

THIRD QUARTER INTERIM REPORT SEPTEMBER 30, 2009



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Corporate Profile

SaskEnergy has the legislated franchise for the distribution and transmission of natural gas within Saskatchewan. The distribution system delivers natural gas to over 342,000 residential, farm, commercial and industrial customers over a 66,000 kilometre pipeline distribution system. The transmission system provides transportation and storage services to the distribution utility, 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;
 - Bayhurst Energy Services Corporation – a wholly owned subsidiary of Bayhurst Gas Limited was created in 2007 and operates as an energy services company.
- 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. On November 2, 2009 SaskEnergy entered into an agreement to sell its 50.1 per cent share of Heritage Gas Limited to AltaGas Utility Group Inc. of Calgary, Alberta. This transaction closed November 18, 2009.

Management's Discussion and Analysis

The Management's Discussion and Analysis (MD&A) 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 nine month period ended September, 2009. This discussion is as of November 24, 2009 and 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, 2008.

The volume of natural gas distributed is sensitive to variations in the weather, particularly through the prime heating season of November to March. Therefore, the consolidated interim financial results 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.

The following discussion contains certain forward-looking statements that are subject to inherent uncertainties and risks. The significant uncertainties and risks of the Corporation include natural gas price, winter weather, operational, regulatory and counterparty credit risks. Consequently, actual results and events may vary significantly from those included in, contemplated or implied by such statements.

| Selected Consolidated Financial Highlights ENDED (\$ millions) | Three Months | | Nine Months | | |
|--|--------------|---------|--------------|-----------|--------|
| | September 30 | | September 30 | | |
| | 2009 | 2008 | 2009 | 2008 | Change |
| Consolidated Net Income | \$ 13 | \$ (65) | \$ 42 | \$ 9 | \$ 33 |
| Total Assets | | | 1,532 | 1,475 | 57 |
| Long-term Debt | | | 776 | 633 | 143 |
| Debt/Equity Ratio | | | 66% | 66% | 0% |
| Capital Expenditures | | | 90 | 80 | 10 |
| Operating Highlights | | | | | |
| Distribution | | | | | |
| Volumes Distributed - Petajoules | 15 | 19 | 90 | 95 | |
| Weather - Compared to thirty year average | n/a | n/a | 14% colder | 6% colder | |
| Transmission | | | | | |
| Volumes Transported - Petajoules (PJ) | 58 | 59 | 196 | 215 | |
| Peak Day Natural Gas Flows (winter season) - PJ | n/a | n/a | 1.18 | 1.50 | |
| - Day of Peak Flow | n/a | n/a | Jan 24 | Jan 28 | |

Consolidated Net Income

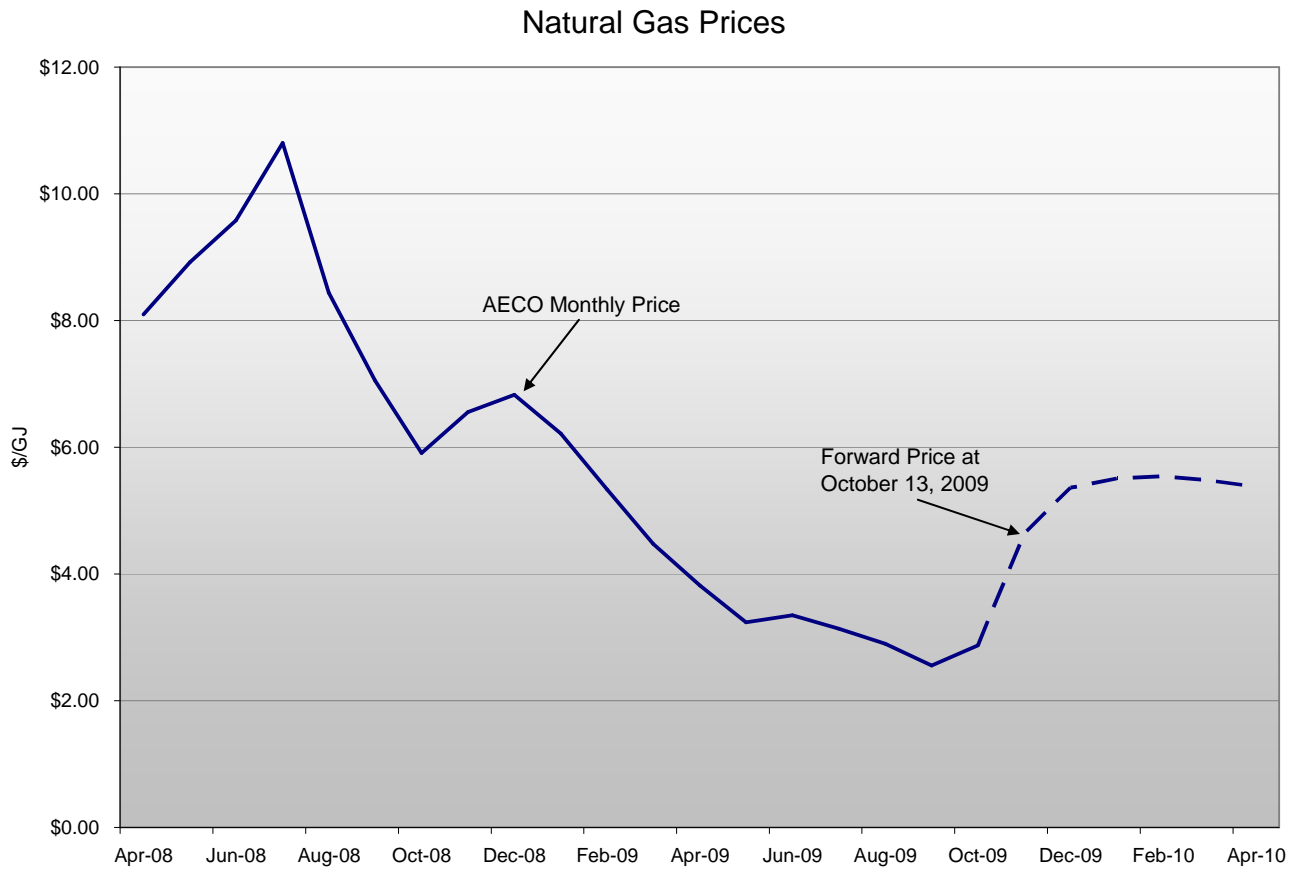
For the nine months ending September 30, 2009 consolidated net income was \$42 million, which was \$33 million higher than the \$9 million net income for the same period in 2008. The increase in consolidated income for 2009 was principally due to favourable fair value adjustments of \$22 million compared to unfavourable fair value adjustments of \$16 million over the same period in 2008.

Natural Gas Prices Remain Low

Despite a modest rebound, natural gas prices remain lower than historical norms. The lasting global economic recession has resulted in a long-standing over-supply of natural gas with natural gas storage levels now at record highs across North America.

Effective November 1, 2009 SaskEnergy received approval for a commodity rate decrease from \$5.96 per Gigajoule (GJ) to \$5.21 per GJ. This is SaskEnergy's lowest commodity rate since 2001.

Following is a chart of AECO natural gas prices. AECO is the major natural gas hub in Canada and is located in Alberta. Natural gas in Saskatchewan is priced at a differential to the AECO price and is usually about \$0.05GJ to \$0.10GJ higher than AECO.



1. Commodity Margin

| Commodity Margin Analysis (millions) | | |
|---|---------------------|---------------------|
| | YTD 2009 | YTD 2008 |
| Average Commodity Rate per GJ | <u>\$7.50</u> | <u>\$6.57</u> |
| Average Cost of Gas Sold per GJ | <u>\$7.67</u> | <u>\$6.55</u> |
| (Loss) Margin on Commodity Sales | \$ (8) | \$ 1 |
| Impact of Fair Value Adjustments | <u>22</u> | <u>(28)</u> |
| Net Commodity Margin (Loss) | <u>\$ 14</u> | <u>\$ (27)</u> |

The average commodity rate for natural gas sales to distribution utility customers was \$7.50 per GJ for the period January 1, 2009 to September 30, 2009. In 2008 the average commodity rate was \$6.57 per GJ for this period.

The weather was 14 per cent colder than normal in the first nine months of 2009 compared to 6 per cent colder than normal weather during the same period in 2008. The colder weather in 2009 increased the amount of natural gas consumed for space heating purposes by 3.6 Petajoules in 2009 compared to 2008.

The higher average rate combined with increased volumes sold resulted in commodity sales of \$342 million in the first nine months which was \$98 million higher than commodity sales of \$244 million for the same period in 2008.

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 September 30. The financial and derivative instruments reported on the Statement of Financial Position are reported at fair value. The change in fair value of financial and derivative instruments from one reporting period to another are reported as fair value adjustments and either increase or decrease net income.

The average cost of natural gas in the first nine months was \$7.67 per GJ which was higher than the average commodity rate of \$7.50 per GJ, resulting in a commodity loss of \$8 million

before fair value adjustments. However, fair value adjustments favourably impacted the financial reporting of the cost of gas sold during the first nine months of 2009 by \$22 million, resulting in a margin on commodity sales of \$14 million. The average cost of gas sold for the first nine months of 2008 of \$6.55 per GJ was lower than the average commodity rate of \$6.57 per GJ resulting in a commodity margin of \$1 million before fair value adjustments. The \$27 million loss on commodity sales for the first nine months of 2008 was primarily due to \$28 million in unfavourable fair value adjustments.

For the three months ended September 30, 2009 the margin on commodity sales was \$10 million. The margin on sales was favourably impacted for financial reporting purposes by the fair value adjustment of \$34 million. This compared to a loss of \$125 million and an unfavourable fair value adjustment of \$123 million on commodity sales in the third quarter of 2008.

2. Gas Marketing

| Gas Marketing Margin Analysis (millions) | | |
|---|---------------------|---------------------|
| | YTD 2009 | YTD 2008 |
| Margin on Gas Marketing | \$ 20 | \$ 6 |
| Impact of Fair Value Adjustments | <u>(1)</u> | <u>13</u> |
| | \$ 19 | \$ 19 |
| Revaluation of Inventory | <u>(3)</u> | <u>n/a</u> |
| Net Gas Marketing Margin | <u>\$ 16</u> | <u>\$ 19</u> |

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

In the first nine months of 2009, the realized margin from the foregoing activity was \$20 million. However, with the decline in natural gas market prices, the net realizable value for gas marketing natural gas in storage has fallen below cost. A downward revaluation of natural gas in storage of \$3 million was recorded. If natural gas prices rise in the future, SaskEnergy will record an upward revaluation

to recognize the increase in net realizable value, up to a maximum of the original cost. Otherwise, the \$3 million will result in improved margins in the future as contracts are settled by virtue of the lower carrying value of natural gas in storage.

The margin from gas marketing activities was unfavourably impacted by the fair value adjustment of \$1 million: this resulted in a net gas marketing margin of \$16 million for the nine month period ending September 30, 2009. This compared to a realized margin of \$6 million and a favourable fair value adjustment of \$13 million, resulting in a net margin of \$19 million for the same period in 2008.

When this natural gas is purchased it is held in storage to meet future sales contracts which have been entered into at a fixed price. The margin is "locked in", and SaskEnergy will receive a positive net cash flow in the future. There is a timing difference as to when the revenue and related cost of gas are recorded, but the same positive net cash flow will be realized over time.

In the three month period ended September 30, 2009, the margin from the foregoing activity was \$14 million. An upward revaluation of natural gas in storage of \$18 million was recorded due to the increase in natural gas market prices as well as the sale of natural gas in storage at a lower carrying value in the quarter. The margin from gas marketing activities was unfavourably impacted by the fair value adjustment of \$18 million; this resulted in a net margin of \$14 million for the three month period. This compared to a loss of \$3 million and a favourable fair value adjustment of \$74 million resulting in a net margin of \$71 million for the same period in 2008.

3. Delivery Revenue

Delivery revenue in the first nine months of 2009 was \$133 million, which was \$10 million higher than the \$123 million reported for the same period in 2008. This was a result of higher delivery rates and increased natural gas consumption in 2009 reflecting the colder weather in 2009 compared to 2008.

For the three month period ended September 30, 2009, delivery revenue of \$27 million was

\$3 million higher than the same period in 2008 due to higher delivery rates.

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 September 30, 2009 was 5 per cent colder than the same period in 2008.

Effective November 1, 2008, SaskEnergy received approval for a delivery rate increase. As a result, the delivery rate charged to distribution utility customers was 5.8 per cent higher for the first nine months in 2009 as compared to the same period on 2008.

4. Transportation and Storage Revenue

Transportation and storage revenue for the first nine months of 2009 was \$60 million, which was \$3 million higher than the \$57 million reported in the same period in 2008.

For the three month period ended September 30, 2009, revenue from the forgoing activity was \$20 million, \$2 million higher than the \$18 million reported in the same period in 2008.

Transportation and storage revenue includes a rate increase of 8.6 per cent effective February 1, 2009. The effect of the rate increase was offset by the reduction in transportation volumes in 2009 that have occurred due to a continued decline in natural gas production in Saskatchewan.

5. Other Expenses

Operating and maintenance expenses for the first nine months of 2009 were \$107 million, which was \$8 million higher compared to the \$99 million reported in the first nine months of 2008 mainly due to higher labour costs and other general expenses. However, the operating and maintenance expenses are currently lower than anticipated in the Corporation's business plan.

For the three month period ended September 30, 2009, operating and maintenance expenses were \$34 million. This was \$2 million over the \$32 million reported in the same period in 2008 due

to higher labour costs and other general expenses.

Interest, amortization, and Saskatchewan taxes to September 30, 2009 and for the three months there ended were consistent with the same periods in 2008.

Subsequent Event

On November 2, 2009 SaskEnergy, AltaGas of Calgary and Scotia Investments of Halifax entered into a purchase and sale agreement involving Heritage Gas Limited. Heritage Gas is the natural gas distribution company with the franchise rights to service parts of six Counties in the Province of Nova Scotia.

Under the terms of this agreement AltaGas has agreed to purchase SaskEnergy's 50.1 per cent share in Heritage Gas for \$73.3 million, as well as the 25 per cent share of the company owned by Scotia Investments. The agreement, which closed November 18, 2009, will have AltaGas own 100 per cent of the company.

SaskEnergy has invested approximately \$55 million of capital in Heritage Gas and has recorded approximately \$9.3 million in earnings since its inception in 2003.

Outlook

SaskEnergy will continue to monitor the impact of changing economic conditions throughout its business operations. SaskEnergy is projecting 4,500 new natural gas customer connections in 2009 compared to the exceptional year in 2008 with 6,100 new customer connections. Transportation revenue is directly impacted by the level of new natural gas wells drilled in the province. The reduced drilling activity seen over the last half of 2008, due to declining prices for natural gas, is continuing in 2009. Fewer wells drilled translate into reduced volumes of gas that shippers transport on the transmission system, which will mean lower revenues.

The Corporation's consolidated net income result for 2009 is expected to be negatively impacted by lower than anticipated transportation revenues and reduced margins on its gas marketing and gas processing activities due to lower market prices.

All internal costs are closely managed in an effort to minimize any future rate adjustments related to the company's operations, while maintaining a focus on high levels of customer service and safety. SaskEnergy conducts its borrowing activity for its capital program through the Province of Saskatchewan and the Corporation does not anticipate any problems accessing adequate capital for the balance of 2009.

Future Accounting Changes - International Financial Reporting Standards (IFRS)

Effective January 1, 2011, publicly accountable Canadian entities will be required to prepare financial information in accordance with International Financial Reporting Standards (IFRS). The Public Sector Accounting Board (PSAB) has approved an amendment to the scope of public sector accounting standards. The amendment confirms that Government Business Enterprises (GBEs), including SaskEnergy, will be required to follow IFRS for periods beginning January 1, 2011. This allows for a comparison of similar entities in the public and private sector.

SaskEnergy commenced its IFRS conversion project and an external advisor has been engaged to assist with the development and implementation of plans and to perform a detailed review of major differences between current Canadian Generally Accepted Accounting Principles and IFRS. SaskEnergy completed an initial assessment of those international reporting standards with the highest potential for impacts. Board members have been briefed on IFRS, participated in high level training and have reviewed and approved project plans. Management and staff from SaskEnergy have participated in IFRS training seminars.

At this time the impact of IFRS on SaskEnergy's future financial position and results of operations is not reasonably determinable. However based on analysis to date the most significant areas of difference are related to the accounting for property, plant and equipment and financial statement disclosure. In conjunction with evaluating the accounting standards, a review of the information technology and data systems' capability to provide the information required by IFRS will be performed.

SaskEnergy Incorporated
Consolidated Statement of Financial Position

(millions)
(unaudited)

| AS AT | Sept. 30, 2009 | Dec. 31, 2008 |
|---|----------------|---------------|
| | (Note 2) | |
| Assets | | |
| Current assets | | |
| Cash | \$ 2 | \$ 4 |
| Accounts receivable | 61 | 163 |
| Natural gas in storage held for resale | 241 | 199 |
| Inventories of supplies | 10 | 17 |
| Debt retirement funds | 9 | - |
| Fair value of derivative instruments | 58 | 46 |
| | 381 | 429 |
| Intangible assets (net) | 15 | 17 |
| Property, plant and equipment (net) | 1,011 | 991 |
| Natural gas in storage held for resale and operations | 34 | 35 |
| Debt retirement funds | 47 | 48 |
| Investments and other assets | 44 | 41 |
| | \$ 1,532 | \$ 1,561 |
| Liabilities and Province's Equity | | |
| Current liabilities | | |
| Short-term debt | \$ 160 | \$ 164 |
| Accounts payable | 81 | 136 |
| Dividend payable | 10 | 6 |
| Current portion of long-term debt | 92 | 39 |
| Fair value of derivative instruments | 53 | 61 |
| | 396 | 406 |
| Asset retirement obligations | 8 | 8 |
| Long-term debt | 684 | 714 |
| | 1,088 | 1,128 |
| Province of Saskatchewan's equity | | |
| Retained earnings | 376 | 364 |
| Accumulated other comprehensive loss | (4) | (3) |
| | 372 | 361 |
| Equity advances | 72 | 72 |
| | 444 | 433 |
| | \$ 1,532 | \$ 1,561 |

(See accompanying notes)

SaskEnergy Incorporated
Consolidated Statement of Income and Retained Earnings

(millions)
(unaudited)

| FOR THE PERIOD ENDED | Three months ended September 30 | | Nine months ended September 30 | |
|--|------------------------------------|--------|-----------------------------------|--------|
| | 2009 | 2008 | 2009 | 2008 |
| | (Note 2) | | (Note 2) | |
| Revenue | | | | |
| Commodity sales | \$ 27 | \$ 29 | \$ 342 | \$ 244 |
| Gas marketing sales | 117 | 292 | 334 | 438 |
| Delivery | 27 | 24 | 133 | 123 |
| Transportation and storage | 20 | 18 | 60 | 57 |
| Revenue collected for municipalities | 1 | 2 | 18 | 17 |
| Other | 3 | 5 | 7 | 13 |
| | 195 | 370 | 894 | 892 |
| Expenses | | | | |
| Commodity cost of gas sold | 17 | 154 | 328 | 271 |
| Gas marketing cost of gas sold | 103 | 221 | 318 | 419 |
| Operating and maintenance | 34 | 32 | 107 | 99 |
| Amortization | 15 | 13 | 43 | 40 |
| Interest | 10 | 10 | 32 | 31 |
| Payments to municipalities | 1 | 2 | 18 | 17 |
| Saskatchewan taxes | 2 | 3 | 6 | 6 |
| | 182 | 435 | 852 | 883 |
| Net income (loss) | 13 | (65) | 42 | 9 |
| Retained earnings, beginning of period | 373 | 422 | 364 | 379 |
| Change in accounting policy | - | - | - | (2) |
| Dividends | (10) | (8) | (30) | (37) |
| Retained earnings, end of period | \$ 376 | \$ 349 | \$ 376 | \$ 349 |

(See accompanying notes)

SaskEnergy Incorporated
Consolidated Statement of Comprehensive Income
(millions)
(unaudited)

| FOR THE PERIOD ENDED | Three months ended | | Nine months ended | |
|---|--------------------|---------|-------------------|-------|
| | September 30, | | September 30, | |
| | 2009 | 2008 | 2009 | 2008 |
| Net income (loss) | \$ 13 | \$ (65) | \$ 42 | \$ 9 |
| Other comprehensive income: | | | | |
| Unrealized gains and losses on translating financial statements of self-sustaining foreign operations | (3) | 1 | (1) | 1 |
| Comprehensive income (loss) | \$ 10 | \$ (64) | \$ 41 | \$ 10 |

SaskEnergy Incorporated
Consolidated Statement of Accumulated Other Comprehensive Loss
(millions)
(unaudited)

| AS AT | Three months ended | | Nine months ended | |
|--|--------------------|--------|-------------------|--------|
| | September 30 | | September 30 | |
| | 2009 | 2008 | 2009 | 2008 |
| Accumulated other comprehensive loss, beginning of period | \$ (1) | \$ (5) | \$ (3) | \$ (5) |
| Other comprehensive income (loss) | (3) | 1 | (1) | 1 |
| Accumulated other comprehensive loss, end of period | \$ (4) | \$ (4) | \$ (4) | \$ (4) |

(See accompanying notes)

SaskEnergy Incorporated
Consolidated Statement of Cash Flows

(millions)
(unaudited)

| FOR THE PERIOD ENDED | Three months ended | | Nine months ended | |
|--|--------------------|---------|-------------------|-------|
| | September | | September | |
| | 2009 | 2008 | 2009 | 2008 |
| | (Note 2) | | (Note 2) | |
| Operating Activities | | | | |
| Net income | \$ 13 | \$ (65) | \$ 42 | \$ 9 |
| Add (deduct) items not requiring an outlay of cash | | | | |
| Amortization | 15 | 13 | 43 | 40 |
| Write-down of NGIS held for resale (Note 3) | (18) | - | 3 | - |
| Change in fair value of derivative instruments (Note 4) | (17) | 49 | (21) | 15 |
| Debt retirement fund earnings | (1) | - | (2) | (1) |
| Equity earnings | (1) | - | (1) | (1) |
| Other | 1 | - | - | (2) |
| | (8) | (3) | 64 | 60 |
| Net change in non-cash working capital related to operations | 1 | (37) | 9 | (36) |
| Cash (used in) provided by operating activities | (7) | (40) | 73 | 24 |
| Investing Activities | | | | |
| Additions to property, plant and equipment | (42) | (34) | (90) | (80) |
| Additions to investments and other assets | (3) | (2) | (3) | (4) |
| Customer capital contributions received | 14 | 6 | 30 | 16 |
| Cash used in investing activities | (31) | (30) | (63) | (68) |
| Financing Activities | | | | |
| Increase (decrease) in short-term debt | 61 | 88 | (4) | 154 |
| Debt retirement fund investments | (3) | (2) | (6) | (4) |
| Debt retirement fund redemptions | - | - | - | 3 |
| Proceeds from long-term debt | - | - | 50 | - |
| Repayments of long-term debt (net) | (15) | - | (26) | (75) |
| Dividends paid | (5) | - | (26) | (20) |
| Cash provided by (used in) financing activities | 38 | 86 | (12) | 58 |
| Increase (decrease) in cash during period | - | 16 | (2) | 14 |
| Cash position, beginning of period | 2 | - | 4 | 2 |
| Cash position, end of period | \$ 2 | \$ 16 | \$ 2 | \$ 16 |

SaskEnergy Incorporated

Notes to the Consolidated Financial Statements September 30, 2009

Unaudited

1. Accounting Policies

SaskEnergy Incorporated (SaskEnergy or the Corporation) prepares its consolidated interim financial statements in accordance with Canadian generally accepted accounting principles (GAAP). The disclosures do not conform in all respects to the requirements for annual financial statements. Except for the change described in Note 2, 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, 2008.

These consolidated interim financial statements, which are unaudited, should be read in conjunction with the consolidated financial statements for the year ended December 31, 2008 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.

a. Future accounting policy changes

The CICA has issued several new Handbook Sections: Section 1582 - Business Combinations, Section 1601 - Consolidated Financial Statements and Section 1602 - Non-Controlling Interests for fiscal years beginning on or after January 1, 2011. These sections replace existing Handbook Sections 1581 and 1600 and establish standards for the accounting of business combinations, the preparation of consolidated financial statements and accounting for a non-controlling interest in a subsidiary. The Corporation is evaluating the potential impacts of these accounting recommendations and does not anticipate a significant impact on the Corporation's financial statements.

The CICA has announced that publicly accountable Canadian entities will be required to prepare financial information in accordance with International Financial Reporting Standards (IFRS) effective January 1, 2011. Although IFRS are a principle-based set of standards, similar to current GAAP, there are areas where the accounting treatment differs from Canadian GAAP. The Corporation is evaluating the potential impacts of IFRS on the Corporation's financial statements.

2. Change in Accounting Policy

Effective January 1, 2009, SaskEnergy adopted the CICA Handbook Section 3064 - Goodwill and Intangible Assets. This section supersedes Section 3062 - Goodwill and Other Intangible Assets and Section 3450 - Research and Development Costs. This section establishes standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. The standard requires retrospective application with restatement of prior year comparative results. Intangible assets are to be presented and disclosed separately in the financial statements and in the notes to the financial statements.

Upon the adoption of the new standard, SaskEnergy is presenting and disclosing intangible assets separately in the financial statements and in the notes to the financial statements. The impact of applying this change in accounting policy effective January 1, 2009 was as follows:

| | Dec. 31 |
|--|-------------------|
| | 2008 |
| | (millions) |
| Intangible assets (net) | \$ 17 |
| Property, plant and equipment (net) | (17) |
| Total assets | \$ - |
| Total liabilities and Province's equity | \$ - |

The adoption of this section did not have a material effect on the results of the nine month period ended September 30, 2009.

3. Natural Gas in Storage Held for Resale and Operations

For the nine months ended September 30, 2009, \$565 million of natural gas in storage held for resale (2008 - \$651 million) was recognized as cost of gas sold. With the decline in natural gas market prices, the net realizable value of gas marketing natural gas in storage has fallen below cost. There was a \$3 million write-down of natural gas in storage held for resale to its net realizable value included in gas marketing cost of gas sold. If natural gas prices rise in the future, there will a reversal of the write-down. There were no net realizable value adjustments to inventory recorded in 2008.

4. Financial Instruments and Risk Management

a. Fair value of financial instruments

The fair value of the Corporation's financial instruments is listed below:

| | September 30, 2009 | | December 31, 2008 | |
|--------------------------|--------------------|------------|-------------------|------------|
| | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| | (millions) | | | |
| Other liabilities | | | | |
| Long-term debt | \$ 776 | \$ 893 | \$ 753 | \$ 853 |
| Held-for-trading | | | | |
| Debt retirement funds | 56 | 56 | 48 | 48 |

The fair values of the above instruments were based on the following:

- i. Long-term debt – The present value of future cash flows discounted at the market rate of interest for the equivalent Province of Saskatchewan debt instruments.
- ii. Debt retirement funds – The market value of the investments held in the debt retirement fund as determined by Saskatchewan's Ministry of Finance as at September 30 and December 31.

b. Natural gas derivative instruments

The fair value of natural gas derivative instruments held-for-trading, with the exception of natural gas price options, is calculated daily and is based on quoted market prices. The fair value of natural gas price options is determined using the Garman-Kohlhagen model which requires the use of various assumptions, including quoted market prices, interest rates and volatility estimates for forward natural gas prices, which are each based on external market sources. For physical natural gas contracts, notional values are an approximation of future net cash flows based on contract price multiplied by contract quantity. For other derivative instruments, the notional value is the difference between the contract price and the market price. SaskEnergy has sufficient borrowing capacity to fund these contractual obligations. Where contract prices are referenced to an index price that has not yet been fixed, the market price at September 30, 2009 has been used to estimate the contract price. At September 30, 2009, all derivative assets and liabilities held-for-trading are recorded on the statement of financial position at fair value.

4. Financial Instruments and Risk Management (continued)

As at September 30, 2009, natural gas derivative instruments held-for-trading had the following fair values, notional values and maturities:

| | <u>2009</u> | <u>2010</u> | <u>2011</u> | <u>2012</u> | <u>2013</u> | <u>2014</u> | <u>Total</u> |
|--|-------------|-------------|-------------|-------------|-------------|-------------|--------------|
| | (millions) | | | | | | |
| Physical natural gas contracts | | | | | | | |
| Fair value | \$ 1 | \$ 6 | \$ 1 | \$ - | \$ - | \$ - | \$ 8 |
| Notional value | (28) | 6 | 7 | 3 | 2 | 2 | (8) |
| Natural gas price swaps | | | | | | | |
| Fair value | (10) | 1 | 4 | 4 | 1 | - | - |
| Notional value | (10) | 1 | 4 | 4 | 1 | - | - |
| Natural gas price options | | | | | | | |
| Fair value | (3) | - | - | - | - | - | (3) |
| Notional value | (3) | - | - | - | - | - | (3) |
| Total | | | | | | | |
| Fair value | \$ (12) | \$ 7 | \$ 5 | \$ 4 | \$ 1 | \$ - | \$ 5 |
| Notional value | \$ (41) | \$ 7 | \$ 11 | \$ 7 | \$ 3 | \$ 2 | \$ (11) |
| Fair value - asset (liability) | | | | | | | |
| Notional value - estimated net cash inflow (outflow) | | | | | | | |

The fair value of derivative instruments is presented on the consolidated statement of financial position as follows:

| | <u>September 30,</u> <u>2009</u> | <u>December 31,</u> <u>2008</u> |
|---|-------------------------------------|------------------------------------|
| | (millions) | |
| Fair value of derivative instrument assets | \$ 58 | \$ 46 |
| Fair value of derivative instrument liabilities | (53) | (61) |
| Total fair value | <u>\$ 5</u> | <u>\$ (15)</u> |

4. Financial Instruments and Risk Management (continued)

c. Changes in fair value

The change in fair value of financial and derivative instruments is recorded in net income within the relevant revenue or expense category. For the period ended September 30, the increase (decrease) in net income arising from these unrealized gains and losses was as follows:

| | Increase (decrease) Three months ended | | Increase (decrease) Nine months ended | |
|-----------------------------------|---|-------|--|---------|
| | 2009 | 2008 | 2009 | 2008 |
| | (millions) | | (millions) | |
| Gas marketing sales | (36) | 104 | (3) | 15 |
| Commodity cost of gas sold | 34 | (123) | 22 | (28) |
| Gas marketing cost of gas sold | 18 | (30) | 2 | (2) |
| Interest | 1 | (1) | 1 | (1) |
| Increase (decrease) in net income | \$ 17 | (50) | \$ 22 | \$ (16) |

d. Risk management

i. Natural gas price risk

The Corporation uses various derivative financial instruments to manage the risks associated with its exposures to fluctuations in the price of natural gas. A Corporate Derivatives Policy and specific risk management strategies establish guidelines for the use of such derivative financial instruments. The purchase or sale price of natural gas may be fixed within the contract, or referenced to a floating index price. When the price is referenced to a floating index price, natural gas derivative instruments may be used to fix the settlement amount. The types of natural gas derivative instruments SaskEnergy uses for price risk management include natural gas price swaps, options, swaptions and futures contracts.

Based on the Corporation's September 30, 2009 closing positions, an increase of \$1.00 per Gigajoule in natural gas prices would have increased net income, through an increase in the fair value of natural gas contracts, by approximately \$15 million. Conversely, a decrease of \$1.00 per Gigajoule would have decreased net income, through a decrease in the fair value of natural gas contracts, by approximately \$15 million.

ii. Credit risk

The Corporation is exposed to credit risk through cash, accounts receivable, debt retirement funds and derivative instrument assets. Credit risk related to cash and debt retirement funds and derivative instrument assets. Credit risk related to cash and debt retirement funds is minimized by dealing with institutions that have strong credit ratings and holding highly-rated financial securities.

The Corporation extends credit to its customers in the normal course of business and is at risk of loss in the event of non-performance by counterparties on certain of the financial instruments described above. To reduce its credit risk, SaskEnergy has established policies and procedures to monitor and limit the amount of credit extended to its customers and counterparties and may require letters of credit and other forms of security. At September 30, 2009 the maximum credit exposure to a single counterparty was \$15 million (December 31, 2008 - \$14 million).

4. Financial Instruments and Risk Management (continued)

The carrying amount of financial and derivative assets represents the maximum credit exposure as follows:

| | September 30 2009 | December 31 2008 |
|--|----------------------|---------------------|
| | (millions) | |
| Cash | \$ 2 | \$ 4 |
| Accounts receivable | 61 | 163 |
| Debt retirement funds | 56 | 48 |
| Fair value of derivative instrument assets | 58 | 46 |
| Maximum credit exposure | <u>\$ 177</u> | <u>\$ 261</u> |

5. Subsequent Event

On November 2, 2009 the Corporation entered into an agreement to sell its 50.1 per cent share of Heritage Gas Limited in the Province of Nova Scotia to AltaGas Utility Group Inc. of Calgary, Alberta. The transaction which closed on November 18, 2009, had a cash purchase price of \$73.3 million.

6. Comparative Figures

Certain of the prior period's figures have been reclassified to conform to the current period's presentation.