



MANAGEMENT DISCUSSION AND ANALYSIS

For the three and twelve month periods ended December 31, 2016

The following management discussion and analysis (“MD&A”) of the financial conditions and results of operations of Canadian Spirit Resources Inc. (“CSRI” or the “Corporation”) for the three and twelve months ended December 31, 2016 should be read in conjunction with the audited financial statements for the year ended December 31, 2016 prepared under International Financial Reporting Standards (“IFRS”), as issued by the International Accounting Standards Board and the International Financial Reporting Interpretations Committee. The financial data presented herein is in accordance with IFRS and all amounts are presented in Canadian dollars. This MD&A has been prepared by management and includes information up to April 25, 2017, the date of review and approval by the Corporation’s Board of Directors.

Corporate Overview

CSRI is a natural resources company whose shares are listed under the trading symbol ‘SPI’ on the TSX Venture Exchange (the “Exchange”) focused on the exploration and development of opportunities in the unconventional natural gas resource sector of the energy industry. Operating on its own 100% working interest lands, and together with its joint venture partner, Canbriam Energy Inc. (“Canbriam”), the Corporation’s principal activity is exploring and developing the productive capability of its Montney unconventional natural gas and natural gas liquids play in the Farrell Creek/Altares area of northeastern British Columbia. The Corporation commenced natural gas production from the Montney Formation in early 2011.

Selected Quarterly Information

The following is a summary of the results of the Corporation for the eight most recently completed quarters (*000’s, unless otherwise indicated*):

	2016				2015			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Average sales volumes								
- natural gas (MMcf/d)	1.10	-	-	0.63	0.57	0.74	0.75	0.82
Sales price (per Mcf)	\$ 2.37	\$ -	\$ -	\$ 1.41	\$ 1.06	\$ 1.82	\$ 2.07	\$ 2.10
Total sales volumes								
- natural gas (MMcf)	101.1	-	-	57.7	52.7	68.2	67.8	73.9
Natural gas sales	\$ 240	\$ -	\$ -	\$ 84	\$ 54	\$ 123	\$ 140	\$ 154
Operating netbacks	\$ 190	\$ (54)	\$ (80)	\$ (20)	\$ (20)	\$ 21	\$ (3)	\$ 31
Net cash flows from operating activities	\$ (133)	\$ 203	\$ (164)	\$ (407)	\$ (213)	\$ (144)	\$ (269)	\$ (203)
Net income (loss)	\$ (29,356)	\$ 111	\$ (682)	\$ (142)	\$ (376)	\$ (978)	\$ (473)	\$ (421)
Net income (loss) per share	\$ (0.19)	\$ 0.00	\$ (0.01)	\$ (0.00)	\$ (0.00)	\$ (0.01)	\$ (0.01)	\$ (0.00)
Net working capital	\$ 1,156	\$ 1,214	\$ 1,259	\$ 1,232	\$ 3,142	\$ 1,772	\$ 2,144	\$ 2,648
Total assets	\$ 45,673	\$ 74,562	\$ 74,485	\$ 75,649	\$ 73,618	\$ 71,738	\$ 72,722	\$ 73,257
Shareholders' capital	\$ 42,978	\$ 71,859	\$ 71,727	\$ 71,772	\$ 70,886	\$ 69,311	\$ 70,262	\$ 70,687
Common shares outstanding	156,759	152,592	152,592	146,192	141,367	128,867	128,867	128,867
Gross capital expenditures	\$ 183	\$ 275	\$ 391	\$ 3,096	\$ 228	\$ 200	\$ 134	\$ 235

Note:

1. Quarterly amounts may not total or calculate to year-to-date amounts due to rounding.

The Corporation has not added any new production on its joint venture lands in the last five years. Production has remained relatively constant due to the lower decline rate associated with the wells being in the stable stages of their production life. Price volatility, due to excess North American gas supply over the past few years, has had a significant negative impact on Canadian natural gas producers. The average natural gas sales price the Corporation realized steadily fell from a high of \$3.17 per Mcf in the fourth

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quarter 2014 to \$1.41 per Mcf in the first quarter 2016. Further declines to \$0.93 per Mcf in the month of March 2016 influenced CSRI and Canbriam to shut-in all joint venture natural gas production at Farrell Creek/Altares effective March 31, 2016. Natural gas prices at Station 2 rebounded in the latter part of 2016, averaging \$2.37 per Mcf in the fourth quarter 2016; as such, natural gas production was resumed at Farrell Creek/Altares effective October 4, 2016.

On August 26, 2016, the Corporation agreed to a proof of loss settlement of an operator's extra expense/well control insurance claim for the c-69-H/94-B-1 well drilled in the first quarter 2016 for an amount of \$425,000. The settlement proceeds were received on September 21, 2016. Together, the settlement and subsequent receipt of the insurance proceeds are considered a separate economic event from the drilling of the well, and are therefore accounted for separately from the well drilling costs. As a result, an amount of \$425,000 was recorded in the third quarter 2016 as other income, while the original cost to drill the well in the first quarter 2016 remains capitalized within exploration and evaluation assets.

The Corporation performed impairment tests as at December 31, 2016 to assess the recoverable value of E&E assets of both the Corporation's Farrell Creek Montney Formation project and the Farrell Creek Gething Formation project. Estimates of fair value less costs of disposal for the Montney E&E assets were determined in part using merger and acquisition metrics, prevailing land tender prices in the Farrell Creek area, as well as reserve values as at December 31, 2016 prepared by independent reservoir engineering consultants. Based on these and other factors, the estimated recoverable amount of the Montney E&E assets was calculated to be greater than the carrying value and as such there was no impairment. However, the estimated recoverable amount of the Gething E&E assets, determined in part by project status as well as feasible future development opportunities available, was found to be impaired as compared to the carrying value. As such, an impairment of natural gas costs for the Gething E&E assets of \$29.1 million was recorded in the statement of operations as at December 31, 2016.

The lack of pipeline take away capacity for the rapidly growing natural gas production that has been discovered in the Montney Formation in northeastern British Columbia has resulted in large volumes of natural gas being trapped behind the sales point at Station 2, the benchmark pricing point on the Spectra pipeline system. This has placed further downward pressure on prices for natural gas producers in northeastern British Columbia. On March 20, 2017, TransCanada Corporation filed a variance application with the National Energy Board to proceed with construction of the North Montney Mainline project in northeastern British Columbia. TransCanada Corporation has secured new 20 year commercial contracts with 11 shippers for approximately 1.5 Bcf per day of firm service. The North Montney Mainline will cross CSRI's lands and provide new egress for natural gas production into Alberta and other North American markets. Construction is to begin in the first half 2018 with initial startup in April 2019.

Natural Gas Properties

Farrell Creek/Altares: Operational Highlights

Despite difficult equity markets, the Corporation raised a total of \$4.6 million of equity capital in the period from December 2015 to December 2016. The principal use of the proceeds was to drill a 100% working interest vertical stratigraphic test well and perform a pressure test workover at c-69-H/94-B-1 in West Farrell Creek for land retention and resource delineation purposes.

The c-69-H/94-B-1 well was successfully drilled and cased, and was rig released on March 6, 2016, at a final total depth of 2,762 metres. The tenure on 8.35 sections of lands, CSRI (8 sections at 100%) and joint venture (1 section at 35%), was extended for an additional 10 years. While drilling through the Doig and Montney Formations, extremely high pressures were encountered resulting in increased costs for well control in order to reach the planned total depth. The Corporation submitted a claim to its insurance provider and on September 21, 2016 received a payment of \$425,000 to compensate for the extra costs associated with drilling the well.

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The Corporation perforated three zones in the Montney Formation in the c-69-H/94-B-1 well. Pressure recorders were placed across these perforations and were retrieved during the third quarter 2016. The pressures recorded in the Montney formation were regionally over pressured but not to the extreme extent seen while drilling the well. Due to the well bore constraints imposed by the placement of additional casing run to manage the extremely high pressures encountered while drilling, the well is no longer a viable option for use as a horizontal well candidate. The well will be abandoned prior to June 30, 2017 in order to preserve the Canadian Exploration Expense status of the funds raised to drill the well (see *Common Shares* on page 10).

Fresh Water Sourcing

The Williston Reservoir Water Pipeline Project (25% owned by CSRI; operated by Canbriam) is able to deliver up to 10,000 m³/d of fresh water from the Williston Reservoir to the Farrell Creek/Altares area in northeastern British Columbia on a year-round basis until December 31, 2031. The project will reduce, by approximately \$500,000 per well, the cost of delivering a secure supply of fresh water used in the fracture stimulation of both vertical and horizontal wells and will lessen the impact on local communities and infrastructure by reducing the need to transport fresh water overland by truck to drilling sites.

Montney Formation Reserves

An independent reserve evaluation covering the Montney Formation at Farrell Creek/Altares was prepared by GLJ as at December 31, 2016 in accordance with the reserves definitions, standards and procedures contained in the Canadian Oil and Gas Evaluation Handbook. The evaluation is based on CSRI's corporate plan to drill and complete four additional Montney wells over the next few years to further develop its Montney lands at Farrell Creek/Altares. Proceeding with full development will be contingent upon factors such as access to capital, economic price conditions, infrastructure, and environmental and regulatory matters. For more information, the Corporation's Form 51-101F1 Statement of Reserves Data and Other Oil and Gas Information and related documents have been filed on SEDAR at www.sedar.com and on the Corporation's website at www.csri.ca

SUMMARY OF RESERVES AND NET PRESENT VALUE ("NPV") AS AT DECEMBER 31, 2016

	Shale Gas ⁽¹⁾		Barrels of Oil Equivalent ⁽⁵⁾		NPV Discounted At 10% ⁽⁶⁾
	Gross ⁽²⁾ (MMcf)	Net ⁽³⁾ (MMcf)	Gross ⁽²⁾ (Mboe)	Net ⁽³⁾ (Mboe)	(Thousands)
PROVED ⁽⁷⁾					
Developed Producing	1,296	1,258	216	210	\$322
Total Proved	1,296	1,258	216	210	\$322
PROBABLE ⁽⁸⁾	8,410	8,077	1,402	1,355	\$1,994
TOTAL PROVED PLUS PROBABLE ⁽⁴⁾	9,706	9,335	1,618	1,556	\$2,316

Notes:

- (1) "Shale Gas" means natural gas contained in dense organic-rich rocks, including low-permeability shales, siltstones and carbonates, in which the natural gas is primarily absorbed on the kerogen or clay minerals, and that usually requires the use of hydraulic fracturing to achieve economic production rates.
- (2) "Gross Reserves" are CSRI's working interest share of the remaining reserves, before deduction of royalties.
- (3) "Net Reserves" are CSRI's working interest share of remaining reserves less all Crown royalties.
- (4) May not add due to rounding.
- (5) Barrel of oil equivalent ("boe") amounts have been calculated by using the conversion ratio of six thousand cubic feet (6 Mcf) of natural gas to one barrel of oil (1 bbl).

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- (6) Boe amounts may be misleading, particularly if used in isolation. A boe conversion ratio of 6 Mcf to 1 bbl is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead.
- (7) Proved Reserves 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.
- (8) 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.

Results from Operations

Natural Gas Production and Revenues

	<u>Three months ended December 31,</u>		<u>Twelve months ended December 31,</u>	
	<u>2016</u>	<u>2015</u>	<u>2016</u>	<u>2015</u>
Total sales volumes of natural gas (Mcf)	101,141	52,650	158,877	262,549
Average sales volumes of natural gas ⁽¹⁾				
Mcf/d	1,098	575	433 ⁽¹⁾	721
boe/d	183	96	72 ⁽¹⁾	120
Total natural gas sales (\$)	\$ 240,136	\$ 54,340	\$ 324,114	\$ 471,622
Average sales price of natural gas				
\$/Mcf	\$ 2.37	\$ 1.06	\$ 2.04	\$ 1.76
\$/boe	\$ 14.25	\$ 6.37	\$ 12.24	\$ 10.58

Note:

(1) Given that there was no production during the second or third quarters of 2016, the year-to-date daily volumes represent six months of active production reported over a twelve month period.

Production in the fourth quarter 2016 was anomalously high relative to prior quarters. With the wells being shut-in for approximately six months during the middle part of 2016, well bore pressures built up resulting in flush production. The Corporation's first month of post shut-in net production averaged 1.32 MMcf/d. Production in the first quarter 2017 has returned to pre shut-in levels.

Due to the low natural gas price environment and the focus of CSRI's joint venture partner on their own 100% working interest lands at Altares, the Corporation has not added any new production over the last five years, and is therefore subject to the inherent declines associated with each producing natural gas well. Although the rate of decline has diminished, future production additions are required to alleviate this decline.

Royalties

The five Montney Formation wells tied into the Farrell Creek/Altares Montney joint venture gas plant are all deep horizontal wells and as such, each of these producing wells qualifies for the British Columbia Government's Deep Royalty Credit Program. This Program generates up to \$2.81 million (gross) in royalty credits for each well and the royalty credits are drawn down over time as the wells produce natural gas. Commencing with the second quarter 2013, the British Columbia Government introduced a minimum 3% royalty which is applicable to wells within the Deep Royalty Credit Program. Royalty credits that were previously generated from the discontinued Summer Drilling Credit Program can be used to offset this minimum royalty. Between these two well royalty credit programs, and at the rates of production experienced to date in 2016 the Corporation will not have to actually remit any crown royalties to the British Columbia Government for the next five years or more. Royalty credits applied are accounted for as an offset against the capital costs accumulated within Property, Plant and Equipment ("P,P&E").

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Operating Netbacks

During the three months ended December 31, 2016, the Corporation applied \$3,318 (2015: \$413) of royalty credits against crown royalties that would otherwise have been payable.

For the three months ended December 31, 2016			\$/Mcf	\$/boe
Natural gas sales	\$ 240,136		\$ 2.37	\$ 14.25
Royalties expense	<u>(3,318)</u>	0.0%	<u>(0.03)</u>	<u>(0.20)</u>
Net revenue	236,818		2.34	14.05
Royalty credits applied	3,318		0.03	0.20
Operating costs	<u>(49,692)</u>		<u>(0.49)</u>	<u>(2.95)</u>
Operating netbacks	<u>\$ 190,444</u>		<u>\$ 1.88</u>	<u>\$ 11.30</u>
For the three months ended December 31, 2015			\$/Mcf	\$/boe
Natural gas sales	\$ 54,340		\$ 1.06	\$ 6.37
Royalties expense	<u>(413)</u>	0.8%	<u>(0.01)</u>	<u>(0.05)</u>
Net revenue	53,927		1.05	6.32
Royalty credits applied	413		0.01	0.05
Operating costs	<u>(74,483)</u>		<u>(1.41)</u>	<u>(8.49)</u>
Operating netbacks	<u>\$ (20,143)</u>		<u>\$ (0.35)</u>	<u>\$ (2.12)</u>

During the twelve months ended December 31, 2016, the Corporation applied \$3,850 (2015: \$18,122) of royalty credits against crown royalties that would otherwise have been payable.

For the twelve months ended December 31, 2016			\$/Mcf	\$/boe
Natural gas sales	\$ 324,114		\$ 2.04	\$ 12.24
Royalties expense	<u>(3,850)</u>	1.2%	<u>(0.02)</u>	<u>(0.15)</u>
Net revenue	320,264		2.02	12.09
Royalty credits applied	3,850		0.02	0.15
Operating costs	<u>(287,174)</u>		<u>(1.81)</u>	<u>(10.84)</u>
Operating netbacks	<u>\$ 36,940</u>		<u>\$ 0.23</u>	<u>\$ 1.40</u>
For the twelve months ended December 31, 2015			\$/Mcf	\$/boe
Natural gas sales	\$ 471,622		\$ 1.76	\$ 10.58
Royalties expense	<u>(18,122)</u>	3.8%	<u>(0.07)</u>	<u>(0.41)</u>
Net revenue	453,500		1.69	10.17
Royalty credits applied	18,122		0.07	0.41
Operating costs	<u>(443,127)</u>		<u>(1.69)</u>	<u>(10.13)</u>
Operating netbacks	<u>\$ 28,495</u>		<u>\$ 0.07</u>	<u>\$ 0.45</u>

Operating Costs

Operating costs, which have fixed and variable rate components, relate to the Corporation's share of plant maintenance, supervision and other production expenses in conjunction with the five producing Montney Formation wells at Farrell Creek/Altares. Operating costs also include transportation costs to transfer the natural gas from the pipeline system at Farrell Creek/Altares to the sales point at Spectra Station 2 and the British Columbia provincial carbon taxes.

Despite an overall decrease in operating costs from 2015 to 2016, as the tables for *Operating Netbacks* above show, total operating costs have increased on a per Mcf basis. The increase in operating costs on a per Mcf basis in 2016 is attributed to the shut-in of production from March 31, 2016 to October 4, 2016

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as well as an increase in well servicing and plant maintenance costs. As production continues to decline, the fixed component of field operations remains relatively constant and thus the per unit cost increases. In addition, lower volume throughput requires more operational attention at the Farrell Creek/Altares Montney joint venture natural gas plant, such as a continued higher level of operating costs on a gross basis due to additional costs associated with natural gas recycling at the plant due to the lower volumes.

Depletion

Depletion of Developed and Producing P,P&E is calculated using the unit of production method based on proved plus probable reserves. The depletion expense for the three and twelve month periods ended December 31, 2016 of \$124,614 and \$191,201, respectively (2015: \$60,194 and \$351,421, respectively) equates to \$1.23 and \$1.20 per Mcf, respectively (2015: \$1.14 and \$1.34 per Mcf, respectively). The reduction in depletion for the respective twelve month periods, on both a gross basis and on a per Mcf basis, is due to the shut-in of production from March 31, 2016 to October 4, 2016 (see *Natural Gas Production and Revenues* on page 4). The increase in depletion for the respective fourth quarter periods, on both a gross basis and on a per Mcf basis, is due to the resultant flush production after the wells were brought back on stream after being shut-in for the second and third quarters of 2016.

Liquidity and Capital Resources

The Corporation's capital expenditures for the three and twelve month periods ended December 31, 2016 and 2015 are detailed in the following table:

	<u>Three months ended December 31,</u>		<u>Twelve months ended December 31,</u>	
	<u>2016</u>	<u>2015</u>	<u>2016</u>	<u>2015</u>
Lease acquisitions and retentions	\$ 27,406	\$ 28,287	\$ 153,496	\$ 137,534
Geological and geophysical	1,266	-	\$ 15,416	-
Net expenditure on drilling, completion and facilities costs	291,353	143,460	\$ 3,426,629	355,160
Other capitalized amounts	<u>(137,486)</u>	<u>55,346</u>	<u>\$ 349,432</u>	<u>295,804</u>
Total natural gas expenditures	182,539	227,093	3,944,973	788,498
Computer and office equipment, furniture and fixtures	-	1,318	-	9,368
Total capital expenditures	<u>\$ 182,539</u>	<u>\$ 228,411</u>	<u>\$ 3,944,973</u>	<u>\$ 797,866</u>

From time to time, certain land leases expire thus eliminating the future economic benefits related to such leases. For the three and twelve months ended December 31, 2016, the Corporation expensed a total of \$Nil and \$255,500, respectively (2015: \$Nil and \$582,354, respectively) of land lease costs as exploration and evaluation expense.

For the three and twelve month periods ended December 31, 2016, net capital expenditures (before royalty credits earned) totaled \$0.2 million and \$3.9 million, respectively (2015: \$0.2 million and \$0.8 million, respectively), compared to an allocated budgeted capital expenditure (before royalty credits earned) of \$0.2 million and \$3.6 million, respectively (2015: \$0.2 million and \$0.6 million, respectively). For the twelve months ended December 31, 2016, the main component of the drilling, completion and facilities total of \$3.4 million were the costs related to the drilling and pressure test workover of the c-69-H/94-B-1 100% working interest vertical well for land retention and resource delineation purposes on the Corporation's western block of lands.

On August 26, 2016, the Corporation agreed to a proof of loss settlement of an operator's extra expense/well control insurance claim for the c-69-H/94-B-1 well previously drilled in February/March 2016 for an amount of \$425,000. The settlement proceeds were received on September 21, 2016. Together, the settlement and subsequent receipt of the insurance proceeds are considered a separate economic event from the drilling of the well, and are therefore accounted for separately from the well drilling costs. As a result, an amount of \$425,000 has been recorded in the third quarter 2016 as other

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income, while the original cost to drill the well in the first quarter 2016 remains capitalized within exploration and evaluation assets.

As at December 31, 2016, the Corporation had a net working capital balance of \$1.3 million consisting of cash in the amount of \$1.3 million, accounts receivable and prepaids of \$0.2 million and the current portion of unapplied royalty credits of \$0.2 million, but offset by accounts payable and other accrued liabilities of \$0.4 million.

CSRI's capital budget is approved on an annual basis, and subsequently reviewed quarterly, by the Corporation's Board of Directors. The Board of Directors has approved a base capital expenditure budget for 2017 of \$0.6 million (net), primarily for lease rental and maintenance capital, but also including an estimated \$0.3 million for capitalized overhead.

CSRI has budgeted for cash administration expenses (general and administrative expenses excluding share-based compensation) for 2017 to total \$1.1 million (a reduction of 6.2% from 2016 budgeted expenses) before capitalization of exploration and development related overhead, and has budgeted for operating netbacks from the Farrell Creek/Altare Montney operations for 2017 of \$0.2 million (2016: \$0.1 million).

Reclamation and Abandonment Management

For operations in British Columbia, the Corporation is required to provide deposits 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 the original Liability Management Rating ("LMR") review performed by the British Columbia Oil and Gas Commission ("BCOGC") in 2011, the Corporation was assessed an initial LMR amount of \$1,235,829. Up to December 31, 2016, CSRI has been assessed by the BCOGC additional cash deposit LMR amounts totaling \$432,391, bringing the total LMR amount to \$1,668,220.

In prior periods, the Corporation had in place a demand bank line of credit facility and a series of letters of credit to secure the initial LMR deposit amount. In January 2015, the line of credit was terminated and the letters of credit formerly placed with the BCOGC totaling \$1,235,829 were replaced with cash deposits. As a result, the total assessed LMR amount of \$1,668,220 as at December 31, 2016 is secured by cash deposits. Since these cash deposits are held against future abandonment and reclamation liabilities, the balance is therefore considered by management to be restricted in its use and is classified as a non-current asset.

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General and Administrative Expenses

	<u>Three months ended December 31,</u>		<u>Twelve months ended December 31,</u>	
	<u>2016</u>	<u>2015</u>	<u>2016</u>	<u>2015</u>
Consulting fees	\$ 3,376	\$ 12,250	\$ 40,089	\$ 107,755
Salaries and benefits	165,980	169,624	673,513	655,505
Other general and administrative	99,357	99,622	423,713	518,617
	<u>268,713</u>	<u>281,496</u>	<u>1,137,315</u>	<u>1,281,877</u>
Capitalized portion of general and administrative expenses	(92,291)	(74,496)	(300,068)	(350,123)
	<u>176,422</u>	<u>207,000</u>	<u>837,247</u>	<u>931,754</u>
Share-based compensation	20,208	19,634	181,042	157,528
Capitalized portion of share-based compensation	(6,299)	(6,575)	(53,404)	(50,959)
	<u>13,909</u>	<u>13,059</u>	<u>127,638</u>	<u>106,569</u>
	<u>\$ 190,331</u>	<u>\$ 220,059</u>	<u>\$ 964,885</u>	<u>\$ 1,038,323</u>

Consulting fees for the three and twelve months ended December 31, 2016 and 2015 are comprised of computer network maintenance fees, software technical support, land administration fees, economic analysis project work, geological consulting services and investor consulting fees. Consulting fees, before capitalization, have decreased by \$67,666 or 62.8% from the year ended December 31, 2015 to the year ended December 31, 2016 due to higher geological consulting fees in 2015 for a full geological review of the Corporation's leases for prospective well targeting and valuation purposes.

Salaries and benefits, before capitalization, for the twelve months ended December 31, 2016 have increased by \$18,008 or 2.7% compared with the twelve months ended December 31, 2015 due to normal annual salary increases and the higher cost of temporary administrative staffing requirements.

The Corporation capitalizes, within both Exploration and Evaluation ("E&E") assets and P,P&E, certain salary and benefit costs associated with staff directly involved in exploration and development activities. For the three and twelve month periods ended December 31, 2016, the Corporation capitalized a total of \$92,291 and \$300,068, respectively (2015: \$74,496 and \$350,123, respectively) of general and administrative expenses, including consulting fees, salaries and benefits directly related to exploration and development activities.

The granting of options to acquire 1,600,000 common shares in the twelve months ended December 31, 2016 (2015: 25,000), although offset by the decrease in the average price of the Corporation's shares on the Exchange from the twelve months ended December 31, 2015 of \$0.22 per share compared to the twelve months ended December 31, 2016 of \$0.12 per share, has caused share-based compensation, before capitalization, to increase by \$23,514 or 14.9% over those periods. For the three and twelve month periods ended December 31, 2016 the Corporation capitalized \$6,299 and \$53,404, respectively (2015: \$6,575 and \$50,959, respectively) of share-based compensation expense for those employees of the Corporation directly involved in exploration and development activities.

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Other General and Administrative Expenses

	<u>Three months ended December 31,</u>		<u>Twelve months ended December 31,</u>	
	<u>2016</u>	<u>2015</u>	<u>2016</u>	<u>2015</u>
Professional fees	\$ 24,270	\$ 14,771	\$ 124,597	\$ 117,579
Investor relations and filing fees	8,494	20,169	44,932	128,274
Directors' fees	8,000	6,000	32,000	29,000
Office premises and insurance	37,783	38,344	145,980	164,558
Office supplies and software licences	14,925	14,196	55,596	54,152
Staffing costs	5,701	5,829	19,631	20,546
Interest and other expenses	184	313	977	4,508
	<u>99,357</u>	<u>99,622</u>	<u>423,713</u>	<u>518,617</u>
Capitalized software licences	(6,599)	(6,599)	(26,397)	(26,397)
	<u>\$ 92,758</u>	<u>\$ 93,023</u>	<u>\$ 397,316</u>	<u>\$ 492,220</u>

Professional fees for the three and twelve month periods ended December 31, 2016 are comprised of legal counsel fees for corporate secretary services and various other corporate and joint venture matters, as well as the quarterly portion of annual audit and reservoir engineer fee accruals for 2016. Professional services and fees for 2016 have been held at consistent levels compared to 2015.

The decrease in investor relations and filing fees for the twelve months ended December 31, 2016 compared to the twelve months ended December 31, 2015 of \$83,342 or 65.0% is attributable to the hiring of a third party investor relations firm in 2015. The investor relations firm contract was terminated in November 2015.

Office premises and insurance expenses for the twelve months ended December 31, 2016 have decreased by \$18,578 or 11.3% compared with the twelve months ended December 31, 2015 due to a reduction in office rent due to renegotiated lease terms effective as of September 2015 (see **Commitments** on page 13).

Interest and other expenses are comprised of bank charges and interest, as well as advertising, promotional costs and charitable contributions, if any.

Critical Accounting Policies

Reference should be made to the Corporation's significant accounting policies contained in note 2 to the Corporation's audited financial statements for the year ended December 31, 2016. 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 and depreciation, the estimated costs associated with the decommissioning liability, the determination of the potential impairment of petroleum and natural gas properties and E&E assets, 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 and E&E assets, the fair value of assets and liabilities, share-based compensation, and deferred income taxes.

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Fair Value of Financial Instruments

Non-derivative Financial Instruments

Non-derivative financial instruments are comprised of cash and cash equivalents, accounts receivable, restricted deposits and accounts payable and other accrued liabilities. Non-derivative financial instruments are recognized initially at fair value including, for instruments not at fair value through comprehensive loss, any directly attributable transaction costs. Subsequent to initial recognition, non-derivative financial instruments are measured as described below.

Cash and cash equivalents are comprised of cash on hand, unrestricted term deposits held with banks, and other short-term highly liquid investments with original maturities of three months or less. Bank overdrafts and amounts owed under lines of credit, if any, that are repayable on demand form part of the Corporation's cash management whereby management has the ability and intent to net bank overdrafts against cash, and are included as a component of cash and cash equivalents, for the purpose of the statement of cash flows.

Other non-derivative financial instruments include accounts receivable and accounts payable and other accrued liabilities. Accounts receivable are measured using the effective interest rate method, less any impairment losses. Accounts payable and other accrued liabilities are initially recognized at the amount required to be paid less any required discount to reduce the payable to fair value.

The Corporation has adopted the following accounting classifications for its financial assets: cash and cash equivalents and accounts receivable are classified as loans and receivables, and restricted deposits are classified as held to maturity. The Corporation has no financial assets classified as available-for-sale. Financial liabilities include accounts payable and other accrued liabilities and are classified as other financial liabilities.

Derivative Financial Instruments

The Corporation may enter into certain financial derivative contracts in order to manage the exposure to market risks from fluctuations in commodity prices, shares prices, interest rates or foreign exchange rates. These instruments are not used for trading or speculative purposes. Debt instruments such as a convertible debenture may contain an embedded derivative. Any embedded derivatives are valued at fair value at each reporting period. Transaction costs are recognized in the statement of operations when incurred. The Corporation did not enter into any derivative financial instruments during the year.

New Accounting Policies

Reference should be made to the changes in accounting policies and practices under IFRS contained in note 3 to the Corporation's audited financial statements for the year ended December 31, 2016. In addition, as of January 1, 2017, the Corporation adopted those IFRS standards disclosed therein that became effective for annual periods commencing on or after January 1, 2017. The adoption of those standards or amendments to previous standards had no impact on the amounts recorded in the audited financial statements for the twelve months ended December 31, 2016 or on the comparative prior period. Other upcoming changes in IFRS may have a significant impact on the financial performance and financial position of the Corporation.

Share Capital

Common Shares

The Corporation has authorized share capital of an unlimited number of common shares with no par value. As at December 31, 2016, and as at the date of this report, there were 156,758,860 common shares outstanding.

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The Corporation has closed the following share issuances since January 1, 2015:

On December 11, 2015, the Corporation closed a private placement of 12,500,000 flow-through shares at a price of \$0.20 per share. The flow-through shares entitle the holder to certain income tax benefits in the form of Canadian Exploration Expense. The \$2,500,000 of total gross proceeds from the flow-through shares private placement was allocated between common shares of \$2,125,000 (calculated at the closing market price of \$0.17 on the Exchange on the trading day prior to the announcement of the private placement) and a flow-through shares premium liability of \$375,000, and was fully expended on eligible exploration costs in the first quarter 2016. Using the look-back rule, despite the expenditures being incurred in the first quarter 2016, the related resource expenditure deductions were renounced to investors effective December 31, 2015. Therefore, the flow-through shares premium liability was reversed and offset by the recording of an equivalent flow-through share premium income amount in the first quarter 2016. Share issue costs of \$193,234 were incurred in relation to the above issuance of flow-through shares.

On January 14, 2016, the Corporation closed a non-brokered private placement of 4,825,000 units at a price of \$0.20 per unit for total gross proceeds of \$965,000. Each unit consists of one common share of the Corporation and one half of one share purchase warrant. Each whole share purchase warrant entitles the holder to purchase an additional common share of the Corporation for a period of one year at an exercise price of \$0.25 per common share. The units were valued using the residual method calculated at the market price on the Exchange on the trading day prior to closing of \$0.17 per common share under which the Corporation assigned a total value of \$820,250 of the unit proceeds to the common shares, with the remaining \$144,750 of the unit proceeds assigned to the share purchase warrants. Share issue costs of \$38,176 were incurred in relation to the issuance of the units.

In June 2016, the Corporation closed a non-brokered private placement consisting of 1,000,000 flow-through shares at a price of \$0.10 per share and 5,400,000 units at a price of \$0.10 per unit for combined total gross proceeds of \$640,000. The flow-through shares portion of the private placement was closed on June 1, 2016 and entitles the holder to certain income tax benefits in the form of Canadian Exploration Expense. The \$100,000 of total gross proceeds from the flow-through shares portion of the private placement was allocated between common shares of \$85,000 (calculated at the closing market price of \$0.085 on the Exchange on the trading day prior to the announcement of the private placement) and a flow-through shares premium liability of \$15,000, and was fully expended on eligible exploration costs in the third quarter 2016. Therefore, the flow-through shares premium liability was reversed in the third quarter 2016 and offset by the recording of an equivalent flow-through share premium income amount. The related resource expenditure deductions will be renounced to investors effective December 31, 2016. On June 27, 2016, the Corporation closed the unit portion of the private placement for total gross proceeds of \$540,000. Each unit consists of one common share of the Corporation and one half of one share purchase warrant. Each whole share purchase warrant entitles the holder to purchase an additional common share of the Corporation for a period of one year at an exercise price of \$0.10 per common share. The units were valued using the residual method calculated at the closing market price on the Exchange on the trading day prior to the announcement of the private placement of \$0.085 per common share, under which the Corporation assigned a total value of \$459,000 of the unit proceeds to the common shares, with the remaining \$81,000 of the unit proceeds assigned to the share purchase warrants. Share issue costs of \$27,046 were incurred in relation to the above combined issuance of flow-through shares and units.

On December 21, 2016, the Corporation closed a non-brokered private placement of 4,166,668 units at a price of \$0.12 per unit for total gross proceeds of \$500,000. Each unit consists of one common share of the Corporation and one half of one share purchase warrant. Each whole share purchase warrant entitles the holder to purchase an additional common share of the Corporation for a period of one year at an exercise price of \$0.12 per common share. The units were valued using the residual method calculated at

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the closing market price on the Exchange on the trading day prior to the announcement of the private placement of \$0.11 per common share, under which the Corporation assigned a total value of \$458,334 of the unit proceeds to the common shares, with the remaining \$41,666 of the unit proceeds assigned to the share purchase warrants. Share issue costs of \$45,029 were incurred in relation to the issuance of the units.

Share Purchase Warrants

As at December 31, 2016, and as at the date of this report, there were 7,195,834 share purchase warrants outstanding at a weighted average exercise price of \$0.16 per share purchase warrant, with expiry dates ranging from January 14, 2017 to December 21, 2017.

Stock Options

As at December 31, 2016, and as at the date of this report, the Corporation had outstanding options to purchase 7,763,000 common shares (being 4.95% of the common shares outstanding) at a weighted average exercise price of \$0.34 per common share. From December 31, 2016 until the date of this report there have been no stock options transactions.

Off-Balance Sheet Transactions

The Corporation had no off-balance sheet transactions during the three and twelve months ended December 31, 2016 and 2015.

Related Party Transactions

Transactions with related parties are recorded at exchange amounts for services provided. During the twelve months ended December 31, 2016 and 2015, the transactions the Corporation had with its directors, related persons or controlled entities in the normal course of business are as follows:

Until June 30, 2016, the Corporation had retained the law firm of Gowling WLG (Canada) LLP (“Gowlings”) to provide CSRI with legal, director and corporate secretary services. A former partner of Gowlings, also the principal of Jeffrey E. Dyck Professional Corporation (“DyckCorp”), has been the Corporate Secretary of the Corporation since September 1, 2014, and became a director of CSRI effective May 28, 2015. Effective July 1, 2016, CSRI retained DyckCorp to provide legal, director and corporate secretary services. During the twelve months ended December 31, 2016, the Corporation incurred \$44,774 (2015: \$73,569) of total fees and disbursements, including taxes, from Gowlings. During the six months ended December 31, 2016, the Corporation incurred \$20,039 of total fees and disbursements, including taxes, from DyckCorp. Such fees have been recorded at amounts agreed upon by the respective parties. The Corporation expects to retain the services of both DyckCorp and Gowlings from time to time. As at December 31, 2016 an accounts payable balance of \$11,540 was outstanding to DyckCorp, and an accounts payable balance of \$1,251 (December 31, 2015: \$31,440) was outstanding to Gowlings.

Related to the private placement closed by the Corporation on December 11, 2015 (see *Common Shares* on page 10), a non-executive director and an executive officer of the Corporation subscribed to a total of 1,035,000 flow-through shares (8.3% of the total) for gross proceeds of \$207,000. Related to the private placement closed by the Corporation on January 14, 2016 (see *Common Shares* on page 10), an executive officer of the Corporation subscribed to 200,000 units (4.1% of the total) for gross proceeds of \$40,000. Related to the unit portion of the private placement closed by the Corporation on June 27, 2016 (see *Common Shares* on page 10) an executive officer of the Corporation subscribed to 200,000 units (3.7% of the total) for gross proceeds of \$20,000. Related to the private placement closed by the Corporation on December 21, 2016 (see *Common Shares* on page 10), directors and executive officers of the Corporation subscribed to a total of 625,002 units (15.0% of the total) for total gross proceeds of \$75,000.

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Commitments

The Corporation had no capital commitments as at December 31, 2016. During 2015, the Corporation's office sub-lease agreement (that was originally commenced on June 1, 2013 for a term of three years) was extended to September 30, 2017. The amended sub-lease requires the Corporation to pay base annual rent of \$11.00 per square foot (formerly \$19.00 per square foot) plus operating costs on 3,420 square feet. The amended sub-lease can be terminated by either party with three months notice at any point throughout the remaining term.

Going Concern

The audited financial statements for the year ended December 31, 2016 have been prepared using International Financial Reporting Standards ("IFRS") as they apply to a going concern, which contemplates the realization of assets and settlement of liabilities in the normal course of operations as they come due. For the year ended December 31, 2016 the Corporation has reported a net loss and comprehensive loss, before a \$29.1 million impairment of natural gas costs, of \$0.9 million (2015: \$2.3 million) and an accumulated deficit, after impairment of natural gas costs, of \$80.5 million as at that date (December 31, 2015: \$50.5 million). In addition to covering on-going working capital requirements and recurring negative cash flows from operating activities (partially due to the shut-in of production from March 31, 2016 to October 4, 2016 due to historically low natural gas prices), the Corporation will need to secure additional funding for any future exploration and development programs. In conjunction with recent energy price fluctuations, the current natural gas market continues to experience low commodity prices due to excess supply and lack of additional international markets to sell into. These circumstances cause material uncertainties that may cast significant doubt upon the Corporation's ability to continue as a going concern, and accordingly, the appropriateness of the use of accounting principles applicable to a going concern.

In recognition of these circumstances, the Corporation has raised a total of \$4.6 million of equity via various non-brokered private placements from December 2015 to December 2016 (see *Common Shares* on page 10). Management has also undertaken steps to reduce operating costs and general administrative expenses, including but not limited to field operational efficiencies, renegotiation of its office lease terms and reductions in staffing levels.

These undertakings, while significant, are not sufficient in and of themselves to enable the Corporation to fund all aspects of its forecasted operations and any future exploration and development, and accordingly, management will need to pursue other financing alternatives to fund the Corporation so that it may continue as a going concern. The necessary financing may be secured through either the exercise of existing warrants for the purchase of common shares, the issue of new equity or debt instruments, or entering into new joint venture or farm-in arrangements. Nevertheless, there is no assurance that such initiatives would be successful.

CSRI's ability to continue as a going concern is dependent upon its ability to fund any future exploration and development programs as well as generate positive cash flows from operating activities. The audited financial statements for the year ended December 31, 2016 do not reflect any adjustments to the carrying values and classifications of assets and liabilities, or to the reported revenues and expenses that would be necessary if the Corporation were unable to realize its assets and settle its liabilities as a going concern in the normal course of operations; such adjustments could be material.

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Business Risks

Productivity

A material risk facing the Corporation is the productive capability of the discovered and undiscovered shale and coalbed methane natural gas resources on the Corporation's existing land base at Farrell Creek/Altares and the Corporation's ability to extract the potential natural gas and natural gas liquids 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 natural gas and natural gas liquids basin in northeastern British Columbia.

Exploration and Development

The Corporation, along with its joint venture partner Canbriam, 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/Altares 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, favorable 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. 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.

Commodity Prices

The Corporation's exploration and development efforts are targeted principally on natural gas and natural gas liquids. There exists an efficient and sophisticated market for natural gas and natural gas liquids in North America which is sensitive to factors affecting the supply of and demand for these commodities. Natural gas prices influence the Corporation's investment decisions, and the timing of its commercial natural gas production which will impact the Corporation's revenue and cash flow. The Corporation considers publically available price forecasts for natural gas and natural gas liquids in its evaluation of investment economics and returns.

Operating Capability

The Corporation is pursuing large unconventional natural gas and natural gas liquids 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 with an operator with the necessary experience and skills.

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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 has acquired its existing mineral rights from the Province of British Columbia and, as a result of drilling expenditures on its lands through to the date of this report, has retained these mineral rights for terms of up to ten years. The Corporation continues to use joint ventures as well as targeted drilling and development activity to reduce the risk of losing any of its mineral rights.

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.

Reader's Advisories

Non-GAAP/IFRS Terminology

This MD&A contains important, comparable industry benchmarks such as net working capital and operating netbacks which are not recognized measures under IFRS, referred to as Generally Accepted Accounting Principles ("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 petroleum and natural gas sales, net of royalties (after adding back royalty credits applied to Property, Plant and Equipment in the financial statements) less operating costs from the statement of loss and comprehensive 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 6 Mcf of natural gas to 1 barrel of crude oil equivalent. Given that the value ratio based on the current price of crude oil as compared to natural gas is significantly different from the energy equivalency of 6:1, utilizing a conversion on a 6:1 basis may be misleading as an indication of value. The Corporation also uses a natural gas heating content conversion ratio of 1 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 CSRI, 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

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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 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; and
- 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 Information

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