss of \$402,446 for the fourth quarter of 2007 was up slightly from \$305,026 in the fourth quarter of 2006 and down from \$1,497,189 in the fourth quarter of 2005 when the Company took an impairment charge of \$1,121,164 related to Bluesky completion costs.

Capital expenditures in the fourth quarter of 2007 were \$1.4 million compared to \$2.1 million in 2006 and \$4.0 million in 2005. Field activities in the last quarter of 2007 included the completion of the d-093 test well and the operating and on-going production testing of those wells comprising the Company's pilot production program which were not shut-in due to regulatory flaring limitations.

Liquidity and Capital Resources

The Company's capital program for each of the last three years is detailed in the following table:

For the years ended December 31	2007	2006	2005
Lease acquisitions and retentions	\$ 84,453	\$ 44,629	\$ 2,209,791
Geological and geophysical	20,146	21,773	106,809
Drilling and completion	4,014,467	9,902,400	6,269,030
Capitalized overhead	644,675	604,174	628,218
Total petroleum and natural gas	<u>4,763,741</u>	<u>10,572,976</u>	<u>9,213,848</u>
Office equipment and furnishings	<u>3,251</u>	<u>15,058</u>	<u>68,378</u>
Total capital expenditures	<u>\$ 4,766,992</u>	<u>\$ 10,588,034</u>	<u>\$ 9,282,226</u>

For the first half of 2008, the Company has a base case capital budget of \$3.9 million including a portion of the \$4.0 million AFE for the tie-in of the Company's pilot program to the Spectra Energy sales pipeline and an estimated \$280,000 for capitalized overhead. The Company's budget is reviewed and approved by the Board of Directors on a quarterly basis. The budget for field testing activities for the first half of 2008 is \$0.6 million.

Cash administration expenses (G&A excluding stock based compensation) for 2008 are expected to be approximately \$1.8 million before capitalization of exploration related overhead; approximately the same as 2007 and 2006. Revenue from interest on cash balances is budgeted at \$121,000. The Company has not budgeted for any cash flow from operations during the first half of 2008.

At December 31, 2007, the Company had working capital of \$0.3 million, consisting of cash in the amount of \$1.1 million, accounts receivable and prepaid expenses of \$0.1 million, net of accounts payable and accrued trade liabilities of \$0.9 million. The accounts payable and accrued trade liabilities relate to field work at Farrell Creek, British Columbia that occurred during the fourth quarter of 2007. The Company has no bank indebtedness and has no credit agreements to borrow money in place at this time.

On February 19, 2008, the Company issued 11,220,000 Units at \$0.50 per Unit for proceeds of \$5.3 million net of fees. Each Unit consisted of one common share and one-half of one share purchase warrant. Each whole warrant entitles the holder to purchase one share for two years at an exercise price of \$0.80 per share. If exercised, the proceeds from these warrants will provide the Company with an enhanced ability to fund any further capital programs in 2008.

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The Company has raised a total of \$47.9 million, after share issue costs, through several private placements and the exercise of warrants and options during the past five years and through the date of this report. At April 22, 2008 there were 1,526,500 warrants outstanding with an exercise price of \$1.10 per share that will expire July 18, 2008 and 5,610,000 warrants outstanding with an exercise price of \$0.80 per share (see above) that will expire February 18, 2010.

The Company's working capital of \$0.3 million at December 31, 2007 combined with the net \$5.3 million raised through the February 2008 private placement above are considered to be sufficient to cover administrative costs of \$0.9 million and the \$3.9 million base case capital budget for the first half of 2008. Additional equity capital may be required to complete any further planned capital programs for the remainder of 2008, such as additional drilling activity and the resultant tie-ins. A portion of future capital requirements may be funded from the exercise of existing share purchase warrants (see above) or possibly through a farmout involving the Company's shallow rights, which is currently being pursued.

Business Risks

Productivity

A material risk facing the Company is the productive capability of the discovered coal and shale resource in the Gething Formation on the Company's existing land base and the Company's ability to extract this discovered natural gas resource economically. The Company has made significant progress in developing an economic well completion and production system and will continue to utilize the knowledge, experience and technology available in the service sector to improve the productivity of the Gething Formation in this emerging gas basin in northeast British Columbia.

With rising natural gas prices and the application of new technology, many new unconventional reservoirs are now producing large volumes of natural gas economically. To accelerate the development of the optimal completion and production methods for the Gething Formation, the Company is pursuing a joint venture on its shallow rights at Farrell Creek.

Exploration

The Company has begun to explore the resource potential of the geological formations below the base of the Cadomin/Nikanassin zone with an initial focus on the Montney Formation. Only a small number of wells have been drilled into these deeper formations in the vicinity of the Company's lands and public information is available on just a small number of these wells. Exploration risk includes both determining the existence of commercial qualities of hydrocarbons and the ability to recover any discovered resource economically. Recognizing the technical expertise, operating capability and financial resources needed to explore these deeper formations, the Company has farmed out the initial exploration of its deep rights at Farrell Creek, British Columbia to a capable partner with the experience and financial ability to accept the exploration risk inherent in the deeper formations.

Financial Resources and Liquidity

The Company'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 continued support of its shareholders, favourable capital market conditions and commodity prices, obtaining additional equity financing, converting discovered resources into economically recoverable reserves, and ultimately, generating revenues sufficient to cover operating costs and capital requirements.

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To minimize financial risk, the Company pre-funds all capital commitments in the equity markets and does not utilize debt at this early stage of development. Included in commitments is the minimum administrative and operating cost to see the Company through anticipated equity market or commodity price cycles.

Commodity Prices

The Company'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 Company's investment decisions and once natural gas production is established, it will impact the Company's revenue. The Company considers publically available price forecasts for natural gas in its evaluation of investment economics and returns.

Operating Capability

The Company is pursuing large unconventional natural gas projects that if successful will require operating staff and experience to fully develop. The Company 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 Company has entered into a joint venture covering the Company's deep rights pursuant to which a party with the necessary experience and skills will assume operatorship. A similar joint venture is planned covering the Company's shallow rights.

Land Acquisition and Tenure

Rights to explore for and extract hydrocarbons, are generally acquired from the Crown or private parties and requires 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 Company 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 Company acquired its existing mineral rights primarily from the Province of British Columbia during the last five years and must make drilling expenditures on these lands during 2008 and 2009 in order to retain a substantial portion of these mineral rights. To reduce the risk of losing its current mineral rights, the Company has farmed out the majority of its deep rights in return for drilling expenditures on its lands. A similar farmout of shallow rights is planned. This would allow the Company to allocate its financial resources to additional land acquisition rather than drilling and development.

Environment and Public Policy

The exploration, development and production activities of the Company 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 components expected to be produced during production operations that would impact the environment are relatively small amounts of saline water and carbon dioxide. The saline water is currently re-injected into deep geologic formations at a commercial facility and in future, will be re-injected using Company owned facilities. Methods to capture and store or use carbon dioxide in commercial applications are being undertaken by the industry and the Company is monitoring these and regulatory developments in order to plan a mitigating strategy.

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Disclosure Controls and Procedures and Internal Controls

Disclosure Control Risk

Disclosure controls and procedures have been designed to ensure that information required to be disclosed by the Company is accumulated and communicated to management as appropriate to allow timely decisions regarding required disclosure. The Company's Chief Operating Officer and Chief Financial Officer (acting in the capacity of Chief Executive Officer) have concluded, based on their evaluation of the effectiveness of the Company's disclosure controls and procedures as of December 31, 2007, that disclosure controls and procedures provide reasonable assurance that material information is made known to them by others within the Company subject to the reportable weakness identified below regarding segregation of duties. However, a control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met.

Internal Control Risks

Management is responsible for certifying the design of the Company's internal control over financial reporting ("ICFR") as required by Multilateral Instrument 52-109 – "Certification of Disclosure in Issuers Annual and Interim Filings". Our ICFR is intended to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian generally accepted accounting principals (GAAP). ICFR includes those policies and procedures that establish the following:

- maintenance of records in reasonable detail, that accurately and fairly reflect the transactions and dispositions of our assets;
- reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with GAAP;
- receipts and expenditures only being made in accordance with authorizations of management and the Board of Directors; and
- reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements.

Because of its inherent limitations, ICFR may not prevent or detect misstatements. Also, the effectiveness of ICFR is subject to the risk that controls may become inadequate because of changes in condition, or that the degree of compliance with the policies or procedures may deteriorate. Management, including the Chief Operating Officer and the Chief Financial Officer (acting in the capacity of Chief Executive Officer), carried out the design of the Company's internal controls over financial reporting and concluded, subject to the inherent limitations noted above, the Company has sufficient controls to meet the requirements as stated above and that one reportable weakness existed, at December 31, 2007, as detailed below.

Segregation of Duties

Segregation of duties is a basic, key internal control and one of the most difficult to achieve in a small company. It is used to ensure that errors or irregularities are prevented or detected on a timely basis by employees in the normal course of business. Due to limited resources, a complete segregation of duties within the Company's operating and accounting groups can not be fully achieved. The result is that the Company is highly reliant on the qualifications, experience and integrity of its staff and on the performance of mitigating procedures during its financial close processes in order to ensure the financial statements are presented fairly in all material respects. No significant change in the current control process occurred in 2007 nor is any change planned until the Company achieves production and cash flow

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For the year ended December 31, 2007

from operations. Management will continue to review existing mitigating controls and, if appropriate, implement changes to its internal control processes whereby more effective mitigating controls will be adopted.

Critical Accounting Policies

Reference should be made to the Company's significant accounting policies contained in Note 2 of the Company's audited financial statements for the year ended December 31, 2007. These accounting policies can have a significant impact on the financial performance and financial position of the Company.

Off Balance Sheet Arrangements

The Company has not entered into any off balance sheet arrangements.

Financial Instruments

The Company's financial instruments consist of cash and cash equivalents, accounts receivable, accounts payable and accrued expenses. It is management's opinion that the Company is not exposed to significant interest, currency or credit risk arising from its financial instruments and that their fair values approximate their carrying values due to their short term nature, unless otherwise noted.

Effective January 1, 2007, the Company adopted the following new Canadian Institute of Chartered Accountants accounting pronouncements: *Section 3855, Financial Instruments – Recognition and Measurement; Section 3861, Financial Instruments – Disclosure and Presentation; Section 1530, Comprehensive Income; Section 3865, Hedges; Section 1506, Accounting Changes; and Section 3251, Equity*. The adoption of these new standards results in no significant changes to the audited financial statements of the Company. See Note 2 to the audited financial statements for a description of the significant accounting policies followed by the Company.

Future Changes in Accounting Policies

The following is an overview of accounting standard changes that the Company will be required to adopt in the near future:

CICA Handbook: *Section 1535, Capital Disclosures; Section 3862, Financial Instruments – Disclosures; and Section 3863 Financial Instruments – Presentation*.

Section 1535 establishes disclosure requirements about an entity's capital and how it is managed. The purpose will be to enable users of the financial statements to evaluate the entity's objectives, policies and processes for managing capital.

Sections 3862 and 3863 will replace Section 3861, *Financial Instruments – Disclosure and Presentation*, revising and enhancing its disclosure requirements, and carrying forward unchanged its presentation requirements. These new sections will place increased emphasis on disclosures about the nature and extent of risks arising from financial instruments and how the entity manages those risks.

These new standards are effective for fiscal years beginning on or after October 1, 2007 and therefore the Company plans to adopt them for its next fiscal year beginning on January 1, 2008.

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Related Party Transactions

During 2007, 2006 and 2005, the Company had transactions with directors and a former officer of the Company, persons related to them or companies controlled by them in the normal course of business as follows:

	2007	2006	2005
Consulting fees	\$ 111,700	\$ 97,650	\$ 79,450

Consulting fees in 2007 included \$111,700 (2006: \$90,450 and 2005: \$79,450) paid or payable to a director and senior officer of the Company and \$Nil (2006: \$7,200 and 2005: \$Nil) to a former officer of the Company. Accounts payable at December 31, 2007 includes \$17,928 (2006: \$14,157 and 2005: \$11,848) due to a director and senior officer for consulting fees earned and \$Nil (2006: \$5,350 and 2005: \$Nil) due to a former officer of the Company for consulting fees.

Transactions with related parties are recorded at cost, which represent exchange amounts for services provided. In addition during 2007, certain directors, relatives of directors, or companies controlled by directors subscribed for 20,250 (2006: Nil and 2005: 14,354) shares or units in private placement offerings of the Company under the same terms as other investors.

Since December 31, 2007 to the date of this report, the Company has continued to contract with a director to provide management services as a consultant.

Share Capital

Subsequent to the year-end, the Company issued 11,220,000 Units at \$0.50 per Unit. Each Unit consists of one common share and one-half of one share purchase warrant. Each whole warrant entitles the holder to purchase one share for two years at an exercise price of \$0.80 per share. Prior to expiry, if the common shares of the Company close at a price of \$1.20 per share or greater for twenty consecutive trading days, then the Company shall have the option upon thirty days written notice to require the exercise of the warrants by the end of such period at which time any unexercised warrants shall expire. The fair value of the warrants was estimated at the date of closing, February 19, 2008, using the Black-Scholes pricing model, under which the Company assigned a value of \$0.18 per whole warrant or \$1,311,618 of the Unit proceeds to warrants, with the remaining \$4,298,382 of the Unit proceeds assigned to common shares.

The Company has authorized share capital of an unlimited number of common shares of no par value. Since December 31, 2007 to the date of this report, the Company has issued 225,000 common shares for the exercise of stock options. During this same period, the Company has granted 50,000 options to purchase common shares to a land consultant; 147,000 options to non-executive employees of the Company, 115,000 options to executive employees of the Company, 550,000 options to independent directors and officers who are also directors of the Company and 25,000 options to a contract consultant. The options granted to directors and senior officers as well as to the Land Consultant are subject to shareholder approval which will be sought at the next Annual and Special General Meeting of Shareholders. The issued share capital as at April 22, 2008 consists of 44,028,082 common shares. In addition, the Company has 7,136,500 warrants and 3,097,000 stock options outstanding as at April 22, 2008 of which 625,000 are subject to shareholder approval.

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Commitments

The Company has entered into an office sub-lease agreement which expires on May 30, 2011. Under the terms of the sub-lease agreement, the Company is obligated to pay base annual rent of \$28.00 per square foot on 6,793 square feet as well as its share of the operating costs. The Company has an option, upon six months notice, at December 31, 2008 to terminate the sub-lease agreement without penalty.

Corporate Information

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