# SASKENERGY INCORPORATED

## SECOND QUARTER REPORT
## September 30, 2016

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 | | Integrity |
| Communication | Safety | Accountability |
| Recognition | | Spirit |

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# FINANCIAL AND OPERATING HIGHLIGHTS

| | Three months ended September 30 | | Six months ended September 30 | |
|---|---|---|---|---|
| | **2016** | **2015** | **2016** | **2015** |
| **FINANCIAL HIGHLIGHTS** ($ millions) | | | | |
| Total revenue | **146** | 141 | **264** | 286 |
| Total expenses | **140** | 161 | **204** | 308 |
| Consolidated net income (loss) | **6** | (20) | **60** | (22) |
| Market value adjustments | **13** | (7) | **70** | (3) |
| Income before unrealized market value adjustments | **(7)** | (13) | **(10)** | (19) |
| Dividends | **-** | 10 | **-** | 20 |
| Cash provided by operating activities | **27** | 34 | **81** | 114 |
| Capital expenditures | **55** | 58 | **84** | 101 |
| Total assets | | | **2,518** | 2,375 |
| Total net debt | | | **1,201** | 1,146 |
| Debt ratio | | | **60.0%** | 62.2% |
| **OPERATING HIGHLIGHTS** | | | | |
| Distribution | | | | |
| Volumes distributed (petajoules) | | | | |
| Residential/Farm | **2** | 3 | **6** | 7 |
| Commercial | **3** | 2 | **7** | 6 |
| Industrial | **30** | 29 | **60** | 57 |
| Total | **35** | 34 | **73** | 70 |
| Weather (compared to last 30 years) | **7% warmer** | 2% warmer | **14% warmer** | 4% warmer |
| Transmission | | | | |
| Volumes transported (petajoules) | | | | |
| Domestic | **60** | 56 | **124** | 114 |
| Export | **14** | 9 | **15** | 13 |
| Total | **74** | 65 | **139** | 127 |

## INTRODUCTION

The Management's Discussion and Analysis (MD&A) highlights the primary factors that affected SaskEnergy's consolidated financial condition and performance for the six months ended September 30, 2016. On November 30, 2015, the Government of Saskatchewan announced a change in the year end for CIC and its subsidiaries from December 31 to March 31. SaskEnergy reported a 15-month period ended March 31, 2016 to transition to the new fiscal period and will report on 12-month periods ending March 31st each year thereafter. 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 November 22, 2016 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 2015-16 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 2015-16 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.

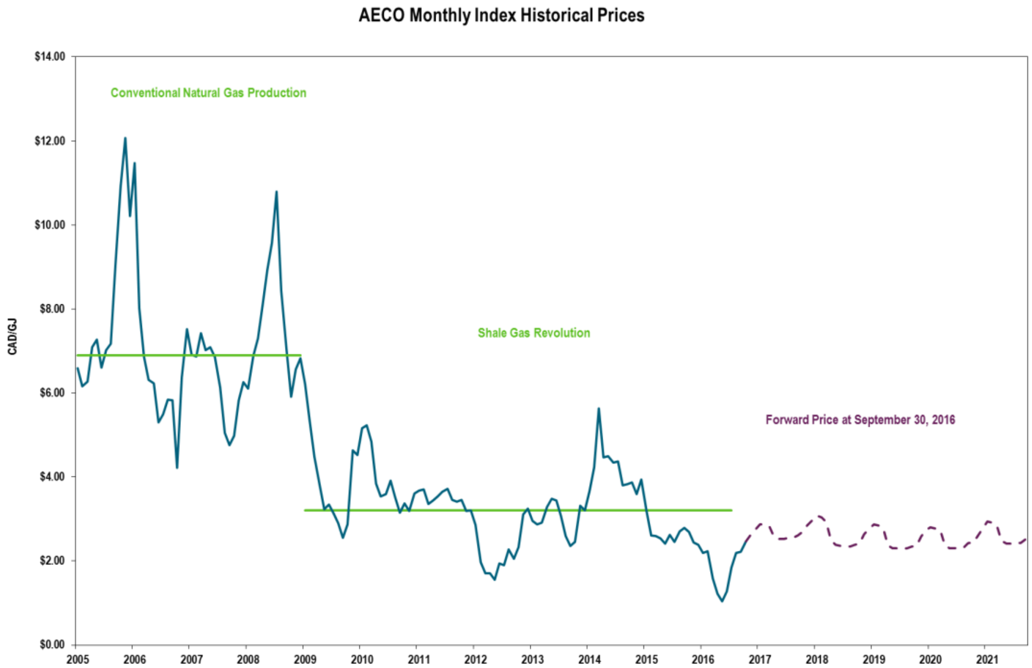
The volume of natural gas delivered to customers is sensitive to variations in the weather, particularly through the prime heating season of November to March. Additionally, changes in market value adjustments may cause significant fluctuations in net income due to the volatility of natural gas prices. Therefore, the condensed consolidated financial results for the first six months of 2016-17 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.

In response to the low prices in 2015 and 2016, North American production slowed, while growth in natural gas demand continued to rise, particularly in the industrial and power generation sectors. This changing supply/demand balance for natural gas initiated a quick recovery of the AECO monthly index, the benchmark price for natural gas in Western Canada, as the index improved from $1.02 per GJ at the end of March 2016 to $2.56 per GJ at the end of September 2016. This was a $1.54 per GJ (151 per cent) recovery in the six month period as noted in the AECO Monthly Index Historical Prices chart. 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.




In previous years shale gas production has responded quickly to natural gas price increases by increasing production, which has limited the recovery of gas prices. During the first quarter of the fiscal year shale gas production has been slower to respond to the price decrease, which allowed for natural gas prices to recover by the end of September 2016 to levels comparable to the fall of 2015.

The rise in gas prices during the first six months of the fiscal period is positive for natural gas prices but is not enough to make investment into additional Saskatchewan gas production economical. SaskEnergy continues to see record amounts of gas imported from Alberta, which is brought into the Province to serve increasing customer loads. Much of the gas imported throughout the summer has been injected into storage facilities within the Province and will be used to serve customers through the winter.

## CONSOLIDATED FINANCIAL RESULTS

### Consolidated Net Income (Loss)

| | Three months ended September 30 | | | Six months ended September 30 | | |
|---|---|---|---|---|---|---|
| (millions) | **2016** | **2015** | **Change** | **2016** | **2015** | **Change** |
| Loss before unrealized market value adjustments | **$ (7)** | $ (13) | $ 6 | **$ (10)** | $ (18) | $ 8 |
| Impact of fair value adjustments | **10** | (6) | 16 | **56** | (3) | 59 |
| Revaluation of natural gas in storage | **3** | (1) | 4 | **14** | - | 14 |
| Consolidated net income (loss) | **$ 6** | $ (20) | $ 26 | **$ 60** | $ (21) | $ 81 |

Net Income for April through September is typically low as the weather is not cold enough to generate high residential and commercial heating loads. The loss before unrealized market value adjustments was $10 million for the six months ended September 30, 2016, $8 million favourable compared to the $18 million loss in 2015. Delivery and Transportation rate increases effective January 1, 2016 have addressed growing operating cost pressure and are contributing to increased revenues compared to 2015. Operating and maintenance, depreciation and Saskatchewan taxes are increasing compared to 2015, a result of recent growth in the Corporation's natural gas infrastructure and customer base. Customer capital contributions are lower than 2015 as the provincial economy and residential customer growth has slowed in 2016. The reduced capital requirement for customer connections has also resulted in lower interest expense. The Corporation continues to aggressively manage operating costs, evidenced by decline in employee benefits expense resulting from the Corporation continuing to manage overtime and staffing levels.

A commodity rate decrease effective January 1, 2016 reduced the realized commodity margin in 2016 compared to 2015. The gas marketing margin slightly increased in 2016 as natural gas market prices reached 20 year lows in 2016, allowing the Corporation to enter into favourable purchase and sale contracts with positive margins realized in July through September.

During April through September 2016, higher priced natural gas purchase contracts related to the Corporation's commodity business expired, which had a positive impact on unrealized fair value adjustments. In addition, natural gas market prices recovered significantly by the end of June 2016 and continued through to September. The AECO near-month natural gas spot price increased from $1.02 per GJ at the end of March 2016 to $2.56 per GJ at the end of September 30, 2016, generating a $56 million favourable unrealized fair value adjustment on outstanding natural gas contracts.

### 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.

As derivative instruments, natural gas contracts 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 or incurring a loss over the long term. For rate-setting purposes, 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 recorded for financial reporting purposes, is either recovered from or refunded to customers as part of future commodity rates. Consequently, higher commodity margins in one year are often followed by a commodity rate reduction and lower commodity margins in the subsequent year, as is the case in 2015-16 and 2016-17.

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, including transportation costs paid to TransGas, as well as the timing related to recognition of financial derivative settlements. While a gain or loss is commonly reported in the Corporation's consolidated financial statements, it should not be taken as indicative of the results recorded within the GCVA.

| | Three months ended September 30 | | | Six months ended September 30 | | |
|---|---|---|---|---|---|---|
| (millions) | **2016** | 2015 | Change | **2016** | 2015 | Change |
| Commodity sales | **$ 17** | $ 30 | $ (13) | **$ 45** | $ 71 | $ (26) |
| Commodity purchases [1] | **(16)** | (31) | 15 | **(43)** | (67) | 24 |
| Realized margin on commodity sales | **1** | (1) | 2 | **2** | 4 | (2) |
| Impact of fair value adjustments | **5** | (2) | 7 | **53** | 7 | 46 |
| Margin on commodity sales | **$ 6** | $ (3) | $ 9 | **$ 55** | $ 11 | $ 44 |

[1] Net of change in inventory

SaskEnergy manages the purchase price of natural gas it buys through its natural gas price risk management program with two objectives – to reduce the impact of natural gas price volatility, and to offer rates that are competitive to other utilities. The two objectives naturally oppose each other, and the balance between the two may change depending on existing 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. In the current low price environment SaskEnergy's price risk management strategy leans more towards reducing volatility and as a result, SaskEnergy has more price risk management transactions which tend to drive more 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 $2 million margin on commodity sales for the six months ending September 30, 2016 compared to the $4 million margin for the same period in 2015. Average revenue was $3.75 per GJ and average cost of gas sold was $3.63 per GJ during April through September 2016, resulting in a margin of $0.12 per GJ. This compared to an average commodity margin of $0.16 per GJ through the same six month period in 2015. Lower margins in 2016 were a result of a commodity rate decrease from $4.84 per GJ to $4.30 effective January 1, 2016. This was partially offset by there being 7 less petajoules (PJs) of excess gas sales during 2016 compared to 2015. Excess gas sales typically have lower margins and reduce the commodity margins.

The realized commodity margin on commodity sales of $1 million for the three months ending September 30, 2016 was $2 million above the $1 million unfavourable margin in 2015. A lower commodity rate in 2016 reduced the commodity margin, however excess gas sales during 2016 were lower than 2015 and had a positive effect on the commodity margin. There were 5 PJs of excess gas sales in the three months ending September 30, 2015 in comparison to only 1 (PJs) sold in 2016.

### Commodity Fair Value Adjustments

The fair value adjustments at the end of the September 30, 2016 increased the margin on commodity sales by $53 million as the $100 million unfavourable fair value position at March 31, 2016 improved to $47 million unfavourable at September 30, 2016. The settlement of higher priced natural gas purchase contracts during the six months contributed to a lower volume of contracts outstanding. In addition, the prices of the remaining natural gas purchase contracts outstanding are closer to market prices due to the recovery of AECO market prices during the first two quarters. Market prices dropped at the end of March 2016, as warmer weather through the winter resulted in higher than expected levels of natural gas in storage. The AECO near-month natural gas spot price increased $1.54 per GJ from $1.02 per GJ at the end of March 2016 to $2.56 per GJ at the end of September 2016.

## Gas Marketing Margin

SaskEnergy's gas marketing activity employs several different strategies, all of which attempt to optimize storage and transportation capacity available to the Corporation to earn a positive margin. The primary strategy involves the purchase and storage injection of natural gas accompanied by a forward sales contract that essentially locks in a future profit margin. Traditionally this strategy has produced significant margins; however, while natural gas market prices have declined and differentials between current and forward market prices have narrowed, the opportunities to generate significant margins have also diminished. The Corporation also optimizes transmission and storage capacity during off-peak periods by purchasing and selling natural gas in the open market to generate additional margins. The margins earned on this activity benefit customers by reducing pressure on transmission and distribution rates. The Corporation also leverages its storage facilities by purchasing natural gas and injecting it into storage when gas prices are low and selling when gas prices recover. This activity is primarily responsible for the revaluation of natural gas in storage, as gas prices have fallen to all time low prices while inventory balances have grown. Lastly, SaskEnergy provides natural gas supply options to larger end-use customers in Saskatchewan through non-regulated contract sales.

| | Three months ended September 30 | | | Six months ended September 30 | | |
|---|---|---|---|---|---|---|
| (millions) | **2016** | 2015 | Change | **2016** | 2015 | Change |
| Gas marketing sales | **$ 46** | $ 40 | $ 6 | **$ 72** | $ 75 | $ (3) |
| Gas marketing purchases [1] | **(40)** | (36) | (4) | **(61)** | (67) | 6 |
| Realized margin on gas marketing sales | **6** | 4 | 2 | **11** | 8 | 3 |
| Impact of fair value adjustments | **4** | (3) | 7 | **(1)** | (5) | 4 |
| Revaluation of natural gas in storage | **3** | (1) | 4 | **14** | - | 14 |
| Margin on gas marketing sales | **$ 13** | $ - | $ 13 | **$ 24** | $ 3 | $ 21 |

[1] Net of change in inventory

The realized margin on gas marketing sales at September 30, 2016, which removes fair value adjustments on derivative instruments and the revaluation of natural gas in storage, was $11 million. This is $3 million higher compared to the same period of 2015. A low market price environment generally constrains opportunities for the Corporation to transact significant volumes of purchases and sales at favourable margins; however, the rapid decline in short-term market prices at the end of March 2016 generated favourable forward pricing differentials as forward pricing did not decline to the same extent. This allowed the Corporation to increase gas marketing activity, although at smaller margins, with 35 PJs of natural gas sold in the six months ended September 30, 2016 compared to 24 PJs in the same period of 2015.

### 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 September 30, 2016 on gas marketing derivative instruments reduced the gas marketing margin by $1 million compared to the unfavourable fair value adjustment of $5 million at the end of the same period in 2015. As the AECO near month spot price dropped to a 20 year low prior to March 2016 the Corporation entered into buy sell transactions, utilizing the price differential between spot prices and forward prices. Between April and the end of September 2016, the spot price increased $1.54 per GJ and at the same time older purchase and sales contracts matured. At the end of September 30, 2016, the volume of outstanding contracts was 16 PJs less than at March 2016. With a lower volume of contracts outstanding and average market prices increasing on those outstanding contracts the fair value adjustment improved compared to March 2016, but still remained unfavourable at September 30, 2016. This is more prominent in the three month period ending September 30, 2016 where the impact of the fair value adjustment is $4 million.

### Revaluation of Natural Gas in Storage

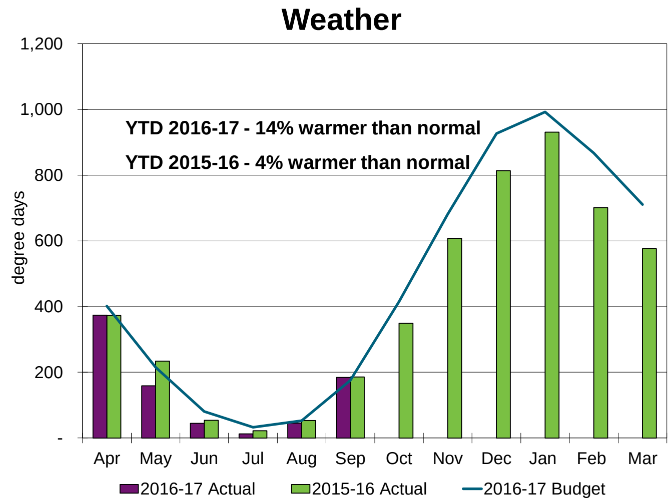
At each reporting period, the Corporation measures the net realizable value of gas marketing natural gas in storage based on forward market prices and anticipated delivery dates. The carrying amount of natural gas in storage is adjusted to reflect the lower of weighted average cost and net realizable value. In recent years, low natural gas prices have translated to reduced prices on the forward price curve. The declining market price environment at the end of March 2016 provided an opportunity for the Corporation to purchase lower priced natural gas and inject it into storage. When natural gas market prices increased throughout the six months ended September 30, 2016, the $34 million unfavourable net realizable value impact at the end of March 2016 improved by $14 million to $20 million at the end of September.

## Revenue

| | Three months ended September 30 | | | Six months ended September 30 | | |
|---|---|---|---|---|---|---|
| (millions) | **2016** | 2015 | Change | **2016** | 2015 | Change |
| Delivery revenue | **$ 35** | $ 32 | $ 3 | **$ 77** | $ 71 | $ 6 |
| Transportation and storage revenue | **33** | 31 | 2 | **65** | 60 | 5 |
| Customer capital contributions | **6** | 9 | (3) | **8** | 11 | (3) |
| Other revenue | **3** | 2 | 1 | **5** | 5 | - |
| | **$ 77** | $ 74 | $ 3 | **$ 155** | $ 147 | $ 8 |

## Delivery Revenue

Delivery Revenue is driven by customer growth and how much 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 $77 million for the six months, and $35 million for the three months ending September 30, 2016, $6 million and $3 million higher than the same periods in 2015. A 4.5 per cent rate increase effective January 1, 2016 contributed to higher revenues. Delivery revenue is typically lower in April through September as residential and commercial customers don't have large heating requirements in the warmer months. The Saskatchewan Rate Review Panel has recommended, and Cabinet has approved, an 8.6 per cent delivery rate increase effective November 1, 2016. The increase will help the Corporation offset increasing operating costs related to the growing natural gas infrastructure and increasing focus on safety, while expanding integrity programs to address the aging infrastructure.

## 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 which 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 the 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. Under an interruptible contract, the customer may deliver or receive gas only when there is available capacity on the system. With a firm contract, customers pay for the amount of capacity they have contracted for whether they use the capacity or not. With an interruptible contract, customers only pay receipt and delivery tolls when they deliver or receive gas.

Transportation and storage revenue was $65 million for the six months and $33 million for the three months ending September 30, 2016, $5 million and $2 million above the same periods in 2015. Industrial customer load growth continues to increase demand for natural gas within the province and is driving higher transportation revenue. A 2.5 per cent transportation rate increase effective January 1, 2016, is also contributing to the higher transportation revenue year-over-year.

### 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 the distribution system. The volume and magnitude of customer contribution revenue can vary significantly period-over-period as various factors influence their receipt and recognition as revenue. The contributions received, less potential refunds, are recognized as revenue once the related property, plant and equipment is available for use. Customers may earn a refund of some or all of the contributions they make depending on how much gas they flow. 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 ended September 30, 2016 and for the six months year-to-date was $3 million below the same periods in 2015. The downturn in the provincial economy is translating into lower distribution customer connections.

### Other Revenue

Other revenue approximates prior year and 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, a result of low natural gas prices.

### Other Expenses and Net Finance Expense (before FVA)

| | Three months ended September 30 | | | Six months ended September 30 | | |
|---|---|---|---|---|---|---|
| (millions) | **2016** | **2015** | **Change** | **2016** | **2015** | **Change** |
| Employee benefits | **$ 20** | $ 21 | $ (1) | **$ 41** | $ 44 | $ (3) |
| Operating and maintenance | **31** | 29 | 2 | **61** | 58 | 3 |
| Depreciation and amortization | **24** | 22 | 2 | **47** | 43 | 4 |
| Saskatchewan taxes | **5** | 4 | 1 | **7** | 6 | 1 |
| Other Expenses | **$ 80** | $ 76 | $ 4 | **$ 156** | $ 151 | $ 5 |
| Net finance expense (before FVA) | **$ 11** | $ 12 | $ (1) | **$ 22** | $ 24 | $ (2) |

Increasing investment in safety and integrity, strong customer growth, and the need to import more natural gas from Alberta as Saskatchewan natural gas production declines are key factors contributing to increases in other expenses. Employee benefits expense of $41 million for the six months and $20 million for the three months ending September 30, 2016 are $3 million and $1 million lower, respectively, than prior year. The Corporation was able to manage vacant positions, through productivity and efficiency initiatives. Overtime was reduced through collaboration with other Crown corporations and third parties, actively managing/scheduling work to meet demands and an overall decline in the volume of work as the pace of the Provincial economy slows down. Operating and maintenance expense of $61 million year-to-date and $31 million for the quarter are $3 million and $2 million higher than the same periods in 2015, due to increasing third party transportation costs as additional cross border transportation capacity is required to import gas from Alberta. This was partially offset by an elevated focus on management of operating costs. Depreciation and amortization of $47 million for the six months and $24 million for the three months ending September 30, 2016 are $4 million and $2 million above prior year as capital additions increase the asset base and depreciation and amortization. Saskatchewan taxes approximate the prior year.

Net finance expenses, before the impact of fair value adjustments, were $2 million lower year-to-date and $1 million lower for the quarter compared to the same periods in 2015. Lower interest rates allowed the Corporation to replace higher cost maturing long-term debt with lower cost long-term debt. There was a $4 million favourable fair value adjustment at September 30, 2016 on debt retirement funds during 2016, an outcome of lower interest rates on fixed-rate investments.

## LIQUIDITY AND CAPITAL RESOURCES

| (millions) | Three months ended September 30 2016 | 2015 | Change | Six months ended September 30 2016 | 2015 | Change |
|---|---|---|---|---|---|---|
| Cash provided by operating activities | **$ 27** | $ 34 | $ (7) | **$ 81** | $ 114 | $ (33) |
| Cash used in investing activities | **(56)** | (57) | 1 | **(87)** | (101) | 14 |
| Cash provided by (used in) financing activities | **28** | 23 | 5 | **(5)** | (22) | 17 |
| Decrease in cash and cash equivalents | **$ (1)** | $ - | $ (1) | **$ (11)** | $ (9) | $ (2) |

Cash provided from operations and debt borrowed from the Province of Saskatchewan's General Revenue Fund is the primary source of liquidity and capital for SaskEnergy. Generally, SaskEnergy finances its investment activity with cash from operations. To the extent that cash from operations is insufficient to support investment activity, debt servicing costs and dividends, additional short and long term debt is borrowed. Sources of liquidity include Order in Council authority to borrow up to $500 million in short-term loans. The Corporation holds a $35 million uncommitted line of credit with the Toronto-Dominion Bank. Over the longer term, *The SaskEnergy Act* allows the Corporation to borrow up to $1,700 million.

### Operating Activities

Cash from operating activities of $81 million for the six months ended September 30, 2016 was $33 million lower than the same period in 2015. Natural gas sales declined in 2016, a result of a commodity rate decrease reducing the commodity margin and warmer weather. Both contributed to lower cash from operations in 2016 compared to 2015. The Corporation also took advantage of low natural gas market prices by purchasing and injecting lower priced natural gas into storage. Higher transportation revenue and delivery revenue combined with lower employee benefits expense partially offset the decreases in operating cash flows compared to 2015.

### Investing Activities

Cash used in investing activities totaled $87 million for the six months ended September 30, 2016; $14 million lower than 2015. Capital investment levels are declining in 2016 compared to 2015, primarily due to lower investment in customer connections and system expansions, while spending on safety and integrity programming to maintain a safe and reliable system remains consistent with 2015.

### Financing Activities

Cash used for financing activities was $5 million during the six months of 2016 compared to $22 million in 2015. 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 amount of short-term debt. If there is insufficient cash from operations, SaskEnergy will borrow more debt, usually short-term debt, to meet its cash requirements. Excluding short-term debt repayments and borrowings, cash used in financing was $85 million in 2016 compared to $51 million in 2015. There was $45 million of long-term debt that matured in 2016, which was not renewed but rather transferred to short-term debt on a temporary basis until the Corporation was able to obtain $100 million of long-term debt in October. SaskEnergy's debt ratio at September 30, 2016 was 60 per cent in comparison to 61 per cent at March 31, 2016 and 62 per cent at September 30, 2015.

## CAPITAL EXPENDITURES

| (millions) | Three months ended September 30 2016 | 2015 | Change | Six months ended September 30 2016 | 2015 | Change |
|---|---|---|---|---|---|---|
| Customer growth and system expansion | **$ 28** | $ 36 | $ (8) | **$ 42** | $ 58 | $ (16) |
| Safety and system integrity | **22** | 18 | 4 | **35** | 34 | 1 |
| Information systems | **3** | 3 | - | **5** | 6 | (1) |
| Vehicles & equipment, buildings, furniture | **2** | 1 | 1 | **2** | 3 | (1) |
| | **$ 55** | $ 58 | $ (3) | **$ 84** | $ 101 | $ (17) |

SaskEnergy continues to invest in its pipeline system to accommodate growth in the natural gas customer base and its transition to becoming a net importer of natural gas. Capital expenditures of $84 million for the six months ended September 30, 2016 are $17 million below the same period in 2015. Customer growth and system expansion capital expenditures are $16 million lower than 2015, primarily due to slower distribution customer growth, combined with lower spending on the Advanced Metering Infrastructure (AMI) and the meter exchange programs.

## OUTLOOK

The transition to the Corporation's new fiscal year-end will report 12-month periods ending March 31st, which changes the perspective of the Corporation's financial reporting cycle. When reporting a December 31st year-end, the Corporation incurred peak winter heating loads from January through March and these results typically remained prominent through the low heating load periods of April through September. With the Corporation's new fiscal period beginning April 1, the financial results and peak winter heating loads are absent. The financial results for the two quarters ending September 30, 2016 highlight operating results and the Corporation's focus on cost management while working to expand the natural gas system and perform important safety/integrity work in preparation for the approaching winter heating loads. Losses will be common during the first two quarters in the absence of the winter heating load and the financial results demonstrate the dependency the Corporation's financial results have on weather and winter heating loads.

### Market Prices

With the warm weather through the 2015-16 winter, the amount of gas in storage throughout North America at the beginning of April 2016 was much higher than usual. Natural gas prices reached 20-year lows at the end of March 2016, but recovered through the end of September 2016. Storage injection levels were strong through the summer of 2016 resulting in Saskatchewan storage levels being 93 per cent full at the end of September 2016, while Western Canada storage and Canadian storage being 98 per cent and 97 per cent full. This compares to Canadian storage being 83 per cent full at the end of September 2015. As storage levels reach capacity, pricing levels may fluctuate until the winter heating season begins, potentially creating gas marketing opportunities for the Corporation based on the spreads between spot prices and forward prices.

### Commodity Margin

A commodity rate reduction effective January 1, 2016, a result of low natural gas prices, is contributing to lower commodity revenue in comparison to the same two quarters in 2015-16. These first two summer quarters generally experience low commodity margins, until the winter heating season begins midway through the third quarter and continues through to the end of the fiscal period. The commodity margin is highly dependent on winter weather conditions and customer consumption during the winter heating season.

With natural gas prices forecasted to remain relatively low in the near future, the Corporation submitted a second application to the Saskatchewan Rate Review Panel to lower the Commodity rate effective November 1, 2016. Natural gas prices have recovered through the year but remain relatively low in comparison to recent years. A result of reduced heating loads from the warmer winter in 2015-16, strong injections through the summer and high levels of natural gas in storage. The requested rate reduction was approved October 12, 2016 and the commodity rate decrease from $4.30 per GJ to $3.65 per GJ will be effective November 1, 2016.

### Gas Marketing Margin

SaskEnergy purchased and injected low priced natural gas into storage as market prices declined earlier this year. These lower cost purchases reduced the average cost of natural gas, improving the margins on sales contracts through the end of September 2016. Natural gas spot prices increased, while the forward price curve remained relatively unchanged through the first six months of the fiscal period, reducing gas marketing opportunities through the summer. SaskEnergy will continue to monitor natural gas prices and capitalize on opportunities through the remainder of the year.

### Delivery Revenue

In the low natural gas price environment, Saskatchewan natural gas production and exploration will remain slow until prices increase and investment into additional production by Saskatchewan producers becomes more economical. At the same time, customer growth within the Province continues to increase natural gas load growth. Without increasing Saskatchewan production to meet growing load growth, a stronger dependency on importing natural gas supply from Alberta is created. The growing dependency on Alberta supply is increasing operating costs for the Corporation, as gas is being transported further distances.

In recent years, the pace of Saskatchewan's provincial economy and residential customer growth contributed to growing delivery revenue, however customer connection levels are declining in 2016 while industrial and commercial demand for service continues to be strong. Overall, delivery revenue is higher for the first six months of 2016-17 due to delivery rates increasing 4.5 per cent effective January 1, 2016. The third and fourth quarters will see delivery revenues increase with the onset of winter weather conditions, which are expected to return to more seasonably colder temperatures compared to the unseasonably warm winter during 2015-16.

During the first quarter, the Corporation submitted an application to the Saskatchewan Rate Review Panel for an average rate increase of 8.6 per cent effective November 1, 2016. Regular delivery service rate increases are required to offset cost pressures related to maintaining a reliable distribution system, increasing Alberta supply costs, and an industry standard rate of return. The requested rate increase was approved October 12, 2016. The Corporation continues to focus on internal efficiencies to help offset cost pressures and ensure delivery service rates remain competitive. The commodity rate decrease that was approved in combination with the delivery rate increase will more than offset the delivery service rate increase, such that customers will see an overall reduction on their bills.

### Transportation Revenue

Transportation and storage service rate increases implemented effective January 1, 2016 are resulting in higher transportation and storage revenue compared to 2015. The rate increases are addressing rising capital and operating costs related to an increasing focus on system integrity, emergency response, public awareness and the increasing cost of importing natural gas supply from Alberta. During the first quarter, Alberta border capacity operated at an average of 94 per cent of capacity and represents the growth in the province's industrial sector as customers maximize purchases of natural gas and storage injections. Natural gas market prices are forecasted to remain low making expansion of Saskatchewan natural gas production uneconomical. Continued load growth within the industrial sector, increases the reliance on importing natural gas supply into the province. Rising demand for natural gas will continue to be sourced from conventional natural gas production in Alberta, which has begun to diminish and is being replaced by shale gas production. Long term sourcing is expected to shift to Northeastern British Columbia as Alberta supply tapers. As the Corporation's dependency on importing higher volumes of natural gas continues, imports will be from further distances. Higher operating, maintenance and compression costs to maintain the additional infrastructure are expected in relation to importing natural gas from further distances. The current transportation rates are expected to cover these increasing transportation costs and no rate increases are expected through 2017-18.

### Other Expenses

In response to the economic downturn in the Province and increasing pressures on transportation and delivery rates, SaskEnergy continues to focus on managing costs throughout 2016-17. With growing infrastructure and increasing dependency on Alberta natural gas supply resulting from growth in the customer base and industrial customer load, operating cost pressures are increasing. In the face of these costs pressures, the Corporation is focused on finding efficiencies in its operations through collaboration with other Crown Corporations, business process changes and technology initiatives The Corporation has achieved more than $38 million in efficiencies since 2009, with another $4 million planned this fiscal year.

The Corporation is expecting staffing levels to remain consistent through 2016. Leveraging efficiency and productivity initiatives, SaskEnergy will continue to meet the Province's growing natural gas requirements while keeping cost increases to a minimum.

### Capital Investment

SaskEnergy will continue to focus its efforts on providing safe and reliable service to customers while managing rate pressure. Spending is focused on upgrading infrastructure to meet industrial customer load growth, new service requirements, as well as the integrity of the transmission, distribution and storage systems. The Corporation is forecasting to spend $292 million on capital expenditures ($249 net of capital customer contributions) for the 12 months ending March 31, 2017. These capital expenditures will be funded through operating cash flows and debt made available through the Province at what are expected to be historically low interest rates.

In summary, SaskEnergy will continue to focus on investing in safety and growth initiatives and realizing efficiencies, while forecasting income before unrealized market value adjustments of $77 million for 2016-17.

# CONSOLIDATED FINANCIAL STATEMENTS

## CONDENSED CONSOLIDATED STATEMENT OF FINANCIAL POSITION

| (millions) | Notes | As at September 30, 2016 (unaudited) | As at March 31, 2016 (audited) |
|---|---|---|---|
| **Assets** | | | |
| Current assets | | | |
| Cash | | **$ -** | $ 11 |
| Trade and other receivables | | **61** | 104 |
| Natural gas in storage held for resale | 4 | **141** | 86 |
| Inventory of supplies | | **12** | 11 |
| Debt retirement funds | | **9** | 10 |
| Fair value of derivative instruments | 5 | **7** | 11 |
| | | **230** | 233 |
| Intangible assets | | **59** | 57 |
| Property, plant and equipment | | **2,135** | 2,068 |
| Debt retirement funds | | **94** | 92 |
| | | **$ 2,518** | $ 2,450 |
| **Liabilities and Province's equity** | | | |
| Current liabilities | | | |
| Short-term debt | | **$ 379** | $ 299 |
| Trade and other payables | | **126** | 105 |
| Dividends payable | | **-** | 21 |
| Current portion of long-term debt | 6 | **77** | 100 |
| Deferred revenue | | **62** | 61 |
| Fair value of derivative instruments | 5 | **53** | 109 |
| | | **697** | 695 |
| Employee future benefits | | **8** | 8 |
| Provisions | | **158** | 130 |
| Deferred revenue | | **6** | 6 |
| Long-term debt | 6 | **848** | 870 |
| | | **1,717** | 1,709 |
| Province's equity | | | |
| Equity advances | | **72** | 72 |
| Retained earnings | | **729** | 669 |
| | | **801** | 741 |
| | | **$ 2,518** | $ 2,450 |

(See accompanying notes)

## CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
(unaudited)

| (millions) | Notes | For the Three Months Ended September 30, 2016: Income before Unrealized Market Value Adjustments | For the Three Months Ended September 30, 2016: Unrealized Market Value Adjustments (Note 8) | For the Three Months Ended September 30, 2016: Total | For the Three Months Ended September 30, 2015: Income before Unrealized Market Value Adjustments | For the Three Months Ended September 30, 2015: Unrealized Market Value Adjustments (Note 8) | For the Three Months Ended September 30, 2015: Total |
|---|---|---|---|---|---|---|---|
| **Revenue** | | | | | | | |
| Natural gas sales | 9 | **$ 63** | **$ 6** | **$ 69** | $ 70 | $ (3) | $ 67 |
| Delivery | | **35** | **-** | **35** | 32 | - | 32 |
| Transportation and storage | | **33** | **-** | **33** | 31 | - | 31 |
| Customer capital contributions | | **6** | **-** | **6** | 9 | - | 9 |
| Other | | **3** | **-** | **3** | 2 | - | 2 |
| | | **140** | **6** | **146** | 144 | (3) | 141 |
| **Expenses** | | | | | | | |
| Natural gas purchases (net of change in inventory) | 9 | **56** | **(6)** | **50** | 67 | 3 | 70 |
| Employee benefits | | **20** | **-** | **20** | 21 | - | 21 |
| Operating and maintenance | | **31** | **-** | **31** | 29 | - | 29 |
| Depreciation and amortization | | **24** | **-** | **24** | 22 | - | 22 |
| Saskatchewan taxes | | **5** | **-** | **5** | 4 | - | 4 |
| | | **136** | **(6)** | **130** | 143 | 3 | 146 |
| **Income (loss) before the following** | | **4** | **12** | **16** | 1 | (6) | (5) |
| Finance income | | **-** | **1** | **1** | 1 | (1) | - |
| Finance expenses | | **(11)** | **-** | **(11)** | (13) | - | (13) |
| **Net finance expenses** | | **(11)** | **1** | **(10)** | (12) | (1) | (13) |
| Other losses | | **-** | **-** | **-** | (2) | - | (2) |
| **Total net income (loss) and comprehensive income (loss)** | | **$ (7)** | **$ 13** | **$ 6** | $ (13) | $ (7) | $ (20) |

(See accompanying notes)

## CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
(unaudited)

| | | For the Six Months Ended September 30, 2016 | | | For the Six Months Ended September 30, 2015 | | |
|---|---|---|---|---|---|---|---|
| **(millions)** | **Notes** | **Income before Unrealized Market Value Adjustments** | **Unrealized Market Value Adjustments (Note 8)** | **Total** | **Income before Unrealized Market Value Adjustments** | **Unrealized Market Value Adjustments (Note 8)** | **Total** |
| **Revenue** | | | | | | | |
| Natural gas sales | 9 | **$ 117** | **$ (8)** | **$ 109** | $ 146 | $ (7) | $ 139 |
| Delivery | | **77** | **-** | **77** | 71 | - | 71 |
| Transportation and storage | | **65** | **-** | **65** | 60 | - | 60 |
| Customer capital contributions | | **8** | **-** | **8** | 11 | - | 11 |
| Other | | **5** | **-** | **5** | 5 | - | 5 |
| | | **272** | **(8)** | **264** | 293 | (7) | 286 |
| **Expenses** | | | | | | | |
| Natural gas purchases (net of change in inventory) | 9 | **104** | **(74)** | **30** | 134 | (9) | 125 |
| Employee benefits | | **41** | **-** | **41** | 44 | - | 44 |
| Operating and maintenance | | **61** | **-** | **61** | 58 | - | 58 |
| Depreciation and amortization | | **47** | **-** | **47** | 43 | - | 43 |
| Saskatchewan taxes | | **7** | **-** | **7** | 6 | - | 6 |
| | | **260** | **(74)** | **186** | 285 | (9) | 276 |
| **Income before the following** | | **12** | **66** | **78** | 8 | 2 | 10 |
| Finance income | | **1** | **4** | **5** | 2 | (5) | (3) |
| Finance expenses | | **(23)** | **-** | **(23)** | (26) | - | (26) |
| **Net finance expenses** | | **(22)** | **4** | **(18)** | (24) | (5) | (29) |
| Other losses | | **-** | **-** | **-** | (2) | - | (2) |
| **Total net income (loss) and comprehensive income (loss)** | | **$ (10)** | **$ 70** | **$ 60** | $ (18) | $ (3) | $ (21) |

(See accompanying notes)

## CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
(unaudited)

| (millions) | Retained Earnings | Equity Advances | Total |
|---|---|---|---|
| **Balance as at April 1, 2015** | $ 668 | $ 72 | **$ 740** |
| Comprehensive loss | (21) | - | **(21)** |
| Dividends | (20) | - | **(20)** |
| **Balance as at September 30, 2015** | $ 627 | $ 72 | **$ 699** |
| **Balance as at April 1, 2016** | $ 669 | $ 72 | **$ 741** |
| Comprehensive income | 60 | - | **60** |
| **Balance as at September 30, 2016** | $ 729 | $ 72 | **$ 801** |

(See accompanying notes)

## CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS
(unaudited)

| (millions) | Notes | For the Six Months Ended September 30 2016 | 2015 |
|---|---|---|---|
| **Operating activities** | | | |
| Net income (loss) and comprehensive income (loss) | | **$ 60** | $ (21) |
| Add (deduct) items not requiring an outlay of cash | | | |
| Net change in fair value of derivative instrument assets and liabilities | 8 | **(52)** | (2) |
| Change in revaluation of natural gas in storage to net realizable value | 8 | **(14)** | - |
| Depreciation and amortization | | **47** | 43 |
| Net finance expenses | | **18** | 29 |
| Other losses on disposal of assets | | **-** | 2 |
| | | **59** | 51 |
| Net change in non-cash working capital related to operations | 10 | **22** | 63 |
| Cash provided by operating activities | | **81** | 114 |
| **Investing activities** | | | |
| Additions to intangible assets | | **(5)** | (7) |
| Additions to property, plant and equipment | | **(81)** | (94) |
| Decommissioning costs | | **(1)** | - |
| Cash used in investing activities | | **(87)** | (101) |
| **Financing activities** | | | |
| Debt retirement funds installments | | **(6)** | (5) |
| Debt retirement funds redemptions | | **10** | - |
| Increase in short-term debt | | **80** | 29 |
| Dividends paid | | **(21)** | (20) |
| Proceeds from long-term debt | 6 | **38** | - |
| Repayment of long-term debt | 6 | **(83)** | - |
| Interest paid | | **(23)** | (26) |
| Cash used in financing activities | | **(5)** | (22) |
| **Decrease in cash and cash equivalents** | | **(11)** | (9) |
| **Cash and cash equivalents, beginning of period** | | **11** | 10 |
| **Cash and cash equivalents, end of period** | | **$ -** | $ 1 |

# NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

**For the Six Months Ended September 30, 2016**

## 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.

On November 30, 2015, the Government of Saskatchewan announced a change in the year end for CIC and its subsidiaries from December 31 to March 31, commencing with the 2015-16 fiscal year. Accordingly, the six-month period ended September 30, 2016 is the second quarter of the 2016-17 fiscal year.

## 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 15-month period ended March 31, 2016.

The condensed consolidated financial statements were authorized for issue by the Board of Directors on November 22, 2016.

### 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
Employee future benefits
Provisions
Natural gas in storage held for resale

### 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

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
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 15-month period ended March 31, 2016, have been applied consistently, by the Corporation and its subsidiaries, to all periods presented in these condensed consolidated financial statements.

Certain comparative amounts in the condensed consolidated financial statements have been reclassified to conform with the current quarter's presentation (Note 12).

### a. Fair value measurements

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.

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

#### i. Level 1

Quoted prices (unadjusted) 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.

#### ii. Level 2

Inputs are other than quoted prices included within Level 1 that are either directly or indirectly observable for the asset or liability as at the reporting date. Level 2 valuations are based on inputs, including 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 instrument.

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.

## 3. Summary of significant accounting policies (continued)

### iii. 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.

### b. Future changes in accounting policies

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

IFRS 9 *Financial Instruments* – introduces a logical approach for the classification of financial assets driven by cash flow characteristics and the business model in which an asset is held. The new standard also replaces the rule-based hedge accounting requirements in IAS 39 *Financial Instruments: Recognition and Measurement* to more closely align the accounting with risk management activities. This standard is effective for annual periods beginning on or after January 1, 2018, with early adoption permitted.

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 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 consolidated financial statements for IFRS 9 *Financial Instruments* and IFRS 15 *Revenue from Contracts with Customers*. The anticipated impacts are as follows:

IFRS 9 *Financial Instruments* – under the new financial asset classifications, the Corporation's debt retirement funds may qualify to be classified as fair value through other comprehensive income. Classification as such would eliminate the recognition of fluctuations in fair value on debt retirement funds in net income, as market value adjustments would be recorded in other comprehensive income. Under the new standard, the Corporation is also evaluating the implementation of hedge accounting for its commodity price risk management strategy. Implementation of hedge accounting would reduce the volatility of market value adjustments for outstanding commodity purchase contracts on net income, as the effective portion of the designated hedging relationships would be reclassified to other comprehensive income.

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 September 30, 2016 | | As at March 31, 2016 | |
|---|---|---|---|---|
| Cost | **$** | **161** | $ | 120 |
| Revaluation to net realizable value | | **(20)** | | (34) |
| | **$** | **141** | $ | 86 |

With the decline in natural gas market prices over recent years, the net realizable value of natural gas in storage at the end of the quarter was $20 million below cost (March 31, 2016 - $34 million below cost). As at September 30, 2016, the Corporation expected that $119 million of the current inventory value would be sold or consumed within the next year, and $22 million of the current inventory value would be sold or consumed after more than one year.

## 5. Financial and derivative instruments

| | | | As at September 30, 2016 | | As at March 31, 2016 | |
|---|---|---|---|---|---|---|
| (millions) | Classification | Fair Value Hierarchy | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| **Financial and derivative assets** | | | | | | |
| Cash | FVTPL | n/a | **$ -** | **$ -** | $ 11 | $ 11 |
| Trade and other receivables | LAR | n/a | **61** | **61** | 104 | 104 |
| Debt retirement funds | FVTPL | Level 2 | **103** | **103** | 102 | 102 |
| Fair value of derivative instrument assets | FVTPL | Level 2 | **7** | **7** | 11 | 11 |
| **Financial and derivative liabilities** | | | | | | |
| Short-term debt | OL | n/a | **379** | **379** | 299 | 299 |
| Trade and other payables | OL | n/a | **126** | **126** | 105 | 105 |
| Dividends payable | OL | n/a | **-** | **-** | 21 | 21 |
| Long-term debt | OL | Level 2 | **925** | **1,134** | 970 | 1,099 |
| Fair value of derivative instrument liabilities | FVTPL | Level 2 | **53** | **53** | 109 | 109 |

*Classification details:*
*FVTPL - fair value through profit or loss*
*LAR - loans and receivables*
*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.*

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 September 30, 2016 natural gas derivative instruments had the following fair values, notional values, and maturities:

| **(millions)** | **2017** | **2018** | **2019** | **2020** | **2021** | **Total** |
|---|---|---|---|---|---|---|
| **Physical natural gas contracts** | | | | | | |
| Fair value | $ (20) | $ (12) | $ (4) | $ 1 | $ - | **$ (35)** |
| Notional value | (124) | (41) | (13) | 6 | - | **(172)** |
| **Natural gas price swaps** | | | | | | |
| Fair value | (10) | (1) | - | - | - | **(11)** |
| Notional value | (10) | (1) | - | - | - | **(11)** |
| **Total** | | | | | | |
| Fair value | $ (30) | $ (13) | $ (4) | $ 1 | $ - | **$ (46)** |
| Notional value | $ (134) | $ (42) | $ (13) | $ 6 | $ - | **$ (183)** |

*Fair value - increase (decrease) in net income*
*Notional value - estimated undiscounted net cash inflow (outflow)*

The fair value of the Corporation's outstanding natural gas contracts is presented in the condensed consolidated statement of financial position as follows:

| **(millions)** | **As at September 30, 2016** | **As at March 31, 2016** |
|---|---|---|
| Fair value of derivative instrument assets | **$ 7** | $ 11 |
| Fair value of derivative instrument liabilities | **(53)** | (109) |
| | **$ (46)** | $ (98) |

6. **Long-term debt**

During the first half of 2016-17, the Corporation issued $38 million in long-term debt, $22 million in the first quarter with an effective interest rate of 3.2% and $16 million in the second quarter with an effective interest rate of 2.9%. Subsequent to the end of the reporting period, the Corporation issued $100 million in long-term debt with an effective interest rate of 3.0%.

During the period, the Corporation also repaid $83 million in long-term debt, in increments of $22 million, $16 million and $45 million, with effective interest rates of 4.8%, 4.9%, and 4.4%, respectively.

7. **Commitments and contingencies**

At period end, the Corporation forecasted to spend an additional $170 million on capital projects during the remainder of the 2016-17 fiscal year, and the Corporation had $71 million of outstanding contractual commitments for the procurement of goods and services in the future.

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.

## 8. Unrealized market value adjustments

| (millions) | For the Three Months Ended September 30 2016 | 2015 | For the Six Months Ended September 30 2016 | 2015 |
|---|---|---|---|---|
| Change in fair value of debt retirement funds | **$ 1** | $ (1) | **$ 4** | $ (5) |
| Change in fair value of natural gas derivative instruments | **9** | (5) | **52** | 2 |
| Change in revaluation of natural gas in storage to net realizable value | **3** | (1) | **14** | - |
| | **$ 13** | $ (7) | **$ 70** | $ (3) |

## 9. Natural gas sales and purchases

| | For the Three Months Ended September 30 | | | | | |
|---|---|---|---|---|---|---|
| | 2016 | | | 2015 | | |
| (millions) | Commodity | Gas Marketing | Total | Commodity | Gas Marketing | Total |
| **Natural gas sales** | | | | | | |
| Natural gas sales to commodity customers | $ 15 | $ - | $ 15 | $ 16 | $ - | $ 16 |
| Realized on natural gas derivative instruments | 2 | 46 | 48 | 14 | 40 | 54 |
| Change in fair value of natural gas derivative instruments | - | 6 | 6 | - | (3) | (3) |
| | 17 | 52 | 69 | 30 | 37 | 67 |
| **Natural gas purchases** | | | | | | |
| Realized on natural gas derivative instruments | (16) | (40) | (56) | (31) | (36) | (67) |
| Change in fair value of natural gas derivative instruments | 5 | (2) | 3 | (2) | - | (2) |
| Change in revaluation of natural gas in storage to net realizable value | - | 3 | 3 | - | (1) | (1) |
| | (11) | (39) | (50) | (33) | (37) | (70) |
| | $ 6 | $ 13 | $ 19 | $ (3) | $ - | $ (3) |

## 9. Natural gas sales and purchases (continued)

| | For the Six Months Ended September 30 | | | | | |
|---|---|---|---|---|---|---|
| | 2016 | | | 2015 | | |
| (millions) | Commodity | Gas Marketing | Total | Commodity | Gas Marketing | Total |
| **Natural gas sales** | | | | | | |
| Natural gas sales to commodity customers | $ 42 | $ - | $ 42 | $ 48 | $ - | $ 48 |
| Realized on natural gas derivative instruments | 3 | 72 | 75 | 23 | 75 | 98 |
| Change in fair value of natural gas derivative instruments | - | (8) | (8) | (1) | (6) | (7) |
| | 45 | 64 | 109 | 70 | 69 | 139 |
| **Natural gas purchases** | | | | | | |
| Realized on natural gas derivative instruments | (43) | (61) | (104) | (67) | (67) | (134) |
| Change in fair value of natural gas derivative instruments | 53 | 7 | 60 | 8 | 1 | 9 |
| Change in revaluation of natural gas in storage to net realizable value | - | 14 | 14 | - | - | - |
| | 10 | (40) | (30) | (59) | (66) | (125) |
| | $ 55 | $ 24 | $ 79 | $ 11 | $ 3 | $ 14 |

## 10. Net change in non-cash working capital related to operations

| | For the Six Months Ended September 30 | |
|---|---|---|
| (millions) | 2016 | 2015 |
| Trade and other receivables | **$ 43** | $ 83 |
| Natural gas in storage held for resale | **(41)** | (41) |
| Inventory of supplies | **(1)** | (2) |
| Trade and other payables | **22** | 20 |
| Deferred revenue | **(1)** | 3 |
| | **$ 22** | $ 63 |

## 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, the Foreign Currency 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.

**11. Financial risk management (continued)**

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 $43 million (March 31, 2016 - $60 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 $44 million (March 31, 2016 - $61 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 September 30, 2016 were as follows:

| | | | Contractual Maturities | | |
|---|---|---|---|---|---|
| **(millions)** | **Carrying Amount** | **Less Than 1 Year** | **1 - 2 Years** | **3 - 5 Years** | **More Than 5 Years** |
| Short-term debt | $ 379 | $ 379 | $ - | $ - | $ - |
| Trade and other payables | 126 | 126 | - | - | - |
| Long-term debt | 925 | 119 | 39 | 227 | 1,188 |
| Derivative instruments | 53 | 134 | 42 | 7 | - |
| | $ 1,483 | $ 758 | $ 81 | $ 234 | $ 1,188 |

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

The Corporation also has posted a 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. During the first quarter of 2016-17, the letter of credit was reduced to $10 million, a $5 million reduction from year-end.

**12. Comparative figures**

Certain of the 2015-16 comparative figures have been reclassified to conform to the current period’s presentation. As a result of the Corporation’s change in fiscal year described in Note 1, comparative balances that were previously reported as the nine months ended September 30, 2015 have been restated to the six months ended September 30, 2015.