SaskEnergy

YOUR NATURAL CHOICE®

Management's Discussion and Analysis

The Management's Discussion and Analysis highlights the primary factors that impacted the operations and financial results of SaskEnergy Incorporated (SaskEnergy or the Corporation) and its wholly owned subsidiaries for the six month period ended June 30, 2007. This discussion should be read in conjunction with the consolidated interim financial statements and accompanying notes. For additional information relative to its operations and financial position, refer to the Corporation's Annual Report for the year ended December 31, 2006.

Corporate Profile

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

SaskEnergy has seven wholly owned subsidiaries:

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

Financial and Operating Highlights

	Three Months Ended June 30		Six Months Ended June 30	
	2007	2006	2007	2006
Financial Highlights				
Consolidated Net Income (Loss) (millions)	$6	($12)	$53	$25
Total Assets (millions)			$1,306	$1,275
Long-term Debt (millions)			$669	$651
Operating Highlights				
Distribution				
Volumes Distributed - Petajoules	24	20	72	62
Winter Weather - Compared to the thirty year average	N/A	N/A	Normal	10% Warmer
Average Cost per Gigajoule of Natural Gas to June 30*	$7.34	$6.44	$7.24	$8.34
Transmission				
Volumes Transported - Petajoules	67	75	169	174
Peak Day Natural Gas Flows (Winter Season) - Petajoules - Date of Peak Flow	N/A	N/A	1.49 February 14	1.53 February 16

*For 2006 before the effect of Saskatchewan Energy Share

Financial Results

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

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

Effective June 1, 2007 the delivery rate charged to SaskEnergy customers increased an average of 5.7%. The average overall bill impact was an increase of 1.5%, including commodity costs. The Basic Monthly Charge increased $2.00 per month for residential customers and $2.50 per month for farm customers, with modest increases for other customer classes. This delivery rate increase is the first in ten years, as the last increase was July 1, 1997.

Consolidated Net Income

For the first six months of 2007 consolidated net income was $53 million, which was $28 million higher than the $25 million for the same period in 2006. A gain on commodity sales in 2007 compared to a commodity loss in 2006 and higher margins on gas marketing sales than in 2006 contributed to the higher net income in 2007.

1. **Commodity**

   (a) Commodity Sales

   The commodity rate for natural gas sales to distribution utility customers was $7.17 per Gigajoule (GJ) for the period January 1, 2007 to June 30, 2007. In 2006 the commodity rate was $7.95 per GJ from January 1 to March 31 and $6.80 per GJ from April 1 to June 30. This resulted in lower average revenue per GJ for the first six months of 2007 compared to 2006.

   The lower average revenue per GJ was offset by normal weather in the six months of 2007 compared to 10% warmer than normal weather in 2006. The colder weather in 2007 increased the amount of natural gas consumed for space heating purposes by 1.5 Petajoules in 2007 compared to 2006.

   Also at the time of the adoption of the new CICA standards for the reporting of financial instruments, SaskEnergy discontinued the use of hedge accounting for natural gas contracts. Accordingly, commodity sales to June 30, 2007 includes commodity revenue of $30 million related to physical contracts entered into for price management purposes. In 2006 the net gain or loss related to these contracts was included in commodity cost of gas sold.

   (b) Commodity Cost of Gas Sold

   The cost of gas sold includes the cost of purchased gas and adjustments that effectively record the fair value of natural gas contracts (fair value adjustments) as at June 30.

   The fair value adjustments decreased the cost of gas sold during the first six months of 2007 by $4 million. Therefore, the gain on commodity sales of $6 million for the first six months of 2007 was primarily due to the fair value adjustments on natural gas contracts. The $10 million loss on commodity sales during the first six months of 2006 was primarily due to $7 million in unfavourable fair value adjustments.

   The effect of unfavourable fair value adjustments was the primary cause of a $12 million loss on commodity sales in the second quarter of 2007 and the $11 million loss on commodity sales in the second quarter of 2006.

2. **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 competes to supply natural gas to larger end-use customers in Saskatchewan through non-regulated contract sales.

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

2. Gas Marketing (continued)

In the first six months of 2007, the realized gain from the foregoing activity was $16 million. However, favourable fair value adjustments on natural gas contracts of $13 million resulted in a gain of $29 million. This compared to a gain of $16 million for the same period in 2006.

In the three month period ending June 30, 2007 the margin from gas marketing sales was $30 million compared with $7 million for the same period in 2006. In the second quarter of 2007, there were favourable fair value adjustments relating to natural gas contracts of $24 million compared to favourable fair value adjustments of $3 million for the second quarter of 2006.

3. Delivery Revenue

Delivery revenue in the first six months of 2007 was $88 million, which was $8 million higher than the same period in 2006. The majority of SaskEnergy's distribution customers consume natural gas for heating purposes and, as a result, the volume of natural gas distributed is sensitive to variations in weather, particularly through the November-to-March prime heating load season. The weather from January 1 to June 30, 2007 was 12% colder than the same period in 2006. Weather and the delivery rate increase (noted earlier) effective June 1, 2007 were the primary reasons for increased delivery revenue.

For the three month period ending June 30, 2007, delivery revenue of $25 million was $2 million higher than in the same period in 2006 due to the rate increase in 2007 and the warmer weather in 2006.

4. Transportation and Storage Revenue

Transportation and storage revenue for the first six months of 2007 was $44 million, which was a decrease of $1 million over the same period in 2006. The decrease is mainly due to a transportation rate reduction of 3% effective June 1, 2006, partially offset by the transportation rate increase of 2% effective January 1, 2007.

5. Other Expenses

Expenses (excluding cost of gas sold) to June 30, 2007 were $132 million, which was $8 million higher than the first six months of 2006. For the three month period ending June 30, 2007 total expenses (excluding cost of gas) were $66 million or $7 million higher than the same period in 2006.

Operating and maintenance expenses for the first six months of 2007 were $65 million, which was $7 million higher compared to the first six months of 2006 primarily due to increased labour costs in 2007 and a gain on the sale of a compressor unit in 2006. For the second quarter ended June 30, 2007 the operating and maintenance expenses of $34 million were $6 million higher than 2006, also due to increased labour costs and the aforementioned sale of the compressor unit.

Interest expense, amortization, payments to municipalities and Saskatchewan taxes to June 30, 2007 were consistent with the same period in 2006.

Outlook

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

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

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

SaskEnergy Incorporated

Consolidated Statement of Financial Position

(millions of dollars)

	As at June 30, 2007 *(unaudited)*	As at December 31, 2006 *(restated)*
Assets		
Current assets		
Cash	$ 1	$ -
Accounts receivable	91	169
Natural gas in storage held for resale	126	111
Inventories of supplies	8	7
Debt retirement funds	3	4
Fair value of derivative instruments	29	1
	258	292
Property, plant and equipment (net)	940	955
Natural gas in storage held for resale and operations	41	46
Debt retirement funds	34	34
Investments and other assets	31	33
Fair value of derivative instruments	2	-
	$ 1,306	$ 1,360
Liabilities and Province's Equity		
Current liabilities		
Bank indebtedness	$ -	$ 2
Short-term debt	52	69
Accounts payable	108	169
Dividend payable	20	12
Current portion of long-term debt	75	48
Fair value of derivative instruments	20	14
	275	314
Long-term debt	594	634
Fair value of derivative instruments	2	-
	871	948
Province of Saskatchewan's equity		
Equity advances	72	72
Retained earnings	364	342
Accumulated other comprehensive income	(1)	(2)
	435	412
	$ 1,306	$ 1,360

(See accompanying notes)

Director

Director

SaskEnergy Incorporated

Consolidated Statement of Income and Retained Earnings

(millions of dollars)

	Three months ended June 30		Six months ended June 30	
	2007	2006	2007	2006
	(unaudited)	*(unaudited)*	*(unaudited)*	*(unaudited)*
Revenue				
Commodity sales	$ 47	$ 31	$ 239	$ 208
Gas marketing sales	122	152	225	312
Delivery	25	23	88	80
Transportation and storage	22	22	44	45
Revenue collected for municipalities	5	4	15	14
Other	2	2	3	4
	223	234	614	663
Expenses				
Commodity cost of gas sold	59	42	233	218
Gas marketing cost of gas sold	92	145	196	296
Operating and maintenance	34	28	65	58
Interest	12	12	23	23
Amortization	13	13	26	26
Payments to municipalities	5	4	15	14
Saskatchewan taxes	2	2	3	3
	217	246	561	638
Net income (loss)	6	(12)	53	25
Retained earnings, beginning of period	378	349	342	324
Change in accounting policy (Note 2)	-	-	2	-
Dividend	(20)	(8)	(33)	(20)
Retained earnings, end of period	$ 364	$ 329	$ 364	$ 329

(See accompanying notes)

SaskEnergy Incorporated

Consolidated Statement of Comprehensive Income

(millions of dollars)

	Three months ended June 30		Six months ended June 30	
	2007	2006	2007	2006
	(unaudited)	*(unaudited)*	*(unaudited)*	*(unaudited)*
Net income (loss)	$ 6	$ (12)	$ 53	$ 25
Other comprehensive income:				
Gains and losses on derivative instruments designated as hedges for accounting purposes in prior periods transferred to net income in the current period	-	-	4	-
Unrealized gains and losses on translating financial statements of self-sustaining foreign operations	(1)	-	(2)	-
	(1)	-	2	-
Comprehensive income	$ 5	$ (12)	$ 55	$ 25

SaskEnergy Incorporated

Consolidated Statement of Accumulated Other Comprehensive Income

(millions of dollars)

	As at June 30, 2007	As at December 31, 2006
	(unaudited)	*(unaudited)*
Accumulated other comprehensive income, beginning of period	$ (2)	$ (2)
Transitional amounts for gains and losses on derivative instruments designated as hedges for accounting purposes in prior periods	(1)	-
Other comprehensive income	2	-
Accumulated other comprehensive income, end of period	$ (1)	$ (2)

(See accompanying notes)

SaskEnergy Incorporated

Consolidated Statement of Cash Flows

(millions of dollars)

	Three months ended June 30		Six months ended June 30	
	2007	**2006**	**2007**	**2006**
	(unaudited)	*(unaudited)*	*(unaudited)*	*(unaudited)*
Operating Activities				
Net income (loss)	$ 6	$ (12)	$ 53	$ 25
Add (deduct) items not requiring an outlay of cash				
Amortization of property, plant and equipment	13	13	26	26
Other non-cash items	(14)	-	(18)	-
	5	1	61	51
Net change in non-cash working capital related to operations	20	16	2	(2)
Cash provided by operating activities	25	17	63	49
Investing Activities				
Additions to property, plant and equipment	(16)	(13)	(26)	(22)
Additions to investments & other assets	(1)	-	(1)	-
Customer capital contributions received	3	2	15	5
Decrease (increase) in natural gas in storage (non-current)	-	(2)	5	(2)
Cash used in investing activities	(14)	(13)	(7)	(19)
Financing Activities				
Proceeds from long-term debt	19	-	36	-
Increase (decrease) in short-term debt	12	8	(17)	(7)
Repayments of long-term debt (net)	(26)	-	(44)	-
Dividend paid	(13)	(13)	(25)	(18)
Decrease in bank indebtedness	-	-	(2)	-
Debt retirement fund instalments	(2)	(1)	(3)	(2)
Cash used in financing activities	(10)	(6)	(55)	(27)
Increase (decrease) in cash during period	1	(2)	1	3
Cash position, beginning of period	-	7	-	2
Cash position, end of period	$ 1	$ 5	$ 1	$ 5

(See accompanying notes)

1. Accounting Policies

SaskEnergy Incorporated (SaskEnergy or the Corporation) prepares its consolidated interim financial statements in accordance with Canadian generally accepted accounting principles except that the disclosures do not conform in all respects to the requirements for annual financial statements. The consolidated interim financial statements follow the same accounting policies and methods of computation as the consolidated financial statements for the year ended December 31, 2006 except as noted in the Change in Accounting Policy Note 2.

These consolidated interim financial statements, which are unaudited, should be read in conjunction with the consolidated financial statements for the year ended December 31, 2006 and have been prepared from the records of the Corporation. The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets, liabilities, revenue and expenses. Actual amounts could differ from these estimates.

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

2. Change in Accounting Policy

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

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

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

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

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

2. Change in Accounting Policy (continued)

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

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

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

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

Adjustment to opening retained earnings
(millions)

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

Impact of reclassifications
(millions)

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

2. Change in Accounting Policy (continued)

Upon the adoption of the new standards, the impact of applying this change in accounting policy prospectively on the net income for the three months and six months ended June 30, 2007 was as follows:

Impact on net income
(millions)

	Three months ended June 30, 2007		Six months ended June 30, 2007	
Gas marketing sales	$	25	$	12
Commodity cost of gas sold		(3)		(2)
Gas marketing cost of gas sold		(2)		-
Increase in net income	$	20	$	10

3. Restatement of Comparative Figures

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

4. Comparative Figures

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

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