



SaskEnergy

SASKENERGY ANNUAL REPORT
BREAKING GROUND

2008

MANAGEMENT'S DISCUSSION AND ANALYSIS

MANAGEMENT'S DISCUSSION AND ANALYSIS

SASKENERGY 2008 ANNUAL REPORT

INTRODUCTION

The Management's Discussion and Analysis (MD&A) highlights the primary factors that impacted the operations and financial results of SaskEnergy and its wholly owned subsidiaries for the year ended December 31, 2008. Using financial and operating results as its basis, the MD&A describes the Corporation's past performance and future prospects. This style of reporting enables readers to view SaskEnergy from the perspective of management.

This MD&A, together with the Corporation's 2008 audited consolidated financial statements and related notes, form the basis for financial reporting. It contains an in-depth discussion about SaskEnergy's consolidated financial results as well as its liquidity and capital resources. It also includes a brief discussion on the current business environment and how it affected the Corporation's financial results.

The following discussion contains certain forward-looking statements that are subject to inherent uncertainties and risks. Risks are outlined in the Risk Management section of this MD&A. Consequently, actual results and events may vary significantly from those included in, contemplated or implied by such statements.

BUSINESS ENVIRONMENT

Impacts of the Global Economy

During 2008, an uncertain and volatile global economy had a significant impact on most countries throughout the world, including Canada. At the time the economic credit crisis emerged, Saskatchewan was experiencing strong economic growth which had carried over from 2007. As a result, the economic downturn had a much lesser impact on the economy in Saskatchewan. Considering the majority of SaskEnergy's business is conducted within the Province, the adverse affects of the economic situation on the Corporation were limited. However, the global economic instability could place downward pressure on growth expectations for 2009.

The Corporation requires access to credit in order to fund working capital for operations, plus capital for system maintenance, system expansion and business

development. During 2008, SaskEnergy continued to have access to credit as the Corporation fulfilled its funding of debt by borrowing from the Province of Saskatchewan. As SaskEnergy's short- and long-term debt requirements do not significantly impact the level of the Provincial Government's total borrowing activity, the Corporation anticipates having continued access to adequate credit throughout 2009.

Similarly, the economic instability did not appear to affect SaskEnergy's customers' abilities to pay bills, as bad debts actually decreased slightly from 2007. In terms of its natural gas price management programs, SaskEnergy conducted business with counterparties in accordance with established risk management policies. These risk management policies include procedures that require ongoing monitoring of the creditworthiness of customers and counterparties and limitations on the amount of credit that can be extended. In the upcoming year, the Corporation will continue to comply with these policies and closely monitor the credit situation of customers and counterparties in order to mitigate the risk of financial losses.

With regard to its liquid assets, such as cash and debt retirement funds, the Corporation is in a position where the risk of financial loss is considered minimal. The Corporation's cash balances are held with Canadian financial institutions that continue to have strong credit ratings. Debt retirement funds are administered by Saskatchewan's Ministry of Finance and are primarily Federal and Provincial Government debt instruments that have relatively low risk.

Overall in 2008, SaskEnergy managed the impact from the global economic situation. As the Saskatchewan economy is linked to the global economy, primarily through exports of goods and services, it is expected that there will be at least some impact on the Province's economic growth in 2009. However, SaskEnergy is well positioned from a financial and operational perspective to provide ongoing safe, reliable service to its customers throughout the Province.

MANAGEMENT'S DISCUSSION AND ANALYSIS

SASKENERGY 2008 ANNUAL REPORT

Natural Gas Industry

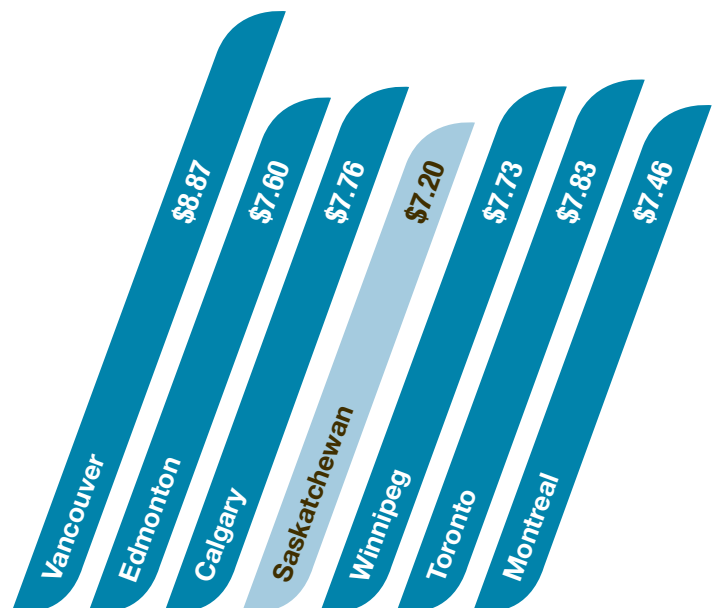
Natural gas prices in Saskatchewan are determined on the open market and are primarily driven by supply and demand within North America. Natural gas prices were around \$6.50 per Gigajoule (GJ) in Western Canada at the beginning of 2008. Colder than normal weather in February and March resulted in an increase in demand. This led to concerns over the adequacy of natural gas supplies in North America to refill storage over the coming summer. Consequently, prices began to move higher to attract liquefied natural gas (LNG) to North America. LNG is natural gas that has been cooled to a temperature where it becomes a liquid and can then be moved by ship to high demand areas around the globe. LNG was also in low supply in the spring which was reflected by higher LNG prices. This resulted in North American natural gas prices rising to over \$11.00 per GJ by the end of June, a 70 per cent increase from the beginning of the year.

The emergence of a global credit crisis led to a fall in financial markets as well as energy prices. Concurrently, economic activity slowed, significantly reducing natural gas demand in the industrial, commercial and power generation sectors in North America. This led to a supply/demand imbalance in the market resulting in natural gas prices falling by the end of the year.

Since SaskEnergy purchases natural gas for its customers on the open market, the Corporation's purchase price of natural gas is subject to market volatility. To help reduce this volatility SaskEnergy has a natural gas price risk management program. SaskEnergy also utilizes storage to ensure safe and reliable service throughout the winter. During the off-peak months of April to October, SaskEnergy purchases more natural gas than its customers use and injects it into storage. SaskEnergy then sells this natural gas to customers during the winter at the cost of purchasing the natural gas in the open market. Typically, natural gas prices tend to be lower during the summer when SaskEnergy injects natural gas and higher during the winter when SaskEnergy withdraws natural gas. However, with particularly volatile natural gas prices in 2008, natural gas prices actually peaked in the summer.

Similar to regulated natural gas utilities in other Canadian jurisdictions, SaskEnergy's mandate is to not profit from nor incur a loss on the sale of natural gas to its distribution customers over the long term as its commodity rate is designed to recover only the cost of natural gas. For the majority of the year, the Corporation was able to maintain a commodity rate of \$6.57 per GJ which was significantly below the market price. However, based on elevated prices that occurred in the summer, a commodity rate of \$8.51 per GJ was approved and became effective on October 1. SaskEnergy was able to avoid the rate increase for most of the year as a result of its natural gas price risk management program, which shielded Saskatchewan customers from natural gas price volatility experienced in other jurisdictions in Canada and enabled SaskEnergy to provide the lowest commodity rates in 2008 as compared to other Canadian utilities.

2008 WEIGHTED AVERAGE COMMODITY RATE (\$ PER GJ)



Based on a Saskatchewan residential consumption pattern and annual usage of 3,200 m³

MANAGEMENT'S DISCUSSION AND ANALYSIS

SASKENERGY 2008 ANNUAL REPORT

Saskatchewan First Investment Policy

In October 2008, the Provincial Government announced its Saskatchewan First investment policy, which focuses on Crown corporations investing in Saskatchewan in conjunction with private sector involvement. A focus on Saskatchewan investment opportunities will add value to the Province through job creation and capital spending.

As part of the Corporation's commitment to the Saskatchewan First investment policy, SaskEnergy will continue to work towards a pragmatic exit of its out-of-Province equity holdings in Heritage Gas (Nova Scotia), Gas Sur (Chile) and Igasamex (Mexico).

A shifting of growth priorities to Saskatchewan-focused business opportunities is integral to SaskEnergy's growth, and therefore the Corporation is aligned with the Saskatchewan First investment policy. SaskEnergy integrated business development opportunities into its Strategic Plan within the context of a strong Saskatchewan economy and energy sector. These initiatives will be undertaken with private sector involvement in the form of direct and joint ownership.

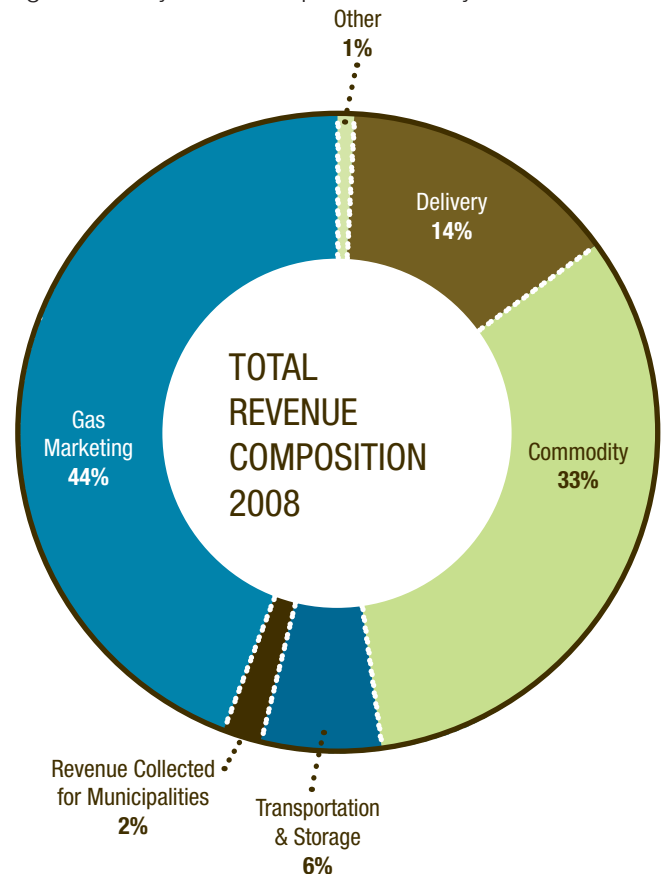
CONSOLIDATED FINANCIAL RESULTS

The consolidated financial results encompass SaskEnergy and its directly and indirectly owned subsidiaries. SaskEnergy's consolidated group of companies generated net income of \$30 million in 2008 and declared dividends of \$43 million to CIC.

Net Income (millions)	2007	2008
Revenues	\$ 1,171	\$ 1,317
Expenses	1,083	1,287
Net Income	\$ 88	\$ 30

Total revenue for 2008 was \$1,317 million, 12 per cent higher than 2007, as sales to utility customers and sales for natural gas marketing activities both increased due to higher volumes sold and natural gas prices.

Additionally, delivery revenue increased due to growth in volumes of natural gas distributed to customers and higher delivery rates for a portion of the year.

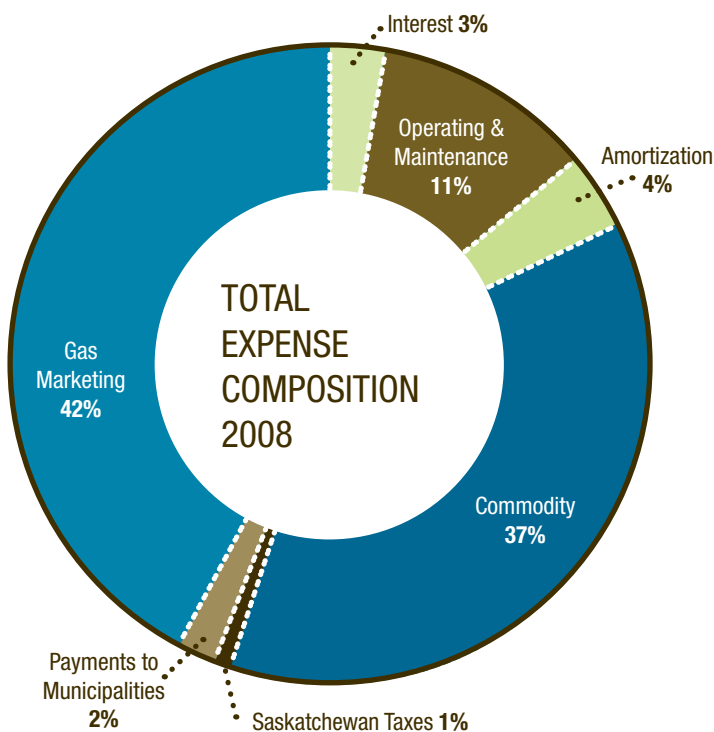


With regard to expenses, higher prices paid for natural gas as well as increased volumes sold resulted in the growth of both commodity cost of gas sold and gas marketing cost of gas sold. Consequently, total expenses were \$1,287 million in 2008, a 19 per cent increase from the prior year.

Although total revenue was higher in 2008, it was offset by the increase in total expenses resulting in a decline in net income from \$88 million in 2007 to \$30 million in 2008. Included in 2008 net income was \$25 million of unfavourable fair value adjustments related to financial instruments compared to \$20 million of favourable fair value adjustments in 2007. As a result, net income before the impacts of fair value adjustments was \$55 million in 2008 and \$68 million in 2007. Dividends are paid to CIC based on this figure.

MANAGEMENT'S DISCUSSION AND ANALYSIS

SASKENERGY 2008 ANNUAL REPORT



As focus on the environment continues, SaskEnergy expects strong demand for natural gas in 2009. Opportunities in business development will further develop SaskEnergy's business within Saskatchewan while at the same time helping the environment. Expanding demand for natural gas is expected to result in modest growth for the well-established distribution and transmission utilities. The Corporation also anticipates additional margins from gas marketing activities as market opportunities become available. With a solid financial position and a positive outlook for the future, the Corporation anticipates strong financial returns with a net income target of \$65 million, before the effects of financial instruments, for 2009.

Commodity Margin

The commodity rate that SaskEnergy charges distribution system customers for natural gas is designed to ensure that, in the long term, the Corporation neither profits from nor incurs a loss on the sale of natural gas. The price SaskEnergy pays to procure natural gas for its customers in the open market constantly fluctuates throughout the year, whereas the commodity rate remains fixed until a new rate is approved by the Provincial Cabinet.

The Gas Cost Variance Account (GCVA), which is not recorded in the Corporation's financial statements, is used for rate-setting purposes to track the variances between the cost of natural gas sold and the revenue earned through the commodity rate. Balances in the GCVA are either refunded to or collected from customers as part of future commodity rate applications. The GCVA is audited annually by the Provincial Auditor with the financial information and related audit report then provided to the Saskatchewan Rate Review Panel.

During 2008, the commodity rate was \$6.57 per GJ from January 1 to September 30 and \$8.51 per GJ from October 1 to December 31 for an average commodity rate, including the impact of the natural gas price risk management program, of \$7.23 per GJ compared to an average rate of \$6.92 per GJ in 2007. The higher average rate combined with increased volumes sold of 61 Petajoules (PJ) in 2008 compared to 57 PJ in 2007 resulted in commodity sales of \$441 million in 2008 which was \$41 million higher than commodity sales of \$400 million in 2007.

Volatility of natural gas purchase prices and an upward movement of market prices during the first half of 2008 resulted in an average cost of natural gas of \$7.85 per GJ which was higher than the 2007 average purchase price of \$6.56 per GJ. As a result, commodity cost of gas sold was \$479 million which was \$106 million over the \$373 million in 2007.

SaskEnergy utilizes a natural gas price risk management program to assist in managing the volatility of natural gas purchase prices so that the Corporation can deliver stable, competitive commodity rates to its customers. With purchase prices for natural gas often based on a floating index price, the Corporation may use derivative instruments, primarily physical contracts, swaps and options, to effectively manage the future purchase price of natural gas. The use of derivative instruments is governed by the Corporate Derivatives Policy and related Local Distribution Company (LDC) Commodity Price Risk Management Policy. Between the time the derivative contract is entered into and the contract

MANAGEMENT'S DISCUSSION AND ANALYSIS

SASKENERGY 2008 ANNUAL REPORT

is settled, changes in the fair value of the derivative contract are recorded in either commodity sales or commodity cost of gas sold depending on the nature of the contract. Upon settlement of the contract, the amount paid or received by SaskEnergy is recorded in commodity sales or commodity cost of gas sold.

The commodity margin, which is commodity sales less the commodity cost of gas sold, is affected by the difference between the commodity rate and the purchase price paid for the natural gas sold as well as the volume of natural gas sold. The commodity margin for 2008 was a \$38 million loss contrasted to a \$27 million gain in 2007. However, included in the 2008 loss on commodity sales was a \$47 million unfavourable fair value adjustment resulting in a realized commodity margin of \$9 million. This compared to an \$18 million favourable fair value adjustment and a \$9 million realized commodity margin in 2007.

In 2008, as the production of natural gas in the Province declined, SaskEnergy's distribution utility considered purchasing a portion of its required supply from Alberta. However, Bayhurst, a wholly owned subsidiary, produces natural gas which it sells to third parties as part of its natural gas marketing activities. Therefore, rather than import natural gas from Alberta, SaskEnergy's distribution utility purchased a small portion of its supply from Bayhurst's Saskatchewan production, which was needed to complete the annual supply requirements. These purchases occurred at Saskatchewan market prices under the same terms and conditions that would have been entered into with third parties. As a result, SaskEnergy's distribution utility was able to fulfill its supply requirements with Saskatchewan production and benefit its customers by avoiding the transportation costs associated with importing natural gas from Alberta. In 2007, as Bayhurst sold all of its production to third parties, the margin was reported as a natural gas marketing margin. For 2008 financial reporting purposes, the margin related to sales from Bayhurst to SaskEnergy's distribution utility was reported as a commodity margin.

Commodity Margin (millions)	2007	2008
Commodity sales	\$ 400	\$ 441
Commodity cost of gas sold	(373)	(479)
Commodity margin (loss)	27	(38)
Less: Fair value adjustments	(18)	47
Realized commodity margin	\$ 9	\$ 9

The \$47 million unfavourable fair value adjustment for 2008 was primarily due to future purchases with an average purchase price of \$7.36 per GJ compared to a market price of \$6.40 per GJ at December 31, 2008.

Gas Marketing Margin

A component of the natural gas marketing activity in 2008 was the sale of natural gas from a storage facility in west-central Saskatchewan owned by Bayhurst that is in the process of being decommissioned. Although natural gas is continually being removed during the decommissioning phase, there is the capability to re-inject natural gas into the facility. This re-injection capability has enabled the Corporation to establish a program whereby it purchases natural gas during periods of relatively low prices, injects this natural gas into the facility and resells it later to earn a margin. This purchase and resale program has enabled the Corporation to increase its volume of production from the facility. The Corporation injected 8.0 PJ of natural gas into the facility during 2007 which increased the volume of natural gas sold during 2008. In 2008, 6.6 PJ of natural gas was injected into the facility and will be sold in future years.

The Corporation also optimizes its contracted transmission and storage capacity during off-peak periods by purchasing and selling natural gas in the open market to generate a margin. Additionally, through a competitive bid process, SaskEnergy supplies certain Saskatchewan large end-use customers with natural gas and provides related natural gas management services.

MANAGEMENT'S DISCUSSION AND ANALYSIS

SASKENERGY 2008 ANNUAL REPORT

When conducting its natural gas marketing activities, the Corporation enters into purchase and sale transactions in the open market, which are subject to natural gas price risk given the volatility of market prices. Similar to the discussion related to the commodity margin, in order to manage natural gas price risk for its natural gas marketing activities, the Corporation may use derivative instruments, principally physical contracts and swaps. Derivative contracts are recorded at fair value until the date of settlement, with changes in fair value recorded in either natural gas marketing sales or natural gas marketing cost of gas sold depending on the type of transaction.

For the year ended December 31, 2008, the Corporation generated \$576 million in natural gas marketing sales compared to \$485 million in natural gas marketing sales in 2007. Natural gas marketing cost of gas sold was \$539 million while 2007 was \$450 million. As a result, the natural gas marketing margin in 2008 was \$37 million compared to \$35 million in 2007, a \$2 million increase.

Gas Marketing Margin (millions)	2007	2008
Gas marketing sales	\$ 485	\$ 576
Gas marketing cost of gas sold	(450)	(539)
Gas marketing margin	35	37
Less: Fair value adjustments	(2)	(23)
Realized gas marketing margin	\$ 33	\$ 14

For 2008, a \$23 million favourable fair value adjustment increased the natural gas marketing margin. This fair value adjustment was primarily due to physical contracts with an average selling price of \$7.16 per GJ compared to a market price of \$6.25 per GJ at December 31. In 2007, there was a \$2 million favourable fair value adjustment that increased the natural gas marketing margin. On a realized basis, the natural gas marketing margin was \$14 million for 2008 compared to \$33 million for 2007. While there was an increase in the volume sold during 2008, margins were lower than the previous year.

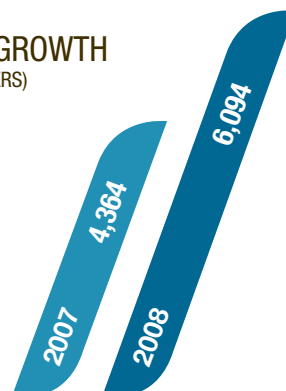
As previously discussed, during 2008 SaskEnergy's distribution utility purchased a portion of Bayhurst's Saskatchewan natural gas production. Therefore, for 2008 financial reporting purposes, the margin from these transactions was included in the commodity margin. This compared to 2007 when all of the production was sold to third parties, and the margin was included in the natural gas marketing margin. The foregoing was the primary reason for the lower natural gas marketing margin for 2008 compared to 2007.

Delivery Revenue

In 2008, delivery revenue was \$182 million which was \$15 million higher than the \$167 million in 2007. As the primary reason SaskEnergy customers consume natural gas is for space heating purposes, winter weather (November to March) significantly influences volumes distributed. Volumes distributed rose with 65 PJ of delivered volumes in 2008 compared to 60 PJ in 2007. Consistent with the growth in volumes, 2008 was 5 per cent colder than normal (normal determined by the 30-year average), primarily due to the coldest December in 25 years, while 2007 was consistent with normal temperatures.

In addition to winter weather, the actual volume delivered is affected by the number of customers on the distribution system and the average usage per customer. During the past two years, SaskEnergy has experienced a comparatively high level of growth in net new customer connections. These new customer connections were located throughout the Province as almost 500 communities experienced customer growth.

CUSTOMER GROWTH (NET NEW CUSTOMERS)



MANAGEMENT'S DISCUSSION AND ANALYSIS

SASKENERGY 2008 ANNUAL REPORT

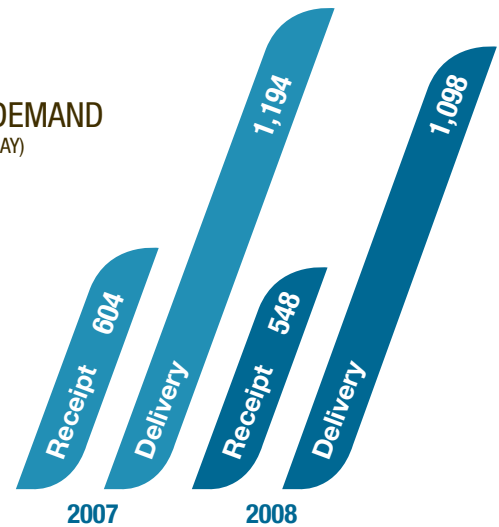
Consistent with the increased emphasis on energy conservation, there has been a reduction in the average usage of natural gas on a per customer basis. This reduction is a result of improvements in building insulation, development of more energy efficient natural gas equipment and a general focus on energy conservation by customers. Although these initiatives reduce delivery revenue per customer, energy conservation is important to the future sustainability of SaskEnergy's distribution system. In fact, SaskEnergy administers specified Provincial and Federal Government energy conservation programs to help consumers use natural gas more efficiently, thereby encouraging them to choose natural gas to meet their long-term energy needs.

Effective November 1, 2008, the Provincial Cabinet, upon recommendation by the Saskatchewan Rate Review Panel, approved a delivery rate increase of 5.8 per cent, which was only the second delivery rate increase in the past 11 years. The basic monthly charge increased \$2.00 per month for residential customers and \$2.55 per month for farm customers with modest increases for other customer classes. Upward pressures on operating costs and declining revenue on a per customer basis led to the delivery rate increase.

Transportation and Storage Revenue

The level of natural gas drilling activity in Saskatchewan as well as the level of production from existing natural gas wells has a direct impact on Provincial natural gas production. The number of natural gas wells drilled in the Province rose from 1,138 in 2007 to 1,203 in 2008, a six per cent increase. This was the first increase in recent years as natural gas prices strengthened significantly during the summer months. However, the increase in the number of new natural gas wells drilled was not enough to offset the normal decline in production from existing natural gas wells resulting in a natural gas production decline. As the amount of capacity shippers require on the transmission system is directly influenced by the volume of natural gas production, transmission revenue declined to \$77 million in 2008 compared to \$82 million in 2007.

CONTRACT DEMAND (TERAJOULES PER DAY)



Deliveries by the transmission system to customers within Saskatchewan, or to points where the natural gas is subsequently exported, are based on the volume of receipts onto the system as well as withdrawals from storage. Despite a reduction in receipts, contracted capacity for deliveries within Saskatchewan remained relatively stable. However, the consequences of lower receipts combined with a stable level of delivery volumes resulted in less natural gas available for export in 2008, with 55 PJ in 2008 compared to 93 PJ in 2007.

In order to assist in mitigating the effects of lower transmission revenue, effective June 1, 2008 transportation rates were increased by 4.2 per cent. Coupled with the rate increase, a number of cost reduction measures were also implemented.

Underground natural gas storage facilities offer customers an essential service in managing their natural gas supply. The strong demand for storage services continued, as storage service was fully contracted for the eleventh consecutive year even with a 2.6 PJ expansion in capacity.

MANAGEMENT'S DISCUSSION AND ANALYSIS

SASKENERGY 2008 ANNUAL REPORT

Revenue Collected for and Paid to Municipalities

Under provisions of *The SaskEnergy Act*, the Corporation is required to collect a percentage of natural gas sales to, or natural gas transported for, customers on behalf of certain municipalities. The Corporation then remits the full amount collected to the respective municipality. As the Corporation does not profit on these transactions, the related revenue and expenses were each \$25 million compared to \$24 million in 2007.

Other Revenue

Other revenue, which includes royalty revenue, natural gas and liquid sales and income from equity investments, increased \$3 million in 2008.

Revenue from a gross overriding royalty on 450 natural gas producing properties in Saskatchewan and Alberta was \$6 million in 2008. Higher average natural gas selling prices and volumes of natural gas produced from these properties resulted in an increase of \$1 million in royalty revenue compared to 2007.

The Corporation generated \$8 million of revenue through its natural gas processing operations. This was an increase of \$2 million as average sales prices were higher given the rise in commodity prices for the majority of the year.

SEI holds equity investments in Gas Sur and Igasamex, which operate natural gas-related businesses in Chile and Mexico respectively. The Corporation's share of income from these equity investments was \$2 million, consistent with the prior year. SEI's share of Gas Sur's 2008 net income was \$1 million. Gas Sur's net income was \$2 million, which was \$2 million lower than 2007 given higher natural gas costs and approximately 30 per cent warmer weather in 2008. SEI's share of Igasamex's 2008 net income was \$1 million. Igasamex's net income was \$2 million, which was consistent with 2007. Igasamex continued to have success signing and connecting new industrial customers with 13 new customers connected in 2008 and an additional 13 new customers contracted for natural gas service.

Operating and Maintenance Expenses

Operating and maintenance expenses were \$139 million for 2008 which was an increase of \$7 million compared to 2007. In 2008, higher oil prices were the direct cause of an increase in vehicle fuel costs (35 per cent) while the strong Saskatchewan economy resulted in both rising labour costs (10 per cent) and higher third-party contractor costs (31 per cent).

In order to ensure the safe and reliable operation of over 80,000 kilometres of transmission and distribution systems that serve over 342,000 customers, SaskEnergy employs approximately 1,100 people, including temporary and seasonal staff. The competitive labour market in the Province resulted in increased salaries, wages and benefits as the Corporation needed to attract and retain skilled and knowledgeable staff.

Growth in customer connection activity levels also contributed to pressures on operating costs. The incremental workload related to activation of new customers was performed by staff during normal business hours. As a result, a certain amount of regular maintenance activities were completed either after normal working hours or through the use of contractors, increasing both labour and third-party contractor costs. In a similar manner, additional work was required to alter underground facilities for improvement projects undertaken by customers.

As a result of strong economic activity within the Province, there was a 15 per cent increase in the workload required to locate underground facilities as requested by customers. For safety reasons, line location services are imperative in preventing third parties from contacting underground natural gas facilities.

With rising cost pressures, SaskEnergy is continually looking for ways to become more efficient. Some initiatives that the Corporation implemented to reduce its costs include electronic billing and implementation of a mobile work management system whereby service technicians are dispatched to their work assignments via computers within their vehicles.

MANAGEMENT'S DISCUSSION AND ANALYSIS

SASKENERGY 2008 ANNUAL REPORT

Interest Expense

There was a \$2 million reduction in interest expense from 2007 to 2008 from a decline in interest on long-term debt partially offset by an increase in interest on short-term debt. The Corporation repaid \$75 million of long-term debt with an average interest rate of 7.8 per cent during the first half of the year and then issued \$120 million of long-term debt with an average interest rate of 4.9 per cent toward the end of the year. Although interest rates on short-term debt were lower in 2008, higher average short-term debt balances led to an increase in interest expense on short-term debt for 2008.

Amortization Expense

Amortization expense of \$56 million was \$2 million above the prior year. The effect of a higher asset base was partially offset by a decrease in amortization rates. Amortization rates were reduced as a result of a depreciation study conducted by an independent third party. See Critical Accounting Policies and Estimates (page 44) for additional information related to the depreciation study.

Saskatchewan Taxes

Saskatchewan taxes include corporate capital taxes paid to the Province on capital employed as well as property taxes paid to municipalities. Saskatchewan taxes of \$8 million were incurred in 2008 which was consistent with 2007.

LIQUIDITY AND CAPITAL RESOURCES

Cash from operations and debt borrowed from the Province of Saskatchewan's General Revenue Fund are the primary sources of liquidity and capital for SaskEnergy. Sources of liquidity include Order in Council authority to borrow up to \$400 million of short-term loans from the General Revenue Fund and a \$35 million line of credit with the Toronto-Dominion Bank. Over the longer term, *The SaskEnergy Act* allows the Corporation to borrow up to \$1.3 billion of debt.

On average, SaskEnergy generates approximately \$99 million of cash from operations per year. Looking forward, SaskEnergy's ability to generate cash from operations, together with the \$400 million of short-term debt the Corporation is authorized to borrow, provides sufficient liquidity and capital to meet its near-term funding requirements.

The volatility of natural gas prices contributes to the liquidity risk inherent in the distribution utility business. A sudden increase in natural gas costs could result in a significant net cash outflow before the rates charged to customers can be adjusted to reflect the higher cost. In the interim, SaskEnergy relies upon its credit lines to fund the difference between the cost of natural gas and the revenue earned on its commodity sales to distribution utility customers.

Due to the nature of SaskEnergy's distribution utility business, cash flows tend to be cyclical as winter weather produces the majority of commodity sales, while natural gas purchases are distributed throughout the year. In the summer, purchases in excess of sales are injected into storage, while in the winter, sales volumes in excess of purchase volumes are withdrawn from storage. Consequently, cash receipts tend to exceed cash expenditures from December to May, while cash expenditures tend to exceed cash receipts from June to November. SaskEnergy relies on temporary loans from the General Revenue Fund to finance natural gas injections into storage during the summer. These loans are then repaid between December and May as customers pay for natural gas consumed for heating purposes during the winter months.

MANAGEMENT'S DISCUSSION AND ANALYSIS

SASKENERGY 2008 ANNUAL REPORT

Recent events in capital markets — the disruption of the asset-backed commercial paper market in 2007 and the economic crisis in the latter part of 2008 — have highlighted the importance of effectively managing liquidity and capital resources. During 2008, the financial condition of several major financial institutions, burdened by non-performing loans and sub-prime mortgages, weakened with several declaring bankruptcy or requiring injections of capital by governments. Financial institutions effectively made capital more expensive and difficult to acquire in order to build up capital reserves. Canada's financial institutions have fared much better than other international banks, and the Bank of Canada has taken measures to stabilize the financial system.

The loss of liquidity and rising credit spreads during the period had relatively little effect on SaskEnergy. The Corporation was able to obtain short-term loans from the Province of Saskatchewan as required and its uncommitted line of credit with the Toronto-Dominion Bank remained unchanged. SaskEnergy's access to long-term capital was strengthened by its ability to borrow debt through the Province of Saskatchewan. In November, SaskEnergy was able to obtain \$120 million of long-term debt from the General Revenue Fund. The Province also continued to have good access to short-term money markets. While the interest rate SaskEnergy paid for new debt had a much higher spread over Government of Canada benchmark bonds, the absolute rate SaskEnergy secured in the fourth quarter of 2008 was lower than other issues in recent years. SaskEnergy's debt to equity ratio of 66 per cent debt, 34 per cent equity at the end of 2008 is comparable to industry standards and provides SaskEnergy with the financial flexibility needed to protect the integrity of its Owner's investment.

Operating Activities

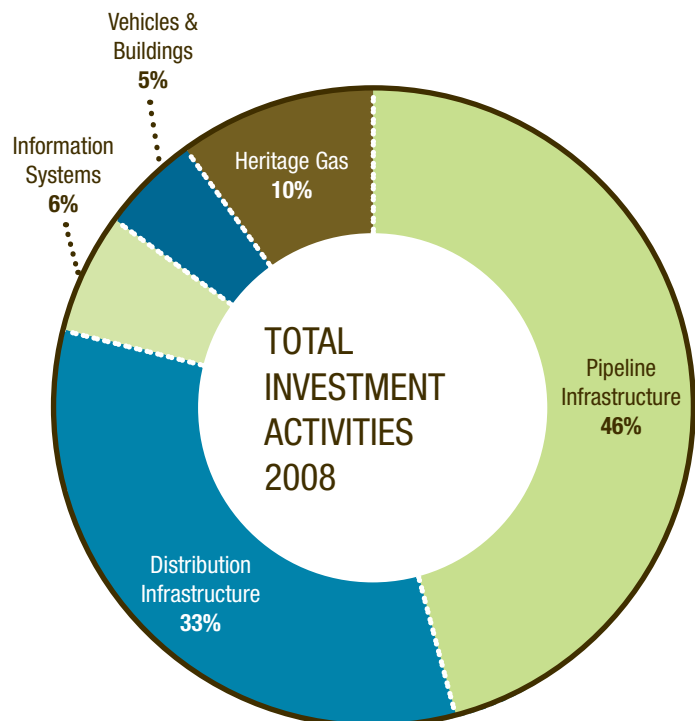
In 2008, cash from operating activities was less than 2007. Income net of non-cash items (i.e. amortization and fair value adjustments) was \$106 million which was comparable, but slightly lower, than income net of non-cash items in the previous year. However, cash from operations was substantially lower than the previous year as SaskEnergy had purchased additional volumes

of natural gas, which were in storage at year end. This additional natural gas in storage was purchased for natural gas marketing activities and will be held for resale in 2009 and subsequent years when it is expected to generate additional profit and cash flow for the Corporation.

Cash provided by operating activities (millions)	2007	2008
Income net of non-cash items	\$ 121	\$ 106
Net change in non-cash working capital related to operations	(19)	(85)
Cash provided by operations	\$ 102	\$ 21

Investing Activities

During 2008, cash used for investing activities was \$92 million compared to \$85 million in 2007. Investments were made as follows:



MANAGEMENT'S DISCUSSION AND ANALYSIS

SASKENERGY 2008 ANNUAL REPORT

SaskEnergy is planning future capital expenditures of approximately \$150 million in 2009. Most of this additional capital will be spent for the purpose of maintaining, improving and expanding the natural gas transmission and distribution systems within the Province. Approximately \$33 million of the total amount has been designated for new business development projects which, with the exception of \$6 million, is expected to be invested within the Province of Saskatchewan.

Financing Activities

During 2008, SaskEnergy received \$73 million from financing activities. SaskEnergy raised \$120 million from the issuance of long-term debt to the General Revenue Fund and increased its promissory notes to the Province of Saskatchewan by \$75 million. The proceeds from these loans were applied to long-term debt repayments, net of debt retirement funds, of \$78 million. SaskEnergy also paid dividends of \$44 million to its Owner, CIC.

As SaskEnergy pursues its business development strategy over the next three years, it will need to issue sufficient debt to repay approximately \$119 million of maturing long-term debt in addition to the incremental capital required to pursue its business development opportunities. SaskEnergy currently has the necessary access to capital resources to accommodate its future funding requirements.

Summary

SaskEnergy's access to capital through the Province of Saskatchewan and the continued profitability of core business operations provide the capital resources and liquidity necessary for continued operation, expansion of its infrastructure and development of new business opportunities.

Cash (used in) provided by financing activities (millions)	2007	2008
Proceeds from long-term debt	\$ 75	\$ 120
Repayments of long-term debt (including debt retirement funds)	(49)	(78)
Dividends paid	(58)	(44)
Increase in bank indebtedness and short-term debt	17	75
Cash (used in) provided by financing activities	\$ (15)	\$ 73

MANAGEMENT'S DISCUSSION AND ANALYSIS

SASKENERGY 2008 ANNUAL REPORT

SASKENERGY'S STRATEGIC PLAN AND KEY SUCCESS MEASURES

SaskEnergy's Strategic Plan, that was the basis for the 2008 business plan, consists of four mandates that are linked, and together are aligned with the vision of the Corporation. These strategic mandates also help employees connect their daily activities to the Strategic Plan and understand how their work impacts the company's direction. This connection is fundamental to the 2008 corporate results achieved and SaskEnergy's forward efforts in 2009 and beyond.



VISION – WE CREATE SUPERIOR VALUE THROUGH INNOVATIVE ENERGY SOLUTIONS.

SaskEnergy's four strategic mandates play a crucial role in the Corporation's business planning, and an equally important role in its business reporting. Each year, SaskEnergy comprehensively sets, measures and reports targets for all aspects of its business according to the highest benchmarks — those it sets for itself to create superior value through innovative energy solutions.

The four strategic mandates are discussed in the sequence of "Our Future", "Our Growth", "Our Service" and "Our People" based on the concept that SaskEnergy must stay focused on its future in order to achieve a healthy and sustainable Corporation.

A successful future comes from SaskEnergy utilizing its core expertise for economic growth in the Province and by developing new business opportunities with partners in Saskatchewan. This growth within the Corporation is built upon the strong customer service that SaskEnergy prides itself in delivering everyday. And this service is attributed to its people, the many dedicated men and women of the Corporation, who collectively contribute to the company's overall success.

The 2008 SaskEnergy annual report reflects the Corporation's efforts to demonstrate best practices in corporate and financial reporting. SaskEnergy benchmarks all activity against best-practice industry standards through a reporting scorecard aligned with the Strategic Plan. Part of the 2008 MD&A is based on the key success measures found within the scorecard.

This scorecard reflects SaskEnergy's four strategic mandates through 39 key success measures used to monitor and manage organizational performance. The targets for these key success measures were established in the 2008 business plan. The scorecard provides a comprehensive picture of the Corporation's 2008 financial results and key operational details about SaskEnergy and its subsidiaries. The future year scorecard targets within the key success measures were reviewed in 2008 relative to the development of the 2009 business plan. A number of the future targets will be modified to reflect the evolving operating and business environment which will be reflected in the 2009 SaskEnergy annual report.

MANAGEMENT'S DISCUSSION AND ANALYSIS

SASKENERGY 2008 ANNUAL REPORT

OUR FUTURE

Strategic Measure	2007 Actual	2008 Actual	2008 Target	2009 Target	2010 Target	2011 Target
Competitive Rates <ul style="list-style-type: none"> SaskEnergy Commodity SaskEnergy Delivery TransGas Export Rates 	\$838 – 3 rd Lowest in Canada \$367 – 2 nd Lowest in Canada Lower than average TCPL (Nova) TransGas 25.3¢/GJ Nova 27.5¢/GJ	\$864 – Lowest in Canada \$381 – Lowest in Canada Lower than average TCPL (Nova) TransGas 26.3¢/GJ Nova 29.2¢/GJ	Lowest in Canada Lowest in Canada Lower than average TCPL (Nova)	Lowest in Canada Lowest in Canada Lower than average TCPL (Nova)	Lowest in Canada Lowest in Canada Lower than average TCPL (Nova)	Lowest in Canada Lowest in Canada Lower than average TCPL (Nova)
Community Investment <ul style="list-style-type: none"> Investment (<i>millions</i>) Projects Supported Communities Impacted Percentage of Goods and Services Sourced in Saskatchewan Total Contracts – Percentage of Aboriginal Labour Content 	\$1.73 1,288 317 69% 10%	\$1.80 1,321 328 81% 22%	\$1.60 1,300 270 70% 10%	\$1.60 1,300 270 72% 11%	\$1.60 1,300 270 74% 12%	\$1.60 1,300 270 74% 13%
Environmental <ul style="list-style-type: none"> Investment in Environmental Impact Programs (<i>thousands</i>) Number of Programs Undertaken Reduction in Energy Consumption Fund and Administer Customer Energy Efficiency Assistance Programs (<i>millions</i>) Number of Customers Impacted 	\$910 6 55 TJ/year \$1.55 7,841	\$1,062 6 25 TJ/year \$1.82 10,414	\$840 6 20 TJ/year \$1.60 8,000	\$840 6 20 TJ/year \$1.60 8,000	\$840 6 20 TJ/year \$1.60 8,000	\$840 6 20 TJ/year \$1.60 8,000
Governance	Comply with CSA Governance Guidelines*	Substantially Compliant with CSA Governance Guidelines*	Comply with CSA Governance Guidelines*	Comply with CSA Governance Guidelines*	Comply with CSA Governance Guidelines*	Comply with CSA Governance Guidelines*
Financial Health <ul style="list-style-type: none"> Debt/Equity Ratio Rate of Return on Equity Net Income (<i>millions</i>) Capital Investment (<i>millions</i>) 	63/37 15.4% \$66 \$100	66/34 12.5% \$55 \$98	63/37 14.8% \$64 \$103	65/35 14.6% \$65 \$87	65/35 13.3% \$60 \$66	65/35 13.1% \$61 \$80

* Canadian Securities Administrators (CSA) Corporate Governance Guidelines "National Policy 58-201" and guidelines for disclosure of Corporate Governance Practices "National Instruments 58-101."

MANAGEMENT'S DISCUSSION AND ANALYSIS

SASKENERGY 2008 ANNUAL REPORT

Competitive Rates — SaskEnergy and TransGas strive to maintain low and stable commodity, delivery and transportation rates in order to offer affordable and accessible natural gas services to all customers in Saskatchewan. Competitive rates allow SaskEnergy to effectively support economic growth in the Province through an energy advantage of doing business in the Province.

In 2008, SaskEnergy achieved the lowest residential natural gas commodity rates when compared to other major utilities in Canada, with an average cost to a typical residential customer of \$864 per year. SaskEnergy was also successful in achieving the lowest delivery rates when compared to other major utilities in Canada, with a cost of \$381 per year for a typical residential customer. On November 1, 2008 SaskEnergy increased the Basic Monthly Charge to residential customers from \$12.50 per month to \$14.50 per month.

SaskEnergy's rates are approved by the Provincial Cabinet, which receives recommendations on proposed rate changes from the Saskatchewan Rate Review Panel, an independent body which reviews all rate changes proposed by the Corporation.

TransGas also reached its target of having rates lower than average TCPL (Nova) export rates with a rate of 26.3¢ per GJ. TransGas rates were approximately three cents less per GJ (or 9.9 per cent less) than those of TCPL (Nova) in Alberta in 2008.

In 2009, SaskEnergy will review its commodity and delivery rates in both the spring and the fall and apply for any necessary adjustment that may result from changing natural gas prices and the management of effectively operating the natural gas distribution system.



Mindy is a key resource in the implementation and ongoing success of many energy efficiency programs such as Saskatchewan EnerGuide for Houses, the Energy Efficient Rebate for New Homes and the Programmable Thermostat Rebate. Mindy is also a participant in the company's Leadership Development Program, an 18-month intensive training program where employees gain key leadership skills to allow them to thrive in a challenging business environment.

Mindy Woloschuk, Customer Solutions Leader – Regina

MANAGEMENT'S DISCUSSION AND ANALYSIS

SASKENERGY 2008 ANNUAL REPORT

Community Investment — SaskEnergy's community investment activities are strategic initiatives designed to build and maintain strong relationships with the communities that the Corporation serves. Corporate Social Responsibility has become a guiding philosophy behind SaskEnergy's approach to doing business. Therefore, by supporting local, provincial and national groups, SaskEnergy is ensuring that it is increasing the sustainability of its operations.

In 2008, SaskEnergy achieved its investment target with \$1.80 million going to support local and provincial groups and organizations. These sponsorships have extensive provincial reach, supporting 1,321 projects in 328 communities. SaskEnergy supports events and activities across the Province in the following five priority categories: Education and Leadership; Community Initiatives; Saskatchewan Pride; Environmental Stewardship; and Saskatchewan Growth.

A component of SaskEnergy's community investment involves purchasing goods and services sourced in Saskatchewan in order to support the provincial economy through local businesses. In 2008, SaskEnergy surpassed its target with 81 per cent of the goods and services required by SaskEnergy being purchased within Saskatchewan. SaskEnergy also supports the Aboriginal population by awarding a percentage of contracts to the Aboriginal labour market. In 2008, SaskEnergy exceeded its target with 22 per cent of its contracts being awarded to Aboriginal contractors.

In 2009, SaskEnergy plans to contribute \$1.60 million to support 1,300 events in 270 communities across Saskatchewan. The Corporation will develop sustainable working relationships with First Nations and Métis communities, with a focus on their integration with SaskEnergy's business.

Environmental — SaskEnergy is committed to environmental leadership. Therefore, this measure is designed to monitor the Corporation's ability to minimize its environmental footprint while assisting customers to lower their consumption with energy efficiency programs.

In 2008, SaskEnergy exceeded its target investment in environmental initiatives with \$1,062 thousand being spent on six environmental impact programs. These programs consisted of initiatives related to reclamation, hazardous material storage, site remediation, pollution prevention, air quality and GHG initiatives and leading edge research.

SaskEnergy also surpassed its target in the area of reduction in energy consumption in 2008. The energy efficiency and GHG emission reduction improvements during the year amounted to 25 Terajoules (TJ). These energy savings resulted from facility enhancements at the Bayhurst storage field; controls upgrades to two compressor engines at Coleville; improved compressor station optimization at key locations across the transmission system to reduce fuel gas usage; and line heater efficiency improvements.

In 2008, the Corporation surpassed its energy efficiency program investment target by investing over \$1.82 million to assist 10,414 customers through various energy efficiency programs. SaskEnergy also worked closely with the Provincial and Federal Governments on energy solutions for customers and had successful participation on the Energy Efficient Rebate for New Homes which is funded by the Ministry of Environment's Go Green Fund and the Saskatchewan EnerGuide for Houses Program which builds on the Federal ecoENERGY Retrofit Homes program. In 2008, Saskatchewan became the leader in national participation in this program with 6.9 per cent of homeowners having had an initial evaluation (pre-retrofit) completed. The average participation rate for Canada is 2.3 per cent.

In 2009, the Corporation will develop and implement a GHG and Clean Air Program that will contribute to meeting future regulatory targets. In addition to this program, the Corporation will implement environmentally sustainable strategies to reduce energy use among the vehicle fleet, buildings and other internal uses of energy.

MANAGEMENT'S DISCUSSION AND ANALYSIS

SASKENERGY 2008 ANNUAL REPORT



With her extensive legal background, Charlene plays a key role in managing the Corporation's Governance and Privacy policies and practices. Her practical application of legal knowledge and excellent project management skills have made her an instrumental member of the legal team at SaskEnergy.

Charlene Greve, Assistant General Counsel and Corporate Secretary – Regina

Governance — SaskEnergy benchmarks its governance practices against the Canadian Securities Administrators (CSA) Corporate Governance guidelines. By doing so, the Corporation ensures that its customers and employees are given fair and equitable treatment and that the proper levels of authority and responsibility are established so that all employees can accomplish their work without unnecessary restrictions or risks. Full details of corporate governance results are available beginning on page 79.

In 2009, the Corporation will actively participate in the Public Enterprise Governance Centre in order to monitor and adopt best practices in Canadian Crown corporations.

Financial Health – The financial health measures ensure the Corporation maintains an appropriate capital structure while providing reasonable financial returns to the Owner.

In 2008, capital expenditures of \$98 million were \$5 million below the target of \$103 million due to the deferral of certain business development projects to 2009. Although the Corporation's capital expenditures were slightly lower than anticipated, additional short-term debt was required

for the purchase of natural gas which was injected into storage and remained there at year end. Consequently, the debt to equity ratio of 66 per cent debt and 34 per cent equity was slightly above the target.

In 2008, consolidated net income, before the effects of fair value adjustments, was \$55 million which was \$9 million below the \$64 million target. This variance was primarily due to lower than anticipated transportation revenues as contract volumes did not reach budget levels thereby reducing receipt and export revenues. Further, lower than expected results from natural gas marketing activities were partially offset by a margin on commodity sales that was due to the transactions discussed in the Consolidated Financial Results (page 20). With consolidated net income lower than anticipated, the rate of return on equity was 12.5 per cent compared to a target of 14.8 per cent.

SaskEnergy anticipates strong financial results in the upcoming year. With the Corporation's sound financial position and strategic direction, SaskEnergy expects growth in both new and existing operations within the Province and projects an average annual net income of \$65 million over the next five years.

MANAGEMENT'S DISCUSSION AND ANALYSIS

SASKENERGY 2008 ANNUAL REPORT

OUR GROWTH

Strategic Measure	2007 Actual	2008 Actual	2008 Target	2009 Target	2010 Target	2011 Target
Incremental Net Income from Business Development (millions)						
• New Business Development	\$0.4	\$1.3	\$3.5	\$7.8	\$9.2	\$12.6
• External Investments	\$4.0	\$4.4	\$5.5	\$7.2	\$8.1	\$8.6
Number of Business Opportunities Considered	27	29	10	10	10	10
Number of Opportunities Under Development	6	4	4	4	4	4
Direct Jobs Created*	2	6	20	16	68	64

* Includes permanent jobs plus jobs created during construction and development phase.

Incremental Net Income from Business Development — This measure allows SaskEnergy to gauge the success of its new business development initiatives as well as its external investments in terms of the net income earned each year.

In 2008, SaskEnergy was below its target of \$3.5 million of net income from its new business development initiatives as the Kisbey Natural Gas Processing Plant expansion, which was planned to be in-service at the beginning of 2008, was deferred to November 1, 2009. This deferral was due to increasing material and labour costs in the marketplace which resulted in the Kisbey Joint Venture having to reconsider the scale and timing of the investment. In addition, the new business development growth target included income from expanded storage operations. This expansion strategy was adjusted to potentially capture synergies of a joint venture.

In 2008, existing investments owned by SNSHL and SEII resulted in combined incremental net income of \$4.4 million which is below the target of \$5.5 million.

Revenue from SNSHL was lower than budget due to lower than expected consumption by activated customers and delays in connecting key large customers to the distribution system. SEII's revenue was slightly lower than projected as one of its external investments, Gas Sur, experienced higher natural gas costs and less demand for natural gas due to warmer than normal temperatures in Chile.

Number of Business Opportunities Considered — The purpose of this measure is to ensure that SaskEnergy is exploring numerous business opportunities in order to determine which projects are most appropriate for the Corporation and to stay current on industry trends and ventures.

In 2008, SaskEnergy considered 29 business opportunities in areas such as enhanced natural gas and oil recovery, CO₂ transportation networks, CO₂ injection, oil gathering systems, heat recovery power production, as well as projects such as natural gas processing plants within the Province.

MANAGEMENT'S DISCUSSION AND ANALYSIS

SASKENERGY 2008 ANNUAL REPORT

Number of Opportunities Under Development —

This measure monitors the number of business development opportunities that are currently underway.

In 2008, SaskEnergy met its target with four initiatives currently being developed. These projects include:

- the Kisbey Natural Gas Processing Plant expansion to provide additional capacity to capture, gather and process natural gas that is currently being flared;
- the Aquistore Project which is a research partnership with the PTRC to determine the viability of utilizing deep saline aquifers for the long-term sequestration of CO₂;
- the Landfill Project in which SaskEnergy is working in cooperation with Solar Hydrogen Energy Corporation (SHEC) and SDTC to convert landfill gas to hydrogen using solar energy on a commercial scale; and,
- the Saskatchewan Research Council Biomass Research contract to quantify biomass-related natural gas opportunities.



Dale is one of the members of a large team dedicated to working on the Bayhurst storage field expansion that is part of TransGas' multi-year Energy to Store Project. Employees from multiple locations share expertise to allow TransGas to expand its storage capabilities by 7.7 PJ by 2011. The Energy to Store Project is a long-term growth opportunity for the company.

Dale Clarkson, Operations Supervisor, seconded to the Energy to Store Project as the on-site Construction Supervisor – Coleville

MANAGEMENT'S DISCUSSION AND ANALYSIS

SASKENERGY 2008 ANNUAL REPORT

Direct Jobs Created — This measure monitors the number of new positions created at SaskEnergy that are a result of business development projects and initiatives.

A total of six jobs were created by the end of 2008 as a result of business development initiatives. This number was below target as the Kisbey Natural Gas Processing Plant expansion was deferred, hence reducing the availability of capital to allow for job creation.

In 2009, business development plans to expand mid-stream natural gas opportunities associated with the capture of flare gas. Additional focus areas will include the transportation of CO₂ and other business opportunities that are closely aligned with Provincial interests such as projects involving environmentally sustainable development and use of natural gas, biomass and landfill natural gas.



Tania brings together her skills from cost of service analysis, accounting and process analysis to help set the groundwork for the Kisbey Natural Gas Processing Plant operation. She conducts the regular review of operations to generate performance measurement and feedback on production levels, operating costs, commodity sales and gross margins.

Tania Penny, Analyst, Business Development – Regina

MANAGEMENT'S DISCUSSION AND ANALYSIS

SASKENERGY 2008 ANNUAL REPORT

OUR SERVICE

Strategic Measure	2007 Actual	2008 Actual	2008 Target	2009 Target	2010 Target	2011 Target
Reliability Index <ul style="list-style-type: none"> SaskEnergy TransGas 	8.1 9.5	7.5 8.9	9.0 9.2	9.0 9.2	9.0 9.2	9.0 9.2
Customer Satisfaction <ul style="list-style-type: none"> SaskEnergy TransGas 	95% 95%	87% 95%	85% 85%	85% 85%	85% 85%	85% 85%
Respond Within One Hour to Safety Incidents <ul style="list-style-type: none"> SaskEnergy TransGas 	90% 100%	88% 100%	98% 98%	98% 98%	98% 98%	98% 98%

Reliability Index — This measure provides a rating of SaskEnergy's and TransGas' systems' ability to provide service to its customers without interruption. The Reliability Index takes many industry lead and lag indicators into account, such as outages, training, customer awareness programs and planned maintenance progress, and applies a weighted score to arrive at a measure to gauge the effectiveness of the Corporation's efforts. The scale is in a range of zero to 10, with 10 being the highest achievable score.

SaskEnergy: In 2008, SaskEnergy achieved a Reliability Index score of 7.5, which is 1.5 points below the target. While the lead indicators, such as planned maintenance, training and job observations, maintained a high average throughout 2008, the high workload of new customer connections as well reduced availability of third-party training sessions had an effect on the lag indicators, affecting the Corporation's ability to achieve the year end forecast of 9.0. One significant event that contributed to the Reliability Index score being lower than target was the unplanned outage at Nipawin that resulted from a third-party pipeline contact. Many customers lost service at this time, however SaskEnergy responded quickly and, once public safety was verified, had service restored in less than 24 hours. An outage such as this is extremely rare,

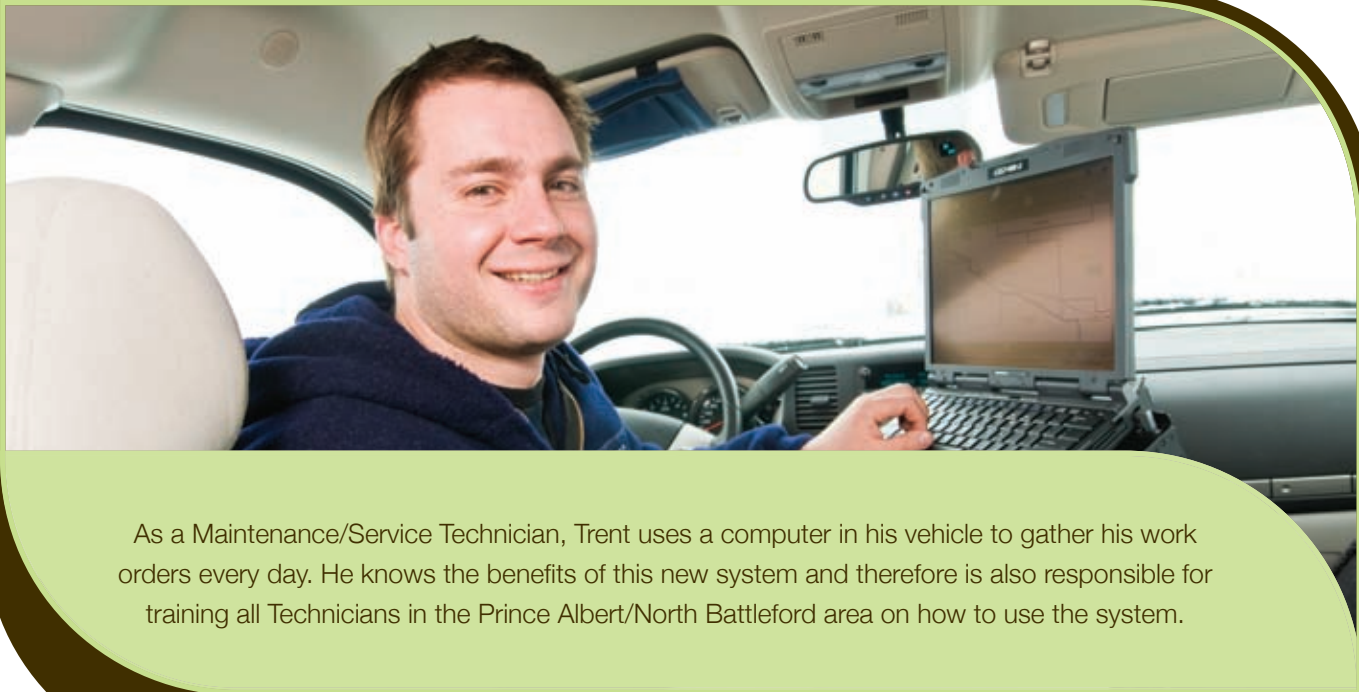
and although the Reliability Index target was not met, the distribution system remains safe and reliable.

TransGas: TransGas was slightly below its Reliability Index target in 2008 with a score of 8.9. This score is largely attributed to the unplanned downtime of primary compressor units which affected the lead indicator of reliability of designated units. Although TransGas experienced a higher than average number of unit breakdowns in this last quarter of 2008, it maintained 100 per cent service to customers.

SaskEnergy and TransGas have extensive facility integrity programs that are based on industry standards and best practices. In 2008, SaskEnergy and TransGas spent \$16.5 million on ongoing integrity and maintenance initiatives including such activities as leak surveys, which were conducted on the entire 14,074-kilometre transmission pipeline system and 20 per cent of the distribution system including 12,200 kilometres of pipe and 69,300 services. Multiple types of leak surveys are performed annually including aerial, all-terrain vehicles and personnel on foot carrying portable laser leak detection equipment. The Corporation also performed In-Line Inspections (ILI) on approximately 360 kilometres of transmission pipelines using specialized tools that

MANAGEMENT'S DISCUSSION AND ANALYSIS

SASKENERGY 2008 ANNUAL REPORT



As a Maintenance/Service Technician, Trent uses a computer in his vehicle to gather his work orders every day. He knows the benefits of this new system and therefore is also responsible for training all Technicians in the Prince Albert/North Battleford area on how to use the system.

Trent Cousins, Maintenance/Service Technician – North Battleford

travel inside the pipelines to gather information about the condition of the pipe which is analyzed to determine what action, if any, is required.

In 2009, the Corporation will focus on expanding the delivery of remote technology operations at customer and company facilities, as well as utilizing provincial video conferencing infrastructure to improve productivity. These efforts will assist staff to contribute to the operations of the Corporation's facilities.

Customer Satisfaction — Ensuring that customers are satisfied is a very high priority for SaskEnergy. The Corporation strives to create a culture whereby employees seek solutions for customers and in turn, increase customer satisfaction.

SaskEnergy: In 2008, SaskEnergy surpassed its target with 87 per cent of residential customers rating their satisfaction with the Corporation providing strong customer service a 5, 6 or 7 out of a total of 7, (a score of 7 represents an excellent score) in a residential survey

conducted by an independent Saskatchewan market research firm. In addition, SaskEnergy participated in an independent national survey on customer satisfaction of Canadian natural gas/electrical companies conducted by Ipsos-Reid and finished second overall out of the 10 companies surveyed.

TransGas: Through the Customer Satisfaction Survey conducted during November 2008, TransGas received a composite score of 4.73 out of a possible 5.00 rating. This score represents a 95 per cent level of customer satisfaction which is above the target of 85 per cent. Many aspects of customer service were evaluated such as staff, applications, reliability and customer service excellence. TransGas continues to earn strong satisfaction ratings with most individual categories achieving a score of over 85 per cent.

In 2009, SaskEnergy will complete a review of its customer service processes that support customer service delivery in the future, including incorporating a plan for a new Customer Information System.

MANAGEMENT'S DISCUSSION AND ANALYSIS

SASKENERGY 2008 ANNUAL REPORT

Respond Within One Hour to Safety Incidents —

This measure reflects the importance that SaskEnergy and TransGas place on ensuring public safety by tracking the frequency at which they respond to safety incidents within one hour.

SaskEnergy: In 2008, SaskEnergy responded to 88 per cent (507 out of 577) of emergency customer calls within one hour, with an average response time of 0.56 hours. This result is below the stretch target of 98 per cent, as a number of the emergency calls were in rural areas of Saskatchewan that are more than one hour away from a Technician's headquarters. However, it is important to note that in situations where customer response exceeds one hour, situations are evaluated and, if necessary, contingent actions are taken to ensure customer safety is not compromised.

TransGas: TransGas exceeded its target of 98 per cent with a 100 per cent rating in 2008. There were a total of three safety incidents requiring TransGas' response, all of which were responded to within one hour.

In 2009, SaskEnergy plans to increase the percentage of time emergency calls are responded to within one hour as the new mobile work management system has now been implemented. This system allows for better management of Technician resources based on proximity to the emergency which will allow for shorter response times to customer calls.



Cindy is a shining example of true customer service. Whether she is responding to customer inquiries, supervising CSRs or taking on the role of the Share the Warmth Home Energy Efficiency Project liaison, she is offering dedicated assistance to our customers and co-workers.

Cindy Fenske, Customer Service Representative (CSR) I – Yorkton

MANAGEMENT'S DISCUSSION AND ANALYSIS

SASKENERGY 2008 ANNUAL REPORT

OUR PEOPLE

Strategic Measure	2007 Actual	2008 Actual	2008 Target	2009 Target	2010 Target	2011 Target
Physical Safety <ul style="list-style-type: none"> • Lost Time Frequency Rate • Preventable Collision Frequency Rate • Medical Aid Frequency Rate 	Third Quartile*	Fourth Quartile*	Second Quartile*	Top Quartile*	Top Quartile*	Top Quartile*
	Top Quartile*	Second Quartile*	Second Quartile*	Top Quartile*	Top Quartile*	Top Quartile*
	Second Quartile*	Second Quartile*	Second Quartile*	Top Quartile*	Top Quartile*	Top Quartile*
Employee Satisfaction	Hay Group survey results 73%	Survey not completed in 2008	Satisfaction Index 55%	Satisfaction Index 60%	Satisfaction Index 60%	Satisfaction Index 60%
Compensation and Benefits <ul style="list-style-type: none"> • Corporate Competitiveness 	Use of this measure was discontinued in 2008**					
Representative Workforce Composition of the Workforce						
• Aboriginal	13.6%	13.7%	12.0%	13.0%	14.0%	15.0%
• Women	38.8%	39.3%	41.0%	41.5%	42.0%	42.5%
• Youth	15.6%	17.3%	14.0%	15.0%	16.0%	17.0%
• People with Disabilities	2.8%	3.6%	6.0%	6.5%	6.5%	6.5%
• Visible Minorities	2.7%	3.4%	3.0%	3.5%	4.0%	4.5%
• Diversity Hires***	42.7%	31.5%	35.0%	35.0%	35.0%	35.0%

* Quartile refers to ranking relative to other Canadian Gas Association and Canadian Energy Pipeline Association companies.

** Measure discontinued in 2008 due to lack of satisfactory method of measuring this target.

*** Diversity Hires include Aboriginals, women, people with disabilities and visible minorities.

Physical Safety — SaskEnergy's highest priority is the safety of its employees. This fact is reflected in the Corporation's commitment to achieving high standards in its safety performance by ranking at least second quartile in terms of the Lost Time Frequency Rate, Preventable Collision Frequency Rate and Medical Aid Frequency Rate.

In 2008, SaskEnergy met its second quartile target in terms of the Preventable Collision Frequency Rate and the Medical Aid Frequency Rate. However, the Corporation was short of its second quartile target for the Lost Time Frequency Rate. In 2008, SaskEnergy experienced higher than normal incidents requiring lost time. The Corporation takes the higher than normal level of lost time incidents seriously and investigates each incident to determine the

root cause. Although the results are below target in this measure, it is important to note that the majority of the incidents resulting in lost time were minor in nature.

In 2009, the Corporation will emphasize personal and supervisor accountability, including hazard awareness, self-discipline, compliance and a safe, productive work ethic.

Employee Satisfaction — An engaged workforce is the key to a productive and successful corporation. That is why SaskEnergy gauges its employees' level of engagement through the Hay Group Survey, which evaluates engagement based on the following five areas: overall recognition, decision making/independence, opportunity for personal growth, competitiveness of compensation and benefits and work/life balance.

MANAGEMENT'S DISCUSSION AND ANALYSIS

SASKENERGY 2008 ANNUAL REPORT



As the Union Co-Chair for his local Safety, Health and Environment (SHE) Committee, Wayne supports health and safety by practicing healthy work habits and promoting a “safety first” attitude amongst his peers. Wayne’s leadership was recognized when the South West TransGas District achieved the exceptional safety performance of 12 consecutive months of zero Lost Time Injuries, zero Preventable Collisions and zero Medical Aids.

Wayne Burton, District Mechanical Operator II, and Union Co-Chair for the Maple Creek SHE Committee.

SaskEnergy did not complete the Hay Survey in 2008, as the results of the 2007 Hay Survey were not made available until early 2008. This survey will be conducted bi-annually, with every interim year being used to develop action plans to address issues that the survey identified with the goal of being an employer of choice.

In 2009, SaskEnergy will conduct a survey by the Hay Group and carefully review the results to drive improved accountability and performance throughout the Corporation.

Compensation and Benefits — In 2008, the Corporation initiated a Job Evaluation project to evaluate its compensation system and processes. The project efforts included assessing all employee job descriptions from an effectiveness and future needs perspective. The evaluation also conducted an external market assessment with SaskEnergy using market data from the Prairie median 50th percentile for job comparisons.

In 2009, the Corporation will complete and implement the results of the Job Evaluation project.

Representative Workforce — SaskEnergy recognizes the need to have a workforce that is diverse and skilled in order to be successful in the future. This measure tracks the Corporation’s ability to do so by utilizing strategic hiring practices.

In 2008, SaskEnergy met or exceeded its target in a number of representative workforce areas such as Aboriginal (13.7 per cent), Youth (17.3 per cent) and Visible Minorities (3.4 per cent). The Corporation was slightly below its target in the areas of Women (39.3 per cent) and People with Disabilities (3.6 per cent) and was short of its overall Diversity Hires stretch target (31.5 per cent). Although the Corporation strives to maintain a high diversity hire rate, it also recognizes the importance of hiring youth in the company, which is a group that is not included as part of the overall diversity

MANAGEMENT'S DISCUSSION AND ANALYSIS

SASKENERGY 2008 ANNUAL REPORT

target. In 2008, 41.0 per cent of all hires were youth. When this fact is considered in conjunction with the diversity hire result, SaskEnergy was successful in hiring 72.0 per cent of its employees in 2008 as either youth or diversity.

In 2009, the Corporation will leverage alliances with Saskatchewan high schools and work with post-

secondary institutions to deliver potential new employees in professional/trades areas. SaskEnergy will also grow relationships with Saskatchewan Tribal Councils, the Regina Open Door Society, Saskatchewan Independent Living Centre and the Saskatchewan Visible Minority Employees Association to more effectively recruit potential employees.



Kelly Cameron is a member of SAGE and has been instrumental in mentoring new Aboriginal employees who have come into the company through the TAWAW program. Dustin Venne is one such employee who benefitted from this key partnership with DTI/SIIT and, along with Kelly's guidance, earned his position as a Service Technician (QP).

Kelly Cameron, Manager, Materials Management in Saskatoon and SAGE member
Dustin Venne, Service Technician Qualifying Program (QP) – Tisdale

RISK MANAGEMENT

The transmission, storage, distribution and sale of natural gas business activities are subject to a number of risks, which can affect the success of SaskEnergy in achieving its business objectives. These risks, their potential impact on the business and SaskEnergy's risk management strategies are discussed in the following table.

SaskEnergy's approach to risk management is to take only those risks for which it has appropriate resources, expertise and financial capacity to manage. Additionally, SaskEnergy endeavors to fully understand the nature of the risks it accepts and the impact of those risks so that effective policies and procedures can be developed.

MANAGEMENT'S DISCUSSION AND ANALYSIS

SASKENERGY 2008 ANNUAL REPORT

Risk Type	Significance	Description	Impact	How is it managed?
Natural gas price risk	Very High	<p>SaskEnergy's exposure to natural gas price risk occurs primarily because the Corporation purchases natural gas at variable market prices and resells this natural gas to utility customers at fixed rates.</p> <p>SaskEnergy buys and sells natural gas in its natural gas marketing business and may be exposed to price movement for short periods.</p>	<p>A \$1.00 per GJ change in the market price of natural gas affects the annual purchase cost of natural gas by approximately \$55 million.</p> <p>Losses are limited to less than \$2 million per year by policy.</p>	<p>The risk of natural gas costs rising above the rate at which the natural gas is sold to utility customers is mitigated through SaskEnergy's natural gas price risk management program. Also, SaskEnergy accumulates differences between the cost of gas sold and its rate in a GCVA. The balance in the GCVA may be recovered from or refunded to customers in subsequent periods.</p> <p>Natural gas price risk is subject to the Natural Gas Marketing Risk Management Policy, which limits the amount of exposure to price volatility and establishes a program to measure, monitor and report on natural gas price risk daily.</p>
Winter weather	High	<p>In Saskatchewan, variability in winter weather temperature has a direct impact on the volume of natural gas consumed by utility customers.</p> <p>Generally, a cold winter will result in higher natural gas purchase prices while a warm winter will result in lower prices.</p>	<p>Every 10 per cent change in heating degree days affects SaskEnergy's distribution utility revenue by approximately \$7 million.</p>	<p>SaskEnergy earns a portion of its revenue through a fixed Basic Monthly Charge which ensures it generates revenue from customers regardless of the level of natural gas consumption.</p> <p>The impact of higher or lower natural gas prices is discussed above under the natural gas price risk discussion.</p>
Operational risk	High	<p>Operational hazards include severe weather conditions, fire, human error, mechanical failures, third-party encroachment on a pipeline, hazardous materials and acts of civil disobedience, sabotage and riots. Operational hazards could disrupt the effective operation of SaskEnergy's natural gas storage, distribution or transmission infrastructure, potentially resulting in financial loss or service interruption.</p>	<p>The incidence of operational risks threatens service reliability, employee and public safety and damages pipelines requiring financial investment to repair.</p>	<p>SaskEnergy mitigates its operational risks through system integrity programs, public awareness programs, employee and operator training, operating manuals and procedures and safety programs. The financial impact of these risks is also mitigated, where possible, through insurance. Additionally, the pipeline system is designed with sufficient capacity to meet customer demand in an extremely cold winter. When the system is not operating at capacity, the winter design capacity enables the system to meet demand even in the event of a disruption.</p>
Regulatory risk	High	<p>The rates that utilities may charge their customers for services are determined in a regulatory process. The recommendations of the regulatory body, the Saskatchewan Rate Review Panel, and the decisions by Provincial Cabinet have a direct effect on the financial results of the utility.</p>	<p>The impact of a one per cent differential between a commodity rate increase request and the approved commodity rate is approximately \$4 million.</p>	<p>SaskEnergy follows standard regulatory principles in designing rates and operating its system and presents these practices to the regulator in its rate applications.</p>
Counterparty credit risk	High	<p>Failure of a counterparty to fulfill contractual financial commitments due to financial distresses such as bankruptcy and insolvency.</p>	<p>The amount of credit extended to individual counterparties is limited so that the annual expected loss should average less than \$4 million and should never exceed \$30 million in a single year.</p>	<p>SaskEnergy mitigates credit risk by constantly reviewing the creditworthiness of large customers and contractual counterparties, limiting the maximum amount of credit extended to any entity and continually monitoring its customer and counterparty credit. Additionally, credit checks and reviews are performed before any transactions are completed, and entities judged to have inadequate credit are required to post security.</p>
Execution risk	Moderate	<p>A shortage of manpower or expertise adversely affects SaskEnergy's ability to properly assess or implement an effective business development strategy.</p>	<p>Growth opportunities are less profitable than current enterprise, reducing overall profit.</p>	<p>SaskEnergy has implemented a Strategic Plan to ensure that adequate resources are acquired and applied in areas of highest priority.</p>

MANAGEMENT'S DISCUSSION AND ANALYSIS

SASKENERGY 2008 ANNUAL REPORT

Risk Type	Significance	Description	Impact	How is it managed?
Interest rate risk	Moderate	SaskEnergy has a significant capital investment in physical assets. About 65 per cent of that investment is financed by issuing debt. The interest paid on debt used to finance assets is a significant component of SaskEnergy's cost structure.	For every \$10 million of debt issued in a year, a 0.25 per cent change in the interest rate will affect annual interest expense by approximately \$25,000. SaskEnergy refinances approximately \$50 million of long-term debt each year.	SaskEnergy manages interest rate risk by financing long-term capital requirements with long-term fixed rate debt, thereby minimizing the impact of changing interest rates on financial results. Furthermore, SaskEnergy manages the maturity dates on its debt to minimize the impact of interest rate risk in any single year. In addition, SaskEnergy may use financial instruments to hedge short-term debt from changes in interest rates.
Declining system throughput	Moderate	While there are currently adequate supplies of natural gas to meet demand within Saskatchewan, the age and declining reserve life of the Western Canadian Sedimentary Basin remains a longer-term issue. Conservation initiatives by customers have reduced the average volume of natural gas usage per customer. Conservation initiatives tend to have a higher impact on customer usage in a high natural gas price environment.	As throughput declines, the unit cost of service increases. As use per customer declines, the fixed costs of the pipeline system are recovered over lower sales volumes.	SaskEnergy promotes the conservation efforts of its customers. Further into the future, nonconventional sources of natural gas such as the Mackenzie Valley Pipeline, natural gas in coal and liquefied natural gas will supplement conventional supplies. SaskEnergy incorporates an assumption for declining use per customer in its revenue forecasts and rate setting process.
Customer credit risk	Moderate	SaskEnergy delivers natural gas to its customers and bills them at the end of each month. When a customer fails to pay for the service received, SaskEnergy realizes a financial loss equivalent to the cost of the natural gas delivered and the cost of delivering the natural gas. Credit risk generally increases as provincial economic conditions worsen.	Bad debts of SaskEnergy's customers have historically been between 0.15 per cent and 0.54 per cent of delivery and commodity revenue.	SaskEnergy mitigates its credit risk by requiring new customers to provide security deposits prior to receiving service and closely monitoring payments on accounts. Customers who fail to pay their bills have their service terminated and are denied service until their outstanding account is settled.
Environmental risk	Moderate	The gathering, compression, storage, transmission and distribution of natural gas involve the use of certain chemicals and materials that are considered hazardous to the environment and require special handling procedures. Federal Government GHG conventions present additional risk to SaskEnergy because methane, the largest component of natural gas, is considered a GHG. Consequently, the release of natural gas into the environment may contribute to Global Warming.	Uncontrolled release of liquid substances or natural gas into the environment (soil, water and air).	The environmental risks presented by natural gas and certain chemicals and materials are mitigated by proper handling and containment procedures, product substitution as well as employee and operator training. SaskEnergy is working to reduce its GHG emissions to limit its impact on the environment and to manage the financial risks associated with this environmental issue.
Provincial economy	Low	SaskEnergy currently serves more than 90 per cent of all communities in Saskatchewan. Increasingly, it is becoming difficult to economically expand service to areas not currently receiving natural gas distribution service. Opportunities to expand service within the existing service area depend upon economic growth. Recently, economic growth has put pressure on SaskEnergy's capacity to meet demand for new services.	Growth in the number of customers within the existing service area helps to reduce the unit cost of service. Higher construction and maintenance costs.	SaskEnergy has cost containment strategies to ensure that rising costs do not significantly exceed the growth of the system. Service is only expanded where the anticipated incremental revenue is sufficient to recover incremental cost of service to ensure that existing customers are not adversely affected by the addition of new customers. SaskEnergy has franchise rights to provide distribution service to customers within Saskatchewan and an implied obligation to meet customer demand where economically feasible.

MANAGEMENT'S DISCUSSION AND ANALYSIS

SASKENERGY 2008 ANNUAL REPORT

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The Corporation prepares its financial statements in accordance with Canadian generally accepted accounting principles (GAAP) applied on a consistent basis. The Corporation's accounting policies are described in Note 2 of the accompanying Consolidated Financial Statements. The preparation of these statements requires the use of estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. These estimates and judgments are prepared using assumptions management believes to be most probable in the circumstances. Consequently, actual results may vary from these estimates. SaskEnergy's critical accounting policies and estimates have been summarized below.

Amortization of Property, Plant and Equipment

Property, plant and equipment are a significant component of the Corporation's assets. As a result, changes in assumptions related to the calculation of amortization expense may have a significant impact on SaskEnergy's net income.

The Corporation's property, plant and equipment are amortized on a straight-line basis over the estimated service life of the asset. SaskEnergy assesses the estimated service life of its assets on an ongoing basis. Any resulting changes in the estimated service life of an asset are treated as a prospective adjustment to amortization.

Effective January 1, 2008, the Corporation reduced the amortization rates of its distribution assets and vehicles, equipment and other assets based on the results of a depreciation study conducted by an independent third party. The impact of implementing these changes in amortization rates resulted in a decrease in amortization expense of approximately \$1 million for the year.

Financial Instruments

The Corporation uses various natural gas derivative instruments, mainly physical contracts, swaps and options, to manage the risk of natural gas price fluctuations. Prior to settlement, SaskEnergy records all natural gas derivative instruments at fair value.

The fair values of physical contracts and swaps are determined using quoted market prices as at year end. The fair values of options are determined using the Garman-Kohlhagen option pricing model that requires the use of different assumptions, including quoted market prices as at year end, interest rates and volatility estimates for forward natural gas prices, which are each based on external market sources. In valuing each derivative instrument, assumptions are also made as to the credit quality of the counterparty. Markets for the Corporation's derivative contracts remained active throughout 2008. As a result, external market sources continued, along with an assessment of credit and liquidity risk, to be used in determining the fair value of these contracts.

Up to the date of settlement, changes in the fair value of natural gas derivative instruments are recorded as unrealized gains or losses in the statement of income during the period of change. Given fluctuations in natural gas prices, fair value adjustments vary throughout the length of the contract until final settlement occurs. As a result, the fair value amounts recorded at year end will be subject to change as market conditions change.

Revenue Recognition

Commodity sales and delivery revenues are recognized when natural gas is delivered to customers. As it is impractical to read all customer meters on December 31 each year, an estimate of the volume of natural gas delivered but unbilled is recognized. The volume of unbilled sales is determined by comparing the total estimated volume of natural gas that entered the distribution system to the total volume of natural gas billed to customers. Regular meter readings throughout the year are used to reconcile volumes purchased to volumes billed. The unbilled revenue related to commodity sales and delivery revenue as at December 31 was \$44 million.

CHANGES IN ACCOUNTING POLICIES

Effective January 1, 2008 SaskEnergy adopted the following Canadian Institute of Chartered Accountants (CICA) Handbook sections in accordance with the transitional provisions of each section:

MANAGEMENT'S DISCUSSION AND ANALYSIS

SASKENERGY 2008 ANNUAL REPORT

Handbook Section	Requirements	Impact
Section 1535 – Capital Disclosures	New disclosure required about an entity's capital and how it is managed.	Additional disclosure included in Note 4 of the Consolidated Financial Statements with no impact on the Corporation's operating results.
Section 3031 – Inventories	New recommendations on accounting treatment for inventories, primarily related to recognition and measurement.	Changed to weighted average cost method for valuing all natural gas inventories resulting in \$5 million decrease in natural gas in storage held for resale, \$3 million decrease in accounts payable and \$2 million decrease in retained earnings as at January 1, 2008. Additional disclosure is included in Note 6 of the Consolidated Financial Statements.
Section 3862 – Financial Instruments – Disclosures and Section 3863 – Financial Instruments – Presentation	Increased disclosure related to the Corporation's financial instruments and the nature, extent and management of the related risks.	Additional disclosure included in Note 17 of the Consolidated Financial Statements with no impact on the Corporation's operating results.

For additional information related to these changes in accounting policies, refer to Note 3 of the Consolidated Financial Statements.

FUTURE CHANGES IN ACCOUNTING POLICIES

The CICA has adopted the following new accounting requirements which SaskEnergy will be adopting in future periods in accordance with the transitional provisions of each section:

Handbook Section	Requirements	Impact
Section 3064 – Goodwill and Intangible Assets	Effective January 1, 2009 new recommendations for the recognition, measurement, presentation and disclosure of goodwill and intangible assets.	Impact not yet determined, except that computer software will be reclassified from property, plant and equipment to intangible assets, but is not expected to be material.
Section 1582 – Business Combinations	Effective January 1, 2011 new recommendations for the accounting and disclosure of business combinations.	No adjustments required for business combinations occurring before January 1, 2011 but would impact any future business combinations.
Section 1601 – Consolidated Financial Statements and Section 1602 – Non-Controlling Interests	Effective January 1, 2011 new recommendations for preparation of consolidated financial statements and accounting for the non-controlling interest in a subsidiary.	Impact not yet determined but is not expected to be material as SaskEnergy's subsidiaries do not have non-controlling interests.

In addition to the above accounting policies, effective January 1, 2011 publicly accountable Canadian entities will be required to prepare financial information in accordance with International Financial Reporting Standards (IFRS). IFRS, like current Canadian GAAP, are a principle-based set of standards. However, there are areas where the accounting treatment of IFRS differs from Canadian GAAP. SaskEnergy is currently evaluating IFRS to determine which areas of the Corporation's financial reporting will be impacted. In conjunction with evaluating the IFRS accounting standards, a review of the

information technology and data systems' capability to provide the information required by IFRS will be performed. SaskEnergy is currently engaged in educational activities to expand its knowledge of IFRS. The Corporation has retained a service provider to provide expertise in the implementation of IFRS.

For additional information related to these future changes in accounting policies, refer to Note 2 of the Consolidated Financial Statements.