



Management's Discussion and Analysis

Q2 2007

Management's discussion and analysis ("MD&A") of financial conditions and results of operations For Spitfire Energy Ltd. for the second quarter of fiscal 2007 should be read in conjunction with the audited consolidated financial statements and notes for the year ended March 31, 2006. This MD&A incorporates information up to and including November 28, 2006. The financial data presented has been prepared in accordance with Canadian generally accepted accounting principles. The reporting and the measurement currency is the Canadian dollar.

Definitions

Natural gas reserves and volumes are converted to barrels of oil equivalent (boe) on the basis of six thousand cubic feet (mcf) of gas to one barrel (bbl) of oil. The term boe 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. "Boed" means boe per day.

The term "cash flow" is defined as revenue less royalties, operating expenses, and general and administrative expenses, which is expressed before changes in non-cash working capital. Cash flow is considered useful to investors and management to analyze operating performance, leverage and liquidity. The term "operating netback", which is calculated as the average unit sales price, less royalties and operating expenses, represents the cash margin for every barrel of oil equivalent sold. These terms do not have any standardized meaning prescribed by Canadian generally accepted accounting principles (GAAP) and, therefore, might not be comparable with the calculation of a similar measure for other companies.

Forward Looking Statements

Certain information regarding Spitfire set forth in this report, including management's assessment of Spitfire's future plans and operations, contains forward-looking statements that involve substantial known and unknown risks and uncertainties. These risks and uncertainties, many of which are beyond Spitfire's control, include the impact of general economic conditions and specific industry conditions, volatility of commodity prices, currency fluctuations, imprecision of reserve estimates, environmental risks, competition from other producers, the lack of available qualified personnel or management, stock market volatility and ability to access sufficient capital from internal and external sources. Spitfire's actual results, performance or achievements could differ materially from those expressed in, or implied by, these forward-looking statements, and accordingly, no assurance can be given that any events anticipated by the forward-looking statements will transpire or occur, or if any of them do, what benefits Spitfire can derive there from. Readers should be aware that historical results are not necessarily indicative of future performance.

Corporate Overview and Strategy

Spitfire Energy Ltd. ("Spitfire") is an independent public company actively engaged in the exploration, development and production of crude oil, natural gas and natural gas liquids in Western Canada. The Company's activities are concentrated in three core geographic areas, namely central Alberta, southern Alberta and southwest Saskatchewan. Spitfire was incorporated in 2001 and began operations in November 2003 when it completed its major transaction. Since then, Spitfire's production growth and reserves base has resulted from exploration and development activities, complemented by strategic acquisitions.

Spitfire's objective has been and remains that of building an exploration and development company capable of delivering and sustaining long-term per share growth. Spitfire operates in a highly competitive, dynamic environment. Fluctuations in commodity prices, access to services and equipment on a timely basis and the general risks associated with the exploration for and development of oil and gas reserves are just a few of the risks that the Company faces. Management and the Board believe that, despite these challenges, the Company has developed a production and reserve base and has exceptional growth opportunities. This base and the opportunities Spitfire has generated are the rewards of a strategy that calls for aggressive growth through exploration and development activities, complemented by strategic acquisitions with upside potential.

Cash Flow and Net Income

	3 Months Ended Sep 30		6 Months Ended Sep 30	
	2006	2005	2006	2005
Cash flow	\$350,632	\$210,011	\$837,009	\$312,180
Per share basic	\$0.01	\$0.01	\$0.03	\$0.01
Per share diluted	\$0.01	\$0.01	\$0.03	\$0.01
Net earnings (loss)	\$45,758	(\$11,721)	\$30,761	(\$8,885)
Per share basic	\$0.00	\$0.00	\$0.00	\$0.00
Per share diluted	\$0.00	\$0.00	\$0.00	\$0.00

Cash flow in 2006 increased as compared to 2005 primarily due to increased production volumes. Assuming commodity prices remain at current levels, management expects cash flow to continue to improve through 2007, as the Company brings on additional production from its southwest Saskatchewan and southern Alberta areas. The Company's cash flow is also affected by the price the Company receives for its medium gravity crude oil. For the period ended September 30, 2006, medium gravity crude comprised approximately 62% of the Company's overall production. This production, which comes from the Company's southwest Saskatchewan core area, is subject to a quality price differential.

Revenue and Production

Total crude oil and natural gas revenues for the quarter ended September 30, 2006 were \$1,120,547, an increase of 48% over the quarter ended September 30, 2005, when oil and natural gas revenues totaled \$759,261. This revenue improvement is the result of increased production volumes.

	3 Months Ended Sep 30		6 Months Ended Sep 30	
	2006	2005	2006	2005
Petroleum and Natural Gas Sales				
Crude Oil and NGLs	\$832,358	\$498,502	\$1,727,301	\$808,624
Natural Gas	\$288,189	\$260,759	\$656,293	\$341,553
Net Revenue	\$1,120,547	\$759,261	\$2,383,594	\$1,150,177
Realized Prices				
Crude Oil and NGLs (\$/bbl)	\$57.26	\$54.73	\$58.26	\$47.51
Natural Gas (\$/mcf)	\$5.81	\$9.00	\$5.98	\$8.52
Total (\$/boe)	\$49.11	\$54.29	\$49.71	\$48.35
Average Production				
Crude Oil and NGLs (bbl/d)	158	99	162	93
Natural Gas (mcf/d)	539	315	600	219
Total (boed)	248	152	262	130

For the quarter ended September 30, 2006, approximately 36% of Spitfire's overall production was natural gas. Management anticipates that the Company's production mix in 2007 will remain weighted towards crude oil. Management does expect to have greater exposure to natural gas through its 2007 exploration program.

Hedging

Spitfire sells all of its crude oil and natural gas production into the spot market. Spitfire does not currently have any hedges in place. Prices received for crude oil and NGLs are determined by the quality of the crude compared to a benchmark price for light, sweet oil. Spitfire manages monthly inventory levels to effect price protection and optimization.

Royalties

	3 Months Ended Sep 30		6 Months Ended Sep 30	
	2006	2005	2006	2005
Royalties	\$176,431	\$174,196	\$455,927	\$253,025
On a boe basis	\$7.73	\$12.46	\$9.51	\$10.64
As a % of revenue	16%	23%	19%	22%

Operating Expenses

	3 Months Ended Sep 30		6 Months Ended Sep 30	
	2006	2005	2006	2005
Operating Expenses	\$265,457	\$191,063	\$560,607	\$292,464
On a boe basis	\$11.63	\$13.66	\$11.69	\$12.29
As a % of revenue	24%	25%	24%	25%

Management expects operating costs to continue to decrease on a per boe basis through fiscal 2007 and targets corporate operating costs in the \$10 to \$12 per boe range. This anticipated decrease is attributable to increased production volumes and expected operating cost savings.

Netbacks

(\$/boe)	3 Months Ended Sep 30		6 Months Ended Sep 30	
	2006	2005	2006	2005
Revenue	\$49.11	\$54.29	\$49.71	\$48.35
Royalties	\$7.73	\$12.46	\$9.51	\$10.64
Operating Expenses	\$11.63	\$13.66	\$11.69	\$12.29
General and Administrative	\$10.74	\$12.96	\$8.87	\$12.05
Operating Netbacks	\$19.01	\$15.21	\$19.64	\$13.37

The majority of the netback improvement for the three and six months ended September 30, 2006 is a result of the increase in production. The higher production provides a larger boe base to absorb fixed costs. The G&A expenses were most significantly impacted by the production base on a boe basis. Operating costs also improved on a BOE basis for the fixed cost components of the facility expenses.

General and Administrative Expenses

	3 Months Ended Sep 30		6 Months Ended Sep 30	
	2006	2005	2006	2005
G&A Expenses	\$385,571	\$239,098	\$698,650	\$408,703
Less capitalized G&A	\$140,563	\$57,888	\$273,586	\$121,928
G&A Expenses (cash portion)	\$245,008	\$181,210	\$425,064	\$286,775
Stock based compensation (non-cash)	\$37,416	\$110,891	\$127,904	\$128,821
	\$282,424	\$292,101	\$552,968	\$415,596
G&A Expenses (cash portion) on a per boe basis	\$10.74	\$12.96	\$8.87	\$12.05
G&A Expenses (cash portion) as a % of revenue	22%	24%	18%	25%

Spitfire capitalized \$76,653 (20%) and \$165,164 (24%) of its G&A expenses for the three and six months ended September 30, 2006 that were directly related to geological and geophysical work performed to generate exploration prospects. Management does not anticipate any significant staff additions through 2007 and expects that Spitfire's G&A expenses will continue to decrease on a per boe basis through 2007 as production is increased.

Stock-based compensation

During the quarter ended September 30, 2006, the Company did not issue any stock options. The stock-based compensation expense for the quarter ended September 30, 2006 was \$37,416 with a corresponding credit to contributed surplus. Assumptions used in the Black-Scholes model were a risk-free interest rate of 4%, a five-year life and a volatility of 85 to 100%.

Related Party Transactions

During the quarter ended September 30, 2006, \$35,643 was paid to companies in which directors or officers of the Company are either principals or own a significant interest. The decrease from 2005 is due to Land and Accounting services moving from consulting arrangements to employees of the Company.

	Capitalized	Expensed	3 Months Ended Sep 30	
			2006	2005
Land	-	-	-	\$25,858
Legal	-	\$5,643	\$5,643	\$2,987
Geological & Geophysical	\$27,000	\$3,000	\$30,000	\$20,976
General & Administrative	-	-	-	\$21,853
Total	\$27,000	\$8,643	\$35,643	\$71,674

Capital Expenditures

In 2006, Spitfire embarked upon a development-drilling program and continued to invest in land, seismic and production facilities necessary to fuel future growth. Total capital expenditures for the quarter ended September 30, 2006 were \$2,135,446.

	3 Months Ended Sep 30		6 Months Ended Sep 30	
	2006	2005	2006	2005
Land and Lease	\$51,023	\$20,865	\$1,839,202	\$35,956
Geological & Geophysical	\$200,294	\$52,817	\$434,593	\$112,976
Drilling	\$926,305	\$195,396	\$2,078,424	\$289,377
Facilities & Equipment	\$957,824	\$111,898	\$1,621,733	\$808,163
Total	\$2,135,446	\$380,976	\$5,973,952	\$1,246,472

During the six months ended September 30, 2006, the Company has closed the acquisition of crude oil reserves and production located in the Company's Fosterton, Antelope, and Verlo core operating areas of southwest Saskatchewan from a joint interest partner. The purchase price of \$2.0 million increased Spitfire's working interest in the property from 48% to 82% and added 45 boed. The proven reserves were acquired at a cost of \$16.90/boe, the proven plus probable reserves were acquired at \$7.32/boe. The Company expects to enhance its operational and capital efficiencies and intends to expand its exploration and development activities in the area.

Depletion and Depreciation

	3 Months Ended Sep 30		6 Months Ended Sep 30	
	2006	2005	2006	2005
Depletion & depreciation & Accretion expense	\$314,351	\$111,580	\$624,060	\$176,640
On a boe basis	\$13.78	\$7.98	\$13.02	\$7.42
As a % of revenue	24%	15%	24%	15%

Spitfire's depletion, depreciation and accretion expense has increased on a boe basis over the prior year as result of the acquisition of crude oil reserves and production located in the Company's existing Fosterton, Antelope, and Verlo core operating area of southwest Saskatchewan. Management expects future depletion, depreciation and accretion expense relating to this asset to decrease on a boe basis as the asset is exploited and reserves move from probable to proven.

In addition to the impact of the acquisition, capital expenditures on existing facilities have also contributed to the higher depletion expense on a boe basis. Spitfire's capital program has included a significant portion of expenditures relating to facility upgrades to realize probable reserves.

Spitfire follows the full cost method of accounting as described in the CICA's accounting guideline 16, "Oil and gas accounting – Full Cost". Accordingly, the cost of all wells, both successful and unsuccessful, are added to the Company's capital base and are depleted at the rate of production over the remaining proven reserves as determined by the independent reserve report relating to the Company's assets prepared by AJM Petroleum Consultants dated June 30, 2006.

Income taxes

Future income tax recovery of \$47,834 was recorded for the three months ended September 30, 2006 and a future tax expense of \$54,284 was recorded for the six months ended September 30, 2006. Current income tax was \$nil for both three and six months ended September 30, 2006.

Capitalization

	Period Ended September 30	
	2006	2005
Outstanding Shares		
Basic	26,167,744	24,202,744
Diluted	28,725,244	26,331,244

Liquidity and Capital Resources

The Company has available a revolving operating demand loan with a maximum available credit of \$6.6 million (March 31, 2006 \$3 million), bearing interest at prime plus 0.5% (March 31, 2006 - 0.75%) and a development or acquisition line of credit of \$2 million (March 31, 2006 - \$500,000), bearing interest at prime plus 1.0% (March 31, 2006 - 1.25%). Both credit facilities are secured by a general assignment of book debts and a \$25 million (March 31, 2006 - \$5 million) debenture with a floating charge over all assets of the Company. As at September 30, 2006 the amount drawn on the operating demand loan was \$4,825,000 (March 31, 2006 - \$nil), the amount drawn on the development or acquisition line of credit was \$1.05 million (March 31, 2006 - \$nil).

The operating demand loan has a sub-limit of \$100,000 for letters of credit or guarantees. The facility is a borrowing base facility that is determined based on, among other things, the Company's current reserve report, results of operations, current and forecasted commodity prices and the current economic environment. Except as described above, Spitfire does not have any debt facilities or capital leases in place.

On an ongoing basis, Spitfire will typically utilize three sources of funding to finance its capital expenditure program: internally generated cash flow from operations, debt where deemed appropriate and new equity issues if available on favorable terms. When financing corporate acquisitions, the Company may also assume certain future liabilities. In addition, the Company may adjust its capital expenditure program depending upon commodity price outlook.

The capital-intensive nature of the Company's activities may create a negative working capital position in quarters with high levels of capital investment. The Company will maintain the total negative working capital plus the outstanding bank debt within the Company's credit line.

The industry has a pre-arranged monthly clearing date for payment of revenues from all buyers of crude oil and natural gas. This occurs on the 25th day following the month of sale. As a result the Company's production revenues are collected in an orderly fashion. The Company monitors its revenue counter party credit positions to mitigate any potential credit losses. To the extent that the Company has joint venture partners in its activities it must collect on a monthly basis the partners' share of capital and operating expenses. These are subject to normal collection risk. The Company normally collects significant amounts related to the partners' share of capital amounts in advance of expenditures taking place in accordance with standard industry operating procedures.

Long-Term Commitments

As part of the Company's exploration and development strategy it will, from time to time, commit to industry partners to drill wells and/or shoot seismic in order to earn positions in contiguous land blocks in core areas. As at September 30, 2006, Spitfire had no outstanding drilling commitments. The Company has entered into a lease agreement for office space effective April 1, 2006. Minimum monthly payments on the lease are \$5,976 until June 30, 2011. There are no other operating or capital leases or commitments.

As part of the Company's initial flow-through share offering in November 2005, the Company was committed to incur and renounce \$1.05 million of qualifying expenditures to the flow-through shareholders. This commitment has been fully satisfied. The Company currently does not have any outstanding flow-through share commitments.

Quarterly Results

The following table summarizes certain quarterly financial information relating to the Company.

	Fiscal 2007	
	Q1	Q2
Revenues	\$1,263,047	\$1,120,547
Net income (loss)	(\$14,997)	\$45,758
per share (basic)	\$0.00	\$0.00
per share (fully diluted)	\$0.00	\$0.00
Total assets	\$13,732,872	\$15,525,528
Total debt	\$4,525,000	\$5,875,000

	Fiscal 2006			
	Q1	Q2	Q3	Q4
Revenues	\$392,996	\$764,684	\$638,104	\$459,401
Net income (loss)	\$2,867	(\$11,721)	\$148,848	(\$192,720)
per share (basic)	\$0.00	\$0.00	\$0.01	(\$0.01)
per share (fully diluted)	\$0.00	\$0.00	\$0.01	(\$0.01)
Total assets	\$6,120,701	\$6,559,581	\$8,434,344	\$10,682,231
Total debt	\$0	\$0	\$0	\$0

	Fiscal 2005			
	Q1	Q2	Q3	Q4
Revenues	\$133,010	\$147,429	\$218,730	\$216,148
Net income (loss)	(\$18,342)	(\$99,707)	(\$26,478)	(\$133,466)
per share (basic)	\$0.00	(\$0.01)	(\$0.01)	(\$0.01)
per share (fully diluted)	\$0.00	(\$0.01)	(\$0.01)	(\$0.01)
Total assets	\$5,175,889	\$5,962,066	\$5,332,832	\$5,173,932
Total debt	\$200,000	\$200,000	\$200,000	\$0

Disclosure Controls and Procedures

Disclosure controls and procedures have been designed to ensure that information required to be disclosed by the Company is accumulated and communicated to the Company's management as appropriate to allow timely decisions regarding required disclosure. The Company's Chief Executive Officer and Chief Financial Officer have concluded, based on their evaluation as of the end of the period covered by the annual filings, that the Company's disclosure controls and procedures as of the end of such period are effective to provide reasonable assurance that material information related to the Company, including its consolidated subsidiaries, is made known to them by others within those entities. It should be noted that while the Company's Chief Executive Officer and Chief Financial Officer believe that the Company's disclosure controls and procedures provide a reasonable level of assurance that they

are effective, they do not guarantee that the disclosure controls and procedures will prevent all errors and fraud. 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.

Critical Accounting Policies

Certain accounting estimates are identified as critical accounting estimates because they form an integral part of Spitfire's financial position and also require management to make judgments and estimates based on conditions and assumptions that are inherently uncertain. These accounting estimates could result in materially different results should the underlying assumptions or conditions change.

Management's assumptions are based on the Company's historical experience, management's experience and other factors that, in management's opinion, are relevant and appropriate. Management's assumptions may change over time, as further experience is gained or as operating conditions.

Significant Accounting Policies

See Note 2 to the audited consolidated financial statements of the Company for the year to date ended September 30, 2006 for a summary of the significant accounting policies employed by the Company.

Risk Factors

Spitfire is engaged in the exploration, development and production of crude oil and natural gas. There are a number of risks facing participants in the Canadian oil and gas industry. Some of the risks are common to all businesses while others are specific to the sector. Operationally, the Company faces risks that are associated with finding, developing, and producing oil and gas reserves. These include risks associated with drilling and completion, reservoir performance uncertainties, access to processing facilities, environmental factors, and regulatory, environment and safety concerns. Financial risks associated with the petroleum industry include fluctuations in commodity prices, interest rates, currency exchange rates, access to capital markets, and the cost of goods and services.

Spitfire attempts to mitigate these risks by employing highly qualified people, utilizing sound operating and business practices, and evaluating all potential and existing wells using the latest applicable technology. Spitfire complies with government regulations and has in place an up-to-date Emergency Response Plan. Environment and safety policies and standards are adhered to. Asset retirement obligations are recognized upon acquisition, construction, development and/or normal use of the assets. Spitfire maintains property and liability insurance coverage. The coverage provides a reasonable amount of protection from risk of loss; however, not all risks are foreseeable or insurable.

The following reviews the general and specific risks and includes Spitfire's approach to managing these risks.

Exploration Risk

Oil and natural gas exploration involves a high degree of risk and there is no assurance that expenditures made on future exploration by the Company will result in new discoveries of oil or natural gas in commercial quantities. It is difficult to project the costs of implementing an exploratory drilling program due to the inherent uncertainties of drilling in unknown formations, the costs associated with encountering various drilling conditions such as over pressured zones and tools lost in the hole, and changes in drilling plans and locations as a result of prior exploratory wells or additional seismic data and interpretations.

In addition, oil and gas operations are subject to the risks of exploration, development and production of oil and natural gas properties, including encountering unexpected formations or pressures, premature declines of reservoirs, blow-outs, cratering, sour gas releases, fires and spills. Losses resulting from the occurrence of any of these risks could have a materially adverse effect on future results of operations, liquidity and financial condition.

Spitfire attempts to minimize finding risk by ensuring that:

- the majority of its prospects have multi-zone potential;
- its activity is focused in core regions where management's expertise and experience is greatest;
- the number of wells drilled is large enough to increase the probability of statistical success rates;
- working interests are targeted at over 50% in new prospects; and
- geophysics is utilized where appropriate.

Investment Risk Profile

The Company's investment selection process is based on risk analysis to ensure capital expenditures balance the objectives of immediate cash flow growth (development activity) and future cash flow from the discovery of reserves (exploration). This careful prospect selection process can yield consistent and efficient results. The Company focuses its activity in a small number of core areas and concentrates on play types with which management is familiar, allowing it to leverage off its experience and knowledge in these areas. The Company will consider the use of farmouts to minimize risk on plays it considers higher risk.

Production

Beyond exploration risk, there is the potential that the Company's oil and natural gas reserves may not be economically produced at prevailing prices. Spitfire minimizes this risk by generating exploration prospects internally, targeting high quality products and attempting to operate the associated project. Operational control allows the Company to control costs, timing, method and sales of production. Concentrating exploration efforts in regions where facilities and infrastructure are Spitfire owned also minimizes production risk.

Reserve Estimates

Estimates of economically recoverable oil and natural gas reserves (including natural gas liquids) and the future net cash flows therefrom are based upon a number of variable factors and assumptions, such as commodity prices, projected production from the properties, the assumed effects of regulation by government agencies and future operating costs. All of these estimates may vary from actual results. Estimates of the recoverable oil and natural gas reserves attributable to any particular group of properties, classifications of such reserves based on risk of recovery and estimates of future net revenues expected therefrom, may vary. The Company's actual production, revenues, taxes, development and operating expenditures with respect to its reserves may vary from such estimates, and such variances could be material.

The Company's independent engineering firm, AJM Petroleum Consultants ("AJM"), uses a deterministic approach in the estimation of reserves. Reserves are assessed using a discrete value for each parameter in the calculation of reserves, such that the resultant reserve value is consistent with the certainty level associated with the reserve classification. Where deemed appropriate, risk modeling is utilized to determine reserve probability distributions. Regardless of which method is employed, the following definitions are followed by AJM in their analysis:

- 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.
- 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.

Financial and Liquidity Risks

The Company anticipates that it will make substantial capital expenditures for the acquisition, exploration, development and production of oil and natural gas reserves in the future. On an ongoing basis, Spitfire will typically utilize three sources of funding to finance its capital expenditure program; internally generated cash flow from operations, debt where deemed appropriate and new equity issues if available on favorable terms.

Cash flow is influenced by factors the Company cannot control, such as commodity prices, the US/Cdn exchange rate, interest rates and changes to existing government regulations and tax policies. Should circumstances affect cash flow in a detrimental way, the Company may have limited ability to expend the capital necessary to undertake or complete future drilling programs. In such circumstances, Spitfire would be required to either reduce the level of its capital expenditures or supplement its capital expenditure program with additional debt and/or equity financing. There can be no assurance that debt or equity financing will be available or sufficient to meet these requirements or, if debt or equity financing is available, that it will be on terms acceptable to the Company. Moreover, future activities may require the Company to alter its capitalization significantly. The inability of the Company to access sufficient capital for its operations could have a material adverse effect on the Company's financial condition, results of operations or prospects.

Issuance of Debt

From time to time, the Company may enter into transactions to acquire assets or the shares of other corporations. These transactions may be financed partially or wholly with debt, which may increase the Company's debt levels above industry standards. Neither the Company's articles nor its by-laws limit the amount of indebtedness the Company may incur. The level of the Company's indebtedness from time to time could impair the Company's ability to obtain additional financing in the future on a timely basis to take advantage of business opportunities that may arise.

Environmental and Safety Risks

There are potential risks to the environment inherent in the business activities of the Company. Spitfire has developed and implemented policies and procedures to mitigate environmental, health and safety (EH&S) risks. These policies and procedures are designed to protect and maintain the environment, and public and employee safety, with respect to all corporate operations on behalf of shareholders, employees and the public. The Company mitigates environmental and safety risks by maintaining its facilities, complying with all provincial and federal environmental and safety regulations and maintaining adequate insurance. The Company has estimated asset retirement obligations of \$306,348 as at September 30, 2006. The Company recognizes period-to-period changes in the liability of the asset retirement obligation resulting from the passage of time and revisions to either the timing or the amount of the original estimate of undiscounted cash flows.

Inflation Risks

Inflation risks subject the Company to potential erosion of product netbacks. For example, increasing domestic prices for oil and natural gas production equipment and services can inflate the costs of operations.

Competitive Industry Conditions

The oil and gas industry is highly competitive. The Company's competitors for the acquisition, exploration, production and development of oil and natural gas properties, and for capital to finance such activities, include companies that have greater financial and personnel resources available to them than the Company.

The Company actively competes for reserve acquisitions, exploration leases, licenses and concessions and skilled industry personnel with a substantial number of other oil and gas companies, many of which have significantly greater financial resources than the Company. The Company's competitors include major integrated oil and natural gas companies, income trusts and numerous other independent oil and natural gas companies and individual producers and operators.

The Company attempts to mitigate competitive risks through the pursuit of strategic farmins and the internal generation of its own exploration prospects. The goal of these efforts is to build a quality inventory of undeveloped lands and drillable prospects that can fuel future growth.

Supply of Service and Production Equipment

The supply of service and production equipment at competitive prices is critical to the ability to add reserves at a competitive cost and produce these reserves in an economic and timely fashion. In periods of increased activity these services and supplies can become difficult to obtain. Demand for such limited equipment or access restrictions may affect the availability of such equipment to the Company and may delay exploration and development activities. The Company attempts to mitigate this risk by developing strong long-term relationships with suppliers and contractors and maintains an appropriate inventory of production equipment.

Prices, Markets and Marketing of Crude Oil and Natural Gas

Oil and natural gas are commodities whose prices are determined based on world demand, supply and other factors, all of which are beyond the control of the Company. World prices for oil and natural gas have fluctuated widely in recent years. Any material decline in prices could result in a reduction of net production revenue. Certain wells or other projects may become uneconomic as a result of a decline in world oil prices and natural gas prices, leading to a reduction in the volume of the Company's oil and gas reserves. The Company might also elect not to produce from certain wells at lower prices. All of these factors could result in a material decrease in the Company's future net production revenue, causing a reduction in its oil and gas acquisition and development activities. A sustained material decline in prices from historical average prices could limit or reduce the Company's borrowing base, therefore reducing the bank credit available to the Company, and could require that a portion of any existing bank debt of the Company be repaid.

In addition to establishing markets for its oil and natural gas, the Company must also successfully market its oil and natural gas to prospective buyers. The marketability and price of oil and natural gas, which may be acquired or discovered by the Company, will be affected by numerous factors beyond its control. The Company will be affected by the differential between the price paid by refiners for light quality oil and the grades of oil produced by the Company. The ability of the Company to market its natural gas may depend upon its ability to acquire space on pipelines, which deliver natural gas to commercial markets. The Company will also likely be affected by deliverability uncertainties related to the proximity of its reserves to pipelines and processing facilities and related to operational problems with such pipelines and facilities and extensive government regulation relating to price, taxes, royalties, land tenure, allowable production, the export of oil and natural gas and many other aspects of the oil and natural gas business. The Company has limited direct experience in the marketing of oil and natural gas.

Outlook

The following discussion reflects management's expectations for fiscal 2007, as discussed throughout this MD&A. A number of risk factors and developments may positively or negatively affect the actual results for 2007 including, without limitation, those risk factors set out above under the heading "Risk Factors".

Operations Overview

Spitfire has continued its record of substantial growth through this fiscal year. Spitfire enjoyed record production, revenue and cash flow for the six months ending September 30, 2006. As compared to the six months ending September 30, 2005, average production increased by 102% to 262 boed, revenues increased over 107% to \$2,383,594 and cash flow increased by 168% to \$837,009.

During the quarter, Spitfire directed capital resources to its strategic business plan focusing on the Fosterton, Saskatchewan exploitation program. The Company successfully completed the battery expansion phase of the program, increasing emulsion handling capacity over 200% by the end of the second quarter. The exploitation program required the field be shut-in for several days, at which time the Company completed a battery turnaround. The exploitation program resulted in a temporary production interruption, decreasing from 276 boed (quarter ending June 2006) to 248 boed (quarter ending September 2006). Several re-completions and high volume pump installations commenced following the September 30, 2006 quarter and were completed in October and November. The Company expects the exploitation program will ultimately provide an additional 160 boed.

Spitfire's current production has grown to approximately 403 boed, consisting of 62% crude oil. With the addition of the production from the second phase of the exploitation program, the Company forecasts production of 500 boed by the end of the third quarter.

Spitfire has an inventory of drilling prospects and is building an undeveloped land base in both Alberta and Saskatchewan. The Company currently has approximately 27,653 net acres of land (24,608 net undeveloped acres), approximately 56% in Alberta and 44% in Saskatchewan.

Looking forward, Spitfire's remaining 2007 capital budget of \$3.2 million is expected to be funded through internally generated cash flow, bank debt and equity financing.

Spitfire's 2007 capital program is a diversified program targeting lower risk development drilling and exploitation projects with a modest component directed at higher risk, high impact exploration opportunities. This level of activity and capital investment is expected to result in production increasing to 600 to 700 boed (unrisked 850 boed) by the end of fiscal 2007.

Property Update

Fosterton Area, Saskatchewan

Since acquisition in November 2001, Spitfire's assets in the Fosterton area have been burdened by litigation that hindered activity and development plans as the Company actively negotiated resolution. On June 30, 2006, the Company resolved the issue, and has closed the acquisition of crude oil reserves and production located in the Fosterton, Antelope, and Verlo from this joint interest partner and the litigation has been discontinued. The purchase increases Spitfire's working interest in the property from an average 48% to 84% allowing the Company to finally move forward with its development plans.

Subsequent to the acquisition in June 30, 2006, Spitfire commenced a significant battery expansion at the Company's main facility. Facility capacity has been increased from approximately 650 to 1800 m3 of emulsion per day.

The pool was producing 105 boed when an interest was acquired in 2001 and it is currently producing 239 boed. The battery expansion was completed in late September, followed by several re-completions, installation of high-volume pumps, and conversion of a poor producer into an injection well. Spitfire expects an additional 160 boed (136 boed net to the Company). The output from wells is increased in stages to ensure operational integrity and reduce facility upsets. Infill drilling is currently being evaluated., Additional development wells are being considered for the winter drilling program

Additionally at Fosterton, the Company plans a horizontal well into the Cantuar horizon. If successful, this activity will lead to several additional wells. The Cantuar has been produced from several existing wells at low rates due to permeability and oil density issues. Research has supported the economics of a horizontal well and Spitfire is eager to prove the concept.

Verlo, Saskatchewan

During 2006, Spitfire drilled a 100% well which appears to have discovered a new pool. Spitfire commenced gas and oil production from the new discovery in August. The well has stabilized at a rate of 45 bopd after producing a small associated gas cap. The Company is planning a 3-D seismic program this winter to exploit geologically defined opportunities.

Antelope, Saskatchewan

The Company has shot a 3-D seismic program which will be interpreted imminently. At least one development location is expected to be included in the winter drilling program.

Alderson, Alberta

The Company has tied into production facilities two wells that are producing at net combined rate of 200 mcf/d (33 boed). A 100% development well is licensed and awaits a drilling rig.

Princess, Alberta

Spitfire plans to drill a development location and maintains a 35% working interest therein.

Pakowki, Alberta

The Company drilled and cased two 50% working interest wells during the first quarter and acquired a third well. The two wells were put on production in the first week of October and are currently producing 315 mcf/d net (53 boed). A 2-D seismic program was shot during the summer. This program identified additional drilling locations, which are planned pending production history and pressure analysis.

Central Alberta

Numerous drilling locations have been identified by Spitfire's internal seismic database. The Company drilled 1 (0.5 net) well and has cased it as a potential gas well in the first quarter. The primary target was not successful; a secondary zone in the well has been evaluated with an expected initial flow rate of up to 300 mcf/d. The Company is currently reviewing tie-in options and the economic viability to bring this well on stream.

Paradise Hill, Saskatchewan

Spitfire has entered into a Joint Venture Agreement in a new area of west central Saskatchewan whereby it will acquire 50% of 23 sections of land in an internally generated geological and geophysically delineated prospect area. Additional land and seismic data are being acquired and Spitfire's first well into the area could be drilled as early as April 2007.

Mergers and Acquisitions

On the acquisition side, Spitfire continues to evaluate a portfolio of assets for potential acquisition. Although still largely opportunity driven, Spitfire is targeting assets which offer a predictable production base with a mixture of exploration and development upside. Southwest Saskatchewan and southern Alberta will be focus areas for the Company's acquisition efforts.

ADDITIONAL INFORMATION

Additional information relating to the Company is filed on SEDAR and can be viewed at www.sedar.com. Information can also be obtained by contacting the Company at Suite 1610, 311 – 6th Avenue S.W., Calgary, Alberta, Canada T2P 3H2 or by visiting the Company's web site at www.spitfireenergy.com