



SASKENERGY INCORPORATED

FIRST QUARTER REPORT
June 30, 2017

SaskEnergy 

VISION, MISSION AND VALUES

As a Crown corporation, SaskEnergy is committed to ensuring that all corporate activities align with the Government of Saskatchewan's Crown Sector Strategic Priorities and the Saskatchewan Plan for Growth. Providing safe, reliable, high quality service to its customers is critically important to the Corporation – as is the provision of infrastructure necessary for the Province to grow and prosper.

VISION

To create a competitive advantage for Saskatchewan through safe, innovative energy solutions.

MISSION

Our team of engaged employees and business partners develops and delivers safe, reliable natural gas solutions that benefit our customers and Saskatchewan.

VALUES

Community
Communication
Recognition

Safety

Integrity
Accountability
Spirit

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FINANCIAL AND OPERATING HIGHLIGHTS

| | Three months ended June 30 | |
|---|-------------------------------|------------|
| | 2017 | 2016 |
| FINANCIAL HIGHLIGHTS | | |
| (\$ millions) | | |
| Total revenue | 166 | 118 |
| Total expenses | 172 | 64 |
| Consolidated net income (loss) | (6) | 54 |
| Market value adjustments | 2 | 57 |
| Income before unrealized market value adjustments | (8) | (3) |
| Other Comprehensive Income | \$ - | - |
| Comprehensive Income | \$ (6) | 54 |
| Dividends | - | - |
| Cash provided by operating activities | 73 | 54 |
| Capital expenditures | 37 | 30 |
| Total assets | 2,494 | 2,451 |
| Total net debt | 1,202 | 1,163 |
| Debt ratio | 60.6% | 59.4% |
| OPERATING HIGHLIGHTS | | |
| Distribution | | |
| Volumes distributed (petajoules) | | |
| Residential/Farm | 4 | 4 |
| Commercial | 4 | 4 |
| Industrial | 29 | 30 |
| Total | 37 | 38 |
| Weather (compared to last 30 years) | 3% warmer | 17% warmer |
| Transmission | | |
| Volumes transported (petajoules) | | |
| Domestic | 61 | 64 |
| Export | 7 | 1 |
| Total | 68 | 65 |

MANAGEMENT'S DISCUSSION & ANALYSIS

INTRODUCTION

The Management's Discussion and Analysis (MD&A) highlights the primary factors that affected SaskEnergy's consolidated financial condition and performance for the three months ended June 30, 2017. Using financial and operating results as its basis, the MD&A describes the Corporation's past performance and future prospects, enabling readers to view SaskEnergy from the perspective of management. This MD&A is presented as at August 23, 2017 and should be read in conjunction with the Corporation's condensed consolidated financial statements, which have been prepared in accordance with International Accounting Standard (IAS) 34 *Interim Financial Reporting* using accounting policies consistent with International Financial Reporting Standards (IFRS). For additional information related to the Corporation, refer to SaskEnergy's 2016-17 Annual Report.

The following discussion contains certain forward-looking statements that are subject to inherent uncertainties and risks, which are described in the Risk Management and Disclosure section of SaskEnergy's 2016-17 Annual Report. All forward-looking statements reflect the Corporation's best estimates and assumptions based on information available at the time the statements were made. However, actual results and events may vary significantly from those included in, contemplated by, or implied by such statements.

The volume of natural gas delivered to customers is sensitive to variations in the weather, particularly through the prime heating season of November to March. Additionally, changes in market value adjustments may cause significant fluctuations in net income due to the volatility of natural gas prices. Therefore, the condensed consolidated financial results for the first three months of 2017-18 should not be taken as indicative of the performance to be expected for the full year.

In order to compare financial performance from period to period, the Corporation uses the following measures: income before unrealized market value adjustments, realized margin on commodity sales, and realized margin on gas marketing sales. Each measure removes the impact of fair value adjustments on financial and derivative instruments and the revaluation of natural gas in storage to the lower of cost and net realizable value. These unrealized market value adjustments vary considerably with the market prices of natural gas, drive significant changes in the Corporation's consolidated net income, and may obscure other business factors that are also important to understanding the Corporation's financial results. The measures referred to above are non-IFRS measures, in that there is no standardized definition, and may not be comparable to similar measures presented by other entities.

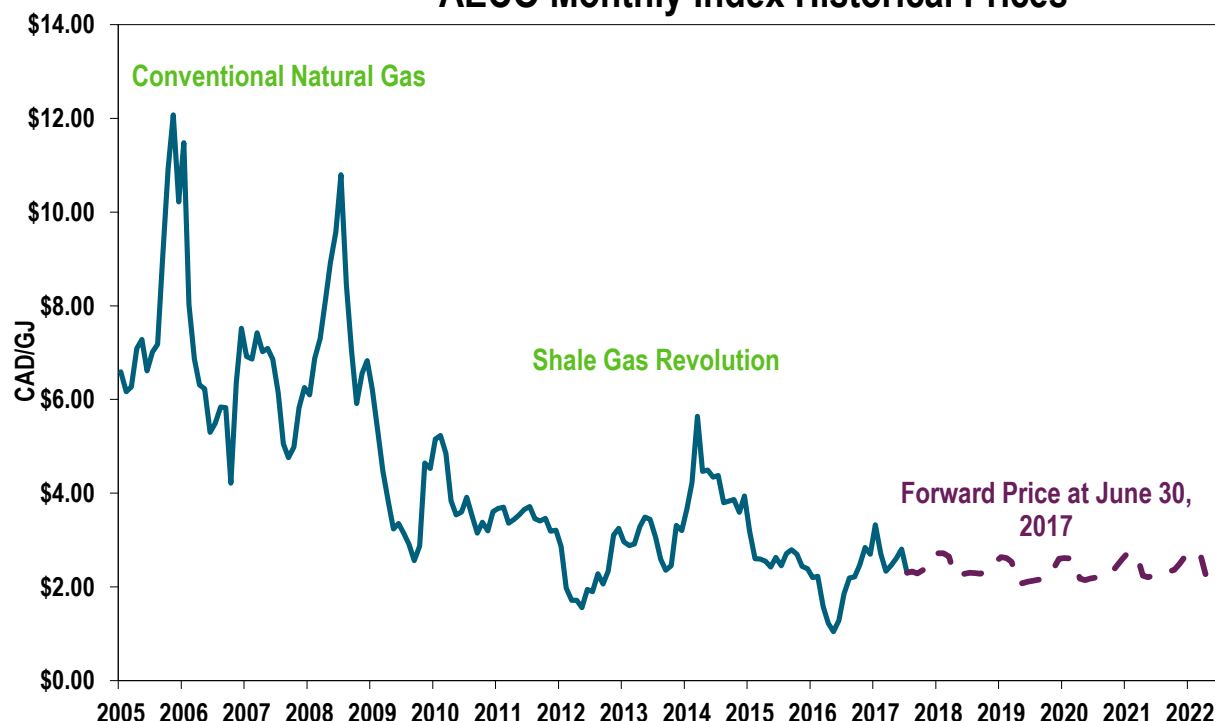
INDUSTRY OVERVIEW

Natural gas prices are set in an open market and are influenced by a number of factors including production, demand, natural gas storage levels and economic conditions. Given the high demand for natural gas to heat homes and businesses during the cold winter months, and the demand for natural gas to produce electricity for air conditioning, weather typically has the greatest impact on natural gas prices in the near term. Due to the high degree of uncertainty associated with weather, natural gas prices can be very volatile.

Natural gas market fundamentals have remained in a reasonably strong supply position relative to demand over the last number of years due to the advancements in shale gas production. Record high storage inventory in Western Canada have resulted after warmer than normal winters. The AECO monthly index, the benchmark price for natural gas in Western Canada, settled at \$2.19 per gigajoule (GJ) for the month of June 2017. Throughout the quarter, market prices have fluctuated modestly with an overall downward trend. Despite the 2016-17 winter season being the second consecutive abnormally warm winter across most of North America, AECO market prices have generally been trading in a \$2.00 - \$3.00 per GJ range.

The index declined from \$2.59 per GJ at the end of March 2017 to \$2.19 per GJ at the end of June 2017. This was a 15 per cent decline in the three month period as noted in the AECO Monthly Index Historical Prices chart, however, during this period AECO gas prices peaked at \$3.03 / GJ and also hit a low of \$2.14 / GJ. Most natural gas in Saskatchewan is priced at a differential to the AECO price and is typically between \$0.05 per GJ and \$0.20 per GJ higher than AECO.

AECO Monthly Index Historical Prices



CONSOLIDATED FINANCIAL RESULTS

Consolidated Net Income

| (millions) | Three months ended June 30 | | |
|---|-------------------------------|--------------|----------------|
| | 2017 | 2016 | Change |
| (Loss) before unrealized market value adjustments | \$ (8) | \$ (3) | \$ (5) |
| Impact of fair value adjustments | 6 | 46 | (40) |
| Revaluation of natural gas in storage | (4) | 11 | (15) |
| Consolidated net (loss) income | \$ (6) | \$ 54 | \$ (60) |

The loss before unrealized market value adjustments was \$8 million for the three months ended June 30, 2017, \$5 million unfavourable compared to the \$3 million loss in 2016, due primarily to impairments taken on non-core storage and gathering, treatment and compression assets. The long term price of natural gas is in backwardation which means that there are less favourable price differentials between current and forward market prices and limited opportunities to use storage to generate gas marketing margins.

With respect to core operations, the delivery rate increase effective November 1, 2016 combined with increased transportation loads is contributing to higher revenues compared to 2016. Both operating and maintenance, and depreciation have increased compared to 2016, a result of growth in the Corporation's natural gas infrastructure and customer base. Continued cost management efforts have resulted in employee benefits remaining unchanged from the prior year.

A large portion of SaskEnergy's revenue is dependent on customer's use of natural gas to heat their premises. Normally, customers do not use a lot of gas in the first quarter of the fiscal year and when weather is warmer than normal, as May proved to be, generating net income during the first quarter is challenging. However, excluding the impairments taken on non-

core assets, SaskEnergy would have generated a small net income during the first quarter due to the recognition of insurance proceeds related to an incident at the Prud'homme storage caverns in 2014.

During April through June 2017, higher priced natural gas purchase contracts related to the Corporation's commodity business were delivered, which had a favourable impact on unrealized fair value adjustments. Also, during the same period, the AECO near-month natural gas spot price declined from \$2.59 per GJ at the end of March 2017 to \$2.19 per GJ. The net effect of expiring contracts that were out of the money and the impact of lower market prices on outstanding contracts generated a \$6 million favourable unrealized fair value adjustment. When natural gas market prices decreased through the three months ended June 30, 2017, the unfavourable net realizable value adjustment to gas in storage at the end of March 2017 increased by \$4 million at June 2017, resulting in an unfavourable impact on the Corporation's consolidated net income.

Natural Gas Sales and Purchases

Included within natural gas sales and purchases are rate-regulated commodity sales to distribution customers and non-regulated gas marketing activities. IFRS requires these activities to be presented together within the consolidated financial statements; however, the Corporation manages these activities as distinct and separate businesses and, as such, the MD&A addresses these natural gas sales and purchases separately.

In the third quarter of 2016, the Corporation started to identify certain natural gas purchase contracts as own-use contracts. The Corporation enters into these contracts to acquire the natural gas it needs to meet expected sales to commodity customers. These non-financial derivative contracts are not recorded at fair value, rather, the contracts are accounted for as a purchase at the time of delivery. Natural gas contracts, not identified as own-use purchases, are classified as derivative instruments, which are recorded at fair value until their settlement date. Changes in the fair value of the derivative instruments, driven by changes in future natural gas prices, are recorded in net income through natural gas sales or natural gas purchases depending on the specific contract. Upon settlement of the natural gas contract, the amount paid or received by SaskEnergy becomes realized and is recorded in natural gas sales or purchases.

Commodity Margin

SaskEnergy sells natural gas to its distribution customers at a commodity rate approved by Provincial Cabinet based on the recommendations of the Saskatchewan Rate Review Panel. The commodity rate, which is reviewed in April and November of each year, is determined based on rate-setting principles and is designed to recover the realized costs associated with natural gas sold to distribution customers without earning a profit. Regulatory principles require that utilities do not earn a profit or realize losses on the sale of natural gas to customers over the long term. Consequently, SaskEnergy accumulates differences between the commodity revenue earned and the cost of natural gas sold in a Gas Cost Variance Account (GCVA). The balance in the GCVA, which is not included in SaskEnergy's financial statements, is either recovered from, or refunded to customers as part of future commodity rates. Consequently, lower commodity margins in one year are often followed by higher commodity margins in the subsequent year.

For financial reporting purposes, the Corporation prepares its financial statements on a consolidated basis while applying IFRS. As a result, the amounts determined for rate-setting purposes are different than those reported within its consolidated financial statements. The most notable differences are the elimination of intercompany costs in the preparation of the consolidated financial statements and how derivative instrument settlements are recognized in the cost of gas. A gain or loss reported in the Corporation's consolidated financial statements may not indicate a similar adjustment in the GCVA.

| (millions) | Three months ended | | |
|------------------------------------|--------------------|-------|---------|
| | June 30 | | |
| | 2017 | 2016 | Change |
| Commodity sales | \$ 24 | \$ 28 | \$ (4) |
| Commodity purchases ¹ | (21) | (27) | 6 |
| Realized margin on commodity sales | 3 | 1 | 2 |
| Impact of fair value adjustments | 1 | 48 | (47) |
| Margin on commodity sales | \$ 4 | \$ 49 | \$ (45) |

¹ Net of change in inventory

SaskEnergy's natural gas price risk management program has two objectives: to reduce the impact of natural gas price volatility on the cost of gas and to support rates that are competitive with other utilities. The two objectives direct activities that naturally oppose each other. Reducing the impact of price volatility requires establishing certainty in the cost of gas, while supporting competitive rates often means allowing purchase prices to follow market prices. As a result, the balance between the two objectives may change depending on current market conditions.

In order to ensure a secure supply of natural gas, SaskEnergy contracts for the physical delivery of natural gas using non-financial derivatives, referred to as forward or physical natural gas contracts. The purchase price contained in these forward contracts may be fixed, or it may be based on a variable index price. While fixed price contracts reduce the impact of natural gas price volatility, variable or market prices can assist in offering competitive rates depending on the pricing environment. SaskEnergy uses financial derivatives and physical swaps to manage the future purchase price of natural gas. Identifying own-use natural gas purchase contracts reduces the variability of fair value adjustments in the Corporation's financial statements. SaskEnergy's price risk management strategy will govern purchases not identified as own-use purchases to reduce the impact of price changes on realized gas purchase costs which add to the variability in fair value adjustments.

The realized margin on commodity sales excludes the impact of unrealized fair value adjustments on derivative instruments, as these adjustments can fluctuate significantly from one period to the next and do not necessarily represent the amount that will be paid upon settlement of the related natural gas contract. On a consolidated basis, the Corporation realized a \$3 million margin on commodity sales for the three months ending June 30, 2017 compared to \$1 million for the same period in 2016. Average revenue was \$3.65 per GJ and average cost of gas sold was \$3.29 per GJ during April through June 2017, resulting in a margin of \$0.36 per GJ. This compared to an average commodity margin of \$0.14 per GJ through the same period in 2016. Margins were lower in 2016 primarily due to the sale of excess gas, a result of a much warmer than normal winter, at prices below the average cost of gas.

Commodity Fair Value Adjustments

The fair value adjustments at the end of June 30, 2017 increased the margin on commodity sales by \$1 million as the \$35 million unfavourable fair value position at March 31, 2017 improved to \$34 million unfavourable at June 2017. The settlement of higher priced natural gas purchase contracts during the three months contributed to a lower volume of contracts outstanding.

Gas Marketing Margin

SaskEnergy uses its access to natural gas markets to execute purchases and sales of natural gas to generate margins. By utilizing off peak transportation and storage capacity, SaskEnergy is able to take advantage of pricing differentials between transportation hubs and time periods while minimizing its exposure to price risk. Its primary strategy is to purchase and inject gas when prices are relatively low, and sell the gas in the future when prices are higher. In most cases the purchases and sales are executed at the same time, thereby mitigating much of the price risk that would normally be associated with such transactions.

| (millions) | Three months ended | | |
|--|--------------------|--------------|---------------|
| | June 30 | | |
| | 2017 | 2016 | Change |
| Gas marketing sales | \$ 51 | \$ 26 | \$ 25 |
| Gas marketing purchases ¹ | (46) | (21) | (25) |
| Realized margin on gas marketing sales | 5 | 5 | - |
| Impact of fair value adjustments | 5 | (5) | 10 |
| Revaluation of natural gas in storage | (4) | 11 | (15) |
| Margin on gas marketing sales | \$ 6 | \$ 11 | \$ (5) |

¹ Net of change in inventory

The realized margin on gas marketing sales at June 30, 2017, which removes fair value adjustments on derivative instruments and the revaluation of natural gas in storage, was \$5 million. This equaled the same period of 2016. The Corporation increased its gas marketing activity in response to the natural gas price volatility, generating slightly larger margins, combined with 18 PJs of natural gas sold in the three months ending June 30, 2017 compared to 17 PJs in the same period of 2016.

Gas Marketing Fair Value Adjustments

The Corporation enters into various natural gas contracts (swaps, options and forwards) in its gas marketing strategies, which are subject to volatility of natural gas market prices. The fair value adjustment at June 30, 2016 on gas marketing derivative instruments increased the gas marketing margin by \$5 million for the three month period. At the end of June 30, 2017, the AECO near month price dropped to \$2.19 per GJ, having a favourable impact on gas marketing natural gas sales contracts, partially offset by older purchase and sales contracts maturing. At the end of June 2017, the volume of outstanding contracts was 34 PJs less than at March 31, 2017.

Revaluation of Natural Gas in Storage

At each reporting period, the Corporation measures the net realizable value of gas marketing natural gas in storage based on forward market prices and anticipated delivery dates. The carrying amount of natural gas in storage is adjusted to reflect the lower of weighted average cost and net realizable value. In recent years, low natural gas prices have translated to reduced prices on the forward price curve. As much of the natural gas in storage is held to meet future sales contracts, it is not unusual to see net realizable value adjustments on gas in storage offset the impact of fair value changes. The declining market price environment in the first quarter provided an opportunity for the Corporation to purchase lower priced natural gas and inject it into storage, which reduced the average cost of gas in storage. When natural gas market prices decreased throughout June 2017, the \$21 million unfavourable net realizable value impact at the end of March 2017 increased by \$4 million to \$25 million at June 30, 2017.

Revenue

| (millions) | Three months ended | | |
|------------------------------------|--------------------|--------------|-------------|
| | June 30 | | |
| | 2017 | 2016 | Change |
| Delivery revenue | \$ 46 | \$ 42 | \$ 4 |
| Transportation and storage revenue | 34 | 32 | 2 |
| Customer capital contributions | 2 | 2 | - |
| Other revenue | 2 | 2 | - |
| | \$ 84 | \$ 78 | \$ 6 |

Delivery Revenue

Delivery Revenue is driven by the number of customers and the amount of natural gas customers consume. As residential and commercial customers consume natural gas primarily as heating fuel, weather is the factor that most affects delivery revenue.

Delivery revenue was \$46 million for the three months ending June 2017, \$4 million higher than the same period in 2016. An 8.6 per cent rate increase effective November 1, 2016 contributed to the higher revenues. The rate increases were the result of increasing operating costs related to expanding natural gas infrastructure and increasing focus on safety and integrity programs that address the aging infrastructure and increasing regulatory requirements.

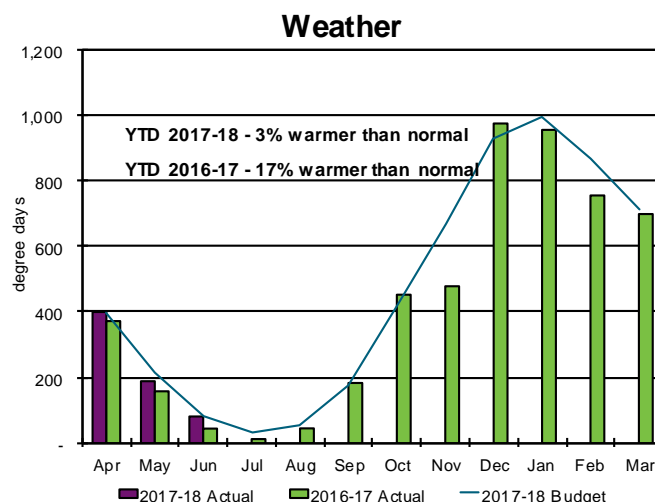
Transportation and Storage Revenue

The Corporation generates transportation revenue by taking delivery of gas from customers at various receipt points in Saskatchewan and Alberta, and delivering natural gas to customers at various delivery points in the Province. The transportation toll structure consists of a receipt service charge that customers pay when they put gas onto the pipeline transportation system, and a delivery service charge, which customers pay when they take delivery off of the pipeline transportation system. Gas delivered to the system by customers is considered to be part of the TransGas Energy Pool (a notional point where producers, marketers and end-users can match supplies to demand) until it is delivered to the end-use customer. For receipt and delivery services, the Corporation offers both firm and interruptible transportation. Under a firm service contract, the customer has a right to deliver or receive a specified quantity of gas on each day of the contract. With a firm contract, customers pay for the amount of capacity they have contracted for whether they use it or not. Under an interruptible contract, customers may deliver or receive gas only when there is available capacity on the system and pay receipt and delivery tolls when they deliver or receive gas.

Transportation and storage revenue was \$34 million for the three months ending June 30, 2017, \$2 million higher than the same period in 2016. Industrial customer and power generation related load growth continues to increase demand for natural gas within the province and is driving higher transportation revenue.

Customer Capital Contributions

The Corporation receives capital contributions from customers to partially offset the cost of constructing facilities to connect them to the transmission and distribution systems. Generally, contributions related to transmission system projects tend to be



larger but less frequent than contributions related to distribution system projects. The volume and magnitude of customer contribution revenue can vary significantly period-over-period as their receipt and recognition as revenue is primarily driven by customer activity. The contributions received, less potential refunds, are recognized as revenue once the related property, plant and equipment is available for use. The Corporation may refund a customer for some or all of the contributions they make depending on how much gas they consume or transport through the system. The amount of contributions expected to be refunded is estimated and recorded in deferred revenue until the eligible refund period expires or a refund is earned by the customer. Customer capital contribution revenue for the three months ending June 30, 2017 remained unchanged from the same period in 2016.

Other Revenue

Other revenue primarily consists of gas processing fees and natural gas liquid sales from two natural gas liquid extraction plants. Compression and gathering service revenue and royalty revenues comprise the remaining balance of other revenue. Royalty revenues are generated from a gross overriding royalty on several natural gas-producing properties in Saskatchewan and Alberta, which have diminished due to the continuing decline of conventional natural gas production and as a result of low natural gas prices. Other revenue equaled the same three month period in 2016.

Other Expenses and Net Finance Expense

| (millions) | Three months ended | | |
|-------------------------------|--------------------|--------------|-------------|
| | June 30 | | |
| | 2017 | 2016 | Change |
| Employee benefits | \$ 21 | \$ 21 | \$ - |
| Operating and maintenance | 35 | 30 | 5 |
| Depreciation and amortization | 24 | 23 | 1 |
| Saskatchewan taxes | 2 | 2 | - |
| Other Expenses | \$ 82 | \$ 76 | \$ 6 |
| Net finance expense | \$ 12 | \$ 11 | \$ 1 |
| Other (losses) gains | \$ 6 | \$ - | \$ 6 |

Expenditures on safety and integrity initiatives, strong customer growth, and the need to import more natural gas from Alberta as Saskatchewan natural gas production declines are key factors contributing to higher expenses. Employee benefits expense of \$21 million for the three months ending June 30, 2017 remained unchanged from the same period in 2016. The Corporation continues to manage vacant positions and overtime costs through productivity and efficiency initiatives. Operating and maintenance expense of \$35 million are \$5 million higher than the same periods in 2016, due to rising third party transportation costs as additional cross border transportation capacity is required to import gas from Alberta. This was partially offset by continued cost management initiatives. Depreciation and amortization of \$24 million for the three months ending June 30, 2016 slightly increased above prior year as capital additions increase the asset base and depreciation and amortization.

Net finance expenses, before the impact of fair value adjustments, were \$1 million higher than the same period in 2016. During the first quarter SaskEnergy issued \$121 million of long term debt which was used to reduce short term debt balances and repay \$19 million of maturing long term debt. Effective April 1, 2017, the Corporation early adopted IFRS 9 *Financial Instruments*. Under the new financial instruments standard, debt retirement funds are classified as fair value through other comprehensive income. As a result any market value adjustments associated with debt retirement funds no longer impact net income as they are recorded in other comprehensive income.

LIQUIDITY AND CAPITAL RESOURCES

| (millions) | Three months ended | | |
|--|--------------------|---------|--------|
| | June 30 | | |
| | 2017 | 2016 | Change |
| Cash provided by operating activities | \$ 73 | \$ 54 | \$ 19 |
| Cash used in investing activities | (37) | (31) | (6) |
| Cash provided by (used in) financing activities | (35) | (33) | (2) |
| Increase (decrease) in cash and cash equivalents | \$ 1 | \$ (10) | \$ 11 |

As a Crown corporation, SaskEnergy's primary sources of capital are cash from operations, debt – which is borrowed through the province's General Revenue Fund – and equity advances from CIC, the Province's crown corporation holding company. Equity advances are rarely used to finance Crown corporations as CIC prefers to use its Subsidiary Crown Dividend Policy to manage its equity interests in its commercial enterprises. Cash provided from operations is SaskEnergy's most important source of capital. As a utility, cash from operations is relatively stable and the Corporation relies upon it to fund dividends, debt servicing costs, and a significant proportion of its investment in pipeline facilities. Long- and short-term debt can be borrowed through the Province of Saskatchewan to meet any long- or short-term incremental capital requirements, and to repay debt as it matures. Sources of liquidity include Order-in-Council authority to borrow up to \$500 million in short-term loans, and a \$35 million uncommitted line of credit with the Toronto-Dominion Bank. By borrowing through the province, SaskEnergy has access to the province's borrowing capacity and North American capital markets. *The SaskEnergy Act* allows the Corporation to borrow up to \$1,700 million.

Operating Activities

Cash from operating activities of \$73 million for the three months ended June 30, 2017 was \$19 million higher than the same period in 2016. Higher transportation revenue and delivery revenue contributed to higher operating cash flows compared to 2016. The Corporation also took advantage of low natural gas market prices by purchasing and injecting lower priced natural gas into storage.

Investing Activities

Cash used in investing activities totaled \$37 million for the three months ended June 30, 2017; \$6 million higher than 2016. Capital investment levels are increasing in 2017 compared to 2016, primarily due to higher investment in safety and integrity programming to maintain a safe and reliable system.

Financing Activities

Cash used in financing activities was \$35 million during the three months of 2017 compared to \$33 million in 2016. From a cash management perspective, SaskEnergy uses cash from operations to pay for its investing activities, dividend payments and debt servicing costs (including interest payments and sinking fund installments). Any remaining cash from operations is applied to reducing the short-term debt balance. If there is insufficient cash from operations, SaskEnergy will borrow more debt, usually short-term debt, to meet its cash requirements. SaskEnergy issued \$120 million of long-term debt during the first quarter which was used to repay a \$19 million maturity and \$101 million of new long-term debt. SaskEnergy's debt ratio at June 30, 2017 was 61 per cent compared to 59 per cent at March 31, 2017 and June 30, 2016.

CAPITAL EXPENDITURES

| (millions) | Three months ended | | |
|--|--------------------|-------|--------|
| | June 30 | | |
| | 2017 | 2016 | Change |
| Customer growth and system expansion | \$ 14 | \$ 14 | \$ - |
| Safety and system integrity | 19 | 13 | 6 |
| Information systems | 2 | 2 | - |
| Vehicles & equipment, buildings, furniture | 2 | - | 2 |
| | \$ 37 | \$ 29 | \$ 8 |

SaskEnergy continues to invest in its pipeline system to accommodate growth in the natural gas customer base and its increasing reliance on Alberta Gas to meet load requirements. Capital expenditures of \$37 million for the three months ended June 30, 2017 are \$8 million higher than the same period in 2016. Safety and system integrity capital expenditures are \$6 million higher than 2016, primarily due to faster progress on system integrity programs.

OUTLOOK

With the Corporation's fiscal period beginning April 1, peak winter heating loads are absent from the financial results until the third and fourth quarter. Without revenue from heating loads it is not uncommon for SaskEnergy to experience minimal net income and even losses through the first two quarters.

Factors that are expected to affect SaskEnergy through the remainder of the year include the growth of the provincial economy, reliance on imported natural gas and interconnected pipeline systems, and customer expectations for safe, reliable natural gas services. Assuming normal weather conditions through 2017-18, net income before market value adjustments is expected to be approximately \$85 million, an increase of \$16 million over the 2016-17 actual result. The increase is primarily due to the return to normal weather in 2017-18 as the prior period was seven per cent warmer than normal. Efficiency and productivity gains as well as aggressive cost management are expected to limit cost increases in 2017-18.

The continued growth in natural gas demand combined with declining conventional gas production means that more gas will be imported or acquired from gas production associated with oil production. This shift in source of supply, together with an aging pipeline system and increasing regulatory requirements, will require incremental investments in pipeline facilities. SaskEnergy is projecting to invest more than \$280 million over the remainder of the year. This additional investment will be funded through cash from operations and an additional \$160 million of incremental borrowing. The additional load growth will generate more revenue for the Corporation; however, the investment in infrastructure will also increase operating costs and put pressure on delivery and transportation rates. The Corporation continues to work with other Crown corporations, and other business enterprises, to investigate technological solutions to more efficiently serve customers and maintain facilities. Since 2009, SaskEnergy has achieved \$42 million of operating efficiency savings and another \$4 million has been targeted for 2017-18.

Operating Expenses

As the pipeline and distribution system continues to age, and supply shifts from conventional Saskatchewan production to associated gas production and Alberta supply, additional investments are required that do not generate additional revenue. Expenditures to address safety and system integrity do not increase revenues and therefore add pressure to utility rates. Consequently, the average cost of serving customers is expected to rise. Depreciation expense and finance expense are expected to rise by \$10 million as a direct result of capital expenditures, while operating expenses (employee benefits and operating and maintenance) are expected to rise by \$7 million even with projected efficiency savings of \$4 million in 2017-18. The cost increases are primarily due to rising third-party transportation costs related to importing more natural gas and over longer distances to meet growing load requirements.

The Corporation is expecting staffing levels to decline somewhat through 2017 as efficiencies and productivity gains are realized. SaskEnergy will continue to meet the Province's growing natural gas requirements while keeping cost increases to a minimum and staffing at efficient levels.

Revenue

The delivery rate increase effective November 1, 2016 will provide additional delivery revenue to help offset increasing cost pressures resulting from customer growth and integrity investments experienced in recent years. Customer connections, which are closely related to the strength of the provincial economy, are expected to increase modestly to 4,500 new customers through 2017-18. Industrial and commercial demand for service is expected to continue to grow. SaskEnergy currently expects revenue to increase by \$60 million in 2017-18, driven by a six per cent increase in load and a delivery rate increase effective November 1, 2017, which is currently before the Saskatchewan Rate Review Panel.

Commodity Margins

While long term natural gas prices have remained relatively unchanged from the end of March 2017, near term natural gas prices have declined. Over a longer period, forward gas prices have displayed a downward trend suggesting that the likelihood of higher prices in the future is small. Currently, the differential between current and forward prices, the driver for much of SaskEnergy's gas marketing activity in the past, is negative with the exception of summer to winter spreads. These market conditions adversely affect the prospect for generating the margins required to support SaskEnergy's non-core storage business. Other gas marketing activities, which leverage off-peak transportation and storage capacity in the distribution utility, are expected to continue to generate margins; however, the potential for gas marketing margins is expected to be lower than it has been in the past.

The November 1, 2016 commodity rate reduction to \$3.65 per GJ will reduce commodity revenue during 2017-18; however, lower natural gas market prices are expected to reduce the average cost of gas by an equal amount. Consequently, favourable margins are expected on commodity sales. As part of the normal course of business, commodity rates are reviewed regularly and adjusted as required.

Summary

Although, SaskEnergy's financial performance is expected to remain strong, there are risks to the outlook. Capital expenditure requirements and rising costs will remain a challenge throughout the forecast period as SaskEnergy adjusts to continued customer load growth, infrastructure renewal requirements and shifting natural gas supply dynamics. A low natural gas price environment will continue to create challenges from a gas marketing perspective. Delivery and transportation revenue will continue to grow, but so will operating costs. SaskEnergy will continue to focus on providing safe and reliable service to its customers and investing in safety and growth initiatives while actively seeking operating and capital deployment efficiencies through collaboration and technology initiatives. Weather will be a key factor affecting 2017-18 financial results. Forecasted results are based on normal weather as defined by the 30-year average. To the extent that weather is colder than normal, delivery revenue will increase, and to the extent that weather is warmer than normal, delivery revenue will be lower. Transportation, storage, and other revenue items are typically not impacted by weather, as is the case with operating expenses. Commodity revenue and gas purchases are both affected by weather but typically offset each other.

CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

CONDENSED CONSOLIDATED STATEMENT OF FINANCIAL POSITION

| (millions) | Notes | As at June 30, 2017 (unaudited) | As at March 31, 2017 (audited) |
|--|-------|--|---|
| Assets | | | |
| Current assets | | | |
| Cash | | \$ 2 | \$ 1 |
| Trade and other receivables | | 72 | 111 |
| Natural gas in storage held for resale | 4 | 99 | 86 |
| Inventory of supplies | | 12 | 12 |
| Debt retirement funds | | 5 | 7 |
| Fair value of derivative instruments | 5 | 9 | 5 |
| | | 199 | 222 |
| Intangible assets | | | |
| Property, plant and equipment | | 2,136 | 2,129 |
| Debt retirement funds | | 99 | 94 |
| | | \$ 2,494 | \$ 2,505 |
| Liabilities and Province's equity | | | |
| Current liabilities | | | |
| Short-term debt | | \$ 187 | \$ 293 |
| Trade and other payables | | 113 | 104 |
| Dividends payable | | - | 14 |
| Current portion of long-term debt | 7 | 40 | 59 |
| Deferred revenue | | 34 | 32 |
| Fair value of derivative instruments | 5 | 38 | 40 |
| | | 412 | 542 |
| Other payables | | 5 | 5 |
| Employee future benefits | | 7 | 7 |
| Provisions | | 130 | 127 |
| Deferred revenue | | 6 | 6 |
| Long-term debt | 7 | 1,081 | 960 |
| | | 1,641 | 1,647 |
| Province's equity | | | |
| Equity advances | | 72 | 72 |
| Retained earnings | | 783 | 786 |
| Other components of equity | | (2) | - |
| | | 853 | 858 |
| | | \$ 2,494 | \$ 2,505 |

(See accompanying notes)

CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

(unaudited)

| (millions) | Notes | For the Three Months Ended June 30, 2017 | | | For the Three Months Ended June 30, 2016 | | |
|--|-------|--|---|--------|--|---|-------|
| | | Income before Unrealized Market Value Adjustments | Unrealized Market Value Adjustments (Note 9) | Total | Income before Unrealized Market Value Adjustments | Unrealized Market Value Adjustments (Note 9) | Total |
| Revenue | | | | | | | |
| Natural gas sales | 10 | \$ 75 | \$ 7 | \$ 82 | \$ 54 | \$ (14) | \$ 40 |
| Delivery | | 46 | - | 46 | 42 | - | 42 |
| Transportation and storage | | 34 | - | 34 | 32 | - | 32 |
| Customer capital contributions | | 2 | - | 2 | 2 | - | 2 |
| Other | | 2 | - | 2 | 2 | - | 2 |
| | | 159 | 7 | 166 | 132 | (14) | 118 |
| Expenses | | | | | | | |
| Natural gas purchases (net of change in inventory) | 10 | 67 | 5 | 72 | 48 | (68) | (20) |
| Employee benefits | | 21 | - | 21 | 21 | - | 21 |
| Operating and maintenance | | 35 | - | 35 | 30 | - | 30 |
| Depreciation and amortization | | 24 | - | 24 | 23 | - | 23 |
| Saskatchewan taxes | | 2 | - | 2 | 2 | - | 2 |
| | | 149 | 5 | 154 | 124 | (68) | 56 |
| Income before the following | | 10 | 2 | 12 | 8 | 54 | 62 |
| Finance income | | 1 | - | 1 | 1 | 3 | 4 |
| Finance expenses | | (13) | - | (13) | (12) | - | (12) |
| Net finance expenses | | (12) | - | (12) | (11) | 3 | (8) |
| Other losses | | (6) | - | (6) | - | - | - |
| Total net (loss) income | | \$ (8) | \$ 2 | \$ (6) | \$ (3) | \$ 57 | \$ 54 |
| Change in fair value of debt retirement funds designated as FVOCI | | | | - | | | - |
| Comprehensive (loss) income | | | | \$ (6) | | | \$ 54 |

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

(unaudited)

| (millions) | Retained Earnings | Equity Advances | Other Components of Equity | Total |
|---------------------------------------|----------------------|--------------------|----------------------------------|--------|
| Balance as at April 1, 2016 | \$ 669 | \$ 72 | \$ - | \$ 741 |
| Comprehensive income | 54 | - | - | 54 |
| Balance as at June 30, 2016 | \$ 723 | \$ 72 | \$ - | \$ 795 |
| Balance as at April 1, 2017 | \$ 786 | \$ 72 | \$ - | \$ 858 |
| IFRS 9 opening adjustments: | | | | |
| Reclassification of fair value losses | 2 | - | (2) | - |
| Recognition of expected credit losses | 1 | - | - | 1 |
| Comprehensive loss | (6) | - | - | (6) |
| Balance as at June 30, 2017 | \$ 783 | \$ 72 | \$ (2) | \$ 853 |

(See accompanying notes)

CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS

(unaudited)

| (millions) | Notes | For the Three Months Ended June 30 | |
|--|-------|---------------------------------------|-------------|
| | | 2017 | 2016 |
| Operating activities | | | |
| Net (loss) income | | \$ (6) | \$ 54 |
| Add (deduct) items not requiring an outlay of cash | | | |
| Net change in fair value of derivative instrument assets and liabilities | 9 | (6) | (43) |
| Change in revaluation of natural gas in storage to net realizable value | 9 | 4 | (11) |
| Depreciation and amortization | | 24 | 23 |
| Net finance expenses | | 12 | 8 |
| Other losses on impairment of assets | | 9 | - |
| | | 37 | 31 |
| Net change in non-cash working capital related to operations | | 36 | 23 |
| Cash provided by operating activities | | 73 | 54 |
| Investing activities | | | |
| Additions to intangible assets | | (2) | (2) |
| Additions to property, plant and equipment | | (35) | (28) |
| Decommissioning costs | | - | (1) |
| Cash used in investing activities | | (37) | (31) |
| Financing activities | | | |
| Debt retirement funds installments | | (4) | (4) |
| Debt retirement funds redemptions | | 2 | 3 |
| (Decrease) increase in short-term debt | | (106) | 2 |
| Dividends paid | | (14) | (21) |
| Proceeds from long-term debt | 7 | 121 | 22 |
| Repayment of long-term debt | 7 | (19) | (22) |
| Interest paid | | (15) | (13) |
| Cash used in financing activities | | (35) | (33) |
| Increase (decrease) in cash | | 1 | (10) |
| Cash, beginning of period | | 1 | 11 |
| Cash, end of period | | \$ 2 | \$ 1 |

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

For the Three Months Ended June 30, 2017

1. General information

SaskEnergy Incorporated (SaskEnergy or the Corporation) is a Saskatchewan provincially owned Crown corporation operating under authority of *The SaskEnergy Act*. The address of SaskEnergy's registered office and principal place of business is 1777 Victoria Avenue, Regina, Saskatchewan, Canada S4P 4K5.

The Corporation owns and operates natural gas-related businesses located both within and outside Saskatchewan. The condensed consolidated 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 business.

By virtue of *The Crown Corporations Act, 1993*, SaskEnergy has been designated as a subsidiary of Crown Investments Corporation of Saskatchewan (CIC), a Saskatchewan provincially owned Crown corporation. Accordingly, the financial results of SaskEnergy are included in the consolidated financial statements of CIC. As a provincial Crown corporation, SaskEnergy and its wholly owned subsidiaries are not subject to Federal or Provincial income taxes in Canada.

2. Basis of preparation

a. Statement of compliance

The Corporation's condensed consolidated financial statements have been prepared in accordance with International Accounting Standard (IAS) 34 *Interim Financial Reporting* using accounting policies consistent with International Financial Reporting Standards (IFRS), as issued by the International Accounting Standards Board (IASB). The condensed consolidated financial statements do not include all the information required for the Corporation's annual consolidated financial statements. Accordingly, these statements should be read with reference to the annual report for the year ended March 31, 2017.

The condensed consolidated financial statements were authorized for issue by the Board of Directors on August 23, 2017.

b. Basis of measurement

The condensed consolidated financial statements have been prepared on the historical cost basis except for the following items:

- Financial instruments classified as at fair value through profit or loss
- Financial assets classified as at fair value through other comprehensive income
- Employee future benefits
- Provisions
- Natural gas in storage held for resale
- Property, plant and equipment

c. Functional and presentation currency

The condensed consolidated financial statements are presented in Canadian dollars, the Corporation's functional currency, unless otherwise stated. All financial information presented in Canadian dollars has been rounded to the nearest million.

d. Use of estimates and judgments

In the application of the Corporation's accounting policies, management is required to make judgments, estimates, and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, revenue, and expenses. Actual results may differ from these estimates.

The estimates and associated assumptions are based on historical experience and other factors that are considered relevant. The estimates and assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised as well as any future periods affected.

2. Basis of preparation (continued)

Information about critical judgments in applying accounting policies that have a significant effect on the amounts recognized in the condensed consolidated financial statements include:

- Revenue recognition related to unbilled revenue
- Existence of decommissioning liabilities
- Identification of own-use derivative contracts

Information about significant management estimates and assumptions that have a risk of resulting in a significant adjustment within the next financial period include:

- Estimated unbilled revenue
- Net realizable value of natural gas in storage held for resale
- Fair value of financial and derivative instruments
- Useful lives and amortization rates for intangible assets
- Useful lives and depreciation rates for property, plant, and equipment
- Recoverable amounts of non-financial assets
- Estimated unearned customer capital contributions
- Estimated future cost of decommissioning liabilities

3. Summary of significant accounting policies

The accounting policies, as detailed in Note 3 to the consolidated financial statements for the year ended March 31, 2017, have been applied consistently, by the Corporation and its subsidiaries, to all periods presented in these condensed consolidated financial statements, with the exception of the change in accounting policy identified below.

a. Change in accounting policy

Effective April 1, 2017, the Corporation early adopted IFRS 9 *Financial Instruments* on a retrospective basis. As a result of the adoption of IFRS 9, the Corporation also adopted consequential amendments to IFRS 7 *Financial Instruments: Disclosures*. These amendments were applied to 2017-18 disclosures but have generally not been applied to comparative information. The key changes as a result of adoption are summarized below.

i. Classification of financial assets and financial liabilities

IFRS 9 *Financial Instruments* includes three principal classification categories for financial assets: measured at amortized cost, fair value through other comprehensive income (FVOCI) and fair value through profit or loss (FVTPL). The classification of financial assets under the new standard is generally based on the business model in which a financial asset is managed and its contractual cash flow characteristics. The standard eliminates the previous IAS 39 *Financial Instruments: recognition and measurement* categories of held to maturity, loans and receivables and available for sale.

The debt retirement funds were classified as FVTPL under IAS 39. The debt retirement funds are administered and managed by the Ministry of Finance. The business model objective is to both hold to collect contractual cash flows and to sell. The contractual terms of the debt retirement funds give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding. As a result of the business model in which debt retirement funds are managed, they are now classified as financial assets at FVOCI under IFRS 9.

The adoption of IFRS 9 has not had a significant effect on the Corporation's accounting policies for financial liabilities.

ii. Impairment of financial assets

IFRS 9 replaces the 'incurred loss' model in IAS 39 with an 'expected credit loss' (ECL) model. The expected credit loss model requires the Corporation to account for expected credit losses and changes in those expected credit losses at each reporting date to reflect changes in credit risk since initial recognition of the financial assets. The new impairment model applies to financial assets measured at amortized cost and debt instruments at FVOCI, but not to investments in equity instruments. Under IFRS 9, credit losses are recognized earlier than under IAS 39. IFRS 9 also provides a simplified approach for measuring the loss allowance at an amount equal to lifetime ECL for trade receivables in certain circumstances.

3. Summary of significant accounting policies (continued)

iii. Transition

Changes in accounting policies resulting from the adoption of IFRS 9 have been applied retrospectively, except comparative periods have not been restated for retrospective application. Differences in the carrying amounts of financial assets and financial liabilities resulting from the adoption of IFRS 9 are recognized in retained earnings as at April 1, 2017.

The following table summarizes the impact of transition to IFRS 9 as at April 1, 2017:

| (millions) | Total |
|---|--------|
| Other Components of Equity | |
| Closing balance under IAS 39 as at March 31, 2017 | \$ - |
| Reclassification of market value losses on debt retirement funds under IFRS 9 | (2) |
| Opening balance under IFRS 9 as at April 1, 2017 | \$ (2) |
| Retained Earnings | |
| Closing balance under IAS 39 as at March 31, 2017 | \$ 786 |
| Reclassification of market value losses on debt retirement funds under IFRS 9 | 2 |
| Recognition of expected credit losses under IFRS 9 | 1 |
| Opening balance under IFRS 9 as at April 1, 2017 | \$ 789 |

iv. Classification of financial assets and financial liabilities upon initial application of IFRS 9

The following table summarizes the changes to the Corporation's financial assets and financial liabilities measurement category under IFRS 9 compared to its original measurement category under IAS 39:

| (millions) | IFRS 9 | | IAS 39 | |
|--|-----------------------------|--------------------|---------------------|--------------------|
| | Classifi- cation | Carrying Amount | Classifi- cation | Carrying Amount |
| Financial and derivative assets | | | | |
| Cash | FVTPL | \$ 1 | FVTPL | \$ 1 |
| Trade and other receivables | Amortized cost | 112 | LAR | 111 |
| Debt retirement funds | FVOCI - debt instruments | 101 | FVTPL | 101 |
| Fair value of derivative instrument assets | FVTPL | 5 | FVTPL | 5 |
| Financial and derivative liabilities | | | | |
| Short-term debt | OL | 293 | OL | 293 |
| Trade and other payables | OL | 109 | OL | 109 |
| Dividends payable | OL | 14 | OL | 14 |
| Long-term debt | OL | 1,019 | OL | 1,019 |
| Fair value of derivative instrument liabilities | FVTPL | 40 | FVTPL | 40 |

Classification details:

FVTPL - fair value through profit or loss

FVOCI - fair value through other comprehensive income

OL - other liabilities

LAR - loans and receivables

Each class of the Corporation's financial assets and financial liabilities has maintained the same measurement category under IFRS 9 as its original measurement category under IAS 39, with the exception that financial assets previously classified as loans and receivables are now classified as amortized cost and debt retirement funds, previously classified as FVTPL, are now classified as FVOCI.

3. Summary of significant accounting policies (continued)

b. Future changes in accounting policies

The following new standards are not yet effective and have not been applied in preparing these condensed consolidated financial statements:

IFRS 15 *Revenue from Contracts with Customers* – clarifies the principles for recognizing revenue from contracts with customers and will affect the Corporation's accounting policies with respect to the following applicable revenue standards and interpretations upon its effective date:

IAS 18 *Revenue*
IAS 11 *Construction Contracts*
IFRIC 18 *Transfer of Assets from Customers*

This standard is effective for annual periods beginning on or after January 1, 2018, with early adoption permitted.

IFRS 16 *Leases* – broadens the definition of a lease and increases transparency regarding a Corporation's leasing obligations. Under the new standard, an asset and liability is recognized on the condensed consolidated statement of financial position for all material contracts that meet the definition of a lease. This standard is effective for annual periods beginning on or after January 1, 2019, with early adoption permitted if IFRS 15 *Revenue from Contracts with Customers* has also been applied.

The Corporation is continuing to review the new standards and has completed a preliminary assessment of the impact on its condensed consolidated financial statements for IFRS 15 *Revenue from Contracts with Customers*. The anticipated impact is as follows:

IFRS 15 *Revenue from Contracts with Customers* – under the new control-based revenue model, the Corporation anticipates minimal impacts to the majority of its revenue streams, but has not yet determined the impact of the new standard to customer capital contribution revenue. Changes to the recognition of customer capital contribution revenue are contingent on the Corporation's identification of performance obligations within the underlying customer contracts.

4. Natural gas in storage held for resale

| (millions) | As at June 30, 2017 | As at March 31, 2017 |
|-------------------------------------|------------------------------------|-------------------------------------|
| Cost | \$ 124 | \$ 107 |
| Revaluation to net realizable value | (25) | (21) |
| | \$ 99 | \$ 86 |

The net realizable value of natural gas in storage at the end of the quarter was \$25 million below cost (March 31, 2017 - \$21 million below cost). As at June 30, 2017, the Corporation expected that \$72 million of the current inventory value would be sold or consumed within the next year, and \$27 million of the current inventory value would be sold or consumed after more than one year.

5. Financial and derivative instruments

For recurring and non-recurring fair value measurements, the Corporation estimates the price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants at the reporting date under current market conditions. This requires the Corporation to make certain assumptions, including the principal (or most advantageous) market, the most appropriate valuation technique and the most appropriate valuation premise. The Corporation's own credit risk and the credit risk of the counterparty have been taken into account in determining the fair value of financial assets and liabilities, including derivative instruments.

5. Financial and derivative instruments (continued)

| (millions) | Classifi- cation | Fair Value Hierarchy | As at June 30, 2017 | | As at March 31, 2017 | |
|--|-----------------------------|-------------------------|------------------------|---------------|-------------------------|---------------|
| | | | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| Financial and derivative assets | | | | | | |
| Cash | FVTPL | n/a | \$ 2 | \$ 2 | \$ 1 | \$ 1 |
| Trade and other receivables | Amortized cost | n/a | 72 | 72 | 111 | 111 |
| Debt retirement funds | FVOCI - debt instruments | Level 2 | 104 | 104 | 101 | 101 |
| Fair value of derivative instrument assets | FVTPL | Level 2 | 9 | 9 | 5 | 5 |
| Financial and derivative liabilities | | | | | | |
| Short-term debt | OL | n/a | 187 | 187 | 293 | 293 |
| Trade and other payables | OL | n/a | 118 | 118 | 109 | 109 |
| Dividends payable | OL | n/a | - | - | 14 | 14 |
| Long-term debt | OL | Level 2 | 1,121 | 1,280 | 1,019 | 1,150 |
| Fair value of derivative instrument liabilities | FVTPL | Level 2 | 38 | 38 | 40 | 40 |

Classification details:

FVTPL - fair value through profit or loss

FVOCI - fair value through other comprehensive income

OL - other liabilities

The fair value hierarchy is not applicable where the carrying amount approximates fair value due to the short-term nature of the financial instrument.

In measuring fair value, the Corporation classifies items according to the fair value hierarchy based on the amount of observable inputs.

a. Level 1

Level 1 valuations use quoted prices (unadjusted) that are available in active markets for identical assets or liabilities as at the reporting date. Active markets are those in which transactions occur in sufficient frequency and volume to provide ongoing pricing information. The Corporation did not classify any of its fair value measurements within Level 1.

b. Level 2

Level 2 valuations are based on inputs that are either directly or indirectly observable for the asset or liability as at the reporting date. Inputs include quoted market prices, time value, volatility factors and broker quotations which can be substantially observed or corroborated in the marketplace.

The fair value of debt retirement funds is determined by Saskatchewan's Ministry of Finance using a market approach with information provided by investment dealers. To the extent possible, valuations reflect indicative secondary pricing for these securities. In all other circumstances, valuations are determined with reference to similar actively traded instruments.

The fair value of natural gas derivative instruments is determined using a market approach. The Corporation obtains quoted market prices from sources such as the New York Mercantile Exchange and the Natural Gas Exchange, independent price publications and over-the-counter broker quotes.

The fair value of long-term debt is determined for disclosure purposes only using an income approach. Fair values are estimated using the present value of future cash flows discounted at the market rate of interest for the equivalent Province of Saskatchewan debt instruments.

c. Level 3

Level 3 inputs are unobservable for the particular assets and liabilities as at the reporting date. The Corporation did not classify any of its fair value measurements within Level 3.

5. Financial and derivative instruments (continued)

Notional values are an approximation of future undiscounted net cash flows. For physical natural gas contracts, the notional value is based on the contract price. For natural gas price swaps, the notional value is the difference between the contract price and the market price. Where contract prices are referenced to an index price that has not yet been fixed, the market price is used to estimate the contract price. As at June 30, 2017 natural gas derivative instruments had the following fair values, notional values, and maturities:

| (millions) | 2018 | 2019 | 2020 | 2021 | 2022 | Total |
|---------------------------------------|---------|---------|------|------|------|---------|
| Physical natural gas contracts | | | | | | |
| Fair value | \$ (17) | \$ (8) | \$ - | \$ - | \$ - | \$ (25) |
| Notional value | (47) | (24) | 2 | - | - | (69) |
| Natural gas price swaps | | | | | | |
| Fair value | (4) | - | - | - | - | (4) |
| Notional value | (4) | - | - | - | - | (4) |
| Total | | | | | | |
| Fair value | \$ (21) | \$ (8) | \$ - | \$ - | \$ - | \$ (29) |
| Notional value | \$ (51) | \$ (24) | \$ 2 | \$ - | \$ - | \$ (73) |

Fair value - increase (decrease) in net income

Notional value - estimated undiscounted net cash inflow (outflow)

6. Property, plant and equipment

The Corporation has three cash generating units that are adversely impacted by market conditions, its non-core gas storage operations and a gas processing plant. At June 30, 2017, as a result of a decline in natural gas prices, the Corporation has recorded a cumulative impairment on its storage and gathering, treatment and compression assets of \$41 million. The impairments were recognized as the carrying value of the assets exceeded the recoverable amounts of \$18 million for its gas storage operations and \$8 million for its gas processing plant. The recoverable amounts were the value in use determined using cash flows attributed to probable production, discounted at 6.9% for gas storage operations and 6.8% for its gas processing plant, and adjusted for future market prices. The impairment losses have been recognized within other losses, with \$9 million recognized in the current period and \$32 million recognized in prior periods.

Future natural gas prices are the main source of estimation uncertainty in determining the recoverable amount of the Corporation's assets. As at June 30, 2017, a five per cent increase in future natural gas and natural gas liquid prices would have increased the recoverable amount and reduced the impairment loss by \$4 million. In future periods, any increases to future natural gas prices will result in the reversal of previously incurred impairment losses, up to the carrying value of the associated assets.

7. Long-term debt

During 2017-18, the Corporation issued \$119 million in long-term debt, in increments of \$100 million and \$19 million with effective interest rates of 3.2% and 2.9%, respectively. The long-term debt issuance of \$100 million was issued at a premium of \$2 million.

During the period, the Corporation also repaid \$19 million in long-term debt with an effective interest rate of 4.7%.

8. Commitments and contingencies

a. Commitments

At period end, the Corporation had \$71 million of outstanding contractual commitments for the procurement of goods and services in the future.

8. Commitments and contingencies (continued)

The Corporation has entered into commodity contracts for the physical purchase of natural gas that qualify as own-use contracts. As at June 30, 2017 own-use natural gas derivative instruments had the following notional values and maturities for the next five years:

| (millions) | 2018 | 2019 | 2020 | 2021 | 2022 | Total |
|---|---------|---------|---------|---------|---------|----------|
| Own-use physical natural gas contracts | | | | | | |
| Notional value | \$ (24) | \$ (34) | \$ (45) | \$ (46) | \$ (34) | \$ (183) |

Notional value - estimated undiscounted net cash outflow

b. Contingencies

The Corporation is involved in litigation resulting from the 2014 natural gas incident in the community of Regina Beach, Saskatchewan. The Corporation does not expect the outcomes to result in any material financial impact.

9. Unrealized market value adjustments

| (millions) | For the Three Months Ended June 30 | |
|---|------------------------------------|--------------|
| | 2017 | 2016 |
| Change in fair value of debt retirement funds | \$ - | \$ 3 |
| Change in fair value of natural gas derivative instruments | 6 | 43 |
| Change in revaluation of natural gas in storage to net realizable value | (4) | 11 |
| | \$ 2 | \$ 57 |

10. Natural gas sales and purchases

| (millions) | For the Three Months Ended June 30 | | | | | |
|---|------------------------------------|---------------|--------------|--------------|---------------|--------------|
| | 2017 | | | 2016 | | |
| | Commodity | Gas Marketing | Total | Commodity | Gas Marketing | Total |
| Natural gas sales | | | | | | |
| Natural gas sales to commodity customers | \$ 24 | \$ - | \$ 24 | \$ 27 | \$ - | \$ 27 |
| Realized on natural gas derivative instruments | - | 51 | 51 | 1 | 26 | 27 |
| Change in fair value of natural gas derivative instruments | - | 7 | 7 | - | (14) | (14) |
| | 24 | 58 | 82 | 28 | 12 | 40 |
| Natural gas purchases | | | | | | |
| Realized on natural gas derivative instruments | (21) | (46) | (67) | (27) | (21) | (48) |
| Change in fair value of natural gas derivative instruments | 1 | (2) | (1) | 48 | 9 | 57 |
| Change in revaluation of natural gas in storage to net realizable value | - | (4) | (4) | - | 11 | 11 |
| | (20) | (52) | (72) | 21 | (1) | 20 |
| | \$ 4 | \$ 6 | \$ 10 | \$ 49 | \$ 11 | \$ 60 |

11. Financial risk management

Through the normal course of business, the Corporation has exposure to market risk (natural gas price risk, interest rate risk, and foreign currency risk), liquidity risk, and credit risk related to its financial and derivative instruments. The Board of Directors, through the Audit and Finance Committee, has the overall responsibility for the establishment and oversight of the Corporation's risk management efforts. The Corporation's risk management policies and strategies, approved by the Board of Directors and reviewed regularly by the Audit and Finance Committee, provide the framework within which the Corporation may use financial and derivative instruments to manage its risks. The Corporation's significant risk management policies include the Corporate Derivatives Policy, the Commodity Risk Management Policy, the Corporate Debt and Interest Rate Risk Management Policy and the Corporate Credit Risk Management Policy. The objectives, policies, and processes for managing risk were consistent with the prior period. The significant risks in relation to financial instruments that impact the Corporation are discussed below.

a. Natural gas price risk

The Corporation purchases natural gas for resale to its customers. While natural gas is purchased at fluctuating market prices, the Corporation sells natural gas to customers at a fixed commodity rate that is reviewed semi-annually. As part of its natural gas price risk management, the Corporation uses derivative instruments to manage the price of the natural gas it buys. The Corporation's objective is to reduce the volatility of natural gas prices and to have rates that are competitive to other utilities. The Corporation also purchases and sells natural gas in the open market to generate incremental income through its gas marketing activities.

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 the Corporation may use for price risk management include natural gas price swaps, options, swaptions, and forward contracts.

The Corporation's commodity price risk management strategy establishes specific hedging targets, which may differ depending on current market conditions, to guide risk management activities. Additionally, the Corporation uses mark-to-market value, value-at-risk, and net exposure to monitor natural gas price risk. These metrics are measured and reported daily to the Commodity Risk Management Committee, a subcommittee of the Corporation's Executive Committee.

Based on the Corporation's period-end 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 derivative instruments, by \$19 million (March 31, 2017 - \$19 million). Conversely, a decrease of \$1.00 per Gigajoule would have decreased net income, through a decrease in the fair value of natural gas derivative instruments, by \$20 million (March 31, 2017 - \$20 million).

b. Liquidity risk

Liquidity risk is the risk that the Corporation is unable to meet its financial obligations as they become due. The Corporation has credit facilities available to refinance maturities in excess of anticipated operating cash flows. The contractual maturities of the Corporation's financial obligations, including interest payments and the impact of netting agreements, as at June 30, 2017 were as follows:

| (millions) | Contractual Maturities | | | | |
|--------------------------|------------------------|------------------|-------------|-------------|-------------------|
| | Carrying Amount | Less Than 1 Year | 1 - 2 Years | 3 - 5 Years | More Than 5 Years |
| Short-term debt | 187 | 187 | - | - | - |
| Trade and other payables | 118 | 113 | - | 5 | - |
| Long-term debt | 1,121 | 87 | 96 | 194 | 1,560 |
| Derivative instruments | 38 | 51 | 24 | - | - |
| | \$ 1,464 | \$ 438 | \$ 120 | \$ 199 | \$ 1,560 |

At period end, the Corporation's borrowing capacity, together with relatively stable operating cash flows, provide sufficient liquidity to fund these contractual obligations.

In addition to the above, the Corporation has posted a \$10 million (March 31, 2017 - \$10 million) letter of credit with NGX Financial Inc. (NGX) as security for natural gas purchases and sales conducted by the Corporation on the NGX natural gas exchange in Alberta. NGX may draw upon the letter of credit if the Corporation fails to make timely payment for, or delivery of, natural gas as per the related contract.