



# **interim statement**

**For the Three Months Ended June 30, 2007**

**July 26, 2007**

Pacific Northern Gas Ltd.  
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# Pacific Northern Gas Ltd.

## MANAGEMENT'S DISCUSSION AND ANALYSIS for the Three Months Ended June 30, 2007

### FORWARD-LOOKING STATEMENTS

This MD&A includes forward-looking statements. Forward-looking statements relate to, among other things, anticipated financial performance, business prospects, strategies, regulatory developments, new services, market forces, commitments and technological developments. Many of these statements can be identified by words such as "believe", "expects", "expected", "will", "intends", "projects", "anticipates", "estimates", "continues" or similar words. The Company believes the expectations reflected in such statements are reasonable but no assurance is given that such expectations will be correct. All forward-looking statements are based on management's beliefs and assumptions based on information available at the time the assumption was made and on its experience and perception of historical trends, current conditions and expected further developments as well as other factors deemed appropriate in the circumstances. In addition to other assumptions made in this MD&A, assumptions have been made in respect of:

- commodity prices;
- forecasted deliveries;
- regulatory conditions, including decisions by the British Columbia Utilities Commission (the "Commission");
- the Company's ability to access capital;
- capital expenditure estimates, plans, schedules and activities and the development, construction, operations and cost of facilities and infrastructure;
- operations and throughput levels;
- income tax considerations;
- operating risks and related insurance coverage and inspection and integrity systems; and
- competitive conditions.

By its nature, such forward-looking information is subject to various risks and uncertainties that are known and unknown, including those material risks discussed in this MD&A and in the Company's 2007 annual information form under "Risk Factors" which could cause the Company's actual results and experience to differ materially from the anticipated results or other expectations expressed. Such risks and uncertainties include but are not limited to: general economic conditions and markets; gas supply and availability; gas 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. Readers are cautioned not to place undue reliance on this forward-looking information, which is given as of the date it is expressed in this MD&A or otherwise, and the Company undertakes no obligation to update publicly or revise any forward-looking information, whether as a result of new information, future events or otherwise.

### Business of the Company

The Company continues to monitor the competitiveness of its natural gas retail rates relative to alternative heating sources in its service area. Substantial increases in gas supply commodity prices over the last few years, combined with increases in the Company's delivery margins for residential, commercial and small industrial customers in the Western system service area, have led to retail gas rates which are similar to, or higher in the case of residential customers, than comparable electricity rates.

Prior to 2006, high natural gas prices and weak economic conditions faced by the Company's customer base in the Western system service area had reduced the quantity of gas sold and delivered to the Company's customers in that area. Currently, natural gas prices are more competitive with other heating sources compared to late 2005 and early 2006 and the economy in the Western system service area is beginning to show improvement, evidenced through significant increases in building permits and selling prices of residential homes., as reported by BC Stats and the Northern B.C. Real Estate Board. The economy in the Northeast system service area continues to grow as a result of activity in the oil and gas exploration sector, which is reflected in customer additions in that area.

In 2005 the Company commenced preliminary study and investigation of a project to loop its mainline 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 approximately 15 kilometers southwest of Kitimat, and 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 to \$1.2 billion.

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

On February 28, 2007 the British Columbia Environmental Assessment Office ("EAO") issued an order under section 11 of the Environmental Assessment Act in relation to the KSL Project. This order set out the formal scope, procedures and methods for the environmental assessment of the KSL Project. The EAO issued the approved Terms of Reference on May 18, 2007 which specified the information that must be contained in the environmental application. On July 24, 2007 PTP filed the Environmental Assessment Certificate application for the KSL Project.

Management anticipates that construction of the KSL Project facilities by PTP will commence in the fourth quarter 2008. Commencement of construction is subject to a number of conditions including the securing of LNG supply by Kitimat LNG Inc., financing for the construction of the Terminal and the KSL Project, and regulatory approvals for the KSL Project. The regulatory requirements for the KSL Project include an Environmental Assessment Certificate to be obtained through the Province of British Columbia's environmental assessment process, approvals under the Canadian Environmental Assessment Act, a Certificate of Public Convenience and Necessity from the Commission and other permits required from the B.C. Oil and Gas Commission. The Company can give no assurances that these conditions will be satisfied or that construction of the KSL Project by PTP will proceed.

### **Decisions on 2007 Revenue Requirements Applications**

In late May 2007 the Company received decisions from the Commission on the Company's 2007 revenue requirements applications for its PNG-West division and for Pacific Northern Gas (N.E.) Ltd. ("PNG(N.E.)"), its wholly owned subsidiary. PNG(N.E.) is comprised of the Fort St. John/Dawson Creek and Tumbler Ridge divisions. The Commission's decisions contained minor adjustments to the applied for 2007 cost of service for ratemaking purposes in each division. The Commission therefore agreed to implement the decisions by making the interim rates permanent effective January 1, 2007 with minor rate adjustments effective July 1, 2007 for the Fort St. John/Dawson Creek division. Deferral accounts were set up in the PNG-West and Tumbler Ridge divisions for disposition in 2008 of the difference between the 2007 cost of service under the interim rates and the 2007 cost of service approved by the Commission in the decisions. A debit of approximately \$50,000 before income taxes and a credit of approximately \$50,000 before income taxes were recorded in the PNG-West and Tumbler Ridge division deferral accounts, respectively. In the decision for the PNG-West division the Commission also approved the Company's request to credit \$0.9 million of deferred income taxes to the 2007 cost of service.

The Company sought approval in the PNG-West 2007 revenue requirements application to commence amortizing in rates the costs incurred by the Commission and intervenors during the 2005 income trust application hearing of approximately \$256,000, before income taxes. The Commission denied recovery of these costs. The impact of the Commission's decisions on earnings previously reported to March 31, 2007 is a reduction of approximately \$170,000, all of which relates to the Commission's denial of the recovery of the 2005 income trust application hearing costs and is included, net of income taxes, in the income statement in project development expenditures and other income deductions.

### **Skeena River pipeline break**

On June 9, 2007, the natural gas service to the communities of Prince Rupert and Port Edward was impaired when the mainline transmission pipe was severed due to the extreme flood condition of the Skeena River. Service to 24 commercial and industrial customers was interrupted for four days. Repairs were completed on July 13, 2007 with the installation of a four inch temporary pipeline, and service was restored to all customers at that time. The cost of the temporary repairs, totalling approximately \$221,000 net of income taxes, was deferred as line break expense and the Company has applied to the Commission for a ten-year amortization period, commencing in 2008. A permanent repair of the pipeline break is expected to be completed in 2008.

### **Overall Performance**

Net loss for the three months ended June 30, 2007 was \$0.8 million, unchanged from the same period in 2006. After providing for preferred share dividends, the loss per common share in the three months ended June 30, 2007 was \$0.24 compared with a loss per common share of \$0.25 for the same period in 2006.

Included in the net losses for the three month periods ended June 30, 2007 and 2006 are charges, net of income taxes, of \$0.4 million and \$0.5 million, respectively for the Company's share of KSL Project development expenditures incurred by PTP.

Lower deliveries to large commercial and small industrial customers in the three months ended June 30, 2007 relative to the same period in 2006 accounted for a \$0.1 million decrease in net income. Variances in deliveries to these customer classes are not subject to regulatory deferral accounts. In addition, net income for the quarter was reduced by \$0.2 million as a result of the Commission's decision to disallow the recovery of certain 2005 income trust hearing costs. Offsetting these effects on net income in the second quarter of 2007 is the drawdown of \$0.2 million of deferred income taxes approved by the Commission.

Net income for the six months ended June 30, 2007 was \$3.1 million, compared to \$4.1 million for the corresponding period in 2006. After providing for preferred share dividends, earnings per common share in the six months ended June 30, 2007 were \$0.81 compared with \$1.08 for the same period in 2006. Net income for the six months ended June 30, 2007 was lower compared to 2006 by approximately \$0.3 million due to the timing of the receipt of transportation services revenue from Methanex Corporation ("Methanex") in the first two months of 2006 prior to the termination of the Methanex contract on February 28, 2006. Included in net income for the six months ended June 30, 2007 and 2006 are charges, net of income taxes, of \$0.7 million and \$0.5 million, respectively for the Company's share of KSL Project development expenditures incurred by PTP. Lower deliveries to large commercial and small industrial customers in the six months ended June 30, 2007 relative to the same period in 2006 accounted for a \$0.2 million decrease in net income. In addition, net income for the period was reduced by \$0.2 million as a result of the Commission's decision to disallow the recovery of certain 2005 income trust hearing costs.

The Company's share of development expenditures for the KSL Project in the last six months of 2007 is expected to be approximately \$1.2 million before income taxes (\$0.22 per share, net of

income taxes) of which \$0.8 million before income taxes (\$0.15 per share, net of income taxes) is expected to be incurred in the third quarter of 2007. The Company's share of further KSL Project development expenditures will continue to be expensed until suitable commercial arrangements for firm gas transportation services by PTP are in place.

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 decreased by \$0.1 million for the three month period ended June 30, 2007 and increased by \$0.1 million for the six month period ended June 30, 2007.

Residential deliveries were higher by approximately 29 percent and 11 percent in the three month and six month periods ended June 30, 2007, respectively, relative to deliveries over the same period in 2006. Total commercial deliveries were higher by 15 percent and 3 percent in the three month and six month periods ended June 30, 2007, respectively, relative to deliveries over the same period in 2006. Management estimates that weather was a key factor in the increase in residential and small commercial deliveries, as it was approximately 27 percent and 8 percent colder for the three month and six month periods ended June 30, 2007, respectively, compared to the same periods in 2006. On the other hand, the weather was 3 percent colder and 1 percent warmer than normal for the three month and six month periods ended June 30, 2007, respectively, with "normal" based on the average of actual temperatures in the regions served by the Company for the preceding 10 years.

Deliveries to small industrial customers were lower by 16 percent and 11 percent for the three month and six month periods ended June 30, 2007 compared to the same periods in 2006. The reductions in small industrial customer deliveries relates primarily to customers in the forestry industry. Variances in deliveries to small industrial customers are not subject to regulatory deferral accounts.

Deliveries to large industrial customers were higher by approximately 52 percent and 38 percent for the three month and six month periods ended June 30, 2007, respectively, compared to the same periods in 2006. The West Fraser Mills pulp mill in Kitimat required more gas in conjunction with the start up of a new electric turbine. It is not certain how long the West Fraser higher gas requirements will continue. In addition, deliveries to the British Columbia Hydro and Power Authority ("BC Hydro") emergency back up electricity generating facility in Prince Rupert were higher in April as a result of the failure of a BC Hydro transmission tower. Deliveries to BC Hydro returned to normal levels in May and June. A deferral account is in place to record margin differences resulting from deliveries to large industrial customers in the PNG-West system varying from the forecast deliveries approved for ratemaking purposes.

## **Results of Operations**

Operating revenues in the three months ended June 30, 2007 decreased to \$17.9 million, as compared with \$20.2 million in the corresponding period in 2006. The decrease in operating revenues was primarily due to a decrease of \$1.6 million in revenues from the sale of gas surplus to the needs of the Company's sales customers ("off system gas sales"), as well a \$0.3 million reduction in gas cost recoveries from sales customers, offset by an increase in transportation services revenue of \$0.3 million, compared with the corresponding period in 2006. Any profit or loss realized on off system gas sales is deferred for future recovery from, or refund to, the Company's sales customers. The decrease in off system gas sales in the second quarter of 2007 reflects the impact of a reduction in the quantity of gas supply purchased on a committed basis in 2007 compared to 2006 as well as increased deliveries to sales customers during the period. 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.

Operating revenues in the first six months of 2007 increased to \$76.9 million as compared with \$76.8 million in the first six months of 2006. The slight increase in operating revenues was primarily due to an increase in off system gas sales of \$9.8 million and an increase of \$1.1 million in Methanex termination payment amortization, offset by a decrease of \$1.4 million in transportation services revenue and a decrease of \$7.8 million in gas supply costs recovered from sales customers, compared with the corresponding period in 2006.

Operating margin in the three months ended June 30, 2007 decreased to \$8.8 million, as compared with \$9.1 million in the same period in 2006. The lower operating margin in the second quarter is primarily the result of lower deliveries to small industrial customers.

Operating margin in the six months ended June 30, 2007 decreased to \$24.5 million, as compared with \$26.4 million in the same period in 2006. The lower operating margin in the first six months of 2007 is primarily the result of transportation services revenue from Methanex being higher in 2006 by approximately \$0.7 million, before income taxes, as the Methanex contract did not terminate until February 28, 2006. In addition, an annual cost of service reduction, relative to 2006, of approximately \$3 million will be reflected in lower 2007 annual operating margin, of which \$1.1 million of the reduction occurred in the first six months of 2007. The reductions in the regulated cost of service include lower amortization, property tax, insurance and maintenance expenses, as well as a credit of \$0.9 million of deferred income taxes to the 2007 cost of service.

Included in project development expenditures and other income deductions for the three month and six month periods ended June 30, 2007 are the Company's before tax share of KSL Project development expenditures expensed by PTP amounting to \$0.6 million and \$1.1 million, respectively.

The Company filed a report with the Commission in June 2007 on past and projected gas supply costs compared to gas cost recoveries from customers. On the basis of the report the Commission issued a letter accepting the Company's recommendation that no changes be made to gas cost rates currently in effect in all of the Company's service areas.

### Summary of Quarterly Results for Eight Quarters Ending June 30, 2007

<i>Thousands of dollars except per share amounts</i>	June 30, 2007	Mar. 31 2007	Dec. 31 2006	Sept 30, 2006	June 30, 2006	Mar 31, 2006	Dec 31, 2005	Sept 30, 2005
Operating Revenues	\$17,934	\$58,960	\$46,190	\$15,850	\$20,203	\$56,605	\$49,621	\$32,238
KSL expenditures, net of income taxes	(367)	(345)	(556)	(575)	(536)	—	—	—
Net income (loss) <sup>1</sup>	(799)	3,927	2,319	(1,451)	(837)	4,920	3,311	(772)
Earnings per share <sup>2</sup>	(\$0.24)	\$1.06	\$0.61	(\$0.42)	(\$0.25)	\$1.33	\$0.89	(\$0.24)
- per share diluted <sup>2</sup>	(\$0.24)	\$1.04	\$0.60	(\$0.42)	(\$0.25)	\$1.31	\$0.88	(\$0.24)

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

<sup>2</sup> 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. Deliveries to residential and commercial customers tend to be more temperature sensitive than deliveries to industrial customers, with deliveries in the first and fourth quarters accounting for more than 75 percent of annual deliveries. 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's credit facilities include a \$20 million operating line and a \$15 million risk management facility. The operating line is subject to borrowing base requirements and financial covenants. As of June 30, 2007, the calculated borrowing base was approximately \$14.0 million, of which \$1.9 million had been used. On July 11, 2007 the Company closed a new, more flexible, \$20 million operating line with its existing operating lender. Amounts drawn on the new operating line will remain subject to the borrowing base cap. The improved terms of the operating line include the elimination of financial covenants which limited the Company's flexibility, with the new line having a single financial covenant where the Company's debt leverage is not to exceed 65 percent, or approximately the same level currently approved by the Commission. The Company's current actual debt leverage is approximately 50 percent. The new operating line is collateralized by a pledge of the Company's accounts receivables and inventories.

With the removal of the restrictive financial maintenance covenants in the new operating line, the Company's debt rating was taken off Under Review with Negative Implications and confirmed at BBB(low) – Negative trend by rating agency DBRS on July 24, 2007.

The risk management facility allows the Company to hedge natural gas purchases in accordance with its annual gas contracting and gas supply price risk 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. With an amendment effective July 11, 2007, the risk management facility is secured by a pledge of a \$20 million debenture issued by the Company.

On July 25, 2007 existing term lender Roynat Inc. refinanced its holdings of \$14 million of the Company's debentures that were scheduled to mature in 2011 and 2012, with a new \$15 million debenture issue maturing in 2017. The new debenture has no required principal prepayments until mid-2010. The Company has also arranged commitments from Canadian Western Bank and Roynat Inc. to jointly provide a \$20 million committed 5-year revolving term loan for general corporate purposes, repayable at maturity. The Commission has approved the facility and it is expected to close in August 2007. The facility will be undrawn at closing.

Cash and short term investments at June 30, 2007 are \$5.7 million lower than at December 31, 2006 primarily due to the payment of \$9.9 million of income and other taxes during the first quarter. Accounts receivable at June 30, 2007 are \$21.3 million lower than at December 31, 2006 due to a reduction in accounts receivable related to off system sales of \$9.3 million as well as the seasonal nature of natural gas deliveries to residential and commercial customers.

In addition, accounts payable and accrued liabilities at the end of the second quarter are \$15.2 million lower due to lower volumes of natural gas purchases in June, 2007 compared to December, 2006. Income and other taxes payable at June 30, 2007 are \$6.5 million lower than at December 31, 2006 primarily due to the payment of the 2006 current income tax and franchise fee liabilities in February 2007. The gas purchase variance payable at June 30, 2007 has decreased by \$3.1 million compared to December 31, 2006 and the gas cost variance recoverable amount increased from nil to \$0.8 million during the same period due to gas commodity costs paid by the Company being less than the gas commodity cost rates paid by customers, as well as reflecting a reduction of \$2.9 million due to recognition of the fair value of derivative assets and liabilities.

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 two quarters of 2007 are approximately \$4.0 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 \$0.8 million and \$0.4 million (\$0.6 million and \$0.2 million after income taxes) in the third and fourth quarters of 2007, respectively. The Company expects to finance these expenditures from internally generated funds and the new debt facilities which the Company expects to close in the third quarter.

### **Off-Balance Sheet Arrangements**

As of June 30, 2007, the Company had no off-balance sheet arrangements.

### **Transactions with Related Parties**

There were no transactions with related parties during the three month and six month periods ended June 30, 2007.

### **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, 2007 comprise 4.5 percent of the Company's operating revenues for the six month period ended June 30, 2007. 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**

On January 1, 2007, the Company adopted the recommendations in the following sections of the Canadian Institute of Chartered Accountants Handbook ("CICA Handbook") – Section 1530, *Comprehensive Income*, Section 3855, *Financial Instruments – Recognition and Measurement*, Section 3861, *Financial Instruments – Disclosure and Presentation*, and Section 3865 – *Hedges*.

These new sections of the CICA Handbook contain comprehensive standards for the recognition, measurement, presentation and disclosure for financial instruments, describe when and how hedge accounting may be applied, and introduce a new measurement of results – comprehensive income. The adoption of these recommendations did not have any material impact on net income.

In accordance with the standards in these new CICA Handbook sections, all derivative financial instruments used by the Company are recorded on the balance sheet at their fair value.

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, 2007 the Company had no interest rate hedging contracts outstanding.

The Company's annual gas contracting and gas supply price risk management plan was filed with and accepted by the Commission during the second quarter of 2007. The plan calls for gas price

hedging, covering purchases over the November 1, 2007 through October 31, 2009 period, to be completed in stages beginning in May 2007. Each hedging transaction is subject to approval by the Company's price risk management plan committee.

At June 30, 2007, the Company had outstanding 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)	Derivative Asset (\$000's)	Derivative Liability (\$000's)
Fixed price contracts	323 178	3.6%	Nov. 2007 – Mar. 2008	\$7.73 to \$8.32	\$ -	\$182
Natural gas swap contracts	3 625 750	40.8%	July 2007 – Oct. 2009	\$6.84 to \$10.28	44	3,995
Natural gas collar contracts	438 150	4.9%	July 2007 – Oct. 2008	Floors from \$6.05; Caps to \$10.65	-	287
Call options	61 500	0.7%	July 2007 – Oct. 2007	Caps at \$8.40	2	-
<b>Total</b>	<b>4 448 578</b>	<b>50.0%</b>			<b>\$46</b>	<b>\$4,464</b>

The fair value amounts used to determine the derivative asset and liability balances reflect the estimated amounts that the Company would receive or pay at June 30, 2007 to terminate the 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 flow through of gas supply costs in customer rates. As a result of the recognition of the derivative asset and liability, the gas cost variance payable account was decreased, net of income taxes, by \$2,143,000 and the gas cost variance recoverable account was increased by \$767,000, net of income taxes, in accordance with specific regulatory treatment. No items of comprehensive income were recorded as a result of adopting the accounting standard for the presentation of comprehensive income.

### Dividends

The Board of Directors declared a quarterly dividend of 20 cents per share on the Company's Common Shares, payable September 21, 2007 to shareholders of record at the close of business on September 6, 2007.

Pacific Northern Gas Ltd., for purposes of the Income Tax Act (Canada), and any similar provincial or territorial legislation, designates all dividends paid by Pacific Northern Gas Ltd. after December 31, 2005 to be "eligible dividends" unless otherwise notified by the Company. An eligible dividend paid to a Canadian resident is entitled to the enhanced dividend tax credit.

### Management's responsibility for financial reporting

Internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with Canadian generally accepted accounting principles. Management is responsible for establishing and maintaining adequate internal control over financial reporting for the Company.

The Company's Chief Executive Officer and Chief Financial Officer certified the appropriateness of the financial disclosures in the interim MD&A and unaudited interim consolidated financial statements for the period ended June 30, 2007. These executives also certified that they are responsible for the design of disclosure controls and procedures and internal control over financial reporting. There have been no changes in internal control over financial reporting during the quarter ended June 30, 2007 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting. As in prior quarters, the Company's Audit Committee reviewed this MD&A and the attached unaudited interim consolidated financial statements and the Board of Directors approved the documents prior to their release.

#### **Other**

The Company files an Annual Information Form on SEDAR which can be accessed at [www.sedar.com](http://www.sedar.com).

Pacific Northern Gas Ltd. had 3,641,180 common shares and 200,000 preferred shares outstanding as of July 26, 2007. 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 26, 2007

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, 2007 have not been reviewed by an auditor.

**PACIFIC NORTHERN GAS LTD**  
**CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME**

	(in thousands)			
	For the six months Ended June 30		For the three months ended June 30	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
<b>Operating revenues:</b>				
Gas sales and transportation services	\$48,733	\$59,607	\$15,183	\$15,828
Off system gas sales	24,556	14,736	944	2,566
Other [note 7]	3,605	2,465	1,807	1,809
	<u>76,894</u>	<u>76,808</u>	<u>17,934</u>	<u>20,203</u>
<b>Cost of sales:</b>				
Gas sales	27,832	35,655	8,236	8,541
Off system sales	24,556	14,736	944	2,566
	<u>52,388</u>	<u>50,391</u>	<u>9,180</u>	<u>11,107</u>
<b>Operating margin</b>	<u>24,506</u>	<u>26,417</u>	<u>8,754</u>	<u>9,096</u>
<b>Operating and maintenance</b>	5,765	5,256	2,970	2,644
<b>Administrative and general</b>	3,498	3,791	1,651	1,678
<b>Amortization of deferred charges</b>	115	363	46	178
<b>Municipal and other taxes</b>	2,284	2,380	1,142	1,192
<b>Depreciation</b>	3,921	3,844	1,961	1,922
	<u>15,583</u>	<u>15,634</u>	<u>7,770</u>	<u>7,614</u>
<b>Operating income</b>	8,923	10,783	984	1,482
<b>Investment and other income</b>	149	285	49	203
	<u>9,072</u>	<u>11,068</u>	<u>1,033</u>	<u>1,685</u>
<b>Income deductions:</b>				
Interest on long term debt	3,204	3,417	1,604	1,711
Interest on short term debt	375	382	168	198
Project development expenditures and other income deductions [note 12]	1,220	535	727	535
	<u>4,799</u>	<u>4,334</u>	<u>2,499</u>	<u>2,444</u>
<b>Income (loss) before income taxes</b>	<u>4,273</u>	<u>6,734</u>	<u>(1,466)</u>	<u>(759)</u>
<b>Income taxes:</b> [note 11]				
Currently payable	518	10,677	(1,572)	(399)
Deferred income taxes	2,331	(8,026)	2,896	477
Future income taxes	(1,704)	—	(1,991)	—
	<u>1,145</u>	<u>2,651</u>	<u>(667)</u>	<u>78</u>
<b>Net income (loss) for the period</b>	<u>\$3,128</u>	<u>\$4,083</u>	<u>(\$799)</u>	<u>(\$837)</u>
<b>Total comprehensive income (loss) for the period</b>	<u>\$3,128</u>	<u>\$4,083</u>	<u>(\$799)</u>	<u>(\$837)</u>
<b>For common shares:</b>				
Net income for the period	\$3,128	\$4,083	(\$799)	(\$837)
Dividends on preferred shares	169	169	85	85
<b>Net income applicable to common shares</b>	<u>\$2,959</u>	<u>\$3,914</u>	<u>(\$884)</u>	<u>(\$922)</u>
<b>Per common share:</b>				
Basic	\$0.81	\$1.08	(\$0.24)	(\$0.25)
Diluted	\$0.80	\$1.06	(\$0.24)	(\$0.25)
<b>Weighted average number of common shares outstanding:</b>				
Basic	3,641,180	3,626,617	3,641,180	3,626,761
Diluted	<u>3,683,737</u>	<u>3,677,673</u>	<u>3,683,197</u>	<u>3,679,170</u>

Unaudited — See accompanying notes

**PACIFIC NORTHERN GAS LTD.**  
**CONSOLIDATED BALANCE SHEETS**  
**AS AT JUNE 30, 2007 AND DECEMBER 31, 2006**  
(in thousands)

<b>ASSETS</b>	<u>June 30, 2007</u>	<u>December 31, 2006</u>
<b>Current assets:</b>		
Cash and short term investments	\$ 5,830	\$11,574
Accounts receivable [note 14]	8,578	29,907
Income taxes recoverable	729	—
Gas purchase variance recoverable [note 1]	767	—
Inventory of supplies and natural gas	1,796	2,603
Prepaid expenses	1,480	4,334
Derivative financial instruments [note 1]	46	—
Future income taxes [note 11]	1,507	—
	<u>20,733</u>	<u>48,418</u>
<b>Plant, property and equipment</b>	<u>173,863</u>	<u>172,996</u>
<b>Other Items:</b>		
Debt costs [note 1]	—	499
Rate stabilization adjustment mechanism	2,462	2,936
Pipeline rehabilitation costs	990	859
Deactivated assets	4,462	4,667
Other regulatory deferral accounts	(525)	(310)
Future income taxes [note 11]	216	—
	<u>7,605</u>	<u>8,651</u>
	<u>\$202,201</u>	<u>\$230,065</u>
<b>LIABILITIES</b>		
<b>Current liabilities:</b>		
Bank indebtedness [note 14]	\$ —	\$ 5,075
Accounts payable and accrued liabilities	6,937	22,094
Gas purchase variance payable [note 1]	—	3,115
Income and other taxes payable	3,909	10,377
Methanex Termination Payment deferral, current portion	4,194	4,065
Long term debt due within one year [note 14]	4,880	4,880
Derivative financial instruments [note 1]	4,464	—
	<u>24,384</u>	<u>49,606</u>
<b>Non-current liabilities</b>	613	477
<b>Methanex Termination Payment deferral non-current portion [note 7]</b>	5,954	8,096
<b>Long term debt, non-current portion [note 14]</b>	69,935	71,679
<b>Deferred income taxes [note 11]</b>	14,980	15,430
	<u>91,482</u>	<u>95,682</u>
<b>SHAREHOLDERS' EQUITY</b>		
Preferred shares [note 5]	5,000	5,000
Common shares [notes 3 and 6]	9,103	9,103
<b>Share capital</b>	<u>14,103</u>	<u>14,103</u>
<b>Contributed surplus [note 3]</b>	3,264	3,168
<b>Retained earnings</b>	68,968	67,506
<b>Accumulated other comprehensive income [note 1]</b>	—	—
	<u>86,355</u>	<u>84,777</u>
	<u>\$202,201</u>	<u>\$230,065</u>

ON BEHALF OF THE BOARD

"Robert F. Chase"  
Director

"Roy G. Dyce"  
Director

Unaudited — See accompanying notes

**PACIFIC NORTHERN GAS LTD.**  
**CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**  
(in thousands)

	For the six months ended June 30		For the three months ended June 30	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
<b>Preferred shares</b>	<b>\$5,000</b>	\$5,000	<b>\$5,000</b>	\$5,000
<b>Common shares</b>				
Balance at beginning of period	<b>\$9,103</b>	\$9,065	<b>\$9,103</b>	\$9,065
Issued during the period	—	2	—	2
Balance at end of period	<b>\$9,103</b>	\$9,067	<b>\$9,103</b>	\$9,067
<b>Contributed surplus</b>				
Balance at beginning of period	<b>\$3,168</b>	\$2,828	<b>\$3,238</b>	\$2,949
Stock option expense [note 3]	96	144	<b>26</b>	23
Excess of cash consideration over par value of common shares issued	—	8	—	8
Balance at end of period	<b>\$3,264</b>	\$2,980	<b>\$3,264</b>	\$2,980
<b>Retained earnings</b>				
Balance at beginning of period	<b>\$67,506</b>	\$65,799	<b>\$70,663</b>	\$69,994
Cumulative impact of adopting new accounting requirements for financial instruments, net of income taxes [note 1]	<b>(41)</b>	—	—	—
Adjusted balance at beginning of period	<b>67,465</b>	65,799	<b>70,663</b>	69,994
Net income (loss) for the period	<b>3,128</b>	4,083	<b>(799)</b>	(837)
Dividends — Preferred shares	<b>(169)</b>	(169)	<b>(169)</b>	(169)
Dividends — Common shares	<b>(1,456)</b>	(1,450)	<b>(727)</b>	(725)
Balance at end of period	<b>\$68,968</b>	\$68,263	<b>\$68,968</b>	\$68,263
<b>Accumulated Other Comprehensive Income</b>	—	—	—	—
<b>Total Shareholders' equity</b>	<b>\$86,335</b>	\$85,310	<b>\$86,394</b>	\$85,310

Unaudited — See accompanying notes

**PACIFIC NORTHERN GAS LTD**  
**CONSOLIDATED STATEMENTS OF CASH FLOW**  
(in thousands)

	For the six months		For the three months	
	Ended June 30		Ended June 30	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
<b>Operating activities:</b>				
<b>Net income for the period</b>	<b>\$3,128</b>	\$4,083	<b>(\$799)</b>	(\$837)
<b>Add (deduct) items not involving cash:</b>				
Deferred income taxes	2,331	(8,026)	2,896	477
Future income taxes	<b>(1,704)</b>	—	<b>(1,991)</b>	—
Depreciation and amortization	4,080	4,266	2,029	2,129
Amortization of Methanex Termination Payment deferral, net of income taxes <i>[note 7]</i>	<b>(2,319)</b>	(1,556)	<b>(1,160)</b>	(1,167)
Stock option expense <i>[note 3]</i>	96	144	26	23
Deferred income taxes on deferred charges	<b>(2,781)</b>	8,026	<b>(2,819)</b>	(477)
Imputed interest on deferred charges	202	158	93	148
Other	249	—	226	—
<b>Operating cash flow</b>	<b>3,282</b>	7,094	<b>(1,499)</b>	296
<b>Non-cash working capital changes</b> <i>[note 13]</i>	<b>3,170</b>	20,284	<b>11,692</b>	13,304
<b>Net cash provided by operating activities</b>	<b>6,452</b>	27,379	<b>10,193</b>	13,600
<b>Investing activities:</b>				
Additions to plant, property and equipment	<b>(4,787)</b>	(1,958)	<b>(2,260)</b>	(1,067)
(Increase) decrease in deferred charges and credits	581	(785)	267	(84)
Methanex Termination Payment deferral, net of income taxes <i>[note 7]</i>	—	15,372	—	—
<b>Net cash provided by (used in) investing activities</b>	<b>(4,206)</b>	12,629	<b>(1,993)</b>	(1,151)
<b>Financing activities:</b>				
Decrease in bank indebtedness	<b>(5,075)</b>	(10,159)	<b>(1,301)</b>	—
Repayment of long term debt	<b>(1,290)</b>	(1,290)	<b>(646)</b>	(645)
Issue of common shares	—	10	—	10
Dividends paid	<b>(1,625)</b>	(1,619)	<b>(896)</b>	(894)
<b>Net cash used in financing activities</b>	<b>(7,990)</b>	(13,058)	<b>(2,843)</b>	(1,529)
<b>Increase (decrease) in cash during the period</b>	<b>(5,744)</b>	26,950	<b>5,357</b>	10,920
<b>Cash and short term investments, beginning of period</b>	<b>11,574</b>	—	<b>473</b>	16,030
<b>Cash and short term investments, end of period</b>	<b>\$5,830</b>	\$26,950	<b>5,830</b>	\$26,950

Supplemental cash flow information *[note 13]*

Unaudited — See accompanying notes

## 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 (“GAAP”), 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, except as described in note 1 below.

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

### 1. CHANGES IN ACCOUNTING POLICY

On January 1, 2007, the Company retroactively adopted the recommendations in the following sections of the Canadian Institute of Chartered Accountants Handbook (“CICA Handbook”) – Section 1530, *Comprehensive Income*, Section 3855, *Financial Instruments – Recognition and Measurement*, Section 3861, *Financial Instruments – Disclosure and Presentation*, and Section 3865 – *Hedges*.

These new sections of the CICA Handbook contain comprehensive standards for the recognition, measurement, presentation and disclosure for financial instruments, describe when and how hedge accounting may be applied, and introduce a new measurement of results – comprehensive income. The adoption of these recommendations did not have any material impact on net income. The new accounting standards have been applied to the carrying amounts of assets and liabilities as at January 1, 2007, with a corresponding adjustment to retained earnings as of that date. Prior year comparative figures have not been restated.

On January 1, 2007, the following adjustments were made to the Company’s balance sheet to adopt the new requirements.

<b>(in thousands)</b>	<b>As at January 1, 2007</b>
<i>Increase (decrease) in:</i>	
Cash and short term investments	\$ 60
Accounts receivable	(121)
Gas purchase variance recoverable	914
Deferred charges – debt costs	(499)
Derivative financial instruments – asset	386
Future income tax asset	2,106
Gas purchase variance payable	(3,115)
Derivative financial instruments – liability	6,501
Long term debt	(499)
Retained earnings	(41)
Accumulated other comprehensive income -	—

The impact of these changes on the consolidated statement of income is as follows:

<b>(in thousands)</b>	<b>Six months ended June 30, 2007</b>	<b>Three months ended June 30, 2007</b>
<i>Increase (decrease) in net income:</i>		
Investment and other income	\$ 5	\$ 1
Future income expense	1,507	1,809
Deferred income tax expense	(1,507)	(1,809)
Net income	<u>\$ 5</u>	<u>\$ 1</u>

### **Other comprehensive income**

The new accounting standard requires the presentation of comprehensive Income, which is comprised of net income, changes in unrealized gains or losses related to available for sale securities and changes in unrealized gains or losses related to cash flow hedges, among other items. This disclosure has been included on Consolidated Statements of Income and Comprehensive Income, following net income.

### **Derivative financial instruments**

The Company uses derivative and other financial instruments in connection with the management of gas supply and interest rates. The Company enters into forward, future, swap, fixed price and option contracts to manage the exposure to the volatility of natural gas prices for sales customers. The prices paid for natural gas are based on variable indices.

In accordance with the new CICA standards, all derivative financial instruments used by the Company will now be recorded on the balance sheet at their fair value. At June 30, 2007 and January 1, 2007, the fair values of the derivative instruments owned by the Company, which were determined through reference to published price quotations in an active market, were as follows:

<b>(in thousands)</b>	<b>As at June 30, 2007</b>	<b>As at January 1, 2007</b>
Presented as assets	\$ 46	\$ 386
Presented as liabilities	(4,464)	(6,501)
Net fair value asset (liability)	<u>(\$4,418)</u>	<u>(\$6,115)</u>

Based on the current regulatory process, any gains or losses arising from utility related derivative financial instruments are treated as part of the flow through of gas supply costs in customer rates. As a result of the recognition of the derivative asset and liability, the gas cost variance payable account at June 30, 2007 was decreased, net of income taxes, by \$2,143,000 with an additional increase to gas cost variance recoverable of \$767,000 [decreased by \$3,115,000 with an additional increase to gas cost variance recoverable of \$914,000 at January 1, 2007], in accordance with specific regulatory treatment.

### **Classification of financial assets and liabilities**

The new accounting standard requires the classification of all the Company's financial assets and liabilities in categories for which clearly defined rules determine the standards to be applied.

Held-for-trading assets and liabilities are measured at their fair value and the gains and losses arising on the revaluation at the end of each period are included in consolidated income.

Available-for-sale assets and liabilities are measured at fair value with unrealized gains and losses recorded in other comprehensive income until the security is either sold, or if an unrealized loss is considered other than temporary, the unrealized loss is recorded in net income.

Loans and receivables, as well as available-for-sale securities where there is no quoted market price, continue to be recorded at amortized cost.

Other financial liabilities are initially presented at their fair value, with subsequent measurements at cost, net of amortization, using the effective interest rate method. Under this method of amortization, the amount of interest expense recognized over the life of the loan varies based on the principal outstanding.

The Company has made the following classifications of financial assets and liabilities:

- a) Cash, short term investments, and derivative instruments have been classified as assets or liabilities held-for-trading.
- b) Accounts receivable from customers and notes receivables are classified as loans and receivables.
- c) Bank indebtedness, amounts to be refunded to customers, accounts payable, accrued liabilities, and long term debt have been classified as other financial liabilities.

The balance of debt costs arising from the issuance of long term debt instruments of \$499,000 as at January 1, 2007 has been reclassified as a reduction of long term debt, and will continue to be amortized using the effective interest rate method.

### **Embedded derivatives**

Derivatives may be embedded in other financial and non-financial instruments (the "host instrument"). Prior to the adoption of the new standards, embedded derivatives were not accounted for separately from the host instrument except in certain circumstances which were not applicable to the Company. Under the new standards, embedded derivatives are treated as separate derivatives when their economic characteristics and risks are not clearly and closely related to those of the host instrument, the terms of the embedded derivative are the same as those of a stand-alone derivative, and the combined contract is not held for trading or designated at fair value. These embedded derivatives are measured at fair value with subsequent changes recognized in the consolidated statement of income and comprehensive income as an element of general and administrative expenses.

The Company has determined that all embedded derivatives will be recognized in the Consolidated Balance Sheet when applicable. The implementation of this standard has had no impact on the Company's financial statements as the Company currently has no contracts with embedded derivatives that can be separated from the host contract.

### **Transaction costs related to long term debt**

The net book value of transaction costs related to long term debt has been reclassified from deferred charges to long term debt, effective January 1, 2007. The Company has used the effective interest rate method for amortization of debt issue costs since 2004. If the effective interest rate method had been used from the inception of each debt instrument, the net book value of debt issue costs would be approximately \$192,000 lower at January 1, 2007. No adjustment has been made to long term debt or retained earnings as these transaction costs form part of the assets subject to regulation and will be recovered from customers in future periods.

## 2. PRINCIPLES OF CONSOLIDATION

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 Company's proportionate interest in the assets, liabilities, revenue and expenses of all incorporated and unincorporated joint ventures, to the extent that the Company is not the primary economic beneficiary and they are subject to joint control. 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 June 30:

	Direct and Indirect Interest Held by the Company (percent)	
	2007	2006
<b>Subsidiaries:</b>		
Pacific Northern Gas (N.E.) Ltd.	100	100
<b>Joint Ventures and Non-Controlled Partnerships [note 9]:</b>		
Pacific Trail Pipelines Limited Partnership	50	—
Pacific Trail Pipelines Management Inc.	50	—

## 3. 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, except as described below.

The Company has one stock option plan. In April, 2007, the Company issued 2,600 options at an exercise price of \$17.93. In addition, 1,400 options were forfeited. The compensation cost that has been charged against income (and credited to contributed surplus) in the quarter ended June 30, 2007 is \$26,000 [2006 - \$23,000] 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, 2007	Three months ended June 30, 2007
Risk free interest rate	3.92%	4.10%
Expected volatility (annualized)	26.5%	26.4%
Expected years of option life (average)	7.5	7.5
Expected annual rate of dividends	4.5%	4.5%

In addition to the stock option plan, on January 1, 2007 the Company implemented a deferred share unit plan for outside directors of the Company. Under this plan, an outside director may elect to defer all or a portion of total compensation as stock units of the Company's common shares. The amount of deferred compensation payments is adjusted to reflect dividends and changes in the market value of the common shares. The deferred compensation payments are paid at such time as an outside director ceases to be a director, and can be paid in cash, shares, or a combination of both. Director compensation expense is recorded in the period in which the compensation is earned. Changes in the amount of the compensation as a result of dividends and share price movement are recorded as director compensation expense in the period of the change.

There were 1,927 deferred share units granted for the three months ended June 30, 2007 and all units granted under the plan remained outstanding at that date. Liabilities related to this plan are recorded in accounts payable and accrued liabilities on the balance sheet and amounted to \$78,000

at June 30, 2007. Directors' compensation related to this plan for the three month and six month periods ended June 30, 2007 amounted to \$36,000 and \$78,000, respectively.

#### **4. 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.

#### **5. 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.

#### **6. COMMON SHARES**

The Company has outstanding stock options for 302,400 common shares, of which 220,020 are exercisable at June 30, 2007. There were 121,000 stock options outstanding at June 30, 2007 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 six month period ended June 30, 2007, no common shares were issued by the Company.

#### **7. 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 "Commission"), the termination payment was recorded in 2006, net of income taxes of \$7.96 million, as an interest bearing credit deferral, and is being 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, 2007, \$1.7 million and \$3.4 million of the termination payment was included in other operating revenues, respectively.

#### **8. COMMITMENTS**

The Company's purchase commitments at June 30, 2007 under various gas supply and transportation service contracts expiring through 2010 were as follows:

<b>(in thousands)</b>	
2007	<b>\$7,385</b>
2008	<b>4,677</b>
2009	<b>903</b>
2010	<b>65</b>
2011	<b>—</b>
Thereafter	<b>—</b>
Total	<b>\$13,030</b>

#### **9. 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.

## 9. JOINT VENTURES (cont'd)

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 June 30, 2007 and December 31, 2006:

<b>(in thousands)</b>	<b>At June 30, 2007</b>		<b>At December 31, 2006</b>	
<b>Balance Sheet</b>				
Current assets	<b>\$ 357</b>		\$596	
Non-current assets	—		—	
<hr/>				
Current liabilities	<b>(228)</b>		(604)	
Non-current liabilities	—		—	
<hr/>				
<b>Income Statement</b>				
	<b>For the six months ended June 30</b>		<b>For the three months ended June 30</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Revenues	\$ —	—	\$ —	—
Expenses	<b>1,048</b>	—	<b>555</b>	—
Net loss	<b>(1,048)</b>	—	<b>(555)</b>	—
<hr/>				
<b>Cash Flow</b>				
Cash Provided by (Used In):				
Operations	<b>(\$1,243)</b>	—	<b>(\$472)</b>	—
Financing	<b>1,185</b>	—	<b>600</b>	—
Investments	—	—	—	—
Proportionate share of increase (decrease) in cash of joint ventures	<b>(\$58)</b>	—	<b>\$128</b>	—

## 10. RELATED PARTY TRANSACTIONS

There were no transactions with related parties during the six month period ended June 30, 2007.

## 11. FUTURE AND DEFERRED INCOME TAXES

The Company recovers tax expense based on the taxes payable method, as prescribed by the Commission, for rate-setting purposes. Under the income taxes currently payable method, no provisions are made for future or deferred income taxes as a result of differences in timing differences between the treatment for income tax and accounting purposes of the various income and expenditure items. Therefore, rates do not include the recovery of future income taxes related to temporary differences. Consequently the Company does not record future income taxes for its regulated activities as the Company expects that all future income taxes will be recovered in rates when they become payable. The Company does record future income taxes related to non-regulated activities. Generally accepted accounting principles require the recognition of future income tax liabilities and future income tax assets in the absence of rate regulation.

## 11. FUTURE AND DEFERRED INCOME TAXES (cont'd)

In its 2007 revenue requirement application for the Western system, the Company requested approval to credit \$900,000 of deferred income taxes to the 2007 cost of service. During the three month and six month periods ended June 30, 2007, deferred income taxes recorded on the balance sheet were drawn down by \$225,000 and \$450,000, respectively, resulting in an equivalent deferred income tax recovery in the consolidated income statement for each period.

## 12. IMPACT OF REGULATORY DECISIONS

The Commission approved interim rates effective January 1, 2007. The results of operations reported by the Company in the first quarter of 2007 were recorded on the basis of the approved interim rates. In the regulatory decisions issued in May 2007, the Commission affirmed the interim rates and made them permanent for the period effective January 1, 2007 with some minor rate adjustments effective July 1, 2007 for PNG(N.E.)'s Fort St. John/Dawson Creek division. However, in the PNG-West decision the Commission denied recovery of approximately \$256,000 of costs incurred by the Commission and intervenors during the 2005 income trust application hearing and billed to the Company. The effect of the disallowance in cost recovery has been included in the calculation of earnings for the second quarter of 2007. If the disallowance had been known at the time, other income deductions would have been increased by \$170,000 and net income reported to March 31, 2007 would have been reduced by \$170,000.

## 13. SUPPLEMENTAL CASH FLOW INFORMATION

(in thousands)	For the six months ended June 30		For the three months ended June 30	
	2007	2006	2007	2006
<b>Depreciation and amortization:</b>				
Depreciation, per income statement	\$3,921	\$3,844	\$1,961	\$1,922
Amortization of deferred charges, per income statement	115	363	46	178
Amortization of debt issue costs, included in long term interest expense	44	59	22	29
<b>Total depreciation and amortization</b>	<b>4,080</b>	<b>4,266</b>	<b>2,029</b>	<b>2,129</b>
<b>Non-cash working capital changes:</b>				
<b>(Increase) decrease in:</b>				
Accounts receivable	\$21,329	\$20,211	17,120	19,266
Income taxes recoverable	(729)	375	(729)	—
Gas purchase variance recoverable	(767)	—	(767)	—
Inventories of supplies and natural gas	807	311	257	(466)
Prepaid expenses	2,854	1,187	1,278	387
<b>Increase (decrease) in:</b>				
Accounts payable and accrued liabilities	(15,157)	(14,682)	(5,226)	(6,341)
Gas purchase variance payable	1,301	2,919	507	1,152
Income and other taxes payable	(6,468)	9,963	(748)	(694)
<b>Attributable to operating activities</b>	<b>3,170</b>	<b>20,284</b>	<b>11,692</b>	<b>13,304</b>
<b>Interest and tax payments:</b>				
<b>Income taxes paid</b>	<b>8,243</b>	<b>1,446</b>	<b>405</b>	<b>723</b>
<b>Interest paid</b>	<b>3,251</b>	<b>3,459</b>	<b>2,051</b>	<b>2,167</b>

#### **14. SUBSEQUENT EVENT**

On July 11, 2007 the Company closed a new \$20 million operating line with its existing operating lender. Amounts drawn on the new operating line will remain subject to a borrowing base cap. The financial maintenance covenants under the previous operating line were removed with the new line having a single financial covenant limiting the Company's debt leverage to 65 percent. The new operating line is collateralized by a pledge of the Company's accounts receivables and inventories.

With the new operating line in place, the Company's debt rating was taken off Under Review with Negative Implications and confirmed at BBB(low) – Negative trend by rating agency DBRS.

With an amendment effective July 11, 2007, the Company's risk management facility is now secured by a pledge of a \$20 million debenture issued by the Company.

On July 25, 2007 existing term lender Roynat Inc. refinanced its holdings of \$14 million of the Company's debentures that were scheduled to mature in 2011 and 2012, with a new \$15 million debenture issue maturing in 2017. The new debenture has no required principal prepayments until mid-2010. The Company has also arranged commitments from Canadian Western Bank and Roynat Inc. to jointly provide a \$20 million committed 5-year revolving term loan for general corporate purposes, repayable at maturity. The Commission has approved the facility and it is expected to close in August 2007. The facility will be undrawn at closing.

#### **15. COMPARATIVE FIGURES**

Certain items in the consolidated financial statements have been reclassified to conform to the 2007 presentation.

**PACIFIC NORTHERN GAS LTD.  
FORM 52-109F2  
CERTIFICATION OF INTERIM FILINGS**

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, 2007;
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 and internal control over financial reporting for the issuer, and we have:
  - (a) 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; and
  - (b) designed such internal control over financial reporting, or caused it to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with the issuer's GAAP; and
5. I have caused the issuer to disclose in the interim MD&A any change in the issuer's internal control over financial reporting that occurred during the issuer's most recent interim period that has materially affected, or is reasonably likely to materially affect, the issuer's internal control over financial reporting.

*"Roy G. Dyce"*

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Roy G. Dyce  
Chief Executive Officer

Date: July 26, 2007

**PACIFIC NORTHERN GAS LTD.  
FORM 52-109F2  
CERTIFICATION OF INTERIM FILINGS**

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, 2007;
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 and internal control over financial reporting for the issuer, and we have:
  - (a) 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; and
  - (b) designed such internal control over financial reporting, or caused it to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with the issuer's GAAP; and
5. I have caused the issuer to disclose in the interim MD&A any change in the issuer's internal control over financial reporting that occurred during the issuer's most recent interim period that has materially affected, or is reasonably likely to materially affect, the issuer's internal control over financial reporting.

*"Elizabeth A. Fletcher"*

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Elizabeth A. Fletcher  
Chief Financial Officer

Date: July 26, 2007