



**Management's Discussion and Analysis**

This Discussion and Analysis is a review of the results of operations, and outlook for SaskEnergy Incorporated (SaskEnergy or the Corporation) and its subsidiaries for the six-month period ended June 30, 2005. This discussion should be read in conjunction with the consolidated interim financial statements and accompanying note. For additional information relative to its operations and financial position, refer to the Corporation's Annual Report for the year ended December 31, 2004.

**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 327,000 residential, farm, commercial and industrial customers over a 65,000 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	
	2005	2004	2005	2004
<b>Financial Highlights</b>				
Consolidated Net Earnings (millions)	\$6	\$12	\$41	\$57
Total Assets (millions)			\$1,260	\$1,172
Long-term Debt (millions)			\$747	\$641
<b>Operating Highlights</b>				
<b>Distribution</b>				
Volumes Distributed - Petajoules	24	25	73	75
Winter Weather - Compared to the thirty year average	N/A	N/A	2 % Colder	5 % Colder
Average Cost per Gigajoule of Natural Gas to June 30	\$6.36	\$6.47	\$6.77	\$6.49
<b>Transmission</b>				
Volumes Transported - Petajoules	78.0	80.4	180.1	185.6
Peak Day Natural Gas Flows (Winter Season) - Petajoules - Date of Peak Flow	N/A	N/A	1.38 January 15	1.49 January 27

## Financial Results

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### Consolidated Net Earnings

The two major components of consolidated net earnings are earnings from operations and the gain or loss on commodity sales. Earnings from operations of \$34.1 million plus a \$7.0 million gain on commodity sales resulted in consolidated net earnings of \$41.1 million for the first six months of 2005.

In comparison, the consolidated earnings were \$56.9 million for the first six months of 2004 as both earnings from operations and the gain on commodity sales were higher in 2004 than the same period in 2005.

The earnings from operations of \$34.1 million were \$4.9 million lower than the first six months of 2004 due to lower revenues of \$6.1 million partially offset by reduced expenses of \$1.1 million.

The major factor contributing to lower earnings in 2005 was the gain on commodity sales which was \$7.0 million in 2005 compared to \$17.9 million for the same period in 2004. The reduced gain on commodity sales for 2005 was due to higher prices paid for natural gas in 2005 compared to 2004 and an accounting adjustment in 2005 related to the market value of financial derivatives.

#### A. Revenue

##### 1. Delivery Revenue

Delivery revenue in the first six months of 2005 was \$86.4 million, which was \$3.2 million lower than the same period in 2004. 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, 2005 was warmer than the same period in 2004, resulting in reduced delivery volumes and revenue.

For the three month period ending June 30, 2005, delivery revenue of \$24.3 million was \$1.9 million lower than the same period in 2004 because weather was warmer in 2005.

##### 2. Transportation and Storage Revenue

Transportation and storage revenue for the first half of 2005 was \$43.3 million, which was down \$0.7 million from the same period in 2004. For the second quarter, transportation and storage revenue was \$21.9 million, a reduction of \$0.2 million compared to the second quarter of 2004.

A 3.4 per cent rate decrease for TransGas Limited implemented in November 2004 reduced transportation revenue in 2005.

Increased storage capacity lead to slightly higher storage revenue for 2005 than in 2004. As in prior periods, storage continues to be fully contracted to customers.

##### 3. Net Sales from Gas Marketing

SaskEnergy leverages its transmission and storage capacity during off-peak periods to earn a margin by purchasing and selling natural gas in the open market. The volume of activity is dependent upon market conditions such as price volatility and therefore margins can vary from year to year. Based on market conditions in 2005, net sales from gas marketing activities for the first six months of 2005 were \$12.7 million compared to \$15.1 million in the first half of 2004.

In the three month period ending June 30, 2005 net sales from gas marketing were \$10.8 million compared with \$11.7 million for the same period in 2004.

#### B. Expenses

Total expenses to June 30, 2005 were \$125.8 million, which were \$1.1 million less than the first half of 2004. Expenses of \$60.5 million for the three months ending June 30, 2005 were \$2.0 million higher than the similar period in 2004.

Operating and maintenance expenses for the first six months of 2005 were \$59.1 million which was comparable to \$59.2 million for 2004. Increases in labour costs and higher costs for vehicles, materials and repairs caused operating and maintenance expenses for the second quarter of 2005 to be \$29.8 million or \$1.7 million higher than the 2004 second quarter.

Interest expense was lower by \$1.2 million for the first six months of 2005 compared to 2004 and down by \$0.8 million for the second quarter compared to the same period in 2004, due to a reduction in both over-all debt levels and average interest rates.

Amortization of property, plant and equipment, payments to municipalities to June 30, 2005 were consistent with the same period in 2004.

### C. Gain on Commodity Sales

Similar to practices in other regulated Canadian jurisdictions, SaskEnergy's commodity rates are designed to ensure that, in the long term, the Corporation neither profits from, nor incurs a loss on, the sale of natural gas to its commodity customers. However, SaskEnergy may experience gains or losses on commodity sales during a fiscal period depending on the difference

between commodity rates and the cost of gas sold.

The gain on commodity sales for the six months ended June 30, 2005 was \$7.0 million compared to a gain of \$17.9 million for the same period in 2004. The gain was lower in the first six months of 2005 as the cost of gas sold was \$6.77 per gigajoule (GJ) compared to the cost of gas sold of \$6.49 per GJ in the first six months of 2004. During both periods the commodity rate charged to consumers was \$6.97 per GJ. The gain on commodity sales for 2005 also includes an accounting adjustment related to the market value of financial derivatives.

Lower volumes sold in the three months ended June 30, 2005 caused the gain to be less than in the same period in 2004.

## Outlook

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

Description of the risk	Factor	Sensitivity	Impact on annual net earnings	
			Decrease	Increase
Natural gas prices fluctuate in the market and can affect earnings if there is a change in the market price per gigajoule with no accompanying change to SaskEnergy's approved commodity rates.	Natural gas prices	\$0.10 change per gigajoule	Higher gas prices \$(5.5)	Lower gas prices \$5.5
Natural gas prices fluctuate in the market affecting earnings by changing the sale price of storage gas volumes sold by Bayhurst Gas Limited.	Natural gas prices	\$0.10 change per gigajoule	Lower gas prices \$(0.6)	Higher gas prices \$0.6
Foreign exchange can affect earnings as a change in value of Canadian currency relative to United States currency impacts natural gas prices in Canada. This in turn may affect commodity purchase costs incurred by SaskEnergy.	Foreign exchange impact on natural gas prices	\$0.01 change to foreign exchange rates	Weaker CDN \$ \$(4.4)	Stronger CDN \$ \$4.4
Winter weather fluctuations can affect earnings. Revenue forecasts are based on the assumption of normal winter weather defined as the average weather experienced over the last thirty years.	Winter weather	One per cent change in winter weather	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

(\$7.0)                      (\$3.5)                      \$0.0                      \$3.5                      \$7.0  
(\$ millions)

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

**SaskEnergy Incorporated**  
**Consolidated Statement of Financial Position**  
*(thousands of dollars)*

	<b>As at</b> <b><u>June 30, 2005</u></b> <i>(unaudited)</i>	<b>As at</b> <b><u>December 31, 2004</u></b> <i>(audited)</i>
<b>Assets</b>		
Current assets		
Cash	\$ -	\$ 3,637
Short-term investments	42,964	-
Accounts receivable	103,859	173,726
Natural gas in storage held for resale	102,620	95,966
Inventories of supplies	7,251	6,843
	<u>256,694</u>	<u>280,172</u>
Property, plant and equipment (net)	943,498	949,461
Investments and other assets	32,829	31,755
Natural gas in storage held for resale and operations	26,589	25,053
	<u>\$ 1,259,610</u>	<u>\$ 1,286,441</u>
<b>Liabilities and Province's Equity</b>		
Current liabilities		
Bank indebtedness	\$ 13,902	\$ -
Short-term debt	-	78,900
Accounts payable	126,041	159,422
Dividend payable	9,800	26,500
Current portion of long-term debt	153,995	106,235
	<u>303,738</u>	<u>371,057</u>
Long-term debt	592,968	569,348
	<u>896,706</u>	<u>940,405</u>
Province of Saskatchewan's equity		
Equity advances	71,531	71,531
Retained earnings	293,426	276,431
Foreign currency translation adjustment	(2,053)	(1,926)
	<u>362,904</u>	<u>346,036</u>
	<u>\$ 1,259,610</u>	<u>\$ 1,286,441</u>

(See accompanying note)



Director



Director

## SaskEnergy Incorporated

### Consolidated Statement of Earnings and Retained Earnings

(thousands of dollars)

	Three months ended June 30		Six months ended June 30	
	<u>2005</u> (unaudited)	<u>2004</u> (unaudited)	<u>2005</u> (unaudited)	<u>2004</u> (unaudited)
<b>Revenue</b>				
Delivery	\$ 24,299	\$ 26,231	\$ 86,438	\$ 89,602
Transportation and storage	21,878	22,066	43,346	44,087
Revenue collected for municipalities	4,237	4,457	14,498	14,902
Net sales from gas marketing	10,780	11,701	12,698	15,074
Other	1,708	1,433	2,930	2,325
	<u>62,902</u>	<u>65,888</u>	<u>159,910</u>	<u>165,990</u>
<b>Expenses</b>				
Operating and maintenance	29,850	28,116	59,132	59,167
Interest	11,965	12,752	24,229	25,439
Amortization of property, plant and equipment	12,532	12,453	24,862	24,751
Payments to municipalities	4,237	4,457	14,498	14,902
Saskatchewan taxes and royalties	1,867	641	3,124	2,732
	<u>60,451</u>	<u>58,419</u>	<u>125,845</u>	<u>126,991</u>
Earnings from operations before the following	<u>2,451</u>	<u>7,469</u>	<u>34,065</u>	<u>38,999</u>
Commodity revenue	42,531	49,163	210,152	223,823
Cost of gas sold	<u>38,657</u>	<u>45,090</u>	<u>203,122</u>	<u>205,895</u>
Gain on commodity sales	<u>3,874</u>	<u>4,073</u>	<u>7,030</u>	<u>17,928</u>
Net earnings	<u>6,325</u>	<u>11,542</u>	<u>41,095</u>	<u>56,927</u>
Retained earnings, beginning of period:	296,901	267,374	276,431	238,589
Dividend	<u>(9,800)</u>	<u>(10,900)</u>	<u>(24,100)</u>	<u>(27,500)</u>
Retained earnings, end of period	<u>\$ 293,426</u>	<u>\$ 268,016</u>	<u>\$ 293,426</u>	<u>\$ 268,016</u>

(See accompanying note)

**SaskEnergy Incorporated**  
**Consolidated Statement of Cash Flows**  
*(thousands of dollars)*

	Three months ended June 30		Six months ended June 30	
	<u>2005</u> <i>(unaudited)</i>	<u>2004</u> <i>(unaudited)</i>	<u>2005</u> <i>(unaudited)</i>	<u>2004</u> <i>(unaudited)</i>
<b>Operating Activities</b>				
Net earnings	\$ 6,325	\$ 11,542	\$ 41,095	\$ 56,927
Add (deduct) items not requiring an outlay of cash				
Amortization of property, plant and equipment	12,532	12,453	24,862	24,751
Other non-cash items	(1,325)	(41)	(1,864)	(1,699)
	<u>17,532</u>	<u>23,954</u>	<u>64,093</u>	<u>79,979</u>
Net change in non-cash working capital related to operations	<u>49</u>	<u>13,165</u>	<u>29,424</u>	<u>37,882</u>
Cash provided by operating activities	<u>17,581</u>	<u>37,119</u>	<u>93,517</u>	<u>117,861</u>
<b>Investing Activities</b>				
Additions to property, plant and equipment	(12,339)	(12,638)	(20,419)	(21,152)
Customer capital contributions received	1,146	2,294	1,520	4,886
Additions to investments and other assets	(907)	-	(907)	-
Increase (decrease) in natural gas in storage (non-current)	(1,594)	-	(1,536)	60
	<u>(13,694)</u>	<u>(10,344)</u>	<u>(21,342)</u>	<u>(16,206)</u>
<b>Financing Activities</b>				
Increase (decrease) in short-term debt	(39,000)	11,100	(78,900)	(51,400)
Repayment of long-term debt	-	(19,757)	-	(19,757)
Dividend paid	(14,300)	(16,600)	(40,800)	(27,160)
Sinking fund instalments	(1,800)	(1,302)	(2,050)	(1,552)
Proceeds from long-term debt	<u>75,000</u>	<u>-</u>	<u>75,000</u>	<u>-</u>
Cash provided by (used in) financing activities	<u>19,900</u>	<u>(26,559)</u>	<u>(46,750)</u>	<u>(99,869)</u>
Increase in cash during period	23,787	216	25,425	1,786
Cash position, beginning of period	<u>5,275</u>	<u>275</u>	<u>3,637</u>	<u>(1,295)</u>
Cash position, end of period	<u>\$ 29,062</u>	<u>\$ 491</u>	<u>\$ 29,062</u>	<u>\$ 491</u>

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

(See accompanying note)

**SaskEnergy Incorporated**  
**Note to the Consolidated Financial Statements**  
**June 30, 2005**  
*Unaudited*

**1. Accounting Policies**

SaskEnergy Incorporated (SaskEnergy or the Corporation) prepares its consolidated interim financial statements in accordance with Canadian generally accepted accounting principles except that the disclosures do not conform in all respects to the requirements for annual financial statements. The consolidated interim financial statements follow the same accounting policies and methods of computation as the consolidated financial statements for the year ended December 31, 2004.

These consolidated interim financial statements, which are unaudited, should be read in conjunction with the consolidated financial statements for the year ended December 31, 2004 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.