SaskEnergy

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Management's Discussion and Analysis

The Management's Discussion and Analysis highlights the primary factors that impacted the operations and financial results of SaskEnergy Incorporated (SaskEnergy or the Corporation) and its wholly owned subsidiaries for the three month period ended March 31, 2007. This discussion should be read in conjunction with the consolidated interim financial statements and accompanying notes. For additional information relative to its operations and financial position, refer to the Corporation's Annual Report for the year ended December 31, 2006.

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 332,000 residential, farm, commercial and industrial customers over a 66,000 kilometre pipeline distribution system. The transmission system provides transportation and storage service to the distribution system, producers, marketers and large volume end-use customers within Saskatchewan.

SaskEnergy has seven wholly owned subsidiaries:

- TransGas Limited − owns natural gas transportation and storage facilities;
- Many Islands Pipe Lines (Canada) Limited − transports natural gas to and from other jurisdictions and is regulated by the National Energy Board;
- 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 March 31	
	2007	2006
Financial Highlights		
Consolidated Net Income (millions)	$47	$37
Total Assets (millions)	$1,354	$1,364
Long-term Debt (millions)	$680	$685
Operating Highlights		
Distribution		
Volumes Distributed − Petajoules	48	42
Winter Weather − Compared to the Thirty Year Average	Normal	9% Warmer
Average Cost per Gigajoule of Natural Gas to March 31*	$7.22	$8.76
Transmission		
Volumes Transported − Petajoules	102	99
Peak Day Natural Gas Flows (Winter Season) − Petajoules	1.49	1.53
− Date of Peak Flow	February 14	February 16

*For 2006 before the effect of Saskatchewan Energy Share

Financial Results

Effective January 1, 2007, SaskEnergy adopted the new Canadian Institute of Chartered Accountants (CICA) standards for the reporting of financial instruments. This change in accounting policy and its impact is discussed in Note 2 of the attached financial statements.

There are two new financial statements resulting from the adoption of the financial instrument standards: the statement of comprehensive income and the statement of accumulated other comprehensive income. These new financial statements incorporate other comprehensive income which represents certain unrealized gains and losses of the Corporation.

Consolidated Net Income

For the first three months of 2007 consolidated net income was $47 million, which was $10 million higher than the $37 million for the same period in 2006.

1. Commodity

(a) Commodity Sales

The commodity rate for natural gas sales to distribution utility customers was $7.17 per Gigajoule (GJ) for the period January 1, 2007 to March 31, 2007. In 2006 the commodity rate was $7.95 per GJ from January 1 to March 31. This resulted in lower revenue per GJ for the heating season months of January to March in 2007 compared to 2006.

The lower rate per GJ was offset by normal weather in the first three months of 2007 compared to 9% warmer than normal weather in 2006. The colder weather in 2007 increased the amount of natural gas consumed for space heating purposes by one Petajoule in 2007 compared to 2006.

Also at the time of the adoption of the new CICA standards for the reporting of financial instruments, SaskEnergy discontinued the use of hedge accounting for natural gas contracts. Accordingly, commodity revenue to March 31, 2007 includes commodity sales of $24 million (3.4 Petajoules) related to physical contracts entered into for price management purposes. The price on these contracts averaged $7.00 per GJ. In 2006 the net gain or loss related to these contracts was included in commodity cost of gas sold.

(b) Commodity Cost of Gas Sold

The cost of gas sold includes the cost of purchased gas and adjustments that effectively record the fair value of natural gas contracts (fair value adjustments) as at March 31.

The fair value adjustments decreased the cost of gas sold during the first three months of 2007 by $14 million. Therefore, the $18 million gain on commodity sales for the first three months of 2007 was primarily due to the fair value adjustments on natural gas contracts.

In response to record-high natural gas prices, in the fall of 2005, the Government of Saskatchewan introduced Saskatchewan Energy Share. Saskatchewan Energy Share was intended to effectively cap the commodity rate consumers would pay at $7.95 per GJ from November 1, 2005 to March 31, 2006.

During the first three months of 2006, the commodity rate charged to consumers was $7.95 per GJ, which was lower than the cost of gas sold. Therefore, during 2006, SaskEnergy received $20.5 million from Saskatchewan Energy Share.

2. Gas Marketing

(a) Gas Marketing Sales and Cost of Gas Sold

In order to maximize the utilization of its assets during off-peak periods, SaskEnergy purchases and sells natural gas in the open market and earns a margin. SaskEnergy also competes to supply natural gas to larger end-use customers in Saskatchewan through non-regulated contract sales.

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

In the first three months of 2007, the realized gain from the foregoing activity was $10 million. However, a fair value adjustment on natural gas contracts of $11 million resulted in a loss of $1 million. This compared to a gain of $9 million for the same period in 2006.

3. **Delivery Revenue**

Delivery revenue in the first three months of 2007 was $63 million, which was $6 million higher than the same period in 2006. The majority of SaskEnergy's distribution customers consume natural gas for heating purposes and, as a result, the volume of natural gas distributed is sensitive to variations in weather, particularly through the November-to-March prime heating load season. The weather from January 1 to March 31, 2007 was 9% colder than the same period in 2006, which was the primary reason for increased delivery volumes and revenue.

4. **Transportation and Storage Revenue**

Transportation and storage revenue for the first three months of 2007 was $22 million, which was a decrease of $1 million over the same period in 2006. The decrease is mainly due to a transportation rate reduction of 3% effective June 1, 2006, partially offset by the transportation rate increase of 2% effective January 1, 2007.

5. **Other Expenses**

Expenses (excluding cost of gas sold) to March 31, 2007 were $66 million, which was $1 million higher than the first three months of 2006.

Operating and maintenance expenses for the first three months of 2006 were $31 million, which was $1 million higher compared to the first three months of 2006 primarily due to a gain on the sale of a compressor unit in 2006.

Interest expense, amortization, payments to municipalities and Saskatchewan taxes to March 31, 2007 were consistent with the same period in 2006.

Outlook

SaskEnergy's financial results are sensitive to changes in a number of key factors. The following are the factors that can cause the greatest variability in income:

Description of the risk	Factor	Sensitivity	Impact on annual net income: Decrease	Impact on annual net income: Increase
Natural gas prices fluctuate in the market and can affect income if there is a change in the market price per Gigajoule with no accompanying change to SaskEnergy's approved commodity rates.	Natural gas prices	$0.10 change per Gigajoule	Higher gas prices $(5.3)	Lower gas prices $5.3
Winter weather fluctuations can affect income. Revenue forecasts are based on the assumption of normal winter weather defined as the average weather experienced over the last thirty years.	Winter weather	One per cent change in winter weather	Warmer than normal $(0.7)	Colder than normal $0.7
TransGas receipt contracted volumes are affected by the capacity contracted by shippers for the transportation of their natural gas.	TransGas receipt contracted volumes	One per cent change to contracted levels	Decreased contracting $(0.6)	Increased contracting $0.6
Short-term interest rates affect the cost of short-term borrowing.	Short-term interest rates	0.25 per cent change in short-term interest rates	Increased rates $(0.2)	Decreased rates $0.2

The above sensitivities are intended to be illustrative of the relationship between the variables and financial performance and are not intended to reflect the likelihood of this variability.

SaskEnergy Incorporated

Consolidated Statement of Financial Position

(millions of dollars)

	As at March 31, 2007 *(unaudited)*	As at December 31, 2006 *(restated)*
Assets		
Current assets		
Accounts receivable	$ 212	$ 169
Natural gas in storage held for resale	77	111
Inventories of supplies	8	7
Debt retirement funds	4	4
Fair value of derivative instruments	4	1
	305	292
Property, plant and equipment (net)	939	955
Natural gas in storage held for resale and operations	41	46
Debt retirement funds	36	34
Investments and other assets	31	33
Fair value of derivative instruments	2	-
	$ 1,354	$ 1,360
Liabilities and Province's Equity		
Current liabilities		
Bank indebtedness	$ -	$ 2
Short-term debt	40	69
Accounts payable	160	169
Dividend payable	13	12
Current portion of long-term debt	80	48
Fair value of derivative instruments	10	14
	303	314
Long-term debt	600	634
Fair value of derivative instruments	1	-
	904	948
Province of Saskatchewan's equity		
Equity advances	72	72
Retained earnings	378	342
Accumulated other comprehensive income	-	(2)
	450	412
	$ 1,354	$ 1,360

(See accompanying notes)

Director

Director

SaskEnergy Incorporated

Consolidated Statement of Income and Retained Earnings

(millions of dollars)

	Three months ended March 31	
	2007	**2006**
	(unaudited)	*(unaudited)*
Revenue		
Commodity sales	$ 192	$ 177
Gas marketing sales	103	160
Delivery	63	57
Transport and storage	22	23
Revenue collected for municipalities	10	10
Other	1	2
	391	429
Expenses		
Commodity cost of gas sold	174	176
Gas marketing cost of gas sold	104	151
Operating and maintenance	31	30
Interest	11	11
Amortization	13	13
Payments to municipalities	10	10
Saskatchewan taxes	1	1
	344	392
Net income	47	37
Retained earnings, beginning of period	342	324
Change in accounting policy (Note 2)	2	-
Dividend	(13)	(13)
Retained earnings, end of period	$ 378	$ 348

(See accompanying notes)

SaskEnergy Incorporated

Consolidated Statement of Comprehensive Income

(millions of dollars)

	Three months ended March 31	
	2007	**2006**
	(unaudited)	*(unaudited)*
Net income	$ 47	$ 37
Other comprehensive income:		
Gains and losses on derivative instruments designated as hedges for accounting purposes in prior periods transferred to net income in the current period	4	-
Unrealized gains and losses on translating financial statements of self-sustaining foreign operations	(1)	-
	3	-
Comprehensive income	$ 50	$ 37

SaskEnergy Incorporated

Consolidated Statement of Accumulated Other Comprehensive Income

(millions of dollars)

	As at March 31, 2007	**As at December 31, 2006**
	(unaudited)	*(unaudited)*
Accumulated other comprehensive income, beginning of period	$ (2)	$ (2)
Transitional amounts for gains and losses on derivative instruments designated as hedges for accounting purposes in prior periods	(1)	-
Other comprehensive income	3	-
Accumulated other comprehensive income, end of period	$ -	$ (2)

(See accompanying notes)

SaskEnergy Incorporated

Consolidated Statement of Cash Flows

(millions of dollars)

	Three months ended March 31	
	2007	**2006**
	(unaudited)	*(unaudited)*
Operating Activities		
Net income	$ 47	$ 37
Add (deduct) items not requiring an outlay of cash		
Amortization of property, plant and equipment	13	13
Other non-cash items	(4)	-
	56	50
Net change in non-cash working capital related to operations	(18)	(18)
Cash provided by operating activities	38	32
Investing Activities		
Additions to property, plant and equipment	(10)	(9)
Customer capital contributions received	12	3
Decrease in natural gas in storage (non-current)	5	-
Cash provided by (used in) investing activities	7	(6)
Financing Activities		
Proceeds from long-term debt	17	-
Decrease in short-term debt	(29)	(15)
Repayments of long-term debt	(18)	-
Dividend paid	(12)	(5)
Decrease in bank indebtedness	(2)	-
Debt retirement fund instalments	(1)	(1)
Cash used in financing activities	(45)	(21)
Increase in cash during period	-	5
Cash position, beginning of period	-	2
Cash position, end of period	$ -	$ 7

(See accompanying notes)

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, 2006 except as noted in the Change in Accounting Policy 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, 2006 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

Effective January 1, 2007, SaskEnergy adopted the new Canadian Institute of Chartered Accountants (CICA) Handbook Section 1530 - Comprehensive Income, Section 3251 - Equity, Section 3855 - Financial Instruments - Recognition and Measurement, Section 3861 - Financial Instruments - Presentation and Disclosure, and Section 3865 - Hedges. The following are the impacts of implementing these new standards prospectively in 2007:

Under the new standards SaskEnergy was required to classify all financial instruments into one of the following categories: 1) held-for-trading, 2) held-to-maturity, 3) loans and receivables, 4) available-for-sale, and 5) other liabilities.

Derivative financial assets and liabilities are classified as held-for-trading and recorded at fair value on the statement of financial position. The change in the fair value of the derivatives (gain or loss) is recorded in net income and classified within the revenue/expense category to which they relate unless the derivative is designated as a hedge for accounting purposes. If the derivative is designated as a hedge for accounting purposes, the gain or loss is temporarily recorded as other comprehensive income. The gain or loss will be transferred into income over the life of the underlying hedged item.

The Corporation discontinued the use of hedge accounting on its natural gas derivatives on January 1, 2007. In accordance with the transitional rules upon the adoption of the new standards, $1 million of unrealized gains and losses on the previously designated natural gas hedges at January 1, 2007, have been recorded in accumulated other comprehensive income and will subsequently be transferred to net income as the contracts settle. All natural gas derivatives will settle by October 31, 2011. Changes in the fair value of these natural gas derivatives since January 1, 2007 have been recognized directly in net income and included with gas marketing sales, commodity cost of gas sold and gas marketing cost of gas sold as gains or losses.

SaskEnergy selected January 1, 2003 as the transition date for embedded derivatives, as such only contracts or financial instruments entered into or modified after the transition date were reviewed for embedded derivatives. The Corporation had outstanding natural gas sales contracts with embedded derivatives as at December 31, 2006 and March 31, 2007. These contracts are for non-regulated contract sales to larger end-use customers in Saskatchewan. These embedded derivatives are recorded at fair value on the statement of financial position.

2. Change in Accounting Policy (continued)

The Corporation is continuing to use hedge accounting for interest rate swaps used to hedge long-term debt and foreign currency forward contracts used to hedge capital expenditures denominated in a foreign currency. In accordance with the transitional provisions upon the adoption of the new standards, $2 million of interest rate swaps settlements have been reclassified in accumulated other comprehensive income and will be subsequently transferred to net income over the life of the underlying long-term debt.

Long-term debt has been classified as other liabilities and recorded at amortized cost. The related debt premium, discount and issue costs have been reclassified and are included in the carrying value of the long-term debt and are being amortized and recorded in interest expense using the effective interest rate method.

The debt retirement funds have been classified as held-for-trading assets and are recorded at fair value on the statement of financial position. The change in the fair value of the debt retirement funds has been recorded in interest expense.

Upon the adoption of the new standards, the impact of applying this change in accounting policy prospectively effective January 1, 2007 was as follows:

Adjustment to opening retained earnings
(millions)

As at January 1, 2007		
Debt retirement funds fair value adjustment	$	2
Total assets	$	2
Retained earnings, beginning of year - net adjustment	$	2
Total liabilities and equity	$	2

Impact of reclassifications
(millions)

As at January 1, 2007		
Fair value of derivative instruments - current asset	$	14
Fair value of derivative instruments - long-term asset		2
Investments and other assets		(2)
Total assets	$	14
Fair value of derivative instruments - current liability	$	14
Fair value of derivative instruments - long-term liability		1
Accumulated other comprehensive income, beginning of year		(1)
Total liabilities and equity	$	14

2. Change in Accounting Policy (continued)

Upon the adoption of the new standards, the impact of applying this change in accounting policy prospectively on the net income for the three months ended March 31, 2007 was as follows:

Impact on net income
(millions)

Three months ended March 31, 2007		
Gas marketing sales	$	(13)
Commodity cost of gas sold		1
Gas marketing cost of gas sold		2
Decrease in net income	$	(10)

3. Restatement of Comparative Figures

Effective January 1, 2007, SaskEnergy adopted the new Handbook Section 1530 – Comprehensive Income. In accordance with this section, the foreign currency translation adjustment of $2 million has been restated to accumulated other comprehensive income as at December 31, 2006.

4. Comparative Figures

The debt retirement funds which were previously presented as a reduction of long-term debt have now been presented at gross value and reported separately on the statement of financial position. Prior year comparative figures have been reclassified to conform with the current year's presentation.

Certain of the other prior year's figures have been reclassified to conform with the current year's presentation, primarily as a result of adopting CICA Sections 1530, 3251, 3855, 3861, and 3865.