SaskEnergy

YOUR NATURAL CHOICE ®

Management's Discussion and Analysis

This Discussion and Analysis is a review of the results of operations, and outlook for SaskEnergy Incorporated (SaskEnergy or the Corporation) and its subsidiaries for the six month period ended June 30, 2006. This discussion should be read in conjunction with the consolidated interim financial statements and accompanying notes. For additional information relative to its operations, financial position and risks, refer to the Corporation's Annual Report for the year ended December 31, 2005.

Corporate Profile

SaskEnergy has the legislated franchise for the distribution and transmission of natural gas within Saskatchewan. The distribution system provides natural gas service to over 329,000 residential, farm, commercial and industrial customers over a 66,000 kilometre pipeline distribution system. The transmission system provides transportation and storage service to the distribution system, producers, marketers and large volume end-use customers within Saskatchewan.

SaskEnergy has seven wholly-owned subsidiaries:

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

Financial and Operating Highlights

	Three Months Ended June 30		Six Months Ended June 30	
	2006	2005	2006	2005
Financial Highlights				
Consolidated Net Earnings (loss) (millions)	($12)	$6	$25	$41
Total Assets (millions)			$1,275	$1,260
Long-term Debt (millions)			$651	$747
Operating Highlights				
Distribution				
Volumes Distributed - Petajoules	20	24	62	73
Winter Weather – Compared to the thirty year average	N/A	N/A	10% Warmer	2% Colder
Average Cost per Gigajoule of Natural Gas to June 30	$6.44	$6.36	$8.34	$6.77
Transmission				
Volumes Transported - Petajoules	75.2	78.0	174.2	180.1
Peak Day Natural Gas Flows (Winter Season) – Petajoules – Date of Peak Flow	N/A	N/A	1.53 February 16	1.38 January 15

*Before the effect of the Saskatchewan Energy Share

Financial Results

Consolidated Net Earnings

For the first six months of 2006 consolidated net earnings were $24.8 million, down from $41.1 million in the same period in 2005. In the second quarter of 2006 there was a loss of $12.1 million compared to net earnings of $6.3 million in the second quarter of 2005. Higher cost of gas and lower delivery revenue in 2006 were the primary causes for the lower earnings.

A. REVENUE

1. Commodity Revenue

The commodity rate was $7.95 per gigajoule for the period January 1, 2006 to March 31, 2006 and $6.80 per gigajoule from April 1 to June 30. In 2005 the commodity rate was $6.97 per gigajoule from January 1 to June 30.

During the first six months of 2006 weather was 10% warmer than normal compared to 2% colder than normal in 2005. In response to high natural gas prices, consumers utilized Federal and Provincial energy efficiency initiatives to achieve lower consumption patterns. The combination of warmer weather and energy efficiency initiatives by consumers reduced the amount of natural gas consumed for space heating purposes in 2006 compared to 2005. As a result, the reduction in volumes sold was the primary reason for the lower commodity revenue in 2006 compared to 2005.

2. Delivery Revenue

Delivery revenue in the first half of 2006 was $80.2 million, which was $6.2 million lower than the same period in 2005. 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 June 30, 2006 was 13.4% warmer than the same period in 2005, which was the primary reason for reduced delivery volumes and revenue.

For the three month period ending June 30, 2006, delivery revenue of $23.0 million was $1.3 million lower than in the same period in 2005 due to the warmer weather in 2006.

3. Transportation and Storage Revenue

Transportation and storage revenue for the first half of 2006 was $44.9 million, which was an increase of $1.5 million over the same period in 2005. The increase is mainly due to incremental revenue generated by two new storage caverns.

For the second quarter, transportation and storage revenue was $22.0 million, an increase of $0.1 million compared with the second quarter of 2005.

4. Net Sales From Gas Marketing

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

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

In the first half of 2006, the margin earned from the foregoing activities was $14.7 million compared with $12.7 million for the same period in 2005, primarily due to higher volumes sold in 2006.

In the three month period ending June 30, 2006 the margin from gas marketing sales was $5.6 million compared with $10.8 million for the same period in 2005 due to higher volumes sold during this period of 2005.

B. EXPENSES

1. Cost of Gas Sold

The cost of gas sold includes the cost of purchased gas plus adjustments that effectively records the market value of natural gas purchase price hedges (mark to market adjustments) as at June 30 and the effects of the Saskatchewan Energy Share.

The mark to market adjustments increased the cost of gas sold during 2006 by $6.8 million. Therefore the $9.3 million loss on commodity sales for the first six months of 2006 was primarily due to the market to market adjustments on hedges. For the comparable period in 2005, the cost of purchased gas (including mark to market adjustments on hedges) was less than the commodity rate. The resulting gain on commodity sales in the first half of 2005 was $7.0 million.

In the second quarter of 2006, the mark to market adjustments relating to natural gas purchase price hedges increased the cost of gas by $7.9 million compared to a decrease in the cost of gas sold of $2.6 million for the second quarter of 2005. The difference in the effect of the mark to market adjustments was the primary cause of a $9.9 million loss in the second quarter of 2006 compared to a $3.9 million gain in the second quarter of 2005.

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

During the first quarter of 2006, the commodity rate charged to consumers was $7.95 per GJ which was lower than the cost of gas sold. Therefore, in the first quarter of 2006, SaskEnergy was eligible to receive $20.5 million from Saskatchewan Energy Share.

2. **Other Expenses**

Expenses (excluding cost of gas sold) to June 30, 2006 were $123.4 million, which were $2.5 million lower than the first half of 2005. For the three month period ending June 30, 2006 total expenses (excluding cost of gas) were $58.6 million or $1.8 million lower than the same period in 2005.

Operating and maintenance expenses for the first half of 2006 were $57.8 million which were $1.3 million lower compared to the first half of 2005 primarily due to a gain on sale of a compressor unit. For the second quarter ended June 30, 2006 the operating and maintenance expenses of $28.4 million were $1.4 million lower than 2005, also due to the sale of the compressor unit.

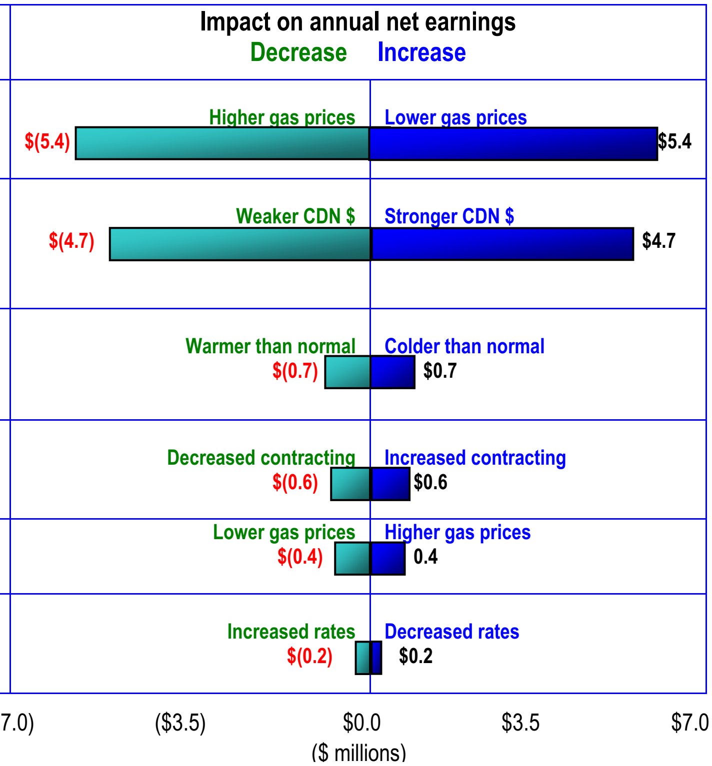
Interest expense was lower by $1.2 million for the first six months of 2006 compared to 2005 and down $0.4 million compared with the second quarter of 2005 due to lower average interest rates.

Amortization of property, plant and equipment for the first half of 2006 of $25.8 million was $0.9 million higher in 2006 and $0.5 million for the second quarter due to a higher asset base in 2006.

Outlook

The earnings of SaskEnergy are influenced by changes in a number of factors. The following are the factors that can cause the greatest variability in earnings:

Description of the risk	Factor	Sensitivity
Natural gas prices fluctuate in the market and can affect earnings if there is a change in the market price per gigajoule with no accompanying change to SaskEnergy's approved commodity rates.	Natural gas prices	$0.10 change per gigajoule
Foreign exchange can affect earnings as a change in value of Canadian currency relative to United States currency impacts natural gas prices in Canada. This in turn may affect commodity purchase costs incurred by SaskEnergy.	Foreign exchange impact on natural gas prices	$0.01 change to foreign exchange rates
Winter weather fluctuations can affect earnings. Revenue forecasts are based on the assumption of normal winter weather defined as the average weather experienced over the last thirty years.	Winter weather	One per cent change in winter weather
TransGas receipt contracted volumes are affected by the capacity contracted by shippers for the transportation of their natural gas.	TransGas receipt contracted volumes	One per cent change to contracted levels
Natural gas prices fluctuate in the market affecting earnings by changing the sale price of storage gas volumes sold by Bayhurst Gas Limited.	Natural gas prices	$0.10 change per gigajoule
Short-term interest rates affect the cost of short-term borrowing.	Short-term interest rates	0.25 per cent change in short-term interest rates



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

SaskEnergy Incorporated

Consolidated Statement of Financial Position

(thousands of dollars)

	As at June 30, 2006 *(unaudited)*	As at December 31, 2005 *(audited)*
Assets		
Current assets		
Cash	$ 3,695	$ 1,572
Accounts receivable	109,220	215,614
Natural gas in storage held for resale	156,510	139,255
Inventories of supplies	7,671	7,346
	277,096	363,787
Property, plant and equipment	937,813	946,947
Investments and other assets	30,717	32,225
Natural gas in storage held for resale and operations	29,860	28,030
	$ 1,275,486	$ 1,370,989
Liabilities and Province's Equity		
Current liabilities		
Short-term debt	$ 73,100	$ 80,500
Accounts payable	147,075	237,591
Dividend payable	7,500	5,200
Current portion of long-term debt	72,332	71,637
	300,007	394,928
Long-term debt	578,732	582,279
	878,739	977,207
Province of Saskatchewan's equity		
Equity advances	71,531	71,531
Retained earnings	328,452	323,878
Foreign currency translation adjustment	(3,236)	(1,627)
	396,747	393,782
	$ 1,275,486	$ 1,370,989

(See accompanying notes)

Director	Director

SaskEnergy Incorporated

Consolidated Statement of Earnings and Retained Earnings

(thousands of dollars)

	Three months ended June 30		Six months ended June 30	
	2006	**2005**	**2006**	**2005**
	(unaudited)	*(unaudited)*	*(unaudited)*	*(unaudited)*
Revenue				
Commodity Revenue	$ 31,721	$ 42,531	$ 208,372	$ 210,152
Delivery	22,989	24,299	80,228	86,438
Transportation and storage	21,994	21,878	44,862	43,346
Net sales from gas marketing (Note 3)	5,633	10,780	14,725	12,698
Revenue collected for municipalities	3,842	4,237	13,654	14,498
Other	1,930	1,708	3,962	2,930
	88,109	105,433	365,803	370,062
Expenses				
Cost of gas sold	$ 41,636	$ 38,657	217,675	203,122
Operating and maintenance	28,437	29,850	57,851	59,132
Interest	11,585	11,965	22,992	24,229
Amortization of property, plant and equipment	13,000	12,532	25,805	24,862
Payments to municipalities	3,842	4,237	13,654	14,498
Saskatchewan taxes and royalties	1,738	1,867	3,052	3,124
	100,238	99,108	341,029	328,967
Net earnings (loss)	(12,129)	6,325	24,774	41,095
Retained earnings, beginning of period:	348,081	296,901	323,878	276,431
Dividend	(7,500)	(9,800)	(20,200)	(24,100)
Retained earnings, end of period	$ 328,452	$ 293,426	$ 328,452	$ 293,426

(See accompanying notes)

Consolidated Statement of Cash Flows

(thousands of dollars)

	Three months ended June 30		Six months ended June 30	
	2006	**2005**	**2006**	**2005**
	(unaudited)	*(unaudited)*	*(unaudited)*	*(unaudited)*
Operating Activities				
Net earnings (loss)	$ (12,129)	$ 6,325	$ 24,774	$ 41,095
Add (deduct) items not requiring an outlay of cash				
Amortization of property, plant and equipment	13,000	12,532	25,805	24,862
Other non-cash items	(940)	(1,325)	(251)	(1,864)
	(69)	17,532	50,328	64,093
Net change in non-cash working capital related to operations	15,974	49	(1,702)	29,424
Cash provided by operating activities	15,905	17,581	48,626	93,517
Investing Activities				
Additions to property, plant and equipment	(12,546)	(12,339)	(21,985)	(20,419)
Customer capital contributions received	2,302	1,146	5,314	1,520
Additions to investments and other assets	(402)	(907)	(402)	(907)
Increase in natural gas in storage (non-current)	(1,659)	(1,594)	(1,830)	(1,536)
	(12,305)	(13,694)	(18,903)	(21,342)
Financing Activities				
Increase (decrease) in short-term debt	7,800	(39,000)	(7,400)	(78,900)
Dividend paid	(12,700)	(14,300)	(17,900)	(40,800)
Sinking fund instalments	(1,800)	(1,800)	(2,300)	(2,050)
Proceeds from long-term debt	-	75,000	-	75,000
Cash provided by (used in) financing activities	(6,700)	19,900	(27,600)	(46,750)
Increase (decrease) in cash during period	(3,100)	23,787	2,123	25,425
Cash position, beginning of period	6,795	5,275	1,572	3,637
Cash position, end of period	$ 3,695	$ 29,062	$ 3,695	$ 29,062

Cash position consists of cash and cash equivalents less bank indebtedness.

(See accompanying notes)

SaskEnergy Incorporated
Notes to the Consolidated Financial Statements
June 30, 2006
Unaudited

1. Accounting Policies

SaskEnergy Incorporated (SaskEnergy or the Corporation) prepares its consolidated interim financial statements in accordance with Canadian generally accepted accounting principles except that the disclosures do not conform in all respects to the requirements for annual financial statements. The consolidated interim financial statements follow the same accounting policies and methods of computation as the consolidated financial statements for the year ended December 31, 2005.

These consolidated interim financial statements, which are unaudited, should be read in conjunction with the consolidated financial statements for the year ended December 31, 2005 and have been prepared from the records of the Corporation. The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets, liabilities, revenue and expenses. Actual amounts could differ from these estimates.

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

2. Saskatchewan Energy Share

In November 2005, the Government of Saskatchewan approved an appropriation of $123,940 thousand to establish the Saskatchewan Energy Share. The appropriation related to the period November 1, 2005 to March 31, 2006 as it was designed to assist natural gas consumers in dealing with high natural gas prices during the winter of 2005/2006.

The Saskatchewan Energy Share included a specific appropriation of $92,040 thousand to be used by SaskEnergy to cap the cost of natural gas sold to customers at $7.95 per gigajoule during the period November 1, 2005 to March 31, 2006. For each month during this period, SaskEnergy calculated its actual cost per gigajoule of natural gas and compared this amount to the cap of $7.95 per gigajoule. Based on estimates of sales volumes, SaskEnergy's actual cost of gas for January, February, and March 2006 was above the cap of $7.95 per gigajoule and accordingly, SaskEnergy received $20,530 thousand from the Saskatchewan Energy Share.

Certain natural gas consumers in Lloydminster, Saskatchewan receive their natural gas service from Direct Energy Regulated Services (a supplier based in Alberta). Under the Saskatchewan Energy Share, $1,000 thousand was allocated to provide eligible Lloydminster customers with a one time credit of $200. This credit was provided to these customers in 2006. During the month of March 2006, SaskEnergy reimbursed Direct Energy Regulated Services for these credits and in turn recovered this amount from the Saskatchewan Energy Share. The cost of this initiative was $549 thousand.

3. Net Sales From Gas Marketing

Net sales from gas marketing includes the following:

	Three months ended June 30	
	2006	2005
	(thousands)	
Competitive gas sales	$ 116,096	$ 114,487
Cost of gas	110,463	103,707
Margin	$ 5,633	$ 10,780

	Six months ended June 30	
	2006	2005
	(thousands)	
Competitive gas sales	$ 254,871	$ 225,354
Cost of gas	240,146	212,656
Margin	$ 14,725	$ 12,698