



Management's Discussion and Analysis

This Discussion and Analysis is a review of the results of operations, and outlook for SaskEnergy Incorporated (SaskEnergy or the Corporation) and its subsidiaries for the three-month and six-month periods ended June 30, 2004. This discussion should be read in conjunction with the consolidated interim financial statements and accompanying notes. For additional information relative to the operations and financial position, refer to the Corporation's Annual Report for the year ended December 31, 2003.

Corporate Profile

SaskEnergy has the legislated franchise for the distribution and transmission of natural gas within Saskatchewan. The distribution system provides natural gas service to over 325,000 residential, farm, commercial and industrial customers over a 65,000 kilometre pipeline distribution system. The transmission system provides transportation and storage service to the distribution system, natural gas producers, marketers and large volume end-use customers within Saskatchewan.

SaskEnergy has seven wholly-owned subsidiaries:

- TransGas Limited – owns a natural gas transportation and storage system;
- Many Islands Pipe Lines (Canada) Limited – transports natural gas to and from other jurisdictions;
- Bayhurst Gas Limited – owns, produces and sells natural gas from storage-related assets and holds natural gas royalty interests;
- SaskEnergy International Incorporated – holds international equity investments;
- Swan Valley Gas Corporation – owns a natural gas distribution utility in the Swan Valley area of Western Manitoba;
- Saskatchewan First Call Corporation – operates an underground infrastructure facility database through which subscribing companies are alerted of the need to perform line locates for landowners or contractors planning to excavate in Saskatchewan;
- SaskEnergy Nova Scotia Holdings Ltd. – holds SaskEnergy's interest in a natural gas distribution utility in Nova Scotia.

Financial and Operating Highlights

| | Three Months Ended June 30 | | Six Months Ended June 30 | |
|---|-------------------------------|--------|-----------------------------|--------------------|
| | 2004 | 2003 | 2004 | 2003 |
| Financial Highlights | | | | |
| Consolidated Net Earnings (millions) | \$12 | \$1 | \$57 | \$3 |
| Total Assets (millions) | | | \$1,172 | \$1,152 |
| Long-term Debt (millions) | | | \$641 | \$666 |
| Operating Highlights | | | | |
| Distribution | | | | |
| Volumes Distributed - Petajoules | 8 | 9 | 37 | 39 |
| Winter Weather - Compared to the thirty year average | N/A | N/A | 5 % Colder | 5 % Colder |
| Average Purchase Price per Gigajoule of Natural Gas | \$6.44 | \$6.92 | \$6.40 | \$7.18 |
| Transmission | | | | |
| Volumes Transported - Petajoules | 54 | 50 | 159 | 153 |
| Peak Day Natural Gas Flows (Winter Season) - Petajoules - Date of Peak Flow | N/A | N/A | 1.49 January 27 | 1.46 January 22 |

Financial Results

Consolidated Net Earnings

The net earnings of \$56.9 million for the first six months of 2004 was an increase of \$53.5 million from the same period in 2003, primarily due to the ongoing recovery in the Gas Cost Variance Account during the first half of 2004 (see next page).

During the first half of 2003, SaskEnergy had a revenue shortfall of \$37.9 million on natural gas sales to customers, whereas in the same period in 2004, the Corporation had a revenue surplus of \$15.6 million (see note three attached to the consolidated interim financial statements).

The consolidated interim financial statements should not be taken as indicative of the performance to be expected for the full year, due to the seasonal nature of the natural gas utility business in Saskatchewan.

Delivery Revenue

Delivery revenue in the first half of 2004 was \$89.6 million, which was \$3.3 million lower than the same period in 2003. The majority of SaskEnergy's distribution customers consume natural gas for space and heating purposes and, as a result, the volume of natural gas distributed is sensitive to variations in the weather, particularly through the November-to-March prime heating load season. The winter weather in 2004 was slightly warmer than the same period in 2003, resulting in somewhat lower delivery revenue.

Transportation and Storage Revenue

Transportation and storage revenue for the first half of 2004 was \$44.1 million, which was \$4.8 million higher than the first half of 2003.

Transportation revenue increased as natural gas well drilling in 2003 and 2004 resulted in increased flows onto the transmission pipeline system. The number of natural gas wells drilled in 2004 was 676, compared to 648 for the same period in 2003.

Storage revenue for the first six months of 2004 increased by \$0.3 million over the same period in 2003. As in prior periods, storage continues to be fully contracted.

Net Sales from Gas Marketing

In order to maximize the utilization of transmission and storage assets during off-peak periods, SaskEnergy purchases and sells natural gas in the open market and earns a margin. SaskEnergy also supplies natural gas to large end-use customers in Saskatchewan through a competitive bidding process.

The Corporation owns underground natural gas storage fields that are no longer used in commercial storage operations. The natural gas from these fields is being removed and sold in the open market.

In the first six months of 2004, net revenue from the foregoing activities was \$15.1 million as compared to \$13.7 million for the same period in 2003, due to higher margins and volumes sold in 2004.

Expenses

Total expenses for the first half of the year were \$127.0 million, which was \$2.5 million higher than the same period in 2003.

Operating and maintenance expense for the first six months of 2004 was \$59.2 million compared to \$56.5 for 2003. Increased labour and third-party contractor costs of \$3.1 million were partially offset by external cost recoveries and amounts allocated to capital projects of \$1.4 million. Other increases over the same period in 2003 include transportation costs paid to third parties of \$0.5 million.

Interest expense of \$25.4 million in the first half of 2004 was lower by \$0.4 million compared to the same period in 2003, primarily as a result of interest rates on short-term debt declining from 3.0 per cent to 2.2 per cent.

Amortization of property, plant and equipment, payments to municipalities and Saskatchewan taxes and royalties for the second quarter were relatively consistent with the same period in 2003.

Net Revenue from Commodity Sales

The net revenue from commodity sales for the six months ended June 30, 2004 was \$17.9 million. This compares to a loss on commodity sales of \$36.0 million for the same period in 2003.

Gas Cost Variance Account

SaskEnergy uses a Gas Cost Variance Account (GCVA) to accumulate the difference between commodity sales revenue and the related cost of gas sold. The change in the balance of the GCVA is included as a component of the cost of gas sold. As a result, a profit or a loss on commodity sales may occur during a fiscal period. Commodity rate changes would be expected to result in an offsetting profit or loss in subsequent periods.

The recovery of the GCVA for the six month period ended June 30, 2004 was \$15.6 million (see note three attached to the consolidated interim financial statements). The GCVA balance to be collected from customers as at June 30, 2004 was \$33.4 million compared to \$69.5 million at June 30, 2003. For additional information on the GCVA, refer to the notes to the 2003 consolidated financial statements.

Outlook

SaskEnergy anticipates operating income from the utility operations to be comparable to 2003. Positive margins from natural gas marketing activities combined with continued recovery of the GCVA should result in a strong financial performance for SaskEnergy in 2004.

The volatility of natural gas prices is expected to continue throughout 2004. As the recovery of the GCVA is subject to the level of natural gas prices, net earnings will be affected by price volatility during the remainder of the year.

The forecast for delivery revenue assumes normal weather patterns for the remainder of the year. Transmission revenue is expected to benefit from increased transportation of natural gas volumes resulting from strong natural gas drilling programs by producers.

During 2004, SaskEnergy anticipates refinancing approximately \$30 million of long-term debt. The lower interest rate on the new debt is projected to save SaskEnergy approximately \$1.4 million in 2004 and approximately \$2 million per year thereafter. In 2004, SaskEnergy expects continued benefits from the low interest rate environment.

Subsequent Events

The President and Chief Executive Officer resigned effective July 16, 2004, and a search process for a successor has commenced.

SaskEnergy Incorporated
Consolidated Statement of Financial Position
(thousands of dollars)

| | <u>As at</u> <u>June 30, 2004</u> <i>(unaudited)</i> | <u>As at</u> <u>December 31, 2003</u> <i>(restated-note 2)</i> |
|---|--|--|
| Assets | | |
| Current assets | | |
| Cash | \$ 491 | \$ - |
| Accounts receivable | 114,075 | 144,524 |
| Natural gas in storage held for resale | 56,417 | 82,102 |
| Inventories of supplies | 7,383 | 6,458 |
| | <u>178,366</u> | <u>233,084</u> |
| Property, plant and equipment (note 2) | 933,084 | 941,569 |
| Investments and other assets | 35,317 | 34,789 |
| Natural gas in storage held for resale and operations | 25,706 | 25,766 |
| | <u>\$ 1,172,473</u> | <u>\$ 1,235,208</u> |
| Liabilities and Province's Equity | | |
| Current liabilities | | |
| Bank indebtedness | \$ - | \$ 1,295 |
| Short-term debt | 58,600 | 110,000 |
| Accounts payable | 121,708 | 139,035 |
| Dividend payable | 10,900 | 10,560 |
| Current portion of long-term debt | 15,240 | 34,997 |
| | <u>206,448</u> | <u>295,887</u> |
| Long-term debt | 625,289 | 627,884 |
| Asset retirement obligation (note 2) | 2,332 | 2,401 |
| | <u>834,069</u> | <u>926,172</u> |
| Province of Saskatchewan's equity | | |
| Equity advances | 71,531 | 71,531 |
| Retained earnings | 268,016 | 238,589 |
| Foreign currency translation adjustment | (1,143) | (1,084) |
| | <u>338,404</u> | <u>309,036</u> |
| | <u>\$ 1,172,473</u> | <u>\$ 1,235,208</u> |

(See accompanying notes)

On behalf of the Board:



Director



Director

SaskEnergy Incorporated

Consolidated Statement of Earnings and Retained Earnings

(thousands of dollars)

| | Three months ended June 30 | | Six months ended June 30 | |
|---|----------------------------|----------------------------------|----------------------------|----------------------------------|
| | <u>2004</u> (unaudited) | <u>2003</u> (restated-note 2) | <u>2004</u> (unaudited) | <u>2003</u> (restated-note 2) |
| Revenue | | | | |
| Delivery | \$ 26,231 | \$ 26,404 | \$ 89,602 | \$ 92,870 |
| Transportation and storage | 22,066 | 19,962 | 44,087 | 39,261 |
| Revenue collected for municipalities | 4,457 | 4,829 | 14,902 | 14,787 |
| Net sales from gas marketing | 11,701 | 12,213 | 15,074 | 13,741 |
| Other | 1,433 | 1,977 | 2,325 | 3,260 |
| | <u>65,888</u> | <u>65,385</u> | <u>165,990</u> | <u>163,919</u> |
| Expenses | | | | |
| Operating and maintenance | 28,116 | 27,368 | 59,167 | 56,463 |
| Interest | 12,752 | 12,565 | 25,439 | 25,794 |
| Amortization of property, plant and equipment | 12,453 | 12,244 | 24,751 | 24,272 |
| Payments to municipalities | 4,457 | 4,829 | 14,902 | 14,787 |
| Saskatchewan taxes and royalties | 641 | 875 | 2,732 | 3,214 |
| | <u>58,419</u> | <u>57,881</u> | <u>126,991</u> | <u>124,530</u> |
| Earnings from operations before the following | <u>7,469</u> | <u>7,504</u> | <u>38,999</u> | <u>39,389</u> |
| Commodity revenue | 49,163 | 48,876 | 223,823 | 202,289 |
| Cost of gas sold | <u>45,090</u> | <u>55,673</u> | <u>205,895</u> | <u>238,247</u> |
| Net revenue (loss) from commodity sales | <u>4,073</u> | <u>(6,797)</u> | <u>17,928</u> | <u>(35,958)</u> |
| Net earnings | <u>11,542</u> | <u>707</u> | <u>56,927</u> | <u>3,431</u> |
| Retained earnings, beginning of period: | | | | |
| As previously reported | 266,523 | 224,297 | 237,738 | 223,373 |
| Change in accounting policy (note 2) | <u>851</u> | <u>972</u> | <u>851</u> | <u>972</u> |
| As restated | <u>267,374</u> | <u>225,269</u> | <u>238,589</u> | <u>224,345</u> |
| Dividend | <u>(10,900)</u> | <u>-</u> | <u>(27,500)</u> | <u>(1,800)</u> |
| Retained earnings, end of period | <u>\$ 268,016</u> | <u>\$ 225,976</u> | <u>\$ 268,016</u> | <u>\$ 225,976</u> |

(See accompanying notes)

SaskEnergy Incorporated
Consolidated Statement of Cash Flows
(thousands of dollars)

| | Three months ended June 30 | | Six months ended June 30 | |
|--|-----------------------------------|---|-----------------------------------|---|
| | <u>2004</u> <i>(unaudited)</i> | <u>2003</u> <i>(restated-note 2)</i> | <u>2004</u> <i>(unaudited)</i> | <u>2003</u> <i>(restated-note 2)</i> |
| Operating Activities | | | | |
| Net earnings | \$ 11,542 | \$ 707 | \$ 56,927 | \$ 3,431 |
| Add (deduct) items not requiring an outlay of cash | | | | |
| Amortization of property, plant and equipment | 12,453 | 12,244 | 24,751 | 24,272 |
| Other non-cash items | (41) | 274 | (1,699) | 448 |
| | <u>23,954</u> | <u>13,225</u> | <u>79,979</u> | <u>28,151</u> |
| Net change in non-cash working capital related to operations | <u>13,165</u> | <u>(9,915)</u> | <u>37,882</u> | <u>28,239</u> |
| Cash provided by operating activities | <u>37,119</u> | <u>3,310</u> | <u>117,861</u> | <u>56,390</u> |
| Investing Activities | | | | |
| Additions to property, plant and equipment | (12,638) | (12,166) | (21,152) | (19,788) |
| Customer capital contributions received | 2,294 | 1,163 | 4,886 | 5,927 |
| Additions to investments and other assets | - | (7,017) | - | (8,058) |
| Decrease in natural gas in storage (non-current) | - | 664 | 60 | 664 |
| Cash used in investing activities | <u>(10,344)</u> | <u>(17,356)</u> | <u>(16,206)</u> | <u>(21,255)</u> |
| Financing Activities | | | | |
| Increase (decrease) in short-term debt | 11,100 | 15,700 | (51,400) | (79,200) |
| Repayment of long-term debt | (19,757) | - | (19,757) | - |
| Dividend paid | (16,600) | (1,800) | (27,160) | (6,260) |
| Sinking fund instalments | (1,302) | (1,300) | (1,552) | (1,550) |
| Proceeds from long-term debt | - | - | - | 50,000 |
| Cash (used in) provided by financing activities | <u>(26,559)</u> | <u>12,600</u> | <u>(99,869)</u> | <u>(37,010)</u> |
| Increase (decrease) in cash during period | 216 | (1,446) | 1,786 | (1,875) |
| Cash position, beginning of period | <u>275</u> | <u>1,402</u> | <u>(1,295)</u> | <u>1,831</u> |
| Cash position, end of period | <u>\$ 491</u> | <u>\$ (44)</u> | <u>\$ 491</u> | <u>\$ (44)</u> |

Cash position consists of cash less bank indebtedness.

(See accompanying notes)

SaskEnergy Incorporated
Notes to the Consolidated Financial Statements
June 30, 2004
Unaudited

1. Accounting Policies

SaskEnergy Incorporated (SaskEnergy or the Corporation) prepares its consolidated interim financial statements in accordance with Canadian generally accepted accounting principles except that the disclosures do not conform in all respects to the requirements for annual financial statements. The consolidated interim financial statements follow the same accounting policies and methods of computation as the consolidated financial statements for the year ended December 31, 2003, except as described in note 2.

These consolidated interim financial statements, which are unaudited, should be read in conjunction with the consolidated financial statements for the year ended December 31, 2003 and have been prepared from the records of the Corporation. The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets, liabilities, revenue and expenses. Actual amounts could differ from these estimates.

The consolidated interim financial statements should not be taken as indicative of the performance to be expected for the full year due to the seasonal nature of the natural gas utility business in Saskatchewan.

2. Change in Accounting Policy

Asset Retirement Obligations

Until December 31, 2003, SaskEnergy recognized its responsibility for the estimated future costs associated with the permanent decommissioning of the Corporation's property, plant and equipment in accordance with the existing Canadian Institute of Chartered Accountants (CICA) Handbook section 3061. The estimated cost of retiring these assets was being amortized on a straight-line basis over the expected useful life of the related assets. As at December 31, 2003, the Corporation had recorded a total provision of \$1,950 thousand for the decommissioning of certain natural gas storage fields.

Effective January 1, 2004 SaskEnergy adopted the new CICA Handbook section 3110, "Asset Retirement Obligations". The decommissioning costs referred to above, are now recognized in accordance with this new standard. The Corporation is required to record this accounting change retroactively with a restatement of prior periods to show what the effect would have been on the assets, liabilities, earnings and retained earnings if the new policy had been followed in prior periods. The impact of the accounting policy change was a \$121 thousand decrease in net earnings for 2003.

The impact of this accounting change is as follows:

| | Year Ended December 31 2003 | Three Months Ended June 30 2003 | Six Months Ended June 30 2003 |
|---|--|--|--|
| Impact of Accounting Change | | Increase/(Decrease) (thousands) | |
| Consolidated Statement of Earnings and Retained Earnings | | | |
| Amortization of property, plant and equipment | \$ 260 | \$ 65 | \$130 |
| Operating and maintenance | (139) | (35) | (70) |
| Net earnings | (121) | (30) | (60) |
| Consolidated Statement of Financial Position | | | |
| Property, plant and equipment, net | 1,302 | 1,432 | 1,432 |
| Accounts payable | (1,950) | (1,825) | (1,825) |
| Asset retirement obligation | 2,401 | 2,345 | 2,345 |
| Retained earnings, beginning of period | 972 | 942 | 972 |
| Retained earnings, end of period | 851 | 912 | 912 |

SaskEnergy Incorporated
Notes to the Consolidated Financial Statements
June 30, 2004
Unaudited

3. Gas Cost Variance Account

The Gas Cost Variance Account (GCVA), as at June 30, includes natural gas costs to be recovered from or refunded to customers as follows: (thousands)

| | Three Months Ended June 30 | | Six Months Ended June 30 | |
|---|-----------------------------------|--|---------------------------------|--|
| | <u>2004</u> | <u>2003</u> <i>(restated-note 2)</i> | <u>2004</u> | <u>2003</u> <i>(restated-note 2)</i> |
| Commodity sales revenue | \$ 49,087 | \$ 48,877 | \$ 223,535 | \$ 202,257 |
| Cost of gas before interest on the GCVA | 45,207 | 55,409 | 207,074 | 239,224 |
| Interest on the GCVA | <u>163</u> | <u>631</u> | <u>414</u> | <u>883</u> |
| | 45,370 | 56,040 | 207,488 | 240,107 |
| Other items: | | | | |
| Mark-to-market gain | 661 | - | 661 | - |
| Interest not recoverable | <u>(64)</u> | <u>-</u> | <u>(194)</u> | <u>-</u> |
| | <u>45,967</u> | <u>56,040</u> | <u>207,955</u> | <u>240,107</u> |
| Change in balance during period | 3,120 | (7,163) | 15,580 | (37,850) |
| Balance, beginning of period, to be collected from customers | <u>36,476</u> | <u>62,364</u> | <u>48,936</u> | <u>31,677</u> |
| Balance, end of period, to be collected from customers in future periods | <u>\$ 33,356</u> | <u>\$ 69,527</u> | <u>\$ 33,356</u> | <u>\$ 69,527</u> |

4. Comparative Figures

Certain of the prior year amounts have been reclassified to conform to the current year's presentation.