



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 nine month period ended September 30, 2006. This discussion should be read in conjunction with the consolidated interim financial statements and accompanying notes. For additional information relative to its operations, financial position and risks, refer to the Corporation's Annual Report for the year ended December 31, 2005.

Corporate Profile

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

SaskEnergy has seven wholly-owned subsidiaries:

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

Financial and Operating Highlights

	Three Months Ended September 30		Nine Months Ended September 30	
	2006	2005	2006	2005
Financial Highlights				
Consolidated Net Earnings (Loss) (millions)	(\$12)	(\$33)	\$13	\$8
Total Assets (millions)			\$1,255	\$1,263
Long-term Debt (millions)			\$649	\$726
Operating Highlights				
Distribution				
Volumes Distributed - Petajoules	20	18	82	91
Winter Weather - Compared to the thirty year average	N/A	N/A	11% Warmer	3% Colder
Average Cost per Gigajoule of Natural Gas to September 30	\$6.57	\$7.17	\$8.10	\$6.66
Transmission				
Volumes Transported - Petajoules	88.0	80.9	261.8	260.0
Peak Day Natural Gas Flows (Winter Season)				
- Petajoules	N/A	N/A	1.53	1.38
- Date of Peak Flow			February 16	January 15

*Before the effect of Saskatchewan Energy Share

Financial Results

Consolidated Net Earnings

For the first nine months of 2006 consolidated net earnings were \$12.8 million, up from \$7.9 million in the same period in 2005. In the third quarter of 2006 there was a loss of \$12.0 million compared to a loss of \$33.2 million in the third quarter of 2005. Losses on commodity sales were lower in 2006 compared to 2005; however, this was partially offset by lower margins on gas marketing sales. Lower operating and maintenance costs in 2006 also contributed to the higher net earnings compared to 2005.

1. Commodity

(a) Commodity Sales

The commodity rate for natural gas sales to distribution utility customers was \$7.95 per gigajoule for the period January 1, 2006 to March 31, 2006 and \$6.80 per gigajoule from April 1 to September 30. In 2005 the commodity rate was \$6.97 per gigajoule from January 1 to September 30. This resulted in higher revenue per gigajoule for the heating season months of January to March in 2006 compared to 2005.

During the first nine months of 2006, weather was 11% warmer than normal compared to 3% colder than normal in 2005. Also, in response to high natural gas prices, consumers utilized Federal and Provincial energy efficiency initiatives to achieve lower consumption patterns. The combination of warmer weather and energy efficiency initiatives by consumers reduced the amount of natural gas consumed for space heating purposes in 2006 compared to 2005.

(b) Commodity Cost of Gas Sold

The cost of gas sold includes; the cost of purchased gas; adjustments that effectively record the market value of natural gas risk management contracts (mark to market adjustments) as at September 30 and the effects of Saskatchewan Energy Share.

The mark to market adjustments increased the cost of gas sold during 2006 by \$21.2 million. Therefore, the \$25.3 million loss on commodity sales for the first nine months of 2006 was primarily due to the mark to market adjustments on risk management contracts. For the comparable period in 2005, the mark to market adjustments increased the cost of gas sold by \$49.0 million. The resulting loss on commodity sales in the first nine months of 2005 was \$37.1 million.

In the third quarter of 2006, the mark to market adjustments relating to natural gas risk management contracts increased the cost of gas by \$14.4 million compared to an increase in the cost of gas sold of \$43.3 million for the third quarter of 2005. The difference in the effect of the mark to market adjustments was the primary cause of a \$16.0 million loss in the third quarter of 2006 compared to a \$44.1 million loss in the third quarter of 2005.

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

During the first quarter of 2006, the commodity rate charged to consumers was \$7.95 per gigajoule which was lower than the cost of gas sold. Therefore, during 2006, SaskEnergy has received \$20.5 million from Saskatchewan Energy Share.

2. Gas Marketing

(a) Gas Marketing Sales and Cost of Gas Sold

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

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

In the first nine months of 2006, the margin earned from the foregoing activities was \$25.6 million compared with \$34.8 million for the same period in 2005, primarily due to higher volumes sold in 2005.

In the three month period ending September 30, 2006 the margin from gas marketing sales was \$10.4 million compared with \$22.1 million for the same period in 2005 due to higher volumes sold in 2005.

3. Delivery Revenue

Delivery revenue in the first nine months of 2006 was \$101.4 million, which was \$6.0 million lower than the same period in 2005. The majority of SaskEnergy's distribution customers consume natural gas for heating purposes and, as a result, the volume of natural gas distributed is sensitive to variations in weather, particularly through the November-to-March prime heating load season. The weather from January 1 to September 30, 2006 was 14% warmer than the same period in 2005, which was the primary reason for reduced delivery volumes and revenue.

For the three month period ending September 30, 2006, delivery revenue of \$21.1 million was \$0.1 million higher than in the same period in 2005.

4. Transportation and Storage Revenue

Transportation and storage revenue for the first nine months of 2006 was \$66.2 million, which was an increase of \$1.0 million over the same period in 2005. The increase is mainly due to incremental revenue generated by two new storage caverns offset by a transportation rate reduction effective June 1, 2006.

For the third quarter, transportation and storage revenue was \$21.3 million, a decrease of \$0.6 million compared with the third quarter of 2005 mainly due to the transportation rate reduction in June of 2006.

5. Other Expenses

Expenses (excluding cost of gas sold) to September 30, 2006 were \$176.2 million, which was \$8.0 million lower than the first nine months of 2005. For the three month period ending September 30, 2006 total expenses (excluding cost of gas) were \$52.4 million or \$6.0 million lower than the same period in 2005.

Operating and maintenance expenses for the first nine months of 2006 were \$82.7 million which were \$5.5 million lower compared to the first nine months of 2005 primarily due to a gain on sale of a compressor unit in 2006 compared to a downward adjustment to assets held for sale in 2005. For the third quarter ended September 30, 2006 the operating and maintenance expenses of \$24.4 million were \$4.6 million lower than 2005, also mainly due to the downward adjustment to assets held for sale in 2005.

Interest expense was lower by \$2.4 million for the first nine months of 2006 compared to 2005 and down \$1.1 million compared with the third quarter of 2005 due to lower average interest rates.

Amortization of property, plant and equipment for the first nine months of 2006 of \$39.2 million was \$1.3 million higher in 2006 and \$0.4 million for the third quarter due to a higher asset base in 2006.

Outlook

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

Description of the risk	Factor	Sensitivity	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 \$(5.4)	Lower gas prices \$5.4
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 \$ \$(4.7)	Stronger CDN \$ \$4.7
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
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 \$(0.4)	Higher gas prices 0.4
Short-term interest rates affect the cost of short-term borrowing.	Short-term interest rates	0.25 per cent change in short-term interest rates	Increased rates \$(0.2)	Decreased rates \$0.2

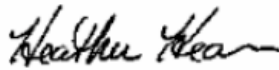
The above sensitivities are intended to be illustrative of the relationship between the variables and financial performance and are not intended to reflect management's view as to the likelihood of this variability.

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

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

	<u>As at</u> <u>September 30, 2006</u> <i>(unaudited)</i>	<u>As at</u> <u>December 31, 2005</u> <i>(audited)</i>
Assets		
Current assets		
Cash	\$ -	\$ 1,572
Accounts receivable	98,335	215,614
Natural gas in storage held for resale	141,349	139,255
Inventories of supplies	7,695	7,346
	<u>247,379</u>	<u>363,787</u>
Property, plant and equipment	945,480	946,947
Investments and other assets	31,012	32,225
Natural gas in storage held for resale and operations	31,508	28,030
	<u>\$ 1,255,379</u>	<u>\$ 1,370,989</u>
Liabilities and Province's Equity		
Current liabilities		
Bank indebtedness	\$ 272	\$ -
Short-term debt	54,324	80,500
Accounts payable	166,892	237,591
Dividend payable	2,100	5,200
Current portion of long-term debt	57,406	71,637
	<u>280,994</u>	<u>394,928</u>
Long-term debt	591,655	582,279
	<u>872,649</u>	<u>977,207</u>
Province of Saskatchewan's equity		
Equity advances	71,531	71,531
Retained earnings	314,365	323,878
Foreign currency translation adjustment	(3,166)	(1,627)
	<u>382,730</u>	<u>393,782</u>
	<u>\$ 1,255,379</u>	<u>\$ 1,370,989</u>

(See accompanying notes)

 Director	 Director
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SaskEnergy Incorporated
Consolidated Statement of Earnings and Retained Earnings

(thousands of dollars)

	Three months ended		Nine months ended	
	September 30		September 30	
	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>
	(unaudited)	(unaudited)	(unaudited)	(unaudited)
Revenue				
Commodity sales	\$ 38,247	\$ 28,526	\$ 246,620	\$ 238,678
Gas marketing sales	177,225	209,746	488,831	464,876
Delivery	21,133	20,973	101,360	107,411
Transportation and storage	21,341	21,886	66,203	65,232
Revenue collected for municipalities	2,330	2,591	15,984	17,089
Other	1,175	1,797	5,137	4,727
	<u>261,451</u>	<u>285,519</u>	<u>924,135</u>	<u>898,013</u>
Expenses				
Commodity cost of gas sold	\$ 54,210	\$ 72,642	271,885	275,764
Gas marketing cost of gas sold	166,849	187,674	463,268	430,106
Operating and maintenance	24,403	29,034	82,716	88,166
Interest	10,491	11,632	33,483	35,861
Amortization of property, plant and equipment	13,380	13,010	39,185	37,872
Payments to municipalities	2,330	2,591	15,984	17,089
Saskatchewan taxes and royalties	1,775	2,089	4,827	5,213
	<u>273,438</u>	<u>318,672</u>	<u>911,348</u>	<u>890,071</u>
Net earnings (loss)	(11,987)	(33,153)	12,787	7,942
Retained earnings, beginning of period:	328,452	293,426	323,878	276,431
Dividend	<u>(2,100)</u>	<u>-</u>	<u>(22,300)</u>	<u>(24,100)</u>
Retained earnings, end of period	<u>\$ 314,365</u>	<u>\$ 260,273</u>	<u>\$ 314,365</u>	<u>\$ 260,273</u>

(See accompanying notes)

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

	Three months ended September 30		Nine months ended September 30	
	<u>2006</u> <i>(unaudited)</i>	<u>2005</u> <i>(unaudited)</i>	<u>2006</u> <i>(unaudited)</i>	<u>2005</u> <i>(unaudited)</i>
Operating Activities				
Net earnings (loss)	\$ (11,987)	\$ (33,153)	\$ 12,787	\$ 7,942
Add (deduct) items not requiring an outlay of cash				
Amortization of property, plant and equipment	13,380	13,010	39,185	37,872
Other non-cash items	(301)	(1,343)	(552)	(3,207)
	<u>1,092</u>	<u>(21,486)</u>	<u>51,420</u>	<u>42,607</u>
Net change in non-cash working capital related to operations	<u>45,839</u>	<u>31,856</u>	<u>44,137</u>	<u>61,280</u>
Cash provided by operating activities	<u>46,931</u>	<u>10,370</u>	<u>95,557</u>	<u>103,887</u>
Investing Activities				
Additions to property, plant and equipment	(22,575)	(16,904)	(44,560)	(37,323)
Customer capital contributions received	1,528	4,155	6,842	5,675
Additions to investments and other assets	(527)	-	(929)	(907)
Increase in natural gas in storage (non-current)	<u>(1,648)</u>	<u>(1,611)</u>	<u>(3,478)</u>	<u>(3,147)</u>
Cash used in investing activities	<u>(23,222)</u>	<u>(14,360)</u>	<u>(42,125)</u>	<u>(35,702)</u>
Financing Activities				
(Decrease) increase in short-term debt	(18,776)	5,000	(26,176)	(73,900)
Repayment of long-term debt	-	(22,012)	-	(22,012)
Dividend paid	(7,500)	(9,800)	(25,400)	(50,600)
Sinking fund instalments	(1,400)	(1,400)	(3,700)	(3,450)
Proceeds from long-term debt	<u>-</u>	<u>3,808</u>	<u>-</u>	<u>78,808</u>
Cash used in financing activities	<u>(27,676)</u>	<u>(24,404)</u>	<u>(55,276)</u>	<u>(71,154)</u>
Decrease in cash during period	(3,967)	(28,394)	(1,844)	(2,969)
Cash position, beginning of period	<u>3,695</u>	<u>29,062</u>	<u>1,572</u>	<u>3,637</u>
Cash position, end of period	<u>\$ (272)</u>	<u>\$ 668</u>	<u>\$ (272)</u>	<u>\$ 668</u>

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

(See accompanying notes)

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

1. Accounting Policies

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

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

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

2. Saskatchewan Energy Share

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

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

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

3. Comparative Figures

Certain of the prior year's figures have been reclassified to conform with the current year's presentation.