



interim statement

For the Three Months Ended March 31, 2007

April 26, 2007

Pacific Northern Gas Ltd.
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Pacific Northern Gas Ltd.
MANAGEMENT'S DISCUSSION AND ANALYSIS
for the Three Months Ended March 31, 2007

FORWARD-LOOKING STATEMENTS

Management's discussion and analysis contains certain forward-looking statements that are subject to risks and uncertainties that may cause the results or events predicted in this discussion to differ materially from actual results or events. Factors which could cause the results or events to differ include, but are not limited to: general economic conditions and markets; gas supply and commodity price volatility; competition; decisions by regulators; seasonal weather patterns; financing of investments as well as the value of such investments; the cost and availability of capital; and the ability of the Company to attract and retain quality employees. Those risks and other material risks are discussed in the Company's Annual Information Form dated March 15, 2007. 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 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 recent years 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. The economy in the Northeast system service area is growing 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. The purpose of this order was to set out the formal scope, procedures and methods for the environmental assessment of the KSL Project. In addition, the EAO established a 30-day public comment period regarding the draft Terms of Reference for the KSL Project to begin on

March 15, 2007 and end on April 16, 2007. The purpose of the draft Terms of Reference is to identify information that PTP must include in its application for an environmental assessment certificate ("EAC"). PTP expects to file the EAC application for the KSL Project in June 2007 following the EAO approval of the final Terms of Reference.

PTP anticipates commencing construction of the KSL Project facilities by 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 of their LNG Terminal and the KSL Project, and regulatory approvals for the KSL Project. The regulatory requirements for the KSL Project include a Project Approval 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 B.C. Utilities Commission and other permits required from the B.C. Oil and Gas Commission. The Company can give no assurances that the regulatory approvals will be obtained or that construction of the KSL Project by PTP will proceed.

On October 26, 2006, the Company filed its 2007 revenue requirements applications for all divisions with the British Columbia Utilities Commission ("the Commission"). The applications seek approval of changes to residential delivery charges, effective January 1, 2007, as follows: PNG West system, increase of 3.1 percent; Fort St. John/Dawson Creek system, increase of 2.5 percent; and Tumbler Ridge system, decrease of 18.4 percent. The forecast residential and commercial deliveries contained in the 2007 revenue requirements application for the PNG West system are approximately 1.4 percent lower than the forecast deliveries to these customer classes used for rate making purposes in 2006. Deliveries to small industrial customers in the PNG West system are projected to be approximately 16 percent lower in 2007 compared to budgeted gas deliveries in 2006. The Company expects that the Commission will issue its decisions on the 2007 revenue requirements applications during the second quarter of 2007.

Overall Performance

Net income for the three months ended March 31, 2007 was \$3.9 million, compared with net income of \$4.9 million for the corresponding period in 2006. After providing for preferred share dividends, the earnings per common share in the three months ended March 31, 2007 were \$1.06 compared with earnings per common share of \$1.33 for the same period in 2006.

Included in net income for the three months ended March 31, 2007 are charges, net of tax, of \$0.3 million (\$0.09 per share) relating to the Company's share of KSL Project development expenditures incurred by PTP.

In addition, net income for the quarter was lower in 2007 compared to 2006 by approximately \$0.5 million due to 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. Lower deliveries to large commercial and small industrial customers in the three months ended March 31, 2007 also accounted for a \$0.1 million decrease in net income. Variances in deliveries to these customer classes are not subject to regulatory deferral accounts.

The Company's share of planned development expenditures for the KSL Project in the last nine months of 2007 is expected to be approximately \$2.1 million before income taxes (\$0.37 per share, net of income taxes) of which \$1.2 million before income taxes (\$0.21 per share, net of income taxes) is expected to be incurred in the second 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 increased by \$0.2 million for the three month period ended March 31, 2007.

Residential deliveries were approximately 5 percent higher in the three months ended March 31, 2007 and total commercial deliveries were relatively unchanged, relative to deliveries over the same period in 2006. Management believes that weather was a key factor in the increase in residential deliveries, as it was approximately 2 percent colder for the three month period ended March 31, 2007 compared to the same period in 2006. On the other hand, the weather was 2 percent warmer than normal for the three month period ended March 31, 2007, with "normal" based on the average of actual temperatures in the region for the preceding 10 years.

Industrial deliveries were higher by approximately 9 percent for the three month period ended March 31, 2007 compared to the same period in 2006. The increase in industrial deliveries is primarily attributable to a 28 percent increase in large industrial customer deliveries, offset by a 6 percent reduction in small industrial deliveries, primarily in the PNG-West system. A deferral account is in place that recovers or refunds margin differences resulting from deliveries to large industrial customers in the PNG-West system varying from the forecast approved for ratemaking purposes.

Results of Operations

Operating revenues in the three months ended March 31, 2007 increased to \$58.9 million, as compared with \$56.6 million in the corresponding period in 2006. The increase in operating revenues was primarily due to an increase of \$11.4 million in revenues from the sale of gas surplus to the needs of the Company's sales customers ("off system gas sales") offset by a \$7.5 million reduction in gas supply costs embedded in sales customers' rates as well as a reduction in transportation services revenue from Methanex of \$0.7 million, compared with the corresponding period in 2006. 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. The increase in off system gas sales in the first quarter of 2007 reflects the impact of the Company securing gas supply for winter peaking requirements under a seasonal contract that required the Company to purchase a firm daily volume every day over the December 2006 to February 2007 three month winter period. The peaking gas contract applicable during the corresponding 2005 to 2006 period did not require the Company to purchase a firm daily volume.

Operating margin in the three months ended March 31, 2007 decreased to \$15.7 million, as compared with \$17.3 million in the same period in 2006. The lower operating margin in the first quarter is primarily the result of transportation services revenue from Methanex being higher in 2006 by approximately \$0.7 million 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 quarter of 2007. The reductions in the regulated cost of service include lower amortization, property tax, insurance and maintenance expenses, as well as a \$0.9 million deferred income tax recovery.

Included in project development expenditures and other income deductions for the three months ended March 31, 2007 are the Company's share of KSL Project development expenditures expensed by PTP amounting to \$0.5 million, before income taxes.

The Company filed a report with the Commission in March 2007 on past and projected gas supply costs compared to gas cost recoveries from customers. On the basis of the report the Commission issued an order confirming the Company's request to modify the gas supply cost rate riders

applicable in the Tumbler Ridge division effective April 1, 2007. The changes to the two rate riders were offsetting and resulted in no net change to Tumbler Ridge gas cost rates. The Commission accepted the Company's recommendation that no changes be made to the gas cost rates applicable in the Company's other service areas.

Summary of Quarterly Results for Eight Quarters Ending March 31, 2007

<i>Thousands of dollars except per share amounts</i>	Mar. 31 2007	Dec. 31 2006	Sept 30, 2006	June 30, 2006	Mar 31, 2006	Dec 31, 2005	Sept 30, 2005	June 30, 2005
Operating Revenues	\$58,960	\$46,190	\$15,850	\$20,203	\$56,605	\$49,621	\$32,238	\$30,293
KSL expenditures, net of income taxes	(345)	(556)	(575)	(536)	—	—	—	—
Net income (loss) ¹	3,927	2,319	(1,451)	(837)	4,920	3,311	(772)	137
Earnings per share ²	\$1.06	0.61	(0.42)	(.25)	1.33	0.89	(0.24)	0.02
- per share diluted ²	\$1.04	0.60	(0.42)	(.25)	1.31	0.88	(0.24)	0.01

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. 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 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 March 30, 2007, the calculated borrowing base was \$20 million, of which \$3.1 million had been used. 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 March 2007.

The Company is in the process of restructuring its operating line of credit to obtain more financial flexibility and plans to obtain commitments for new long term debt in 2007 of approximately \$15 million during the second quarter of 2007.

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.

Cash and short term investments at March 31, 2007 are \$11.1 million lower than at December 31, 2006 primarily due to the payment of \$9.9 million of income and other taxes during the quarter. Accounts receivable at March 31, 2007 are \$4.2 million lower than at December 31, 2006 due to a reduction in accounts receivable related to off system sales.

In addition, accounts payable and accrued liabilities at the end of the first quarter are \$9.9 million lower due to lower volumes of natural gas purchases in March, 2007 compared to December, 2006. Income and other taxes payable at March 31, 2007 are \$5.7 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 March 31, 2007 has increased by \$1.4 million compared to December 31, 2006 due to gas commodity costs paid by the Company being less than the gas commodity cost rates paid by customers, as well as reflecting an increase of \$0.6 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 three quarters of 2007 are approximately \$6 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 \$2.1 million (\$1.4 million after income taxes) in the remainder of 2007. The Company expects to finance these expenditures from internally generated funds and planned new debt facilities.

Off-Balance Sheet Arrangements

As of March 31, 2007, the Company had no off-balance sheet arrangements.

Transactions with Related Parties

There were no transactions with related parties during the three month period ended March 31, 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 March 31, 2007 comprise 13 percent of the Company's operating revenues for the three month period ended March 31, 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.

Operating revenues for the three month period ended March 31, 2007 are based on interim rates that have been approved by the Commission. Permanent rates will be set following receipt of the Commission's decision on the Company's 2007 revenue requirements applications and may result in retroactive adjustments to the interim rates. The Company has no reason to believe that the permanent rates will be materially different from the interim rates.

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 will now be 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 March 31, 2007 the Company had no interest rate hedging contracts outstanding.

The Company expects to file its annual gas contracting and gas supply price risk management plan with the Commission during the second quarter of 2007. The plan will call 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 March 31, 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)
Natural gas swap contracts	3,584,000	36.1%	Apr '07 to Oct '08	\$6.84 to \$10.28	\$1,182	447
Natural gas collar contracts	473,000	4.8%	Apr '07 to Oct '08	Floors from \$6.05 to \$8.47; Caps from \$8.65 to \$10.65	105	—
Call options	107,000	1.1%	Apr '07 to Oct '08	Caps at \$8.40	44	—
Total	4,164,000	42.0%			\$1,331	\$447

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 March 31, 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 increased, net of income taxes, by \$582,000, 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 semi-annual dividend of 84.375 cents per share on the Company's 6-3/4 percent cumulative, redeemable, preferred shares, payable July 1, 2007 to the shareholders of record at the close of business on June 11, 2007.

The Board of Directors also declared a quarterly dividend of 20 cents per share on the Company's Common Shares, payable June 22, 2007 to shareholders of record at the close of business on June 5, 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 information

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 March 31, 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 March 31, 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.

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

April 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 March 31, 2007 have not been reviewed by an auditor.

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

	For the three months ended March 31	
	<u>2007</u>	<u>2006</u>
Operating revenues:		
Gas sales and transportation services	\$33,550	\$43,779
Off system sales	23,612	12,170
Other [note 7]	1,798	656
	<u>58,960</u>	<u>56,605</u>
Cost of sales:		
Gas sales	19,596	27,114
Off system sales	23,612	12,170
	<u>43,208</u>	<u>39,284</u>
Operating margin	<u>15,752</u>	<u>17,321</u>
Operating and maintenance	2,795	2,613
Administrative and general	1,847	2,112
Amortization of deferred charges	69	185
Municipal and other taxes	1,142	1,188
Depreciation	1,960	1,922
	<u>7,813</u>	<u>8,020</u>
Operating income	7,939	9,301
Investment and other income	100	82
	<u>8,039</u>	<u>9,383</u>
Income deductions:		
Interest on long term debt	1,600	1,706
Interest on short term debt	207	184
Project development expenditures and other income deductions	493	—
	<u>2,300</u>	<u>1,890</u>
Income (loss) before income taxes	<u>5,739</u>	<u>7,493</u>
Income taxes: [note 11]		
Currently payable	2,090	11,076
Deferred income taxes	(565)	(8,503)
Future income taxes	287	—
	<u>1,812</u>	<u>2,573</u>
Net income for the period	<u>\$3,927</u>	<u>\$4,920</u>
Total comprehensive income for the period	<u>\$3,927</u>	<u>\$4,920</u>
For common shares:		
Net income for the period	\$3,927	\$4,920
Dividends on preferred shares	84	84
Net income applicable to common shares	<u>\$3,843</u>	<u>\$4,836</u>
Per common share:		
Basic	<u>\$1.06</u>	<u>\$1.33</u>
Diluted	<u>\$1.04</u>	<u>\$1.31</u>
Weighted average number of common shares outstanding:		
Basic	3,641,180	3,626,180
Diluted	<u>3,684,334</u>	<u>3,676,269</u>

See accompanying notes

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

	March 31, 2007	December 31, 2006
ASSETS		
Current assets:		
Cash and short term investments	\$ 473	\$11,574
Accounts receivable	25,698	29,907
Inventory of supplies and natural gas	2,053	2,603
Prepaid expenses	2,758	4,334
	30,982	48,418
Plant, property and equipment	173,563	172,996
Other Items:		
Debt costs <i>[note 1]</i>	—	499
Rate stabilization adjustment mechanism	2,770	2,936
Pipeline rehabilitation costs	797	859
Deactivated assets	4,565	4,667
Other regulatory deferral accounts	(316)	(310)
Derivative financial instruments <i>[note 1]</i>	1,331	—
Future income taxes <i>[note 11]</i>	34	—
	9,181	8,651
	\$213,726	\$230,065
LIABILITIES		
Current liabilities:		
Bank indebtedness	\$ 1,301	\$ 5,075
Accounts payable and accrued liabilities	12,161	22,094
Gas purchase variance payable	4,493	3,115
Income and other taxes payable	4,657	10,377
Methanex Termination Payment deferral, current portion	4,138	4,065
Long term debt due within one year	4,880	4,880
	31,630	49,606
Non-current liabilities	557	477
Methanex Termination Payment deferral non-current portion <i>[note 7]</i>	7,023	8,096
Derivative financial instruments <i>[note 1]</i>	447	—
Long term debt, non-current portion	70,558	71,679
Deferred income taxes <i>[note 11]</i>	15,205	15,430
Future income taxes <i>[note 1]</i>	302	—
	94,092	95,682
	125,722	145,288
SHAREHOLDERS' EQUITY		
Preferred shares <i>[note 5]</i>	5,000	5,000
Common shares <i>[notes 3 and 6]</i>	9,103	9,103
Share capital	14,103	14,103
Contributed surplus <i>[note 3]</i>	3,238	3,168
Retained earnings	70,663	67,506
Other comprehensive income, cumulative <i>[note 1]</i>	—	—
	88,004	84,777
	\$213,726	\$230,065

ON BEHALF OF THE BOARD

"Robert F. Chase"
Director

"Roy G. Dyce"
Director

See accompanying notes

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

	For the three months ended March 31	
	<u>2007</u>	<u>2006</u>
Preferred shares	\$5,000	\$5,000
Common shares	\$9,103	\$9,065
Contributed surplus		
Balance at beginning of period	\$3,168	\$2,828
Stock option expense <i>[note 3]</i>	70	121
Balance at end of period	\$3,238	\$2,949
Retained earnings		
Balance at beginning of period	\$67,506	\$65,799
Cumulative impact of adopting new accounting requirements for financial instruments, net of income taxes <i>[note 1]</i>	(41)	—
Adjusted balance at beginning of period	67,465	65,799
Net income	3,927	4,920
Dividends — Common shares	(729)	(725)
Balance at end of period	70,663	\$69,994
Other Comprehensive Income, cumulative		
Balance at beginning and end of period	—	—
Total Shareholders' equity	\$88,004	\$87,008

See accompanying notes

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

	For the three months	
	Ended March 31	
	<u>2007</u>	<u>2006</u>
Operating activities:		
Net income for the period	\$3,927	\$4,920
Add (deduct) items not involving cash:		
Deferred income taxes	(565)	(8,503)
Future income taxes	287	—
Depreciation and amortization	2,051	2,137
Amortization of Methanex Termination Payment deferral, net of income taxes <i>[note 7]</i>	(1,159)	(389)
Stock option expense <i>[note 3]</i>	70	121
Deferred income taxes on deferred charges	38	8,503
Imputed interest on deferred charges	109	10
Other	23	—
Operating cash flow	4,781	6,799
Non-cash working capital changes <i>[note 12]</i>	(8,522)	6,980
Net cash provided by operating activities	(3,741)	13,779
Investing activities:		
Additions to plant, property and equipment	(2,527)	(891)
(Increase) decrease in deferred charges and credits	314	(701)
Methanex Termination Payment deferral, net of income taxes <i>[note 7]</i>	—	15,372
Net cash provided by (used in) investing activities	(2,213)	13,780
Financing activities:		
Decrease in bank indebtedness	(3,774)	(10,159)
Repayment of long term debt	(644)	(645)
Dividends paid	(729)	(725)
Net cash used in financing activities	(5,147)	(11,529)
Increase in cash during the period	(11,101)	16,030
Cash and short term investments, beginning of period	11,574	—
Cash and short term investments, end of period	473	\$16,030

Supplemental cash flow information [note 12]

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.

(in thousands)	As at January 1, 2007
<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:

(in thousands)	For the 3 months ended March 31, 2007
<i>Increase (decrease) in net income:</i>	
Investment and other income	4
Future income expense	(302)
Deferred income tax recovery	302
Net income	4

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 contract 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 March 31, 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:

(in thousands)	As at March 31, 2007	As at January 1, 2007
Presented as assets	1,331	386
Presented as liabilities	(447)	(6,501)
Net fair value asset (liability)	884	(6,115)

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 March 31, 2007 was increased, net of income taxes, by \$582,000 [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.

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

Embedded derivatives

An embedded derivative is a component of a hybrid (combined) instrument or another contract that also includes a non-derivative host contract, with the effect that some of the cash flows of the combined instrument vary in a way similar to a stand-alone derivative.

The CICA Handbook recommends that an embedded derivative be separated from the host contract and recognized at its fair value in the balance sheet if certain predetermined conditions are met. 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.

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 March 31:

	Direct and Indirect Interest Held by the Company (percent)	
	2007	2006
Subsidiaries:		
Pacific Northern Gas (N.E.) Ltd.	100	100
Joint Ventures and Non-Controlled Partnerships [note 7]:		
Pacific Trail Pipelines Limited Partnership	50	—
Pacific Trail Pipelines Management Inc.	50	—

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 March, 2007, the Company issued 36,000 options at an exercise price of \$17.90. The compensation cost that has been charged against income (and credited to contributed surplus) in the quarter ended March 31, 2007 is \$70,000 [2006 - \$121,000] 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:

	Three months ended March 31 2007
Risk free interest rate	3.91%
Expected volatility (annualized)	26.6%
Expected years of option life (average)	7.5
Expected annual rate of dividends	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 2,397 deferred share units granted in the three months ended March 31, 2007 and all units granted 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 \$43,000 at March 31, 2007. Directors' compensation related to this plan for the three months ended March 31, 2007 was also \$43,000.

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 301,200 common shares, of which 220,900 are exercisable at March 31, 2007. There were 122,400 stock options outstanding at March 31, 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 quarter ended March 31, 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 periods ended March 31, 2007 and March 31, 2006, \$1.7 million and \$0.6 million of the termination payment was included in other operating revenues, respectively.

8. COMMITMENTS

The Company's purchase commitments at March 31, 2007 under various gas supply and transportation service contracts expiring through 2010 were as follows:

(in thousands)	
2007	\$14,973
2008	5,271
2009	903
2010	65
2011	—
Thereafter	—
Total	\$21,212

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 March 31, 2007 and December 31, 2006:

(in thousands)	At March 31, 2007	At December 31, 2006
Balance Sheet		
Current assets	\$233	\$596
Non-current assets	—	—
Income Statement		
	For the three months ended March 31	
	2007	2006
Revenues	—	—
Expenses	493	—
Net loss	(493)	—
Cash Flow		
Cash Provided by (Used In):		
Operations	(\$771)	—
Financing	585	—
Investments	—	—
Proportionate share of decrease in cash of joint ventures	(\$186)	—

10. RELATED PARTY TRANSACTIONS

There were no transactions with related parties during the three month period ended March 31, 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 draw down deferred income taxes by \$900,000 during 2007, with a credit being applied to the cost of service. During the three month period ended March 31, 2007, deferred income taxes recorded on the balance sheet were drawn down by \$225,000, resulting in a deferred income tax recovery of \$225,000 in the consolidated income statement. The draw down of the deferred income tax balance is subject to a future decision of the Commission.

12. SUPPLEMENTAL CASH FLOW INFORMATION

(in thousands)	For the three months ended March 31	
	2007	2006
Depreciation and amortization:		
Depreciation, per income statement	\$1,960	\$1,922
Amortization of deferred charges, per income statement	69	185
Amortization of debt issue costs, included in long term interest expense	22	30
Total depreciation and amortization	2,051	2,137
Non-cash working capital changes:		
(Increase) decrease in:		
Accounts receivable	4,209	945
Income taxes recoverable	—	375
Inventories of supplies and natural gas	550	777
Prepaid expenses	1,576	800
Increase (decrease) in:		
Accounts payable and accrued liabilities	(9,933)	(8,341)
Gas purchase variance payable	796	1,767
Income and other taxes payable	(5,720)	10,657
Attributable to operating activities	(8,522)	6,980
Interest and tax payments:		
Income taxes paid	\$7,838	\$723
Interest paid	\$1,200	\$1,292

13. 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 March 31, 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"

Roy G. Dyce
Chief Executive Officer

Date: April 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 March 31, 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"

Elizabeth A. Fletcher
Chief Financial Officer

Date: April 26, 2007