



interim statement

For the Three Months Ended September 30, 2006

October 26, 2006

Pacific Northern Gas Ltd.
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Pacific Northern Gas Ltd.

MANAGEMENT'S DISCUSSION AND ANALYSIS **for the Three Months Ended September 30, 2006**

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 and markets; gas supply and commodity price volatility; competition; decisions by regulators; seasonal weather patterns; financing of investments as well as the value of such investments; the cost and availability of capital; and the ability of the Company to attract and retain quality employees. Those risks and other material risks are discussed in the Company's Annual Information Form dated March 16, 2006. 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

The Company continues to monitor the competitiveness of its natural gas retail sales relative to alternative heating sources in its service areas. There were significant increases in the commodity cost of natural gas in the third and fourth quarters of 2005, with prices falling off in the first nine months of 2006. Average spot commodity prices during the nine months ended September 2006 were approximately 29 percent lower than prices in the twelve month period ended December 31, 2005. Notwithstanding the decreases in commodity prices in 2006, retail gas rates for residential customers located in the west-central region of northern British Columbia remain slightly higher than the comparable electricity rates.

In 2005 the Company commenced preliminary study and investigation of a project to loop its main line transmission system from Kitimat to Summit Lake (the "KSL Project"). The KSL Project would provide gas transportation services for up to 1.0 billion cubic feet per day from the proposed Kitimat LNG Inc. liquefied natural gas ("LNG") receiving and regasification terminal (the "Terminal") to be located on the Douglas Channel approximately 15 kilometers southwest of Kitimat to the Company's existing interconnection with the Duke Energy Gas Transmission ("Duke") system. The KSL Project would entail the construction of approximately 470 kilometers of a 30 or a 36 inch diameter pipeline and associated compression facilities, at an estimated cost of \$900 million or \$1.2 billion, respectively. Kitimat LNG Inc., a private company based in Calgary, Alberta received a Project Approval Certificate from the British Columbia Environmental Assessment Office, and is awaiting approval from the Canadian Environmental Assessment Agency for the Terminal.

On July 17, 2006, the Company announced the formation of Pacific Trail Pipelines Limited Partnership ("PTP"), a 50/50 partnership between the Company and Galveston LNG Inc., the parent company of Kitimat LNG Inc., for the purpose of developing the KSL Project. In addition, PTP and Kitimat LNG executed a Precedent Agreement to coordinate the process of obtaining authorizations for the KSL Project with the development of the Terminal. The agreement outlines, among other things, the key economic arrangements between PTP and Kitimat LNG, as well as the targeted timeline and key milestones for construction of the KSL Project and the Terminal.

The route for the KSL Project will be determined through technical field studies and consultation with First Nations, the public and regulatory authorities. The Company's existing right-of-way will be used where appropriate. Upon completion of the KSL Project, and subject to regulatory

and shareholder approvals, the Company's existing mainline transmission system will be transferred to PTP and integrated with the KSL Project facilities. The Company will continue to own and operate its existing gas distribution systems, including its Customer Care Centre in Terrace.

PTP expects to commence construction of the KSL Project facilities by the first quarter 2008. Construction is subject to a number of conditions including the securing of LNG supply by Kitimat LNG Inc., financing of both projects and regulatory approvals for the KSL Project. The Company can give no assurances that construction of the KSL Project by PTP will proceed.

On October 26, 2006, the Company filed its 2007 revenue requirements applications for all divisions with the British Columbia Utilities Commission ("the Commission"). The applications seek approval of changes to residential delivery charges, effective January 1, 2007, as follows: PNG West system, increase of 3.1 percent; Fort St. John/Dawson Creek system, increase of 2.5 percent; and Tumbler Ridge system, decrease of 18.4 percent. The forecast residential and commercial deliveries contained in the 2007 revenue requirements application for the PNG West system are approximately 1.4 percent lower than the forecast deliveries to these customer classes used for rate making purposes in 2006. Deliveries to small industrial customers in the PNG West system are projected to be approximately 17 percent lower in 2007 compared to budgeted gas deliveries in 2006.

Decisions on 2006 Revenue Requirements Applications

In late August 2006 the Company received decisions from the Commission on the Company's 2006 revenue requirements applications for its PNG-West division as well as for the Fort St. John/Dawson Creek and Tumbler Ridge divisions of the Company's wholly owned subsidiary, Pacific Northern Gas (N.E.) Ltd. ["PNG(N.E.)"]. With respect to the PNG-West division, the Commission concluded that the level of 2006 costs was appropriate having regard to a number of factors including the Company's initiatives to reduce its annual cost of service in response to the closure in November 2005 of the Methanex methanol/ammonia facility in Kitimat. The Commission concluded that the Company had taken all prudent steps to manage and reduce its costs and there were no unnecessary or unreasonable costs in the applied for 2006 cost of service. A negotiated settlement agreement was reached in March 2006 in respect of PNG(N.E.)'s Fort St. John/Dawson Creek and Tumbler Ridge divisions. The Commission confirmed the terms of the negotiated settlement agreement. The Commission's decisions did not have an impact on earnings previously reported to June 30, 2006.

Income Trust

By decision dated September 9, 2005 and modified on October 28, 2005, the Commission granted conditional approval of the Company's December 2004 application to recapitalize under an income trust ownership structure. In connection with the Company's announcement on July 17, 2006 that it has entered into a partnership arrangement with Galveston LNG Inc. to jointly develop the KSL Project, the Company indicated that conversion to an income trust will not be pursued while the KSL Project continues under development.

Overall Performance

Net loss for the three months ended September 30, 2006 was \$1.5 million, compared with a net loss of \$0.8 million for the corresponding period in 2005. After providing for preferred share dividends, the loss per common share in the three months ended September 30, 2006 was \$0.42 compared with a loss per common share of \$0.24 for the same period in 2005. Included in net loss for the three months ended September 30, 2006 are charges, net of tax, of \$0.6 million relating to the Company's share of KSL Project development expenditures incurred by PTP. The Company's share of further KSL Project costs will continue to be expensed until suitable commercial arrangements for firm gas transportation services by PTP are in place. If anticipated development expenditures for the last quarter of 2006 are expensed, earnings will be further reduced by an estimated \$1.0 million, or

\$0.28 cents per share. In addition, net loss for the third quarter was negatively impacted by \$0.4 million due to a shift in the timing of the recovery of operating margin, since deliveries to residential and commercial customers are temperature sensitive and make up a higher proportion of annual deliveries in 2006 compared to 2005. These impacts were offset by reductions in operating expenses arising due to lower volumes of gas delivered, compared to 2005.

Net income for the nine months ended September 30, 2006 was \$2.6 million, compared to \$3.3 million in the corresponding period in 2005. After providing for preferred share dividends, earnings per common share in the nine months ended September 30, 2006 were \$0.66 compared with \$0.86 for the same period in 2005. Included in net income for the nine months ended September 30, 2006 are charges, net of income taxes, of \$1.1 million, or \$0.31 cents per share, relating to the Company's share of KSL Project development expenditures. Offsetting these charges are reductions in operating expenses, compared to 2005, due to lower volumes of gas delivered in 2006.

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. As a result of this account, the Company's net income was increased by \$0.8 million for the nine month period ended September 30, 2006, but was unchanged for the three month period ended September 30, 2006.

Residential deliveries were 9 percent lower in the three months ended September 30, 2006, and were 10 percent lower in the nine months ended September 30, 2006, relative to deliveries over the same periods in 2005. Commercial deliveries were 6 percent lower in the three months ended September 30, 2006 and were 2 percent lower in the nine months ended September 30, 2006, compared to the same periods in 2005. Management believes that a key factor in the reduction in deliveries was warmer weather, as it was warmer by approximately 32 percent and 5 percent for the three month and nine month periods ended September 30, 2006, respectively, compared to the same periods in 2005. The weather was 33 percent and 12 percent warmer than normal for the three month and nine month periods ended September 30, 2006, respectively. In addition, the reductions in deliveries to residential customers in the first three quarters of 2006 are likely due in part to increased prices encouraging customer conservation measures.

Industrial deliveries were lower by 82 percent and 80 percent for the three month and nine month periods ended September 30, 2006, respectively, compared to the same periods in 2005. The reduction in industrial deliveries is primarily attributable to the closure of Methanex's Kitimat facility in the fourth quarter of 2005. Excluding the effect of the closure of Methanex's Kitimat facility, deliveries to large industrial customers in the three month and nine month periods ended September 30, 2006 were lower by 1 percent and 3 percent, respectively, compared with deliveries to the same customers in the corresponding periods in 2005. A deferral account is in place that recovers or refunds margin differences resulting from large industrial customers' demand varying from the forecast approved for ratemaking purposes.

Results of Operations

Operating revenues in the three months ended September 30, 2006 decreased to \$15.9 million, as compared with \$32.2 million in the corresponding period in 2005. The decrease in operating revenues was primarily due to a reduction of \$14.6 million in revenues from the sale of gas surplus to the needs of the Company's sales customers ("off system gas sales") as well as a reduction of \$1.4 million in transportation services revenue from Methanex, compared with the corresponding period in 2005. Natural gas commodity prices, which are passed through to the Company's sales customers without mark-up, are very volatile and result in significant variability of the Company's reported operating revenues, but do not affect net income. Any profit or loss realized on off system gas sales is deferred for future recovery from, or refund to, the Company's sales customers. Off system gas sales volumes have declined as the Company has reduced its base load gas purchases during the summer months to more closely align gas purchases with customers' gas demand.

Operating revenues in the first nine months of 2006 decreased to \$92.7 million as compared with \$110.3 million in the first nine months of 2005. The decrease in operating revenues was primarily due to a reduction of \$22.7 million in off system gas sales combined with a reduction of \$3.3 million in transportation services revenue from Methanex, offset by an increase of \$8.0 million in gas supply costs embedded in sales customers rates, compared with the corresponding period in 2005.

Operating margin in the three months ended September 30, 2006 decreased to \$7.2 million, as compared with \$8.5 million in the same period in 2005. The lower operating margin in the third quarter is primarily the result of deliveries to residential and commercial customers making up a higher proportion of annual deliveries compared to 2005, when Methanex was operating its methanol/ammonia facility in Kitimat. Deliveries to residential and commercial customers tend to be more temperature sensitive, with deliveries in the first and fourth quarters accounting for more than 75 percent of annual deliveries. As a consequence, the Company's operating margin is approximately \$0.6 million lower in the third quarter of 2006 than in the same period in 2005.

Operating margin in the first nine months of 2006 also decreased to \$33.7 million, as compared with \$34.4 million in the first nine months of 2005. In addition to the closure of the Methanex facility, lower budgeted operating expenses, depreciation and amortization in 2006 resulted in lower requirements for recovery in customer rates.

Included in Other income deductions for the three months ended September 30, 2006 are the Company's share of KSL Project development expenditures expensed by PTP amounting to \$1.4 million. For the nine months ended September 30, 2006, the Company's share of KSL Project development expenditures included in other income deductions amounts to \$2.0 million.

The Company filed a report with the Commission in late 2006 on past and projected gas supply costs compared to gas cost recoveries from customers. On the basis of the report, and at the Company's request, the Commission issued an order confirming that no changes would be made to the gas supply cost recovery rates for customers that were made effective July 1, 2006.

Summary of Quarterly Results for Eight Quarters Ending September 30, 2006

<i>Thousands of dollars except per share amounts</i>	Sept 30, 2006	June 30, 2006	Mar 31, 2006	Dec 31, 2005	Sept 30, 2005	June 30, 2005	Mar 31, 2005	Dec 31, 2004
Operating Revenues	\$15,850	\$20,203	\$56,605	\$49,621	\$32,238	\$30,293	\$47,798	\$40,757
Net income (loss) ¹	(1,451)	(837)	4,920	3,311	(772)	137	3,984	2,670
- per share ²	(0.42)	(.25)	1.33	0.89	(0.24)	0.02	1.08	0.72
- per share diluted ²	(0.42)	(.25)	1.31	0.88	(0.24)	0.01	1.06	0.71

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 approximately \$84,000 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. Given that a substantial portion of its gas sales are used for space heating purposes, the Company earns in excess of its annual net income in the first and fourth quarters of its fiscal year and generally realizes losses in the other two quarters.

Liquidity

The Company has several credit facilities, including a \$20 million operating line and a \$15 million risk management facility. The operating line is subject to borrowing base requirements and financial covenants which may act to restrict the amount the Company can borrow under the operating line. As of September 30, 2006, the calculated borrowing base was \$5.5 million, of which \$1.8 million had been utilized in the form of a letter of credit. The credit facilities are collateralized by the pledge of a \$40 million debenture and a charge on certain accounts receivables and inventories.

In addition to the borrowing base, the Company has provided certain financial covenants to its operating lender. One of these covenants is a restricted payments test which, in essence, prevents the Company from borrowing under the operating line to fund capital expenditures, scheduled debt amortization payments, or dividend payments. The Company is in compliance with the covenants under its operating line through the end of September 2006.

The risk management facility allows the Company to hedge natural gas purchases in accordance with its annual gas contracting and gas supply price management plan and to enter into interest rate hedging transactions to the extent of a total maximum exposure of \$15 million, with exposure calculated by the facility provider using its standard methodology.

On July 21, 2006 the Company and its operating lender executed an extension of the operating line and risk management facility to July 22, 2007.

Cash and short term investments at September 30, 2006 are \$22.7 million higher than at December 31, 2005 due to receipt of the Methanex Termination Payment in February 2006, which was partially used to repay outstanding bank indebtedness. Accounts receivable at September 30, 2006 are \$24.3 million lower than at December 31, 2005 due to the seasonal nature of deliveries to residential and commercial customers. In addition, accounts payable and accrued liabilities at the end of the third quarter are \$13.8 million lower due to lower commodity prices and volumes of purchases of natural gas in September, 2006 compared to December, 2005. Income and other taxes payable at September 30, 2006 are \$5.8 million higher than at December 31, 2006 primarily due to the current tax liability associated with the receipt of the Methanex Termination Payment. The gas purchase variance payable at September 30, 2006 has increased by \$3.5 million compared to December 31, 2005 due to gas commodity costs paid by the Company being less than the gas commodity cost rates paid by customers.

The Company purchases gas for resale to its gas sales customers and passes through the commodity cost of gas to those customers without mark-up. The rates charged to gas sales customers are based, in part, on projected gas supply prices. The Company's liquidity requirements can be affected by delays between increases or decreases in the cost of gas purchased by the Company and regulatory approval of rate adjustments to reflect the cost increases or decreases.

Capital Resources

The Company does not have material commitments for capital expenditures at this time. Planned capital expenditures in the last quarter of 2006 are approximately \$2.0 million in order to maintain the transmission and distribution system and to provide for minor expansions of its distribution system to service new customers. In addition, the Company's share of funding of the development expenditures for the KSL Project through PTP is expected to be approximately \$1.5 million in the fourth quarter of 2006. The Company expects to finance these expenditures from existing cash balances.

Off-Balance Sheet Arrangements

As of September 30, 2006, the Company had no off-balance sheet arrangements, other than the natural gas hedging contracts described in Financial and Other Instruments below.

Transactions with Related Parties

Accounts receivable at September 30, 2006 include \$48,000 due from Pacific Trail Pipelines Limited Partnership, and relate to expenditures made by the Company that are to be reimbursed by the partnership.

Critical Accounting Estimates

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, adjusted for weather variations, which may differ from actual consumption patterns. The estimates of unbilled operating revenue at September 30, 2006 comprise 1.9 percent of the Company's operating revenues for the nine month period ended September 30, 2006. Through future meter readings, the usage estimates are replaced with actual delivered volumes which will be reflected in the Company's financial results at that time.

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 September 30, 2006 the Company had no interest rate hedging contracts outstanding.

During the second quarter of 2006 the Company filed its annual gas contracting and gas supply price risk management plan with the Commission. Review and acceptance of the plan by the Commission was received on June 8, 2006. The plan calls for gas price hedging, covering purchases over the November 1, 2006 through October 31, 2008 period, to be completed in stages beginning in May 2006. Each hedging transaction is subject to approval by the Company's price risk management plan committee.

At September 30, 2006, the Company had outstanding fixed price contracts, natural gas swap contracts, natural gas collar contracts and call options relating to natural gas supply as follows:

Financial instrument	Notional Quantity (GJ's)	Percent of Annual Gas Purchases	Delivery period	Price Range (per GJ)	Estimated Fair Value Receivable (Payable)
Fixed price contracts	696 321	7.1%	Nov. 2006 to Mar. 2007	\$6.66 to \$8.30	(\$677,262)
Natural gas swap contracts	4 519 250	45.7%	Oct. 2006- Oct. 2008	\$6.84 to \$10.28	(7,293,683)
Natural gas collar contracts	310 000	3.1%	Nov. 2006 – Oct. 2007	Floors from \$6.05; Caps to \$10.65	(380,256)
Call options	190 750	1.9%	Oct. 2006 – Mar. 2007	Caps from \$8.99 to \$14.00	42,952
Total	5 716 321	57.8%			(\$8,308,249)

The fair value reflects the estimated amounts that the Company would receive or pay at September 30, 2006 to terminate the fixed price contracts, natural gas swap contracts, natural gas

collar contracts, or call options based on the estimated net cash flows under the terms of each contract. These estimated fair market values have no impact on earnings due to the regulated nature of the Company's operations. Based on the current regulatory process, any gains or losses arising from utility related financial instruments would be treated as part of the cost of gas sold.

Dividends

The Board of Directors declared a semi-annual dividend of 84.375 cents per share on the Company's 6-3/4 percent cumulative, redeemable, preferred shares, payable January 1, 2007 to the shareholders of record at the close of business on December 11, 2006.

The Board of Directors also declared a quarterly dividend of 20 cents per share on the Company's Common Shares, payable December 21, 2006 to shareholders of record at the close of business on December 5, 2006.

Other

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

Pacific Northern Gas Ltd. had 3,640,380 common shares and 200,000 preferred shares outstanding as of October 26, 2006. These are the only issued 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

October 26, 2006

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 September 30, 2006 have not been reviewed by an auditor.

PACIFIC NORTHERN GAS LTD.
CONSOLIDATED STATEMENTS OF INCOME
(in thousands)

	For the nine months ended September 30		For the three months ended September 30	
	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>
Operating revenues:				
Gas sales and transportation services	\$69,832	\$68,620	\$ 10,225	\$13,663
Off system sales	18,583	41,331	3,847	18,482
Other	4,243	378	1,778	93
	<u>92,658</u>	<u>110,329</u>	<u>15,850</u>	<u>32,238</u>
Cost of sales:				
Gas sales	40,420	34,594	4,765	5,258
Off system sales	18,583	41,331	3,847	18,482
	<u>59,003</u>	<u>75,925</u>	<u>8,612</u>	<u>23,740</u>
Operating margin	<u>33,655</u>	<u>34,404</u>	<u>7,238</u>	<u>8,498</u>
Operating and maintenance	7,658	8,201	2,402	2,609
Administrative and general	5,094	4,799	1,303	1,565
Amortization of deferred charges	518	564	155	135
Municipal and other taxes	3,567	3,090	1,187	1,030
Depreciation	5,710	6,011	1,866	2,007
	<u>22,547</u>	<u>22,665</u>	<u>6,913</u>	<u>7,346</u>
Operating income	11,108	11,739	325	1,152
Investment and other income	552	15	267	12
	<u>11,660</u>	<u>11,754</u>	<u>592</u>	<u>1,164</u>
Income deductions:				
Interest on long term debt	5,034	5,335	1,617	1,777
Interest on short term debt	572	222	190	115
Other income deductions	2,170	165	1,635	164
	<u>7,776</u>	<u>5,722</u>	<u>3,442</u>	<u>2,056</u>
Income (loss) before income taxes	<u>3,884</u>	<u>6,032</u>	<u>(2,850)</u>	<u>(892)</u>
Income taxes - Currently payable	9,429	2,289	(1,248)	(58)
- Deferred	(8,177)	394	(151)	(62)
	<u>1,252</u>	<u>2,683</u>	<u>(1,399)</u>	<u>(120)</u>
Net income (loss) for the period	<u>\$2,632</u>	<u>\$3,349</u>	<u>\$(1,451)</u>	<u>(\$772)</u>
For common shares:				
Net income (loss) for the period	\$2,632	\$3,349	\$(1,451)	(\$772)
Dividends on preferred shares	253	253	84	84
Net income (loss) applicable to common shares	<u>\$2,379</u>	<u>\$3,096</u>	<u>\$(1,535)</u>	<u>(\$856)</u>
Per common share:				
Basic	\$0.66	\$0.86	(\$0.42)	(\$0.24)
Diluted	\$0.65	\$0.84	(\$0.42)	(\$0.24)
Weighted average number of common shares outstanding:				
Basic	3,631,407	3,617,356	3,636,384	3,626,180
Diluted	3,676,816	3,676,510	3,678,378	3,679,336

PACIFIC NORTHERN GAS LTD.
CONSOLIDATED BALANCE SHEETS
AS AT SEPTEMBER 30, 2006 AND DECEMBER 31, 2005
(in thousands)

ASSETS	September 30, <u>2006</u>	December 31, <u>2005</u>
Current assets:		
Cash and short term investments	\$22,704	\$ —
Accounts receivable	4,516	28,831
Income taxes recoverable	—	375
Inventory of supplies and natural gas	1,531	2,688
Prepaid expenses	1,580	1,800
	30,331	33,694
Plant, property and equipment	172,493	171,351
Deferred charges:		
Debt expense	528	615
Rate stabilization adjustment mechanism	3,241	2,311
Pipeline rehabilitation costs	901	1,011
Deactivated assets	4,765	5,050
Other deferred charges (deferred credits)	(371)	1,178
	9,064	10,165
	\$211,888	\$215,210
LIABILITIES		
Current liabilities:		
Bank indebtedness	\$ —	\$ 10,159
Accounts payable and accrued liabilities	7,328	21,121
Gas purchase variance payable	4,352	881
Income and other taxes payable	9,092	3,263
Methanex Termination Payment deferral, current portion <i>[note 5]</i>	4,006	—
Long term debt due within one year	4,880	4,880
	29,658	40,304
Non-current liabilities	224	224
Methanex Termination Payment deferral non-current portion <i>[note 5]</i>	9,135	—
Long term debt, non-current portion	74,125	76,560
Deferred income taxes	15,430	15,430
	98,914	92,214
	128,572	132,518
SHAREHOLDERS' EQUITY		
Preferred shares <i>[note 3]</i>	5,000	5,000
Common shares <i>[note 4]</i>	9,101	9,065
Contributed surplus <i>[notes 1 and 4]</i>	3,131	2,828
Retained earnings	66,084	65,799
Common shareholders' equity	78,316	77,692
	83,316	82,692
	\$211,888	\$215,210

ON BEHALF OF THE BOARD

"Robert F. Chase"
Director

"Roy G. Dyce"
Director

PACIFIC NORTHERN GAS LTD.
CONSOLIDATED STATEMENTS OF RETAINED EARNINGS
(in thousands)

	For the nine months ended September 30		For the three months ended September 30	
	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>
Balance, beginning of period	\$65,799	\$62,374	\$68,263	\$64,879
Net income (loss) for the period	2,632	3,349	(1,451)	(772)
	<u>68,431</u>	<u>65,723</u>	<u>66,812</u>	<u>64,107</u>
Preferred Dividends	169	169	—	—
Common dividends	2,178	2,172	728	725
	<u>2,347</u>	<u>2,341</u>	<u>728</u>	<u>725</u>
Balance, end of period	<u>\$66,084</u>	<u>\$63,382</u>	<u>\$66,084</u>	<u>\$63,382</u>

CONSOLIDATED STATEMENTS OF CASH FLOW
(in thousands)

	For the nine months ended September 30		For the three months ended September 30	
	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>
Operating activities:				
Net income (loss) for the period	\$2,632	\$3,349	\$(1,451)	(\$772)
Add (deduct) items not involving cash				
Deferred income taxes	(8,177)	394	(151)	(62)
Depreciation and amortization	6,349	6,679	2,083	2,143
Amortization of Methanex Termination Payment deferral <i>[note 5]</i>	(3,878)	—	(1,667)	—
Stock option expense <i>[note 1]</i>	146	102	3	55
Other	9,748	(169)	838	217
Operating cash flow	<u>6,820</u>	<u>10,355</u>	<u>(345)</u>	<u>1,616</u>
Non-cash working capital changes <i>[note 9]</i>	<u>21,448</u>	<u>4,692</u>	<u>1,234</u>	<u>5,420</u>
Net cash provided by operating activities	<u>28,268</u>	<u>15,047</u>	<u>889</u>	<u>7,036</u>
Investing activities:				
Additions to plant, property and equipment	(5,660)	(3,759)	(3,702)	(1,558)
(Increase) decrease in deferred charges and credits	(527)	(860)	258	(390)
Methanex Termination Payment deferral	15,372	—	—	—
Net cash provided by (used in) investing activities	<u>9,185</u>	<u>(4,619)</u>	<u>(3,444)</u>	<u>(1,948)</u>
Financing activities:				
Decrease in bank indebtedness	(10,159)	(5,837)	—	(3,217)
Repayment of long term debt	(2,435)	(2,435)	(1,145)	(1,145)
Issue of common shares	192	185	182	—
Dividends paid	(2,347)	(2,341)	(728)	(725)
Net cash used in financing activities	<u>(14,749)</u>	<u>(10,428)</u>	<u>(1,691)</u>	<u>(5,088)</u>
Increase in cash during the period	22,704	—	—	—
Cash and short term investments, beginning of period	—	—	26,950	—
Cash and short term investments, end of period	<u>\$22,704</u>	<u>\$ —</u>	<u>\$22,704</u>	<u>\$ —</u>

Supplemental cash flow information [note 9]

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.

The consolidated financial statements include the accounts of Pacific Northern Gas Ltd., its wholly owned subsidiary Pacific Northern Gas (N.E.) Ltd., as well as the accounts of all incorporated and unincorporated joint ventures, to the extent of the Company interest in their respective assets, liabilities, revenue and expenses. All intercompany transactions and balances are eliminated on a pro rata basis for joint ventures.

Significant subsidiaries and joint ventures are as follows, as at September 30:

	Direct and Indirect Interest Held by the Company (percent)	
	2006	2005
Subsidiaries:		
Pacific Northern Gas (N.E.) Ltd.	100	100
Joint Ventures and Non-Controlled Partnerships [note 7]:		
Pacific Trail Pipelines Limited Partnership	50	—
Pacific Trail Pipelines Management Inc.	50	—

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, 2006, the Company issued 35,600 options at an exercise price of \$18.70. The compensation cost that has been charged against income (and credited to contributed surplus) in the quarter ended September 30, 2006 is \$3,000 [2005 - \$55,000] and represents expense for options issued in the current and previous periods which are being amortized over their vesting period.

The fair value of each option grant is estimated on the date of the grant using the Black-Scholes option pricing model with the following assumptions:

	Nine months ended September 30 2006	Three months ended September 30 2006
Risk free interest rate	4.15%	4.15%
Expected volatility (annualized)	28.2%	28.2%
Expected years of option life (average)	7.5	7.5
Expected annual rate of dividends	4.3%	4.3%

2. SEASONALITY

Due to the seasonal nature of natural gas sales, the Company generally reports net income in the first and fourth quarters of the year, and losses in the second and third quarters, reflecting 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 266,700 common shares, of which 207,060 are exercisable at September 30, 2006. There were 123,100 stock options outstanding at September 30, 2006 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.

During the quarter ended September 30, 2006, the Company issued 13,500 common shares for cash consideration of \$182,000 upon the exercise of employee options. Of this amount, \$149,000 has been credited to contributed surplus, representing the excess of the issue price over the par value of the shares.

5. METHANEX TERMINATION PAYMENT DEFERRAL

On August 30, 2005, Methanex Corporation gave notice of termination of its Firm and Interruptible Gas Transportation Service Agreement with the Company. Under the terms of the agreement, Methanex made a termination payment to the Company of approximately \$23.3 million on February 28, 2006, the effective date of the termination. As approved by the British Columbia Utilities Commission, the termination payment has been recorded, net of income taxes of \$7.96 million, as an interest bearing credit deferral, and will be amortized into income over the period from March 1, 2006 to October 31, 2009. For the three month and nine month periods ended September 30, 2006, \$1.7 million and \$3.9 million of the termination payment has been included in other operating revenues, respectively.

6. COMMITMENTS

The Company's purchase commitments at September 30, 2006 under various gas supply and transportation service contracts expiring through 2010 were as follows:

(in thousands)	
2006	\$22,460
2007	39,534
2008	4,834
2009	835
2010	52
Thereafter	—
Total	<u>\$67,715</u>

7. JOINT VENTURES

In 2005 the Company commenced preliminary study and investigation of a project to loop its main line transmission system from Kitimat to Summit Lake (the "KSL Project"). On July 17, 2006, the Company announced the formation of Pacific Trail Pipelines Limited Partnership, an equal partnership between the Company and Galveston LNG Inc., the parent company of Kitimat LNG Inc., for the purpose of developing the KSL Project.

The following amounts represent the Company's proportionate interest in Pacific Trail Pipelines Limited Partnership and its general partner, Pacific Trail Pipelines Management Inc. at September 30, 2006:

(in thousands)	At September 30, 2006
Balance Sheet	
Current assets	<u>\$308</u>
Non-current assets	<u>—</u>
Current liabilities	<u>(395)</u>
Non-current liabilities	<u>—</u>
For the period from July 14, 2006 to September 30, 2006	
Income Statement	
Revenues	—
Expenses	<u>1,997</u>
Net loss	<u>(1,997)</u>
Cash Flow	
Cash Provided by (Used In):	
Operations	(\$477)
Financing	697
Investments	—
Proportionate share of increase in cash of joint ventures	<u>220</u>

8. RELATED PARTY TRANSACTIONS

Accounts receivable at September 30, 2006 include \$48,000 due from Pacific Trail Pipelines Limited Partnership, and relate to expenditures made by the Company which are to be reimbursed by the partnership.

9. SUPPLEMENTAL CASH FLOW INFORMATION

(in thousands)	For the nine months ended September 30		For the three months ended September 30	
	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>
Depreciation and amortization:				
Depreciation, per income statement	\$5,710	\$6,011	1,867	\$2,008
Amortization of deferred charges, per income statement	520	564	156	135
Amortization of debt issue costs, included in long term interest expense	87	105	29	35
Total depreciation and amortization	\$6,317	\$6,680	\$2,052	\$2,178
Non-cash working capital changes:				
(Increase) decrease in:				
Accounts receivable	\$24,315	\$8,712	\$4,104	\$891
Income taxes recoverable	375	(36)	—	(398)
Inventories of supplies and natural gas	1,157	(175)	846	270
Prepaid expenses	220	(1,105)	(967)	888
Increase (decrease) in:				
Accounts payable and accrued liabilities	(13,792)	(2,329)	890	3,664
Gas purchase variance payable	3,344	25	495	285
Income and other taxes payable	5,829	(400)	(4,134)	(181)
Attributable to operating activities	\$21,448	\$4,692	1,234	5,419
Interest and tax payments:				
Income taxes paid	\$1,957	\$2,326	\$511	\$750
Interest paid	\$4,661	\$4,740	\$1,202	\$1,209

10. COMPARATIVE FIGURES

Certain items in the consolidated financial statements have been reclassified to conform to the 2006 presentation.

**PACIFIC NORTHERN GAS LTD.
FORM 52-109F2
MODIFIED CERTIFICATION OF INTERIM FILINGS DURING TRANSITION PERIOD**

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

1. I have reviewed the interim filings (as this term is defined in Multilateral Instrument 52-109 *Certification of Disclosure in Issuers' Annual and Interim Filings*) of Pacific Northern Gas Ltd., (the issuer) for the interim period ended September 30, 2006;
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; and
4. The issuer's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures for the issuer, and we have designed such disclosure controls and procedures, or caused them to be designed under our supervision, to provide reasonable assurance that material information relating to the issuer, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which the interim filings are being prepared.

"Roy G. Dyce"

Roy G. Dyce
Chief Executive Officer

Date: October 27, 2006

PACIFIC NORTHERN GAS LTD.
FORM 52-109F2
MODIFIED CERTIFICATION OF INTERIM FILINGS DURING TRANSITION PERIOD

I, Elizabeth A. Fletcher, the Chief Financial Officer of Pacific Northern Gas Ltd., certify that:

1. I have reviewed the interim filings (as this term is defined in Multilateral Instrument 52-109 *Certification of Disclosure in Issuers' Annual and Interim Filings*) of Pacific Northern Gas Ltd., (the issuer) for the interim period ended September 30, 2006;
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; and
4. The issuer's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures for the issuer, and we have designed such disclosure controls and procedures, or caused them to be designed under our supervision, to provide reasonable assurance that material information relating to the issuer, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which the interim filings are being prepared.

"Elizabeth A. Fletcher"

Elizabeth A. Fletcher
Chief Financial Officer

Date: October 27, 2006