



interim statement

For the Three Months Ended June 30, 2006

July 27, 2006

Pacific Northern Gas Ltd.
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Pacific Northern Gas Ltd.
MANAGEMENT'S DISCUSSION AND ANALYSIS
for the Three Months Ended June 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; 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. 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 and second quarters of 2006. Average spot commodity prices during the six months ended June 2006 were approximately 26 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 any required 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 obtaining federal permits for the Terminal, 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.

Negotiated Settlement of 2006 Revenue Requirements Applications

On March 15, 2006 settlements of the 2006 revenue requirement applications for all of the Company's operating divisions were reached between the Company and customer representatives, except one item of dispute for the western system, through a negotiated settlement process facilitated by staff of the British Columbia Utilities Commission (the "Commission"). The terms of the settlements and letters of comment from the participants in the process were made public at the end of March, 2006 and considered by the Commission in early April, 2006. The Commission issued an Order on April 10, 2006 setting out the terms of a written process to review the one matter in dispute. The issue concerns the recovery in customer rates of the 2006 revenue deficiency due to the termination by Methanex Corporation ("Methanex") of its transportation contract with the Company. The Commission issued another Order on June 28, 2006 setting out a final written argument process to be completed on July 24, 2006. This final process is expected to result in the Commission rendering a decision on the 2006 revenue requirements applications in the third quarter of 2006.

Income Trust Decision

By decision dated September 9, 2005 and modified on October 28, 2005 (together the "income trust decision"), 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 June 30, 2006 was \$0.8 million, compared with net income of \$0.1 million for the corresponding period in 2005. After providing for preferred share dividends, the loss per common share in the three months ended June 30, 2006 was \$0.25 compared with earnings per common share of \$0.02 for the same period in 2005. Net loss for the three months ended June 30, 2006 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.

Included in net loss for the three months ended June 30, 2006 are charges amounting to \$0.3 million and \$0.1 million, relating to a write down of KSL Project development expenditures deferred in 2005 and the first quarter of 2006, respectively. The Company's development expenditures on the KSL Project had been deferred with approval of the Commission. However, with the creation of PTP, these costs will now be transferred and expensed in the partnership, which is not yet a public utility able to defer the KSL Project costs. The Company's share of further KSL Project costs in 2006 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 two quarters of 2006 are expensed, earnings will be further reduced by an estimated \$1.9 million, or 53 cents per share.

Net income for the six months ended June 30, 2006 was \$4.1 million, unchanged from the corresponding period in 2005. After providing for preferred share dividends, earnings per common share in the six months ended June 30, 2006 were \$1.08 compared with \$1.09 for the same period in 2005.

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 \$0.4 million and \$0.8 million for the three month and six month periods ended June 30, 2006, respectively.

Residential deliveries were 7 percent lower in the three months ended June 30, 2006, and were 10 percent lower in the six months ended June 30, 2006, relative to deliveries over the same periods in 2005. The reductions in deliveries to residential customers in the first two quarters of 2006 may be due to a reaction by customers to increased prices which averaged 20 percent higher in the second quarter of 2006 relative to the same period in 2005. Commercial deliveries remained unchanged in the three months ended June 30, 2006 and were 1 percent lower in the six months ended June 30, 2006, compared to the same period in 2005. Weather in the second quarter of 2006 was approximately 1 percent colder compared to the same period in 2005, however weather for the six months ended June 30, 2006 was approximately 1 percent warmer, compared to the same period in 2005. The weather was 21 percent and 9 percent warmer than normal for the three month and six month periods ended June 30, 2006, respectively.

Industrial deliveries were lower by 81 percent and 79 percent for the three month and six month periods ended June 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 six month periods ended June 30, 2006 were 4 percent higher and 4 percent lower, respectively, than 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 June 30, 2006 decreased to \$20.2 million, as compared with \$30.3 million in the corresponding period in 2005. The decrease in operating revenues was primarily due to a reduction in revenues from the sale of gas surplus to the needs of the Company's sales customers ("off system gas sales") of \$10.2 million as well as a reduction in transportation services revenue from Methanex of \$4.2 million, offset by higher gas supply costs embedded in sales customers' rates 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.

Operating revenues in the first six months of 2006 decreased to \$76.8 million as compared with \$78.1 million in the first six months of 2005. The decrease in operating revenues was primarily due to a reduction in off system gas sales of \$8.1 million, offset by an increase of \$6.3 million in gas supply costs embedded in sales customers rates, compared with the corresponding period in 2005.

Operating margin in the three months ended June 30, 2006 decreased to \$9.1 million, as compared with \$9.8 million in the same period in 2005. The lower operating margin in the second 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 \$0.7 million lower in the second quarter of 2006 than in the same period in 2005.

Operating margin in the first six months of 2006 increased to \$26.4 million, as compared with \$25.9 million in the first six months of 2005. The higher operating margin in the first six months of 2006 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. Consequently, the Company's operating margin is approximately \$0.6 million higher in the first six months of 2006 than in the same period in 2005. Accordingly, assuming all other things remained equal, the Company would expect to record \$0.6 million less operating margin during the last six months of 2006 relative to the same period in 2005.

The Company filed a report with the Commission in June 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 effective July 1, 2006 to decrease gas rates for customers. The decreases applicable to residential customer rates were \$0.77 per gigajoule (or 5 percent) in the PNG-West division, \$0.91 per gigajoule (8 percent) in the Fort St. John/Dawson Creek division and \$0.45 per gigajoule (3 percent) in the Tumbler Ridge division.

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

<i>Thousands of dollars except per share amounts</i>	June 30, 2006	Mar 31, 2006	Dec 31, 2005	Sept 30, 2005	June 30, 2005	Mar 31, 2005	Dec 31, 2004	Sept 30, 2004
Operating Revenues	\$20,203	\$56,605	\$49,621	\$32,238	\$30,293	\$47,798	\$40,757	\$25,169
Net income (loss) ¹	(837)	4,920	3,311	(772)	137	3,984	2,670	(1,427)
- per share ²	(.25)	1.33	0.89	(0.24)	0.02	1.08	0.72	(0.42)
- per share diluted ²	(.25)	1.31	0.88	(0.24)	0.01	1.06	0.71	(0.42)

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 June 30, 2006, the calculated borrowing base was \$10.7 million, of which \$1.6 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 June 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 June 30, 2006 are \$27.0 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 June 30, 2006 are \$20.2 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 second quarter are \$14.7 million lower due to lower commodity prices for natural gas in June, 2006 compared to December, 2005. Income and other taxes payable at June 30, 2006 are \$10.3 million higher than at December 31, 2006 primarily due to the current tax liability associated with the receipt of the Methanex Termination Payment.

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 are 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 two quarters of 2006 are approximately \$7 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 PTP is expected to be approximately \$3.0 million in the last two quarters of 2006. The Company expects to finance these expenditures from existing cash balances.

Off-Balance Sheet Arrangements

As of June 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

The Company has not had any transactions with related parties during 2006.

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 June 30, 2006 comprise 1.9 percent of the Company's operating revenues for the six month period ended June 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.

Operating revenues for the three month and six month periods ended June 30, 2006 are based on the rates which reflect the Company's best estimate of the rates which will be approved by the Commission. These rates were recently agreed between the Company and customer

representatives under negotiated settlements, save for one item of dispute for PNG-West which is being addressed by the Commission via a written process, with a final determination of the 2006 rates expected before the end of the third quarter of 2006.

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, 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 June 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	336,425	3.40%	Nov. 2006 to Mar. 2007	\$7.23 to \$8.01	\$311,962
Natural gas swap contracts	2,457,400	24.87%	July 2006-Mar. 2008	\$7.50 to \$9.75	(1,088,596)
Natural gas collar contracts	120,500	1.22%	Nov. 2006 – Mar. 2007	Floors from \$8.25; Caps to \$10.20	(10,918)
Call options	307,500	3.11%	April-Oct. 2006	Caps from \$13.10 to \$14.00	1,971
Total	3,221,825	32.61%			(\$785,581)

The fair value reflects the estimated amounts that the Company would receive or pay at June 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 also declared a quarterly dividend of 20 cents per share on the Company's Common Shares, payable September 25, 2006 to shareholders of record at the close of business on September 8, 2006.

Other

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

Pacific Northern Gas Ltd. had 3,626,880 common shares and 200,000 preferred shares outstanding as of July 27, 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

July 27, 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 June 30, 2006 have not been reviewed by an auditor.

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>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>
Operating revenues:				
Gas sales and transportation services	\$59,607	\$54,957	\$15,828	\$17,330
Off system sales	14,736	22,849	2,566	12,799
Other	2,465	285	1,809	164
	<u>76,808</u>	<u>78,091</u>	<u>20,203</u>	<u>30,293</u>
Cost of sales:				
Gas sales	35,655	29,336	8,541	7,719
Off system sales	14,736	22,849	2,566	12,799
	<u>50,391</u>	<u>52,185</u>	<u>11,107</u>	<u>20,518</u>
Operating margin	<u>26,417</u>	<u>25,906</u>	<u>9,096</u>	<u>9,775</u>
Operating and maintenance	5,256	5,592	2,644	2,683
Administrative and general	3,791	3,234	1,678	1,542
Amortization of deferred charges	363	429	178	215
Municipal and other taxes	2,380	2,060	1,192	1,030
Depreciation	3,844	4,004	1,922	2,015
	<u>15,634</u>	<u>15,319</u>	<u>7,614</u>	<u>7,485</u>
Operating income	10,783	10,587	1,482	2,290
Investment and other income	285	3	203	(1)
	<u>11,068</u>	<u>10,590</u>	<u>1,685</u>	<u>2,289</u>
Income deductions:				
Interest on long term debt	3,417	3,558	1,711	1,785
Other	917	108	733	(14)
	<u>4,334</u>	<u>3,666</u>	<u>2,444</u>	<u>1,771</u>
Income (loss) before income taxes	<u>6,734</u>	<u>6,924</u>	<u>(759)</u>	<u>518</u>
Income taxes - Currently payable	10,677	2,347	(399)	50
- Deferred	(8,026)	456	477	331
	<u>2,651</u>	<u>2,803</u>	<u>78</u>	<u>381</u>
Net income (loss) for the period	<u>\$4,083</u>	<u>\$4,121</u>	<u>(\$837)</u>	<u>\$137</u>
For common shares:				
Net income (loss) for the period	\$4,083	\$4,121	(\$837)	\$137
Dividends on preferred shares	169	169	85	85
Net income (loss) applicable to common shares	<u>\$3,914</u>	<u>\$3,952</u>	<u>(\$922)</u>	<u>\$52</u>
Per common share:				
Basic	\$1.08	\$1.09	(\$0.25)	\$0.02
Diluted	\$1.06	\$1.08	(\$0.25)	\$0.01
Weighted average number of common shares outstanding:				
Basic	3,626,617	3,612,870	3,626,761	3,617,098
Diluted	3,677,673	3,674,513	3,679,170	3,669,441

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

ASSETS	June 30, 2006	December 31, 2005
Current assets:		
Cash and short term investments	\$26,950	\$ —
Accounts receivable	8,620	28,831
Income taxes recoverable	—	375
Inventory of supplies and natural gas	2,377	2,688
Prepaid expenses	613	1,800
	38,560	33,694
Plant, property and equipment	169,464	171,351
Deferred charges:		
Debt expense	557	615
Rate stabilization adjustment mechanism	3,213	2,311
Pipeline rehabilitation costs	931	1,011
Deactivated assets	4,861	5,050
Other	1,099	1,178
	10,661	10,165
	\$218,685	\$215,210
LIABILITIES		
Current liabilities:		
Bank indebtedness	\$ —	\$ 10,159
Accounts payable and accrued liabilities	6,439	21,121
Gas purchase variance payable	3,800	881
Income and other taxes payable	13,226	3,263
Methanex Termination Payment deferral, current portion	3,948	—
Long term debt due within one year	4,880	4,880
	32,293	40,304
Non-current liabilities	224	224
Long term debt, non-current portion	75,270	76,560
Methanex Termination Payment deferral non-current portion	10,158	—
Deferred income taxes	15,430	15,430
	101,082	92,214
	133,375	132,518
SHAREHOLDERS' EQUITY		
Preferred shares	5,000	5,000
Common shares	9,067	9,065
Contributed surplus	2,980	2,828
Retained earnings	68,263	65,799
Common shareholders' equity	80,310	77,692
	85,310	82,692
	\$218,685	\$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 six months ended June 30		For the three months ended June 30	
	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>
Balance, beginning of period	\$65,799	\$62,374	\$69,994	\$65,636
Net income (loss) for the period	4,083	4,121	(837)	137
	<u>69,882</u>	<u>66,495</u>	<u>69,157</u>	<u>65,773</u>
Preferred Dividends	169	169	169	169
Common dividends	1,450	1,447	725	725
	<u>1,619</u>	<u>1,616</u>	<u>894</u>	<u>894</u>
Balance, end of period	<u>\$68,263</u>	<u>\$64,879</u>	<u>\$68,263</u>	<u>\$64,879</u>

CONSOLIDATED STATEMENTS OF CASH FLOW
(in thousands)

	For the six months ended June 30		For the three months ended June 30	
	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>
Operating activities:				
Net income (loss) for the period	\$4,083	\$4,121	(\$837)	\$ 137
Add (deduct) items not involving cash				
Deferred income taxes	(8,026)	456	477	331
Depreciation and amortization	4,266	4,501	2,129	2,263
Amortization of Methanex Termination Payment deferral	(2,211)	—	(1,659)	—
Stock option expense	143	47	22	24
Other	8,910	(386)	208	(297)
Operating cash flow	<u>7,165</u>	<u>8,739</u>	<u>340</u>	<u>2,458</u>
Non-cash working capital changes	<u>20,214</u>	<u>(727)</u>	<u>13,262</u>	<u>3,112</u>
Net cash provided by operating activities	<u>27,379</u>	<u>8,012</u>	<u>13,602</u>	<u>5,570</u>
Investing activities:				
Additions to plant, property and equipment	(1,958)	(2,201)	(1,067)	(1,113)
Increase in deferred charges and credits	(785)	(470)	(86)	(323)
Methanex Termination Payment deferral	15,372	—	—	—
Net cash provided by (used in) investing activities	<u>12,629</u>	<u>(2,671)</u>	<u>(1,153)</u>	<u>(1,436)</u>
Financing activities:				
Decrease in bank indebtedness	(10,159)	(2,620)	—	(2,723)
Repayment of long term debt	(1,290)	(1,290)	(645)	(645)
Issue of common shares	10	185	10	128
Dividends paid	(1,619)	(1,616)	(894)	(894)
Net cash used in financing activities	<u>(13,058)</u>	<u>(5,341)</u>	<u>(1,529)</u>	<u>(4,134)</u>
Increase in cash during the period	26,950	—	10,920	—
Cash and short term investments, beginning of period	—	—	16,030	—
Cash and short term investments, end of period	<u>\$26,950</u>	<u>\$ —</u>	<u>\$26,950</u>	<u>\$ —</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, 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 June 30, 2006 is \$22,000 [2005 - \$24,000] 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:

	Six months ended June 30 2006	Three months ended June 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 289,300 common shares, of which 218,580 are exercisable as at June 30, 2006. There were 96,000 stock options outstanding at June 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 June 30, 2006, the Company issued 700 common shares for cash consideration of \$9,645 upon the exercise of employee options. Of this amount, \$7,895 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. Under the terms of a negotiated settlement with registered intervenors and approved by the British Columbia Utilities Commission on November 17, 2005, 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 six month periods ended June 30, 2006, \$1.7 million and \$2.2 million of the termination payment has been included in other operating revenues, respectively.

6. COMMITMENTS

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

(\$ in thousands)

2006	\$10,741
2007	7,251
2008	5,163
2009	835
2010	51
Thereafter	—

7. KSL PROJECT DEVELOPMENT COSTS

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. The Company's development expenditures to date on the KSL Project had been deferred, net of income taxes, with approval of the British Columbia Utilities Commission. However, commencing in July 2006 these costs will be transferred and expensed in the Partnership, which is not yet a public utility able to defer the KSL Project costs. As a result, deferred KSL Project expenditures, net of income taxes, have been included in Other income deductions for the quarter ended June 30, 2006, as follows:

Period in which amounts were deferred	(\$ in thousands)
2005	\$300
First quarter, 2006	126
Second quarter, 2006	109
Total	535

8. COMPARATIVE FIGURES

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

**PACIFIC NORTHERN GAS LTD.
FORM 52-109FM2
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 June 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: July 28, 2006

**PACIFIC NORTHERN GAS LTD.
FORM 52-109FM2
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 June 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: July 28, 2006