



interim statement

June 30, 2004

Pacific Northern Gas Ltd.
Suite 950, 1185 West Georgia Street
Vancouver, BC V6E 4E6 Canada
www.png.ca

Pacific Northern Gas Ltd.
MANAGEMENT'S DISCUSSION AND ANALYSIS
for the Period Ended June 30, 2004

FORWARD-LOOKING STATEMENTS

Management's discussion and analysis contains certain forward-looking statements that are subject to risks and uncertainties that may cause the results or events predicted in this discussion to differ materially from actual results or events. Factors which could cause the results or events to differ include, but are not limited to: general economic conditions; gas commodity price volatility; decisions by regulators; seasonal weather patterns; the cost and availability of capital; and the ability of the Company to attract and retain quality employees. No assurance can be given that results, performance or achievement expressed in, or implied by, forward-looking statements within this disclosure will occur, or if they do, that any benefits may be derived from them. The Company undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Business Environment

High natural gas supply prices and weak economic conditions in the western system area continue to depress the Company's sales and transportation of natural gas.

As of the date of this report, the Company had not received decisions from the British Columbia Utilities Commission (the "Commission") on its 2004 revenue requirement applications or its application to recapitalize under an income trust ownership structure. It is expected these decisions will be rendered in the third quarter of 2004.

Overall Performance

Net income for the first six months of 2004 was \$4.2 million, compared with \$3.7 million for the corresponding period in 2003. After providing for preferred share dividends, earnings per common share in the first six months of 2004 were \$1.11 compared with \$1.00 for the first six months of 2003. The increase in net income is primarily the result of the timing of the Company's revenues from gas sales and transportation services in 2004 versus 2003, on an after-tax basis. The positive revenue effect of this timing issue will be reversed during the last six months of 2004, neutralizing its impact by year-end. In particular, the Company recorded \$1.7 million in deferred revenue, as approved by the Commission, in the latter half of 2003 in respect of the New Skeena Forest Products pulp mill in Prince Rupert as this mill was expected to reopen by mid-June 2003. The pulp mill, however, remained idle and the Company's 2004 interim rates were then set assuming no revenue would be realized from service to the facility in 2004. This assumption resulted in rate increases to other customers which are applied to deliveries throughout 2004. As a consequence, the Company's revenues are an estimated \$0.9 million higher in the first half of 2004 than in the same period of 2003. Accordingly, assuming all other things remained equal, the Company would expect to record \$0.9 million less revenue in the last half of 2004 relative to the same period in 2003. The increase in net income resulting from the revenue timing factor noted above was partially offset by a decline in revenues from services to the Company's small industrial customers in the first six months of 2004 compared to 2003 as well as an increase in the Company's operating and administrative expenses in the same period.

Net income for the quarter ended June 30, 2004 was \$0.3 million, compared with no net income for the quarter ended June 30, 2003. After providing for preferred share dividends, the earnings per common share in the quarter ended June 30, 2004 were \$0.06 compared with a loss of \$0.01 in the

corresponding period in 2003. The increase in net income in the second quarter of 2004 is largely due to the factors that contributed to the increase in net income in the first six months of 2004.

The rate stabilization adjustment mechanism approved by the Commission continues to contribute to the stability of the Company's earnings. This mechanism allows the Company to record the after-tax revenue variances arising from differences between actual and forecast sales volumes for residential and small commercial customers in a deferral account for collection or refund in future rates. Net income was higher by \$0.7 million and \$0.8 million for the three months and six months ended June 30, 2004, respectively, as a result of this account.

Residential and commercial deliveries were down 7 percent in the first six months of 2004 and were down 29 percent in the three months ended June 30, 2004, relative to deliveries over the same time periods in 2003. Weather was a prime contributor to reduced residential and commercial sales being almost 6 percent warmer in the six months ended June 30, 2004 and 15 percent warmer in the second quarter of 2004 relative to the same periods of 2003. Gas consumption also continued to decline as consumers reduce energy consumption in response to near-record high natural gas prices. Industrial deliveries decreased less than 1 percent for the second quarter and were effectively the same as in 2003 for the 6 months ended June 30, 2004.

Results of Operations

Operating revenues in the first six months of 2004 increased to \$71.8 million as compared with \$70.3 million in the first six months of 2003. The increase in operating revenues was due to an increase in sales of gas surplus to the needs of the Company's sales customers ("off-system sales") of \$5.0 million in the first six months of 2004, compared with the corresponding period in 2003. This was offset by a \$3.5 million decline in revenues from the Company's sales and transportation customers which mainly reflects lower gas supply costs embedded in sales customers' rates compared to the same period in 2003.

Operating revenues in the second quarter of 2004 decreased to \$28.2 million as compared to \$28.6 million in the second quarter of 2003. This decline in operating revenues was the result of a \$4.2 million decline in revenues from transportation and sales customers, largely reflective of lower gas supply costs charged to customers in this period in 2004 relative to 2003. This decline was offset by an increase in off-system sales revenues in the second quarter of 2004 relative to the same period of 2003.

Operating margin in the first six months of 2004 increased to \$26.9 million, as compared with \$26.1 million in the first six months of 2003. Operating margin also increased in the second quarter of 2004 relative to the same period in 2003, to \$10.4 million from \$10.2 million. These increases in operating margin are largely a result of the timing factor discussed in the first paragraph of the Overall Performance section above.

During the second quarter of 2004 the public hearing into the Company's proposed new 10-year transportation service agreement with West Fraser Mills Ltd., the Company's 2004 revenue requirements applications and the Company's application to recapitalize under an income trust ownership structure was completed. Decisions by the Commission on these matters are expected in the third quarter of 2004.

The Company filed a report with the Commission in June 2004 on forecast gas supply prices. On the basis of the report, the Commission approved increases to the gas supply commodity component of its rates effective July 1, 2004 of approximately \$0.87 per gigajoule, on average.

Summary of Quarterly Results for Eight Quarters Ending June 30, 2004

<i>Thousands of dollars except per share amounts</i>	Jun 30, 2004	Mar 31, 2004	Dec 31, 2003	Sept 30, 2003	Jun 30, 2003	Mar 31, 2003	Dec 31, 2002	Sept 30, 2002
Operating Revenues	\$28,245	\$43,584	\$39,448	\$24,025	\$28,571	\$41,683	\$32,889	\$16,714
Net Income ¹	317	3,848	2,665	(723)	47	3,679	1,270	(889)
- per share ²	0.06	1.05	0.72	(0.23)	(0.01)	1.00	0.34	(0.28)
- per share diluted ²	0.06	1.03	0.70	(0.22)	(0.01)	0.99	0.34	(0.28)

¹ The Company did not have any extraordinary items which impacted net income over the most recently completed eight quarters.

² Per share amounts are after provision for preferred share dividends of \$84 thousand per quarter.

The Company's natural gas distribution business is very seasonal, with higher sales in the colder winter months and lower sales in warmer months as a result of a substantial portion of its gas sales being used for space heating purposes. As a result, the Company earns the majority of its net income in the first and fourth quarters of its fiscal year and often realizes losses in the other quarters.

Liquidity

During the second quarter, the Company agreed to certain amendments to its bank operating line which will improve its liquidity during the months of May through October. Amounts available to the Company under its bank operating line are generally subject to borrowing base requirements which are determined in relation to the Company's accounts receivable and inventories. As a result of the seasonality in operations, the Company's accounts receivable are significantly reduced in the second and third quarters, compared to the winter heating season. The Company's operating lender has agreed to provide additional credit of \$5 million in excess of the Company's borrowing base during the months of May through October.

The Company continues to be in compliance with the covenants under its operating line through the end of June 2004.

Capital Resources

The Company has not made any material commitments for capital expenditures at this time. It expects to award a contract for an estimated \$1.5 million in the third quarter of 2004 related to replacing a dual-line underwater crossing of the Salmon River on the Company's transmission system. The Company expects to fund this expenditure through a combination of draws on its operating line and cash flows.

Off-Balance Sheet Arrangements

As of June 30, 2004, the Company had no off-balance sheet arrangements.

Transactions with Related Parties

The Company has not had any transactions with related parties during the first six months of 2004.

Critical Accounting Estimates

Operating revenues for the period ended June 30, 2004 are based on interim rates that have been approved by the Commission. Permanent rates will be set following receipt of the Commission's decisions on the Company's 2004 rate applications and may result in retroactive adjustments to the

interim rates. The Company has no reason to believe that the permanent rates will be materially different than its interim rates.

Operating revenues include natural gas sales that are recorded on the basis of regular meter readings and estimates of customer usage from the last meter reading date to the end of the reporting period for such operating revenues. These estimates are made assuming normal consumption patterns which may differ from actual consumption patterns. The estimates of unbilled operating revenue comprise 3 percent of the Company's operating revenues to June 30, 2004. Through future meter readings the usage estimates are replaced with actual delivered volumes which become reflected in the Company's financial results at that time.

Certain gas purchase volumes for deliveries in June have also been estimated as the meter readings were not available from the Company's supplier at the time the Company completed its financial statements. These estimates were based on previous years' delivery volumes in June for the supply locations in question.

The Company's subsidiary Pacific Northern Gas (N.E.) Ltd. is involved in a dispute with a customer over the payment for gas transported to the customer. The dispute relates to the customer's obligation to supply its own gas for transportation to its facilities, or failing that, to pay for gas delivered to those facilities. The Company believes it has a substantial case for recovery of the amounts billed and has recorded the related accounts receivable at management's best estimate of the amount ultimately recoverable. Approximately \$2 million relating to the dispute has been included in accounts receivable at June 30, 2004 and December 31, 2003.

Financial and Other Instruments

The Company utilizes natural gas commodity hedging contracts in order to manage the volatility inherent in the prices of its natural gas purchases. It also utilizes interest rate hedging contracts to reduce the volatility of the interest expense associated with its floating rate debt instruments. As of June 30, 2004 the Company had no natural gas commodity hedging contracts or interest rate hedging contracts outstanding.

During the second quarter the Company completed its annual gas contracting and gas supply price management plan and filed it with the Commission for review and acceptance. The Commission accepted the plan as filed early in the third quarter of 2004. The plan calls for gas price hedging, covering purchases over the period November 1, 2004 through October 31, 2005, to be completed in stages over the mid-July to mid-October 2004 period. Each hedging transaction is subject to approval by the Company's price management committee.

Other

The Company files an Annual Information Form on SEDAR which can be accessed at www.sedar.com.

Pacific Northern Gas Ltd. had 3,598,580 common shares outstanding as of June 30, 2004. These are the only issued voting securities of the Company and it has no securities outstanding which may be converted into voting or equity securities.

"Roy G. Dyce"
President and Chief Executive Officer

July 22, 2004

**Notice Required Under Part 4.3(3)
of National Instrument 51-102**

TO THE SHAREHOLDERS OF PACIFIC NORTHERN GAS LTD.

The interim financial statements of Pacific Northern Gas Ltd. for the period ended June 30, 2004 have not been reviewed by an auditor.

PACIFIC NORTHERN GAS LTD.
CONSOLIDATED BALANCE SHEETS
AS AT JUNE 30, 2004 AND DECEMBER 31, 2003
(in thousands)

	<u>June 30</u> <u>2004</u>	<u>December 31,</u> <u>2003</u>
ASSETS		
Current assets:		
Cash	\$ 6,195	\$ 313
Accounts receivable	13,609	25,100
Inventory of supplies and natural gas	1,685	2,215
Prepaid expenses	<u>861</u>	<u>133</u>
	<u>22,350</u>	<u>27,761</u>
Plant, property and equipment	<u>173,359</u>	<u>174,348</u>
Deferred charges:		
Debt expense	839	915
Rate stabilization adjustment mechanism	1,535	864
Pipeline rehabilitation costs	1,030	1,093
Other	<u>952</u>	<u>1,433</u>
	<u>4,356</u>	<u>4,305</u>
	<u>\$ 200,065</u>	<u>\$ 206,414</u>
LIABILITIES		
Current liabilities:		
Bank indebtedness	\$ -	\$ 2,900
Accounts payable and accrued liabilities	10,415	15,054
Gas purchase variance payable	2,489	3,562
Income and other taxes payable	3,586	2,737
Long term debt due within one year	<u>4,382</u>	<u>4,382</u>
	<u>20,872</u>	<u>28,635</u>
Long term debt	<u>84,539</u>	<u>85,827</u>
Deferred income taxes	<u>15,418</u>	<u>15,430</u>
SHAREHOLDERS' EQUITY		
Preferred shares	<u>5,000</u>	<u>5,000</u>
Common shares	8,996	8,960
Contributed surplus	2,500	2,379
Retained earnings	<u>62,740</u>	<u>60,183</u>
	<u>74,236</u>	<u>71,522</u>
	<u>79,236</u>	<u>76,522</u>
	<u>\$ 200,065</u>	<u>\$ 206,414</u>

ON BEHALF OF THE BOARD

"Robert F. Chase"
Director

"Roy G. Dyce"
Director

PACIFIC NORTHERN GAS LTD.

CONSOLIDATED STATEMENTS OF INCOME

(in thousands)

	For the six months ended June 30		For the three months ended June 30	
	<u>2004</u>	<u>2003</u> (note 1)	<u>2004</u>	<u>2003</u> (note 1)
Operating revenues	\$ 71,829	\$ 70,254	\$ 28,245	\$ 28,571
Cost of sales	<u>44,958</u>	<u>44,198</u>	<u>17,839</u>	<u>18,338</u>
Operating margin	<u>26,871</u>	<u>26,056</u>	<u>10,406</u>	<u>10,233</u>
Operating and maintenance	6,078	5,875	2,702	2,806
Administrative and general	3,497	3,281	1,717	1,733
Amortization of deferred charges	345	262	173	113
Municipal and other taxes	1,970	1,971	985	965
Depreciation	<u>3,942</u>	<u>3,911</u>	<u>1,971</u>	<u>2,004</u>
	<u>15,832</u>	<u>15,300</u>	<u>7,548</u>	<u>7,621</u>
Operating income	11,039	10,756	2,858	2,612
Investment and other income	<u>24</u>	<u>32</u>	<u>19</u>	<u>5</u>
	<u>11,063</u>	<u>10,788</u>	<u>2,877</u>	<u>2,617</u>
Income deductions:				
Interest on long term debt	3,812	3,734	1,968	1,854
Other interest	<u>368</u>	<u>366</u>	<u>171</u>	<u>189</u>
	<u>4,180</u>	<u>4,100</u>	<u>2,139</u>	<u>2,043</u>
Income before income taxes	<u>6,883</u>	<u>6,688</u>	<u>738</u>	<u>574</u>
Income taxes				
- Currently payable	1,872	818	105	2,046
- Deferred	<u>846</u>	<u>2,144</u>	<u>316</u>	<u>(1,519)</u>
	<u>2,718</u>	<u>2,962</u>	<u>421</u>	<u>527</u>
Net income for the period	<u>\$ 4,165</u>	<u>\$ 3,726</u>	<u>\$ 317</u>	<u>\$ 47</u>
For common shares:				
Net income for the period	\$ 4,165	\$ 3,726	\$ 317	\$ 47
Provision for dividends on preferred shares	<u>168</u>	<u>168</u>	<u>84</u>	<u>84</u>
Net income (loss) applicable to common shares	<u>\$ 3,997</u>	<u>\$ 3,558</u>	<u>\$ 233</u>	<u>\$ (37)</u>
Per common share:				
Basic	<u>\$ 1.11</u>	<u>\$ 1.00</u>	<u>\$ 0.06</u>	<u>\$ (0.01)</u>
Diluted	<u>\$ 1.09</u>	<u>\$ 0.98</u>	<u>\$ 0.06</u>	<u>\$ (0.01)</u>

PACIFIC NORTHERN GAS LTD.

CONSOLIDATED STATEMENTS OF RETAINED EARNINGS

(in thousands)

	For the six months ended June 30		For the three months ended June 30	
	<u>2004</u>	<u>2003</u> (note 1)	<u>2004</u>	<u>2003</u> (note 1)
Balance, beginning of period	\$ 60,183	\$57,719	\$ 63,312	\$ 60,682
Net income for the period	<u>4,165</u>	<u>3,726</u>	<u>317</u>	<u>47</u>
	64,348	61,445	63,629	60,729
Preferred Dividends	169	168	169	168
Common dividends	<u>1,439</u>	<u>1,434</u>	<u>720</u>	<u>718</u>
	<u>1,608</u>	<u>1,602</u>	<u>889</u>	<u>886</u>
Balance, end of period	<u>\$ 62,740</u>	<u>\$59,843</u>	<u>\$ 62,740</u>	<u>\$ 59,843</u>

CONSOLIDATED STATEMENTS OF CASH FLOW

(in thousands)

	For the six months ended June 30		For the three months ended June 30	
	<u>2004</u>	<u>2003</u>	<u>2004</u>	<u>2003</u>
Operating activities:				
Net income for the period	\$ 4,165	\$ 3,754	\$ 317	\$ 61
Add (deduct) items not involving cash				
Deferred income taxes	846	2,144	316	(1,519)
Depreciation and amortization	4,287	4,173	2,144	2,117
Stock option expense	47	-	24	-
Other	<u>(858)</u>	<u>(2,156)</u>	<u>(322)</u>	<u>1,513</u>
Operating cash flow	8,487	7,915	2,479	2,172
Non-cash working capital changes	<u>7,503</u>	<u>1,731</u>	<u>7,246</u>	<u>607</u>
Net cash provided by operating activities	<u>15,990</u>	<u>9,646</u>	<u>9,725</u>	<u>2,779</u>
Investing activities:				
Additions to plant, property and equipment	(2,953)	(2,285)	(2,250)	(1,318)
Decrease (increase) in deferred charges	<u>(1,469)</u>	<u>(3,732)</u>	<u>(541)</u>	<u>2,631</u>
Net cash provided by (used in) investing activities	<u>(4,422)</u>	<u>(6,017)</u>	<u>(2,791)</u>	<u>1,313</u>
Financing activities:				
Decrease in bank indebtedness	(2,900)	-	-	(2,643)
Repayment of long term debt	(1,288)	(1,305)	(643)	(648)
Issue of common shares	110	27	11	4
Dividends paid	<u>(1,608)</u>	<u>(11,454)</u>	<u>(889)</u>	<u>(886)</u>
Net cash used in financing activities	<u>(5,686)</u>	<u>(12,732)</u>	<u>(1,521)</u>	<u>(4,173)</u>
Increase (decrease) in cash during the period	5,882	(9,103)	5,413	(81)
Cash, beginning of period	<u>313</u>	<u>10,027</u>	<u>782</u>	<u>1,005</u>
Cash, end of period	<u>\$ 6,195</u>	<u>\$ 924</u>	<u>\$ 6,195</u>	<u>\$ 924</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

These unaudited interim consolidated financial statements are prepared, from the records of the Company, in accordance with Canadian generally accepted accounting principles, except that disclosures do not conform, in all respects, to the requirements for annual consolidated financial statements. While management believes that the disclosures presented are adequate to make the information not misleading, these consolidated financial statements and notes should be read in conjunction with the Company's most recent annual consolidated financial statements.

These interim consolidated financial statements follow the same accounting policies and methods of their application as the Company's most recent annual consolidated financial statements.

Earnings for the interim periods may not be indicative of results for the fiscal year due to weather variations and other factors.

1. STOCK-BASED COMPENSATION

The Company does not have any plans which result in the direct award of stock, stock appreciation rights and awards that call for settlement in cash or other assets. The Company has one stock-based compensation plan. In March 2004, 25,900 options were issued at an average exercise price of \$20.80.

The Company has adopted the fair-value based method to account for stock based transactions with employees prospectively effective January 1, 2003 and as a result has restated the comparative figures for the three and six month periods ending June 30, 2003. Previously the Company's reported results reflected the intrinsic value based method to account for stock-based compensation. The adjustment to reflect the fair value method to account for stock options results in a reduction of net income of \$28 thousand for the six months ended June 30, 2003 and \$14 thousand for the three months ended June 30, 2003. Reported basic earnings per share are unchanged by the adjustment, while reported diluted earnings per share decline \$0.01 for the six months ended June 30, 2003 but are unchanged for the three months ended June 30, 2003.

The following is a summary of the significant assumptions used in adjusting the Company's earnings:

	Six months ended June 30 2003	Three months ended June 30 2003
Risk free interest rate	3%	3%
Expected volatility (annualized)	44%	44%
Expected years of option life (average)	7	7
Expected annual rate of dividends	4%	4%

2. SEASONALITY

Due to the seasonal nature of natural gas sales, more than 85 percent of the Company's net income is generally reported in the first and fourth quarters of the year, representing the typical timing of the heating season.

3. PREFERRED SHARES

The 6.75 percent preferred shares are redeemable at the option of the Company at \$26 per share plus any accrued and unpaid dividends at the date of the redemption.

4. COMMON SHARES

The Company has outstanding stock options for 283,400 common shares, of which 217,600 are exercisable as at June 30, 2004. At June 30, 2004, there were 64,800 stock options outstanding that could potentially dilute basic earnings per share in the future but were not included in the computation of diluted earnings per share because the options' exercise prices were greater than the average market price of the common shares.

<i>[Thousands of shares]</i>	Six months ended June 30		Three months ended June 30	
	2004	2003	2004	2003
Weighted average number of common shares outstanding – basic	3,593.9	3,582.8	3,598.6	3,583.0
Effect of dilutive stock options	78.2	46.6	76.9	46.4
Weighted average number of common shares outstanding – diluted	3,672.1	3,629.4	3,675.5	3,629.4

5. CONTINGENCY AND MEASUREMENT UNCERTAINTY

Pacific Northern Gas (N.E.) Ltd. is involved in a dispute with a customer over the payment for gas transported to the customer. The dispute relates to the customer's obligation to supply its own gas for transportation to its facilities, or failing that, to pay for gas delivered to those facilities. The Company believes it has a substantial case for recovery of the amounts billed and has recorded the related accounts receivable at management's best estimate of the amount ultimately recoverable. Approximately \$2 million relating to the dispute has been included in accounts receivable at June 30, 2004 and December 31, 2003.

6. COMPARATIVE FIGURES

Certain items in the consolidated financial statements have been reclassified to conform to the 2004 presentation.

I, Roy Dyce, the Chief Executive Officer of Pacific Northern Gas Ltd., certify that:

1. I have reviewed the interim filings of Pacific Northern Gas Ltd., (the issuer) for the interim period ending June 30, 2004;
2. Based on my knowledge, the interim filings do not contain any untrue statement of a material fact or omit to state a material fact required to be stated or that is necessary to make a statement not misleading in light of the circumstances under which it was made, with respect to the period covered by the interim filings; and
3. Based on my knowledge, the interim financial statements together with the other financial information included in the interim filings fairly present in all material respects the financial condition, results of operations and cash flows of the issuer, as of the date and for the periods presented in the interim filings.

"Roy G. Dyce"

Roy G. Dyce
Chief Executive Officer

Date: July 22, 2004

◆—————◆

I, Kevin Teitge, the Chief Financial Officer of Pacific Northern Gas Ltd., certify that:

1. I have reviewed the interim filings of Pacific Northern Gas Ltd., (the issuer) for the interim period ending June 30, 2004;
2. Based on my knowledge, the interim filings do not contain any untrue statement of a material fact or omit to state a material fact required to be stated or that is necessary to make a statement not misleading in light of the circumstances under which it was made, with respect to the period covered by the interim filings; and
3. Based on my knowledge, the interim financial statements together with the other financial information included in the interim filings fairly present in all material respects the financial condition, results of operations and cash flows of the issuer, as of the date and for the periods presented in the interim filings.

"Kevin R. Teitge"

Kevin R. Teitge
Chief Financial Officer

Date: July 22, 2004