

Second Quarter Report

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Saskatchewan Telecommunications
Holding Corporation

Second Quarter Report 2006
For the Period Ending June 30, 2006

Saskatchewan Telecommunications Holding Corporation (SaskTel) is a Crown corporation of Saskatchewan. Saskatchewan Telecommunications (Telco) is the leading full service communications provider in Saskatchewan, providing competitive voice, data, dial-up and high speed internet, entertainment and multimedia services, web hosting, text and messaging services, and cellular and wireless data services over its digital networks. The Corporation also provides security monitoring services through SecurTek, directory services through DirectWest, in-room communications services to the healthcare sector through Hospitality Network, telecommunications consulting services through SaskTel International and an out-of province

sales and service channel in Alberta and British Columbia through Navigata Communications.

SaskTel and its wholly-owned subsidiaries have a workforce of approximately 4,000 permanent full-time employees. Saskatchewan Telecommunications (Telco) provides communication services to more than 425,000 customers in Saskatchewan living in 13 cities, 535 smaller communities and their surrounding rural areas and about 49,000 farms. SaskTel's subsidiaries also have points of presence throughout Canada and internationally.

Financial Highlights

Consolidated Net Income

Millions of dollars, (unaudited)	Three months ended			Six months ended		
	2006	June 30, 2005	% Change	2006	June 30, 2005	% Change
Operating revenues	\$252.8	\$238.1	6.2	\$500.0	\$487.4	2.6
Operating expenses	239.0	223.6	(6.9)	444.5	417.2	(6.5)
Income from operations	13.8	14.5	(4.8)	55.5	70.2	(20.9)
Other items	2.4	0.7	242.9	3.3	2.5	32.0
Interest and related costs	(6.8)	(5.9)	(15.3)	(13.5)	(12.8)	(5.5)
Gain on sale of investments	-	-	<i>nmf</i> ¹	0.1	-	<i>nmf</i> ¹
Net income	\$9.4	\$9.3	1.1	\$45.4	\$59.9	(24.2)

The Corporation's consolidated net income for the second quarter of 2006 is \$9.4 million, up \$0.1 million from the same period in 2005. Year-to-date net income is \$45.4 million, down \$14.5 million from 2005. Excluding the 2005 revenues recognized as a result of Telecom Decision CRTC 2005-6, Competitor Digital Network Services (CDN) (\$12.1 million), consolidated year-over-year net income was down \$2.4 million. This was driven by increased restructuring charges, partially offset by increased revenue from growth services, net of related expenses. Restructuring charges of \$26.0 million were incurred as part of the ongoing operational efficiency program, an increase of \$8.8 million from the same period in 2005.

¹ No meaningful figure (*nmf*)

Management Discussion and Analysis

Forward - Looking Information

The following discussion focuses on the consolidated financial position and results of the operations of the Corporation for the second quarter 2006. This discussion and analysis should be read in conjunction with the Corporation's audited financial statements for the year ended December 31, 2005. Some sections of this discussion include forward-looking statements about SaskTel's corporate direction and financial objectives. A statement is forward-looking when it uses information known today to make an assertion about the future. Since these forward-looking statements reflect expectations and intentions at the time of writing, actual results could differ materially from those anticipated if known or unknown risks and uncertainties impact the business, or if estimates or assumptions turn out to be inaccurate. As a result, SaskTel can not guarantee that any of

the predictions forecasted by forward-looking statements will occur. As well, forward-looking statements do not take into consideration the effect of transactions or non-recurring items announced or occurring subsequently. Therefore, SaskTel disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. For a full discussion of risk factors, please consult Management's Discussion & Analysis in the Corporation's 2005 annual report. These interim statements have been prepared in accordance with the Canadian Institute of Chartered Accountants section 1751, "Interim Financial Statements." These interim statements have been approved by the SaskTel Board of Directors.

Results of Operations

Operating revenues

Millions of dollars	2006	2005	Change	%
Three months ended June 30,	\$252.8	\$238.1	\$14.7	6.2
Year-to-date	\$500.0	\$487.4	\$12.6	2.6

Operating revenues for the second quarter were \$252.8 million, an increase of \$14.7 million or 6.2% over the same period in 2005. Year-to-date operating revenues were \$500.0 million which represents a \$12.6 million or 2.6% increase over 2005. Excluding the positive impact of the CDN decision on 2005 revenues, year-to-date operating revenues increased \$24.7 million or 5.1%. Revenue growth continues to be driven significantly by SaskTel Wireless and revenues from diversified services and operations including, *MaxTM* Interactive Services.

Operating expenses

Millions of dollars	2006	2005	Change	%
Three months ended June 30,	\$239.0	\$223.7	\$(15.3)	(6.9)
Year-to-date	\$444.5	\$417.2	\$(27.3)	(6.5)

Operating expenses were \$239.0 million during the second quarter, up \$15.3 million from the same period in 2005. On a year-to-date basis, expenses increased to \$444.5 million, up \$27.3 million from 2005. These year-over-year changes were in support of revenue growth including SaskTel Wireless and *Max* Interactive Services. Also included in the year-to-date 2006 results are restructuring charges of \$26.0 million, up \$8.8 million from the same period in 2005. Operational savings have been realized through both salary savings achieved through the Early Retirement Program and operational efficiencies.

Interest and related costs

Interest and related costs were \$6.8 million for the second quarter, up \$0.9 million from the same period in 2005. Year-to-date, interest and related costs were \$13.5 million, up \$0.7 million from 2005 due primarily to reduced sinking fund earnings.

Liquidity and Capital Resources

Cash provided by operating activities

Millions of dollars	2006	2005	Change	%
Three months ended June 30,	\$44.6	\$57.7	\$(13.1)	(22.7)
Year-to-date	\$99.4	\$74.0	\$25.4	34.3

Cash provided by operating activities during the second quarter of 2006 was \$44.6 million, down \$13.1 million from the same period in 2005. Cash generated by operations increased \$5.4 million in the second quarter of 2006 as compared to 2005, offset by increased working capital requirements of \$18.5 million. The increase in working capital requirements was mainly due to a reduction in accrued liabilities. Accrued liabilities decreased primarily due to timing of supplier payments and the 2005 accrual for curtailment of the service recognition defined benefit program.

Cash provided by operating activities in the first six months was up \$25.4 million when compared to the same period in 2005. While cash from operations decreased \$11.0 million, working capital requirements declined \$36.4 million compared to the same period in 2005. The accounts receivable balance at December 31, 2004 included \$50.9 million of rebates applied to customer accounts as part of the Corporation's contract with Crown Investments Corporation to administer the Lowest Cost Utility Program. This resulted in artificially low cash receipts in the first half of 2005 as compared to the first half of 2006.

Cash used in financing activities

Millions of dollars	2006	2005	Change	%
Three months ended June 30,	\$(27.0)	\$(22.1)	\$(4.9)	(22.2)
Year-to-date	\$(29.4)	\$(54.9)	\$25.5	46.4

Cash used in financing activities during the second quarter was \$27.0 million compared to \$22.1 million for the same period in 2005. Year-to-date cash used in financing activities was \$29.4 million compared to \$54.9 million in 2005. During 2006 the Corporation repaid \$14.4 million in long-term debt and paid a dividend of \$13.3 million to Crown Investment Corporation of Saskatchewan compared to debt repayment of \$1.0 million and dividends of \$52.4 million for the same period in 2005.

Cash used in investing activities

Millions of dollars	2006	2005	Change	%
Three months ended June 30,	\$(46.5)	\$(34.1)	\$(12.4)	(36.4)
Year-to-date	\$(98.8)	\$(54.6)	\$(44.2)	(81.0)

Cash used in investing activities increased by \$12.4 million to \$46.5 million in the second quarter of 2006 compared to the same period in 2005. Year-to-date cash used in investing activities increased by \$44.2 million from the same period in 2005 to \$98.8 million in 2006. The increase can be attributed to an increase in overall capital spending.

The Corporation's net capital spending for the second quarter of 2006 was \$45.3 million, up \$13.3 million from the same period in 2005. Net capital spending for the six months ended June 30, 2006 was \$97.5 million, up \$45.3 million from the same period in 2005. Capital spending has increased significantly from 2005 as a result of the Next Generation Access Infrastructure (NGAI) program that SaskTel is undertaking to provide greater bandwidth to customers. In addition, there has been a significant amount of capital invested to support the telecommunications network and meet customer demand. SaskTel continued to invest capital to support growth and diversification, including established initiatives such as Max Interactive Services, cellular expansion and multimedia development as well as on new initiatives such as Voice Over Internet Protocol (VoIP) and CommunityNet II, a program to expand SaskTel's high speed internet.

Liquidity and capital resource ratios

Debt ratio

(\$ millions)

As at June 30,	2006	2005	Change	%
Long-term debt	342.2	364.8	22.6	6.2
Less cash and short-term investments	68.3	106.0	(37.7)	(35.6)
Net debt	273.9	258.8	(15.1)	(5.8)
Equity	685.5	671.7	(13.8)	(2.1)
Capitalization	959.4	930.5	(28.9)	(3.1)
Debt ratio	28.6%	27.8%	(0.8)	(2.9)

The debt ratio after the second quarter of 2006 increased to 28.6% from 27.8% at June 30, 2005 as the Corporation continues to self-finance its capital and dividend requirements. The overall level of net debt increased \$15.1 million due to a reduction in cash and short-term investments partially offset by repayment of debt. In addition, retained earnings increased by \$13.8 million to the end of the second quarter.

2006 Outlook

The 2005 SaskTel Annual Report identified a consolidated net income target for 2006 of \$70.5 million. Results to June 30, 2006 are favourable, driven primarily by favourable long distance and access revenues due to delays in competition, and favourable cellular accesses, partially offset by related cellular customer acquisition costs. The Corporation anticipates increased competitive pressures and increased restructuring charges through the remainder of 2006 that may negatively impact the stated target, however, at this time the Corporation believes the 2006 net income will meet the established target.

Risk Assessment

The 2005 Annual Report discussed the risks and uncertainties in SaskTel's business environment. It included developments in the economic and regulatory environments, challenges faced by the defined benefit pension plan, competitive activity and more. The Corporation continues to monitor individual risks as they change and evolve and employs the industry accepted risk management processes of identification, mitigation, transfer and assumption. A key regulatory focus is the April 6, 2006 CRTC decision on the forbearance of local exchange services. While there is no immediate impact, the ruling will severely limit SaskTel's ability to compete where new IP-based competitors are likely to operate. The company has a number of initiatives underway to mitigate this risk.

Consolidated Statement of Operations

Thousands of dollars, (unaudited)	Three months ended June 30,		Six months ended June 30,	
	2006	2005	2006	2005
Operating revenues	\$252,816	\$238,112	\$499,974	\$487,359
Operating expenses				
Operations	175,236	170,071	343,000	327,543
Depreciation and amortization	37,801	36,401	75,434	72,423
Restructuring charges (Note 2)	25,927	17,186	26,003	17,186
	238,964	223,658	444,437	417,152
Income from operations	13,852	14,454	55,537	70,207
Other items	2,371	746	3,298	2,502
Interest and related costs	(6,801)	(5,872)	(13,549)	(12,772)
Income before the following	9,422	9,328	45,286	59,937
Gain on sale of investments (Note 3)	-	-	114	-
Net income	\$9,422	\$9,328	\$45,400	\$59,937

See Accompanying Notes

Consolidated Statement of Retained Earnings

Thousands of dollars, (unaudited)	Three months ended June 30,		Six months ended June 30,	
	2006	2005	2006	2005
Retained earnings, beginning of period	\$438,545	\$438,036	\$415,067	\$408,632
Net income	9,422	9,328	45,400	59,937
	447,967	447,364	460,467	468,569
Dividends	12,500	25,709	25,000	46,914
Retained earnings, end of period	\$435,467	\$421,655	\$435,467	\$421,655

See Accompanying Notes

Consolidated Statement of Financial Position

As at	June 30,	December 31,
Thousands of dollars, (unaudited)	2006	2005
Assets		
Current assets		
Cash and short-term investments	\$68,257	\$97,079
Accounts receivable	91,753	100,380
Inventories	7,454	6,832
Prepaid expenses	25,082	14,651
	192,546	218,942
Property, plant and equipment	2,702,870	2,640,616
Less accumulated depreciation	1,803,492	1,766,147
	899,378	874,469
Intangible assets	49,343	47,195
Less accumulated amortization	19,989	17,534
	29,354	29,661
Investments	769	748
Goodwill	18,359	18,953
Other assets	71,144	70,892
	\$1,211,550	\$1,213,665
Liabilities and Province's equity		
Current liabilities		
Accounts payable and accrued liabilities	\$116,152	\$136,845
Dividend payable	12,500	815
Service billed in advance	43,412	42,009
Current portion of long-term debt	23,028	38,320
	195,092	217,989
Deferred revenue	11,440	9,539
Long-term debt	319,196	320,742
	525,728	548,270
Non-controlling interest	355	328
Province of Saskatchewan's equity		
Equity advance	250,000	250,000
Retained earnings	435,467	415,067
	685,467	665,067
	\$1,211,550	\$1,213,665

See Accompanying Notes

Consolidated Statement of Cash Flows

Thousands of dollars, (unaudited)	Three months ended June 30,		Six months ended June 30,	
	2006	2005	2006	2005
Cash provided by (used in):				
Operating activities				
Income from operations	\$9,422	\$9,328	\$45,400	\$59,937
Items not affecting cash (Note 4)	57,860	52,577	94,126	90,617
Other operating items (Note 5)	(22,690)	(4,196)	(40,176)	(76,594)
	44,592	57,709	99,350	73,960
Financing activities				
Repayment of long-term debt	(13,625)	(139)	(14,432)	(1,024)
Capital lease obligations	(844)	(758)	(1,644)	(1,430)
Dividends paid	(12,500)	(21,205)	(13,315)	(52,420)
	(26,969)	(22,102)	(29,391)	(54,874)
Investing activities				
Property, plant and equipment expenditures	(45,349)	(32,013)	(97,468)	(52,238)
Businesses acquired, net of cash acquired	-	(1,266)	-	(1,266)
Investments disposed of (acquired)	17	(370)	592	(370)
Customer accounts	(1,130)	(801)	(1,905)	(1,285)
Other assets	-	304	-	605
	(46,462)	(34,146)	(98,781)	(54,554)
Increase (decrease) in cash	(28,839)	1,461	(28,822)	(35,468)
Cash and cash equivalents, beginning of period	97,096	104,563	97,079	141,492
Cash and cash equivalents, end of period	\$68,257	\$106,024	\$68,257	\$106,024
Comprised of:				
Cash			\$13,369	\$4,526
Short-term investments			54,888	101,498
Cash and short-term investments			\$68,257	\$106,024
Interest Paid	\$8,656	\$8,656	\$15,486	\$15,486
<i>See Accompanying Notes</i>				

Notes to Consolidated Financial Statements, June 30, 2006

Note 1 – Interim financial statements

The interim consolidated statements of Saskatchewan Telecommunications Holding Corporation (the Corporation) have been prepared in accordance with generally accepted accounting principles in Canada. The accounting policies and methods for interim reporting purposes are consistent with those used in the preparation of the Corporation's audited financial statements for the year ended December 31, 2005. The unaudited interim statements should be read in conjunction with the Corporation's December 31, 2005 audited financial statements.

Note 2 – Restructuring charges

During the period, \$26.0 million was recorded to restructuring charges. The charges relate to phase two of a proposed three-phase voluntary Early Retirement Program (ERP) for Saskatchewan Telecommunications.

The ERP has been undertaken to reduce operating costs and manage the employee demographic profile in the context of a changing labour market. The second phase began in the fall of 2005 and will be completed during 2006. In the first six months of 2006, 93 employees elected to receive a package that includes a cash allowance and immediate pension benefits.

Thousands of dollars, (unaudited),	2006	2005
Balance in accounts payable and accrued liabilities at January 1	\$8,670	\$8,989
Restructuring charges	26,003	17,186
Less:		
Cash payments	6,384	8,099
Special termination benefit costs	21,076	12,288
Balance in accounts payable and accrued liabilities at June 30	\$7,213	\$5,788

Note 3 – Acquisitions and disposals

On January 10, 2006 the Corporation purchased, through its subsidiary DirectWest Corporation, the directory assets of THE Telephone Book COMPANY Inc. as follows:

Thousands of dollars, (unaudited)	
Total consideration	\$350
Total tangible assets	113
Total intangible assets	243
Total liabilities	(7)
Net assets acquired	\$350

Notes to Consolidated Financial Statements, June 30, 2006

Note 3 – Acquisitions and disposals, continued

During the first quarter the Corporation disposed of its majority interest in Business Watch International Inc. for cash proceeds of \$574,228 resulting in a gain on sale of \$113,865.

Effective May 1, 2006, the Corporation integrated the majority of the operations and net assets of Navigata Communications Partnership with those of Saskatchewan Telecommunications. As part of the integration the balance of outstanding partnership units were sold to the former partner in exchange for a non-interest bearing note receivable in the amount of \$100,000, due in September of 2006, resulting in a nominal gain.

Note 4 – Items not affecting cash

Thousands of dollars, (unaudited)	Three months ended June 30,		Six months ended June 30,	
	2006	2005	2006	2005
Depreciation and amortization	\$37,801	\$36,401	\$75,434	\$72,422
Pension expense (income) of defined benefit plans	805	(2,121)	818	238
Special termination benefits	21,076	12,288	21,076	12,288
Net share of (income) loss from significantly influenced companies	(47)	(71)	(37)	(73)
Sinking fund earnings	(161)	(1,109)	(763)	(1,737)
Gain on sale of investments	-	-	(114)	-
Service recognition defined benefit program curtailment	-	7,452	-	7,452
Other	(1,614)	(263)	(2,288)	27
	\$57,860	\$52,577	\$94,126	\$90,617

Note 5 – Other operating items

Thousands of dollars, (unaudited)	Three months ended June 30,		Six months ended June 30,	
	2006	2005	2006	2005
Changes in non-cash working capital				
Accounts receivable	\$(1,413)	\$(2,845)	\$8,573	\$(36,884)
Inventories	95	638	(622)	1,121
Prepaid expenses	(1,094)	(3,132)	(10,432)	(6,475)
Accounts payable and accrued liabilities	(9,776)	11,074	(21,568)	(19,889)
Deferred revenue	1,316	1,377	1,882	1,902
Deferred expenses	(1,019)	(1,039)	(1,477)	(1,485)
Service billed in advance	(2,098)	(1,072)	1,403	3,592
Contributions to defined benefit pension plans	(8,701)	(9,197)	(17,935)	(18,476)
	\$(22,690)	\$(4,196)	\$(40,176)	\$(76,594)

Notes to Consolidated Financial Statements, June 30, 2006

Note 6 – Pension costs

The table below shows the cost components of the defined benefit pension plan.

Thousands of dollars, (unaudited)	Three months ended		Six months ended	
	June 30,		June 30,	
	2006	2005	2006	2005
Current service cost - defined benefit plan	\$(1,817)	\$(1,954)	\$(3,687)	\$(3,908)
Interest cost	(13,200)	(13,369)	(26,054)	(26,020)
Expected return on pension plan asset	14,877	14,297	29,773	28,594
Special termination benefits cost	(21,076)	(12,288)	(21,076)	(12,288)
Amortization of net transitional asset	2,919	2,913	5,832	5,826
Amortization of past service costs	(1,055)	(1,233)	(2,110)	(2,478)
Amortization of actuarial loss	(1,604)	(3,388)	(3,181)	(6,776)
Impact of settlement	(1,189)	-	(1,189)	-
Pension cost	\$(22,145)	\$(15,022)	\$(21,692)	\$(17,050)

Effective April 5, 2006, the Corporation received approval from the Office of the Superintendent of Financial Institutions to settle the Navigata Communications Inc. Pension Plan, governed by Navigata Communications Partnership. Management is in the process of settlement, the cost of which is recognized when payment occurs, in accordance with generally accepted accounting principles. To date, \$1.2 million of the cost has been recognized as a component of pension cost.

Note 7 – Contingencies

On August 9, 2004, a proceeding under the Class Actions Act (Saskatchewan) was brought against several Canadian wireless and cellular service providers, including the Corporation and Saskatchewan Telecommunications. The proceeding involves allegations by wireless customers of breach of contract, misrepresentation, negligence, collusion, unjust enrichment and breach of statutory obligations concerning system administration fees. The plaintiffs seek unquantified damages from the defendant wireless communications service providers. Similar proceedings have been filed by, or on behalf of, plaintiffs' counsel in other provincial jurisdictions. On July 18, 2006, the Saskatchewan court declined to certify the action as a class action, but granted the plaintiffs leave to renew their application in order to further address certain statutory requirements respecting class actions. The Corporation believes that it has strong defenses to the allegations. Should the ultimate resolution of these actions differ from management's assessments and assumptions, a material adjustment to the Company's financial position and the results of the corporation could result.

Notes to Consolidated Financial Statements, June 30, 2006

Note 8 – Rate regulation

Direct Connect and Access Tandem Services

Direct Connect and Access Tandem are inter-connection services sold to long distance competitors. On April 27, 2006 the Canadian Radio-television and Telecommunications Commission (CRTC) issued Telecom Decision CRTC 2006-22 and Telecom Decision CRTC 2006-23 approving final rates for Direct Connect and Access Tandem Services. These rates are retroactive to June 1, 2002 for Access Tandem Services and to December 17, 2003 for Direct Connect Services. As a result of these decisions, adjustments were made to previously accrued liabilities to reflect the retroactive application of the final rates. This had a positive impact to 2006 net income of \$2,078,000.

Note 9 – Comparative figures

Certain of the 2005 figures have been reclassified to conform to the current period's presentation.