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Janet P. Kennedy
Vice President, Regulatory Affairs & Gas Supply

Via e-mail

August 3, 2012

B.C. Utilities Commission
6th Floor - 900 Howe Street
Vancouver, B.C.
V6Z 2N3

File No.: 4.2

Attention: Erica M. Hamilton
Commission Secretary

Dear Ms. Hamilton:

Re: BCUC Generic Cost of Capital Proceeding ("GCOC") – Project No. 3698660
Minimum Filing Requirements ("MFR")
Evidence of Pacific Northern Gas Ltd. and Pacific Northern Gas (N.E.) Ltd.

This letter responds to the Commission's request for utilities identified as Affected Utilities in the GCOC proceeding to submit documentation related to the MFR as set forth in Appendix A to Commission Order G-72-12. The information that follows applies to Pacific Northern Gas Ltd. ("PNG-West") and Pacific Northern Gas (N.E.) Ltd. ("PNG(NE)") (collectively, "PNG"), both registered as Affected Utilities in this proceeding.

Company-Related Documents

The Commission has directed the Affected Utilities to file company-specific information as outlined under Section A – Company-Related Documents of the MFR. This material is provided in the Appendices accompanying this letter.

Other Filing Requirements

The Commission has directed the Affected Utilities to file evidence on a number of matters as outlined under Section B – Other Filing Requirements of the MFR, which PNG addresses below.

ROE Matters and Capital Structure Matters

With respect to ROE Matters and Capital Structure Matters, PNG supports and adopts the evidence submitted by the FortisBC Utilities, including the evidence of their expert witnesses, James H. Vander Weide, PH.D, Kathleen C. McShane and Aaron Engen.

In terms of process for the determination of the return on equity and equity ratio for individual utilities, PNG agrees with the Commission Panel's suggestion to hold a separate proceeding (Stage 2) following the determination of the benchmark utility metrics. PNG acknowledges that there would be efficiencies with the evidentiary record, as well as improved timeliness and consistency from having the same Commission panel overseeing the GCOC proceeding also address the determinations for the individual utilities. This approach differs from the initial proposal by PNG to have these matters addressed as part of its 2013 revenue requirements applications.

Designation of a Benchmark Low-risk Utility

PNG supports the continued designation of FortisBC Energy Inc. ("FEI") as the benchmark utility for purposes of setting a benchmark return on equity and benchmark capital structure instead of using a hypothetical benchmark low-risk utility. PNG supports and adopts the FortisBC Utilities' evidence on this matter.

Deemed Capital Structure and Deemed Debt Issue Matters

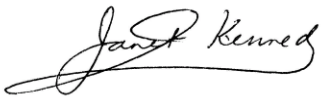
PNG submits that the matters related to deemed capital structure and deemed debt issues are generally not relevant to the determination of the appropriate cost of capital for FEI, PNG's chosen benchmark utility. PNG has no difference of opinion on the evidence submitted by FEI on these matters as they apply to its unique circumstances and PNG notes that these matters are generally not applicable to PNG's current circumstances with one exception.

PNG's capital structure has been deemed to be materially different than its actual capital structure for in excess of 10 years. PNG's deemed common equity component has been below its actual common equity component and therefore it has had a deemed debt over this same period. However, both PNG-West and PNG(NE) have either third-party or non-arms length debt which comprise a majority of the debt component of their approved capital structure, which has allowed the use of these instruments as a reference for the setting of the deemed interest rate on the deemed debt. It is also expected that PNG and PNG(NE) will continue to have either third-party or non-arms length debt to the extent they do today and that new issues of such debt will be reviewed by the Commission in accordance with the appropriate sections of the *Utilities Commission Act.* In other words, PNG and PNG(NE) fully expect to continue to have either third-party or non-arms length debt instruments which can be used as a reference for setting the deemed interest rate on deemed debt, to the extent there is deemed debt in PNG's capital structure.

With respect to other issues associated with the deeming of PNG's capital structure, PNG respectfully submits that these are core issues related to its utility-specific risk premium and capital structure and that these issues do not have any elements which can be addressed in a generic manner for the purposes of this proceeding.

Please forward any questions regarding this submission to my attention.

Yours truly,



J.P. Kennedy
cc. Registered Participants

APPENDICES

COMPANY-RELATED DOCUMENTS

Filing Requirement	Documentation	Appendix
1. Most recent Annual Report	PNG 2010 Annual Report	1
2. Credit rating agency reports since 2006	Bond rating reports – PNG	2
	Bond rating reports – AltaGas (parent)	3
3. Investment analyst reports since 2006	Investment analyst reports – PNG	4
	Investment analyst reports – AltaGas (parent)	5
4. Prospectuses of debt offerings in last 5 years	PNG – n/a – no debt offerings in period noted	n/a
	AltaGas (parent)	6
5. Bond issues applicable to 2012 Test Year and future	n/a – no bond issues in 2012 or anticipated in future	n/a
6. Prospectuses of equity offerings in last 5 years	PNG – n/a – no equity offerings in period noted	n/a
	AltaGas (parent)	7
7. 2011 BCUC Annual Reports	2011 BCUC Annual Reports for PNG-West and PNG(N.E)	8
8. Historical regulatory financial information for period 2002-2011	Summary financial information and summary of deferral accounts	9
9. Price-to-book value ratios of recent transactions involving sale of company or parent since 2000	Summary of relevant transactions	10
10. Significant changes in accounting policies for last 10 years	Summary of accounting policy changes from historic annual report	11

APPENDIX 1

PNG 2010 ANNUAL REPORT

PNG

PACIFIC NORTHERN GAS LTD.

2010
ANNUAL
REPORT

Pacific Northern Gas Ltd. (PNG or the Company) delivers natural gas to customers in west-central British Columbia, and through its subsidiary, Pacific Northern Gas (N.E.) Ltd., to customers in the province's northeast.

PNG's transmission pipeline is connected to the Spectra Energy system near Summit Lake, British Columbia and extends 587 kilometers to the west coast. Service is provided to some 21 thousand customers including a number of industrial operations. In addition, propane vapour distribution is provided in the community of Granisle.

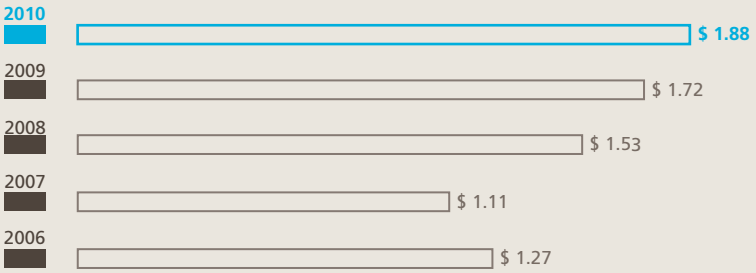
Pacific Northern Gas (N.E.) systems serve some 18 thousand customers in the Fort St. John, Dawson Creek, and Tumbler Ridge areas. Gas supply is received at a number of locations within the Fort St. John service area. In the Dawson Creek area, the Company's transmission pipeline is used to transport gas from the Spectra Energy system. In Tumbler Ridge, the Company operates its own gas processing plant.

PNG's head office is located in Vancouver, British Columbia. Customer care and administrative functions are supported from a regional centre in Terrace, British Columbia. In addition, personnel responsible for customer service and system construction, operation and maintenance are stationed in nine communities located within the Company's service area.

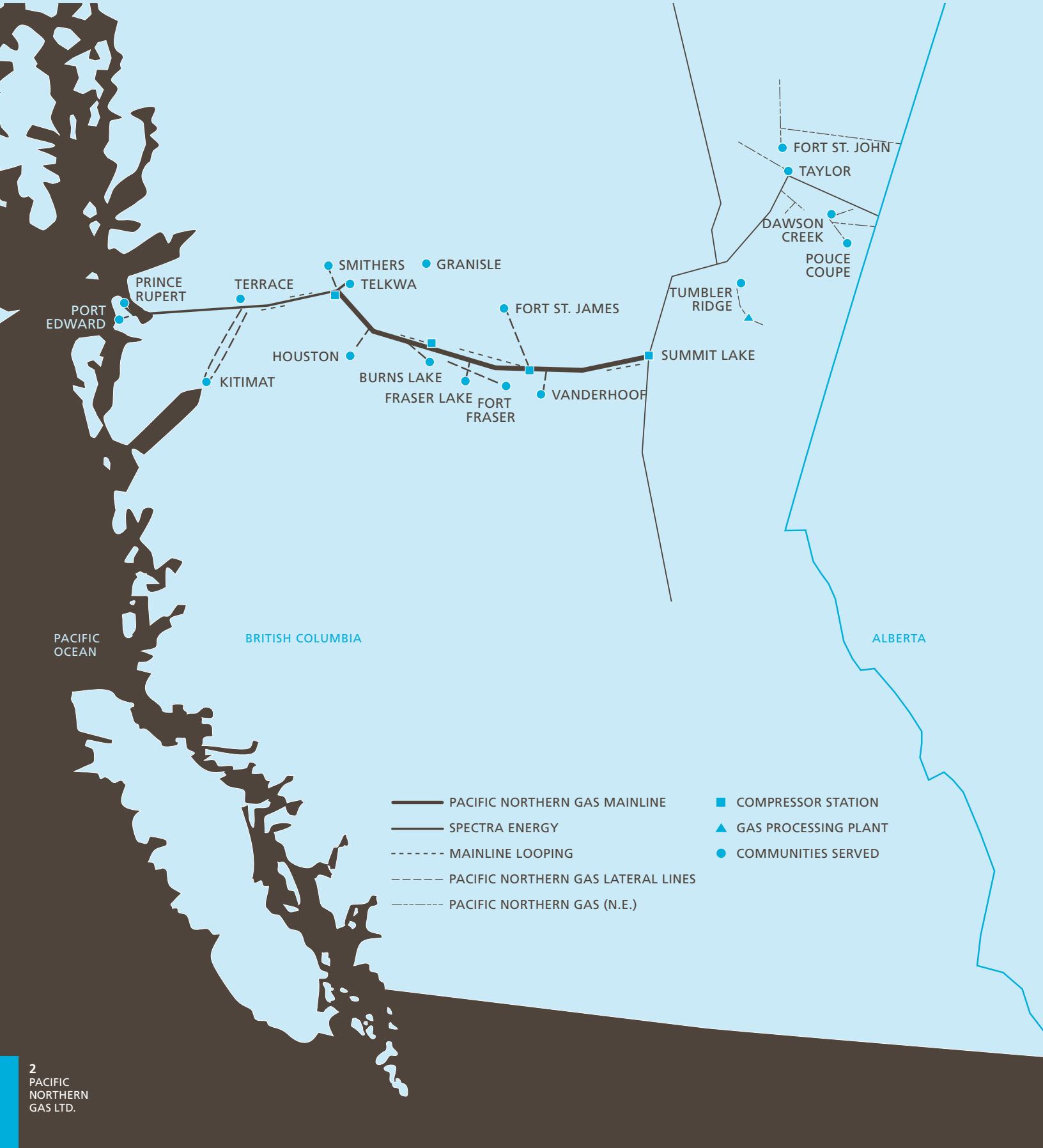
Comparative Financial Highlights

YEARS ENDED DECEMBER 31	2010	2009	2008	2007	2006
TOTAL ENERGY DELIVERED (terajoules)	**9,487**	12,145	12,542	13,210	12,395
INCOME STATEMENT ($ in thousands)					
Revenues	**95,164**	104,131	132,839	129,464	138,848
Operating margin, consisting of revenues less cost of gas	**51,051**	46,892	46,715	45,018	47,730
Net income attributable to shareholders	**7,088**	6,532	5,937	4,373	4,951
CASH FLOW STATEMENT ($ in thousands)					
Cash flow relating to operating activities (before working capital)	**18,037**	9,617	8,691	7,297	10,403
Additions to plant, property, equipment and intangible assets	**(15,447)**	(9,601)	(10,373)	(8,855)	(8,093)
Decrease (increase) in regulatory assets and liabilities	**1,718**	3,763	1,141	971	(269)
BALANCE SHEET ($ in thousands)					
Total investment in plant, property and equipment	**196,860**	178,420	177,773	175,234	172,996
Total assets	**249,924**	220,209	222,049	219,817	230,065
Long-term debt	**90,953**	74,579	76,933	75,121	76,559
Common shareholders' equity	**89,043**	85,436	83,724	81,229	79,777
COMMON SHARE STATISTICS ($ per share)					
Earnings per common share–Basic	**1.88**	1.72	1.53	1.11	1.27
Earnings per common share–Diluted	**1.83**	1.71	1.52	1.10	1.26
Dividends declared per common share	**1.14**	0.96	0.88	0.80	0.80
Dividends declared per preferred share	**1.69**	1.69	1.69	1.69	1.69
Common shares outstanding (thousands)					
Average for the year	**3,598**	3,595	3,665	3,649	3,631
End of year	**3,615**	3,556	3,665	3,665	3,641

EARNINGS PER COMMON SHARE



Map of Operations



Report to Shareholders

HIGHLIGHTS

- PNG sold its 50 per cent interest in Pacific Trail Pipelines (PTP), the developer of the Kitimat-Summit Lake (KSL) Project, to partners Apache Canada Ltd. and EOG Resources Canada Inc. following year end. This transaction has value of up to $50 million plus additional potential future value through long-term transportation and operating/ maintenance agreements.
- The PTP sale enabled PNG to declare a special dividend of $3.00 per common share over and above the regular 2011 first quarter dividend of $0.30 per share. The total dividend of $3.30 was paid March 24, 2011 to shareholders of record at the close of business on March 15, 2011.
- PNG achieved a 9 per cent gain in net income in 2010 driven by higher returns on PNG's regulated assets and positive contributions from the McNair Creek acquisition.
- We anticipate continued growth through accretive renewable power acquisitions and positive economic developments in our service areas from the LNG industry, new mining and metal processing projects, and a strong oil and gas production sector.

FINANCIAL REVIEW

PNG's net income in 2010 reached $7.1 million or $1.88 per share, up 9 per cent from $6.5 million or $1.72 per share in 2009. Our annualized dividend rate, excluding the special dividend, rose to $1.20 per share, up 25 per cent from $0.96 per share paid in 2009 and 50 per cent above the $0.80 per share paid in 2007. These progressive increases reflect PNG's strategy to align dividend payout ratios with other publicly-traded utilities.

Growth in the regulated components of our business and the inclusion of a partial year of operations at the McNair Creek hydroelectric facility, positively contributed to earnings while one-time McNair acquisition costs, KSL Project expenditures and expenses for corporate reorganization and strategic initiatives had a downward impact on earnings.

In February 2010, PNG's existing $20 million revolving term facility was increased to $35 million and the maturity date was extended to January, 2015, resulting in more liquidity to meet ongoing capital obligations and to pursue strategic initiatives.

BUSINESS MILESTONES

Sale of PTP

On March 2, 2011, PNG completed the sale of its 50 per cent interest in PTP for value of up to $50 million, to our Calgary-based PTP partners Apache Canada and EOG Resources Canada. PTP is the developer of the KSL Project, a planned 463-kilometre natural gas pipeline from Summit Lake, BC to Kitimat, BC that is expected to commence serving the Kitimat LNG terminal in 2015.

The $50 million transaction has two components. The first was a cash payment of $30 million (about $21 million after taxes and transaction-related expenses) received by PNG on closing. Approximately $11 million of these proceeds were used to pay the special dividend of $3.00 per share in March, 2011. The second is a cash payment of $20 million contingent on a decision being made to proceed with construction of the Kitimat LNG terminal. PNG can give no assurance that the $20 million contingent payment will be made.

The initial $30 million payment and contingent $20 million payment compare with PNG's investment on shareholders' behalf of approximately $7.5 million in pre-tax dollars or about

LEFT: Roy G. Dyce, President and Chief Executive Officer
RIGHT: Robert F. Chase, Chair of the Board

$5 million in after-tax dollars since 2005. In value per share, the transaction equates to roughly $9 or $10 after taxes and transaction-related expenses, including management incentives. Clearly, the sale delivers full and fair value to PNG's shareholders for their investment in PTP.

Assuming the Kitimat LNG facility proceeds, long-term benefits will result from the transportation and operating/maintenance agreements PNG negotiated as part of the sale terms. Under the 20-year transportation agreement, a portion of PNG's current pipeline capacity would serve the Kitimat LNG terminal provided the capacity is not first used by LNG Partners, LLC of Houston to serve their planned smaller-scale LNG project. Either way, throughput on PNG's existing pipeline would significantly increase, thereby lowering the average cost of transporting gas and creating efficiencies for PNG and its customers. The operating/maintenance agreement will also contribute long-term stability and benefits to customers and shareholders alike.

LNG Partners Small-Scale LNG Project

PNG and LNG Partners are parties to a firm gas transportation service agreement (TSA) that provides LNG Partners with the option to commit to use 80 million cubic feet per day of existing capacity on PNG's Western system. If the option is exercised, LNG Partners will use the transportation service to deliver natural gas to their planned smaller-scale LNG project to be located on Douglas Channel near Kitimat.

To date, PNG has received option fees of $4.5 million under the TSA, including a $1.0 million payment made in December, 2010 to extend the exclusive option period until June 30, 2011. This period may be extended to December 31, 2011 and then to June 30, 2012, upon payment of $1.0 million per extension. If the option is exercised, LNG Partners may initially designate a two- to five-year primary term and then has the right to renew for three additional consecutive five-year terms.

While PNG cannot assure the option will be exercised, if service commences under the TSA, PNG's Western system will be at full capacity, generating about $16 million per year of incremental revenue for the benefit of PNG and its customers. The cost to reactivate the facilities left idle in 2005 when Methanex permanently closed its operations in Kitimat will be recovered from these incremental revenues. All or a portion of the option fees will be credited to the charges payable by LNG Partners to PNG under the TSA, with the credit declining as the commencement of service date is extended.

LNG Industry Potential

A continent-wide gas surplus and an attractive price spread between North American and Asian markets continue to support growth of an LNG industry in PNG's Western system service area. Kitimat is considered an ideal location for LNG liquefaction terminals because of its more direct access to Asian markets compared to southerly ports and due to its relatively close proximity to the vast natural gas fields in northeastern BC.

PNG believes it will benefit from the LNG industry, in large part due to the key relationships developed with First Nations and other stakeholders during the past five years. Our excellent pipeline operating track record, expertise in securing environmental and pipeline permits, understanding of regulatory matters and capabilities in terms of pipeline operation and maintenance will be attractive to LNG industry participants. The Kitimat area can support more LNG terminals and we believe PNG is well positioned to participate in the building of additional pipelines along the Summit Lake to Kitimat corridor.

Renewable Power Initiatives

PNG has specific strategies for capitalizing on the growth potential of electricity and renewable energy generation. Significant steps were taken in this direction in April, 2010 when we formed a key partnership with Skookum Power Corporation and acquired the McNair Creek run-of-river hydroelectric generation facility on BC's Sunshine Coast.

Our development and operating agreement with Skookum Power gives PNG access to extensive expertise in hydrology, engineering and commercial development that we expect will facilitate continued expansion of investments in renewable power opportunities. We consider our first such investment a success given 2010's positive cash flow from the operation of the McNair facility, disregarding one-time acquisition costs.

PNG and Skookum are evaluating several other potential renewable power projects, with a focus on acquiring operating assets while also considering participation at the development level.

Natural Gas Deliveries

In 2010, deliveries of natural gas decreased, due in part to the loss of a large customer in the forest industry. West Fraser Mills Ltd.'s paper mill in Kitimat closed in January, 2010. The transportation service agreement with West Fraser provided for early cancellation with a termination payment designed to recover almost 80 per cent of lost revenues over the remaining term of the agreement. West Fraser paid PNG just over $5 million on December 1, 2010 to terminate the agreement at the end of November. PNG is seeking approval from the BC Utilities Commission (BCUC) to amortize the termination payment over the period ending December 31, 2013 (the original expiration date under the agreement) to limit the impact of the loss of revenue on customer rates.

We believe there are several promising resource-based industry prospects for future economic growth and higher natural gas demand in PNG's service areas. Rio Tinto Alcan has announced a $300 million investment for construction of facilities that would be required if they proceed with their proposed $2.5 billion modernization of the company's aluminum smelter in Kitimat. Other potential investments in coal and metal mining, the possible expansion of Ridley Terminals' coal port in Prince Rupert, and continued oil and gas developments in the Northeast, should generate significant economic activity and a corresponding increase in demand for gas in our service areas.

Positive Regulatory Conditions

Last year the BCUC approved important changes to the return on common equity components applicable to PNG. These changes included an increase in the deemed regulated common equity from 40 per cent to 45 per cent for our Western system, effective January 1, 2009, and from 36 to 40 per cent for our Northeastern system as of January 1, 2010. In addition, the benchmark return on equity that underpins the calculation of PNG's allowed return on equity was increased by 103 basis points from 8.47 to 9.50 per cent. The increase was effective for the latter half of 2009 and for the full year in 2010.

CLOSING

Strategically, we intend to continue increasing shareholder value by optimizing our existing assets, as well as growing and diversifying our business through targeted acquisition and development opportunities. The KSL Project, and the value that has accrued through the sale of our interest in PTP, demonstrates how PNG can use its assets, capital and capabilities to generate added value for shareholders and customers alike.

On behalf of the Board of Directors, I would like to express my gratitude to you, our shareholders, for your ongoing support as we look to the future growth of our company. I would also like to thank all of our employees for another year of unrelenting dedication and hard work.

ROY G. DYCE
President and Chief Executive Officer
March, 2011

Management's Discussion & Analysis

DATE: MARCH 3, 2011

This management's discussion and analysis ("MD&A") should be read in conjunction with the accompanying audited consolidated financial statements of Pacific Northern Gas Ltd. ("the Company") and related notes for the year ended December 31, 2010. The financial data included in this discussion has been prepared in accordance with Canadian generally accepted accounting principles ("Canadian GAAP") and all dollar amounts are in Canadian dollars unless otherwise indicated.

Additional information concerning the Company, including its most recent Annual Information Form, can be found at www.sedar.com.

FORWARD-LOOKING STATEMENTS

This MD&A includes forward-looking statements. Forward-looking statements relate to, among other things, (i) anticipated growth, financial performance and business prospects, (ii) business and economic conditions, (iii) strategies, (iv) regulatory developments, (v) new services, (vi) market forces and (vii) technological developments. Specifically, forward-looking statements are made with respect to expectations regarding:

- The timing and results of regulatory decisions, including with respect to the 2011 revenue requirements application (see "Regulatory Activities");
- The timing of the closing of the sale of the Company's interest in Pacific Trail Pipelines Limited Partnership ("PTP") and receipt of payments (see "Business Overview – KSL Project);
- The timing for the commencement of transportation service for the potential LNG Partners LLC ("LNG Partners") small scale liquefied natural gas ("LNG") project and the cost of reactivating compressor stations to provide such service (see "Business Overview – Capacity Utilization on the Western System");
- Growth of opportunities in renewable energy generation;
- The benefits of the acquisition of the McNair Creek hydroelectric generation facility (see "Business Overview – Renewable Energy Business");
- The regulatory treatment of the West Fraser termination payment (see "Business Overview – Closure of West Fraser Eurocan Paper Mill");
- The competitiveness of retail gas rates relative to electricity rates (see "Business Overview - Competitiveness of Rates");
- The trends in customer numbers in the Western and Northeastern service areas;
- The impact of economic conditions on the Company's performance and prospects for growth;
- The required levels of pension funding and the fair value of pension assets;
- The renewal of franchise and operating agreements;
- The level of and source of funding for capital expenditure requirements; and
- The impact of climate change initiatives on the Company's performance.

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:

- gas commodity prices and, in particular, the continuation of low gas prices;
- forecasted gas deliveries as set out in the Company's 2011 revenue requirements application;
- regulatory conditions, including decisions by the British Columbia Utilities Commission (the "Commission");
- the Company's future growth opportunities;
- 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;
- income tax considerations;
- operating risks and related insurance coverage and inspection and integrity systems; and
- general economic 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 2010 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; federal and provincial climate change initiatives; financing of investments as well as the value of such investments; the cost and availability of capital; the impact on the Company's liquidity if it were to go offside of the covenants in its debt facilities; successful execution of strategic initiatives; the ability of the Company to attract and retain quality employees, and the impact of accounting changes, including the transition to International Financial Reporting Standards ("IFRS"). 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, except as required by applicable securities laws.

ENERGY MEASURES

This MD&A includes references to various energy measurements, including the joule, which is a metric energy measurement unit. One gigajoule (GJ) is one billion joules and is equivalent to 947, 817 British thermal units. One terajoule (TJ) is one thousand GJ and one petajoule (PJ) is one million GJ. One GJ is equivalent to approximately 0.9225 Mcf of gas. Mcf means one thousand cubic feet and Mmcf means one million cubic feet. 10^3m^3 means one thousand cubic metres. In volumetric units, one thousand cubic metres is equivalent to 35.30 thousand cubic feet.

NON-GAAP MEASURES

References to "operating margin" are to revenues less cost of gas. Operating margin is not a recognized measure under Canadian GAAP and does not have a standardized meaning prescribed by Canadian GAAP. Therefore, operating margin may not be comparable to similar measures presented by other issuers. Readers are cautioned that operating margin should not replace revenues as a measure of performance. Management believes operating margin is a meaningful measure of performance because the Company's gas transmission and distribution financial results are best measured by excluding the cost of gas which is flowed through to customer rates without a mark-up.

References to "net earnings before acquisition and reorganization costs" and "net earnings before acquisition and reorganization costs per share" represent pro forma earnings and earnings per share measures based on net earnings before deduction of acquisition and reorganization costs incurred. These pro forma measures are not recognized measures under Canadian GAAP and do not have standardized meanings prescribed by Canadian GAAP. Therefore, net earnings before acquisition and reorganization costs and net earnings before acquisition and reorganization costs per share may not be comparable to similar measures presented by other issuers. Readers are cautioned that net earnings before acquisition and reorganization costs and net earnings before acquisition and reorganization costs per share should not replace net earnings and net earnings per share as measures of performance. Management believes net earnings before acquisition and reorganization costs and net earnings before acquisition and reorganization costs per share are meaningful measures of performance for the Company's recently acquired McNair hydroelectric facility as it removes the impact of one-time acquisition and reorganization costs and provides earnings results that might be considered more indicative of future performance.

BUSINESS OVERVIEW

The Company and its wholly-owned subsidiary Pacific Northern Gas (N.E.) Ltd. ("PNG (N.E.)") are natural gas distribution utilities operating within the Province of British Columbia, Canada.

The Company operates a transmission and distribution system in the west-central portion of northern British Columbia ("Western system") and PNG (N.E.) operates a distribution system in northeastern British Columbia ("Northeast system"). The Northeast system is comprised of two divisions, the Fort St. John/Dawson Creek division and the Tumbler Ridge division.

The Company also operates and owns a 97 percent interest in the 9.8 megawatt ("MW") McNair Creek hydro-electricity generation facility ("McNair") located on British Columbia's Sunshine Coast.

Business Strategy

The Company's strategy is to increase shareholder value by optimizing the value of its existing assets and by growing and diversifying its business through targeted acquisition and development opportunities. The Company is focusing its strategic initiatives on enhancing value from its regulated business and evaluating development and acquisition opportunities. It is also reviewing its business strategy in light of the recent sale of its interest in the proposed natural gas

pipeline in central British Columbia, from Kitimat to Summit Lake ("KSL Project"), and the March 2, 2011 receipt of $30 million of the $50 million sales price (see "Business Overview – KSL Project" and "Subsequent Event").

In respect of its strategy, the Company has concluded:

- It must grow profitably and increase its market capitalization in order to enhance shareholder value;
- It is important for the Company to seek growth opportunities in areas that complement its strengths and fit well within its existing risk profile;
- Merger and acquisition opportunities are limited in the Canadian utility sector given the Company's small relative size; and
- There are two near-term business improvement opportunities in the Company's service area that would materially benefit the Company and its customers: (i) the LNG Partners small scale LNG project; and (ii) the transportation service agreements for delivery of LNG to supplement the KSL Project and an operating and maintenance agreement for the KSL Project (see "Business Overview – KSL Project" and "Business Overview – Capacity Utilization on the Western System").

As there are limited opportunities to expand through acquisitions of Canadian natural gas distribution assets, management and the Board of Directors have identified specific parameters for evaluating growth opportunities through electricity and renewable energy generation.

In particular, based on the following factors, it has been determined that renewable independent hydro power development and operation with long-term off-take contracts would provide the best fit for the Company:

- renewable energy is a growth area;
- long term fixed-price off-take agreements are available for independent power projects in a number of Canadian jurisdictions, including British Columbia;
- the technology is well developed and the resource is relatively predictable;
- the Company can utilize its operating skills, permitting expertise, project management capabilities, financing acumen and energy market and regulatory expertise;
- both operating projects and development projects are available in sizes which fit the Company's access to capital; and
- although the Company does not have internal technical expertise for hydro power, it has contracted access to that expertise through an agreement with Skookum Power Corp. ("Skookum Power") and may broaden such access via additional partnerships or acquisitions.

The Company can give no assurances that it will be successful in identifying, financing or realizing value from these opportunities.

The Company has focused on increasing its dividend yield to shareholders to a level more consistent with other publicly-traded utilities. In that regard, the Company announced a quarterly dividend increase in February 2010 to $0.28 per common share and a further increase in October 2010 to $0.30 per common share.

KSL Project

PTP is the developer of the KSL Project, a proposed 463 kilometre natural gas pipeline in central British Columbia, from Kitimat to Summit Lake. The KSL Project would serve the planned Kitimat LNG facility owned by Apache Canada Ltd. ("Apache Canada") and EOG Resources Canada Inc. ("EOG Canada"). The Kitimat LNG facility and the KSL Project have the support of, and will provide benefits to, many stakeholders including the First Nations with traditional territories in the project area. The Company has held a 50 percent interest in PTP since the KSL Project's inception in 2005.

In the third quarter of 2010, PTP commenced the detailed design phase of the KSL Project and the Company commenced capitalization of these expenditures. The Company's share of expenditures on the KSL Project for the year ended December 31, 2010 was $1.25 million, including $0.7 million which has been capitalized relating to engineering and technical studies.

On February 4, 2011, the Company entered into an agreement to sell its 50 percent interest in PTP and the underlying KSL Project to Apache Canada and EOG Canada, the Company's partners in the project, for payments of up to $50 million (see "Subsequent Event"). This transaction has two components, the first being a cash payment of $30 million that the Company received on March 2, 2011, and the second being a cash payment of $20 million to be paid contingent on the purchasers making a decision to proceed with construction of the Kitimat LNG facility. The Company can give no assurances that construction of the Kitimat LNG facility will be completed or that the $20 million payment will be made.

As a result of the transaction, Apache Canada's ownership of the pipeline will increase from 25.5 percent to 51 percent and EOG Canada's ownership will increase from 24.5 percent to 49 percent.

The Company's shareholders will benefit from the full crystallization of cash proceeds received on this transaction. The $50 million sale proceeds have an approximate value of $9 to $10 per share after taxes and related expenses, including payments under the KSL Project management incentive plan, should the second contingent payment of $20 million be released.

The Company has recorded $7.3 million of KSL Project expenditures from its inception to December 31, 2010, of which $6.6 million has been expensed and $0.7 million has been capitalized.

On March 3, 2011, the Company's Board of Directors declared a special dividend of $3.00 per common share, which represents approximately $11 million of the proceeds from the sale of PTP.

TRANSPORTATION SERVICE AGREEMENT

In connection with the sale, the Company agreed on the terms for a 20-year transportation service agreement with Apache Canada and EOG Canada that will significantly increase the utilization of the Company's current pipeline in the event that LNG Partners does not claim this capacity first.

If the LNG Partners project does not proceed and the Kitimat LNG facility does proceed, Apache Canada and EOG Canada would use up to 50 MMcf per day of the Company's existing pipeline capacity to supplement KSL Project pipeline throughput. Initial deliveries via the Company would be 30 MMcf per day starting with initial LNG production. Delivery of an additional 20 MMcf per day via the Company would commence if liquefaction capacity is later increased.

Service under the agreement would commence with commercialization of the Kitimat LNG facility which is expected to occur in 2015. The transportation service agreement is subject to approval by the Commission.

OPERATING AND MAINTENANCE AGREEMENT

The Company will operate the KSL Project pipeline under an operating and maintenance agreement negotiated with Apache Canada and EOG Canada. The operating and maintenance agreement will have an initial term of seven years beginning in 2015, with renewal provisions, and will be subject to approval by the Commission.

Capacity Utilization on the Western System

A letter agreement with Merrill Lynch Commodities Inc. ("Merrill Lynch") provided Merrill Lynch with an option to contract for 75 MMcf per day of firm gas transportation service using existing capacity on the Company's Western system. The letter agreement also provided for the parties to negotiate a definitive transportation service agreement ("TSA") for filing with the Commission for acceptance as a filed tariff. The TSA was accepted by the Commission as a filed tariff on June 17, 2010. During final negotiations, the parties agreed to increase the capacity option from 75 to 80 MMcf per day. The TSA documents the option provisions and the transportation service provisions that would apply following exercise of the option. On August 11, 2010 Merrill Lynch assigned and novated the TSA to LNG Partners. If LNG Partners exercises its option, it is expected to utilize the transportation service to deliver natural gas to a small scale LNG facility to be located on the Douglas Channel near Kitimat, British Columbia. It is expected that the LNG produced at this facility would be exported to LNG markets in Asia.

The Company has received option fees of $4.5 million to secure an exclusive option under the TSA until June 30, 2011 to contract for firm gas transportation capacity for a two-to five-year primary term, with a right to renew for three additional five-year terms. LNG Partners may extend the option period by up to two further six-month periods, with payment of $1 million for each extension.

If service commences under the TSA, the Company's Western system would be at full capacity utilization, generating approximately $16 million per year of incremental margin for the benefit of the Company and its customers. The cost to reactivate the facilities left idle when Methanex Corporation ("Methanex") ceased operations in 2005 will be recovered from these incremental revenues. The reactivation costs are in the range of $1.3 million with the largest single expense being the cost of completing a compressor overhaul at an estimated cost of $0.5 million. For regulatory purposes, the Company anticipates expensing all reactivation costs in the first year of operation. If service commences by June 30, 2012 all of the option fees previously paid to the Company will be credited to transportation service fees payable in 2012. The option fee credit to LNG Partners will be reduced by $0.5 million if service commences after June 30, 2012 but before December 31, 2012. A further reduction of $0.5 million will apply if service commences after December 31, 2012. If service does not commence by January 1, 2015 then the TSA would terminate and the Company would retain all option fees.

The Company can give no assurances that LNG Partners will continue to extend the option or exercise its option to take capacity on the Western system.

Renewable Energy Business

In April 2010, the Company entered into a joint development and operating agreement with Skookum Power gaining access to extensive expertise in hydrology, engineering and commercial development to support its new renewable energy business platform. The principals of Skookum Power are former power company executives who have collectively more than 50 years experience in the hydro-electricity and energy sectors.

On April 19, 2010, the Company, in partnership with Skookum Power, closed the acquisition of the 9.8 MW McNair Creek hydro-electricity generation facility from Kiewit Hydropower Investors Inc. and Renewable Power Corp., with the Company holding a 97% share. The McNair facility is located on British Columbia's Sunshine Coast near Port Mellon and has been in operation for more than 5 years. The facility's generation is committed for sale under a long-term contract to BC Hydro.

The total purchase price was approximately $17.5 million and has been funded in part by the assumption of $9.4 million in non-recourse debt and the remainder in cash payments. The Company's cash purchase obligations were met through drawings on its existing credit facilities. The transaction is expected to be cash flow positive for 2011 onwards.

On December 16 and 17, 2010, the McNair Creek Hydro Partnership (a general partnership) was converted to McNair Creek Hydro Limited Partnership through a series of restructuring transactions and the Company became a limited partner owning 97.1% of the limited partnership. The McNair Creek Hydro Limited Partnership was registered under the laws of British Columbia on December 17, 2010. Its main business activity continues to be the operation of the 9.8 MW McNair hydro-electricity generation facility.

Closure of West Fraser Eurocan Paper Mill

West Fraser Timber Co. Ltd. ("West Fraser") permanently closed its Kitimat linerboard mill at the end of January 2010. The Company had a transportation service agreement with West Fraser which specified a daily contract demand volume of 6.0 MMcf per day that was set to expire on December 31, 2013. Under the terms of the transportation agreement, West Fraser paid the Company an annual demand charge of approximately $2.1 million and was entitled to cancel its obligations by providing the Company with a termination payment that would recover almost 80 percent of the lost revenues under the remaining term of the agreement.

On May 31, 2010 West Fraser provided the Company with the required six months cancellation notice. West Fraser paid the monthly demand charge due under the transportation agreement until November 2010. A termination payment of $5.1 million was received on December 1, 2010. The Company expects that the termination payment will be amortized into earnings over the remaining life of the agreement; the same regulatory treatment accorded the Methanex termination payment made in 2006. The Company has sought Commission approval of this treatment in its 2011 revenue requirements application. In addition, as was the case with the closure of the Methanex plant, the Company will mitigate the impact of lower margin recovery by managing its costs and by seeking Commission approval to recover the future loss of margin through standard rate applications to the Commission. Should these measures be approved, the Company anticipates limited impact on future earnings.

Competitiveness of Rates

As a distributor of natural gas, the Company continuously monitors the competitiveness of its natural gas retail rates relative to alternative heating sources in its service area. The Company's current residential rates in all divisions are lower than the current comparable residential electricity rate. Declines in gas commodity prices payable by the Company during 2010 helped to make gas rates more competitive relative to electricity.

The Province of British Columbia's (the "Province") Energy Plan, released in early 2007, calls for the Province to become self-sufficient in electricity by 2016 with all new generation capacity being carbon neutral and to use demand side management to curtail growing electricity consumption. These policy objectives have contributed to and are expected to result in higher electricity rates over the long term. The Province implemented a carbon tax on fossil fuel consumption effective July 1, 2008. The carbon tax on natural gas was just under $0.50 per GJ effective July 1, 2008, rising annually by approximately $0.25 per GJ each July 1, to just under $1.50 per GJ effective July 1, 2012. Notwithstanding the impacts of carbon tax on natural gas, the cessation of the Methanex termination payment credit amortization and the closure of the West Fraser Eurocan Kitimat paper mill in January 2010, the Company expects its retail gas rates will maintain their relative competitiveness with electricity rates as electricity rate increases have been higher than the impact of the carbon tax on natural gas prices and electricity rates are expected to rise over time to meet the Province's energy policy objectives. The Company's 2011 Western system revenue requirements application is seeking Commission

approval of a bundled average residential rate of $20.31 per GJ effective January 1, 2011, including the current carbon tax of $0.9932 per GJ. This is approximately 5 percent less than the equivalent residential conservation electricity rate of $21.44 per GJ.

Amendments made to the *Utilities Commission Act* (British Columbia) in 2008 focus on the energy conservation and demand side management goals and objectives set forth in the Energy Plan. The Company is participating with government stakeholder groups to keep apprised of potential cost effective demand side management initiatives that make sense for its customers.

Negotiated Settlement Agreements – 2010 Revenue Requirements Applications and the Capital Structure and Equity Risk Premium Application (the "CAP/ROE Application")

On June 23, 2010 the Commission approved the negotiated settlement agreements in respect of the 2010 revenue requirements applications for the Western system and Northeast system and the CAP/ROE Application (the "settlement agreements"). The key matters agreed to under the settlement agreements are summarized as follows:

- The parties agreed the common equity capitalization and risk premiums relative to the benchmark utility return on equity ("ROE") for the Western system division (effective January 1, 2009) and the Fort St. John/Dawson Creek and Tumbler Ridge divisions (effective January 1, 2010) would be as follows:

	Western System Division	Fort St. John/ Dawson Creek Division	Tumbler Ridge Division
Common equity capitalization	45%	40%	40%
Equity risk premium	65 basis	40 basis	65 basis

On a consolidated basis, this provided the Company with the opportunity to increase overall earnings in 2010 by approximately $0.6 million or $0.17 per share. Further, an additional $0.5 million of net income was included in the second quarter to reflect the January 1, 2009 effective date for the Western system common equity capitalization ratio adjustment.

The equity risk premiums are relative to the benchmark utility ROE of 9.50% that became effective July 1, 2009 resulting in the following ROE's in 2010 and 2009 for each division:

Year	Western System Division	Fort St. John/ Dawson Creek Division	Tumbler Ridge Division
2010	10.15%	9.90%	10.15%
2009	9.63%	9.38%	9.63%

The 2009 ROE's are lower than applicable in 2010 to account for the fact the benchmark ROE of 9.50% was made effective July 1, 2009.

- The interim rates effective January 1, 2010 were made permanent for 2010. Having regard to the fact the interim rates were based on forecast 2010 costs of service using common equity capitalization and ROE figures that were less than the agreed to figures, the parties agreed the difference between: (i) the 2010 gross margins using the interim rates; and (ii) the costs of service based on the parameters agreed to under the final settlement agreements would be recorded, for future disposition, in the common equity deferral accounts approved by the Commission under Order G-172-09.
- On December 31, 2010, the Company used a portion of the balance in the LNG Partners option fees deferral account to draw down the remaining $2.0 million balance in the Western system common equity deferral account as agreed under the Western system negotiated settlement agreement.

OVERALL PERFORMANCE

Net income for 2010 was $7.1 million, compared with $6.5 million for 2009. After providing for preferred share dividends, basic earnings per common share for 2010 were $1.88 compared with $1.72 for 2009. Net income available to common shareholders increased by $0.6 million mainly due to higher allowed rates of return on common equity, higher common equity components and incremental operating earnings from McNair, partially offset by higher KSL Project development expenses incurred in 2010 compared to 2009 and by costs incurred on the McNair acquisition and reorganization as well as other strategic initiatives.

The allowed weighted-average return on deemed common equity increased from 9.58 percent in 2009 to 10.09 percent in 2010. The increased ROE reflects the impact of the Commission's decision in December 2009 to increase the return on equity for the benchmark low-risk utility in British Columbia from 8.47 percent to 9.50 percent effective July 1, 2009.

Included in net income for 2010 are after-tax charges of $0.4 million, or $0.11 per share, compared with after-tax charges of $0.1 million, or $0.04 per share for 2009, relating to the

Company's share of KSL Project development expenses and after-tax charges of $0.7 million, or $0.19 per share relating to the McNair acquisition and subsequent reorganization. The Company's decision to early adopt the new accounting standard for business combinations has resulted in the expensing of $0.5 million of costs related to the McNair acquisition, rather than their inclusion as part of the cost of the business acquisition. If not for the Company's early adoption of this standard, net earnings per common share for the year ended December 31, 2010 would have been $2.01 instead of $1.88.

SELECTED ANNUAL INFORMATION

The following financial information has been prepared in accordance with Canadian GAAP and is shown in Canadian dollars.

$ in thousands, except TJ, customer, per GJ and per share data	**2010**	2009	2008
Deliveries (TJ):			
Sales: Western system	**2,330**	2,965	3,070
Sales: Northeast system	**3,365**	3,765	3,608
Transportation service: Western system	**1,867**	3,214	3,572
Transportation service: Northeast system	**1,925**	2,201	2,292
Total	**9,487**	12,145	12,542
Customers at period end	**39,405**	39,113	39,113
Weighted average cost of gas purchased (per GJ)	**5.44**	6.35	7.84
Revenues	**95,164**	104,131	132,839
Operating margin*, consisting of revenues less cost of gas	**51,051**	46,892	46,715
Net income attributable to shareholders	**7,088**	6,532	5,937
Basic earnings per common share	**1.88**	1.72	1.53
Diluted earnings per common share	**1.83**	1.71	1.52
Total assets	**249,924**	220,209	222,049
Total long-term financial liabilities	**114,389**	93,913	88,380
Dividends paid per common share	**1.14**	0.96	0.88
Dividends paid per preferred share	**1.69**	1.69	1.69

* Operating margin is not a recognized measure under Canadian GAAP and does not have a standardized meaning prescribed by Canadian GAAP. See "Non-GAAP Measures".

RESULTS OF OPERATIONS

The following table summarizes the Company's revenues and operating results by business segment.

Year ended December 31, 2010 $ in thousands	**Gas Transmission and Distribution**	**Renewable Energy**	**Total**
Revenues	**93,848**	**1,316**	**95,164**
Operating margin	**49,735**	**1,316**	**51,051**
Net income (loss) attributable to shareholders	**7,640**	**(552)**	**7,088**
Year ended December 31, 2009 $ in thousands			
Revenues	104,131	–	104,131
Operating margin	46,892	–	46,892
Net income attributable to shareholders	6,532	–	6,532

Gas Transmission and Distribution

Revenues in 2010 were $93.8 million compared with $104.1 million in 2009. Gas sales to residential and commercial customers were down by $13 million in 2010 compared to 2009, primarily due to the effects on revenues of warmer weather and a lower commodity cost of gas during 2010. Natural gas commodity prices, which are passed through to the Company's sales customers without mark-up, can be volatile, creating significant variability in the Company's reported revenues and cost of gas. The decrease in 2010 gas sales revenues was partially offset by the positive impacts of the CAP/ROE Application settlement which provided for both a higher ROE and higher equity components.

Operating margin in 2010 increased to $49.7 million, as compared with $46.9 million in 2009. The increase of $2.8 million was mainly due to the higher weighted-average allowed return on deemed common equity of 10.09 percent in 2010 compared to 9.58 percent in 2009 and the recognition of the 5 percent increase in the equity component for the Company's Western system effective January 1, 2009. This was partially offset by lower than anticipated deliveries to large commercial customers and lower than anticipated net customer additions in 2010.

Renewable Energy

For the period from the acquisition date to December 31, 2010, the McNair hydro-electric facility generated revenues of $1.3 million. Operating costs for this period amounted to $0.18 million. The Company recorded net earnings before acquisition and reorganization costs of approximately $0.15 million from renewable energy operations. Transaction costs amounted to approximately $0.7 million after-tax for the nine month period ended December 31, 2010. As noted in the "Summary of Quarterly Results", production from the McNair facility is seasonal.

During 2010, the McNair Creek facility experienced above-average hydrologic conditions due to a higher than normal snowpack, cooler temperatures in the second quarter and above-average precipitation in the fourth quarter. As a result, from the acquisition date to December 31, 2010, electricity generation from the McNair Creek facility was higher than the estimated long-term average.

Natural Gas Deliveries

A comparison of natural gas deliveries for the years 2010 and 2009 is provided in the following table:

Deliveries in TJ	2010	2009
Sales		
Residential	**2,858**	3,221
Commercial	**2,430**	2,851
Small industrial	**400**	471
Large industrial	**7**	187
Total sales	**5,695**	6,730
Transportation service		
Commercial	**274**	230
Small industrial	**2,347**	2,595
Large industrial	**1,171**	2,590
Total transportation service	**3,792**	5,415
Total deliveries	**9,487**	12,145

Deliveries to residential and commercial customers in 2010 were lower by 784 TJ, or 13 percent, compared to deliveries in 2009 due primarily to the warmer weather in 2010 compared to 2009. Weather was warmer by 8 percent compared to prior year and 3 percent warmer than normal. These deliveries were lower than the forecast used for rate making purposes but this did not significantly impact net income due to the existence of the rate stabilization adjustment mechanism ("RSAM") deferral account that captured the after-tax value of the revenue variance, amounting to $2.1 million in 2010. In 2009, deliveries were higher than forecast due to colder weather and resulted in an after-tax value revenue variance of $0.97 million recorded as a credit to the RSAM deferral account.

Industrial Customers

Deliveries to small industrial customers decreased by 319 TJ in 2010 compared to 2009 primarily due to lower consumption by small industrial customers in the forestry sector.

The Company has a firm transportation service and interruptible sales/service agreements with Rio Tinto Alcan Inc. ("Alcan") effective through October 31, 2012. The agreement with Alcan will continue to be in effect beyond October 31, 2012 unless Alcan or the Company gives notice of termination. During 2010, deliveries to Alcan accounted for 9.1 percent of the Company's total gas deliveries and 2.7 percent of revenues.

Alcan produces a commodity that is subject to price fluctuations. The Company's gas deliveries to Alcan have been and may in the future be affected by their ability to continue operations during sustained periods of low prices. Alcan's gas consumption in 2010 was lower by 59 TJ, or 6.3 percent, compared to 2009.

West Fraser permanently closed its Kitimat mill at the end of January 2010 and terminated its agreement with the Company by providing six months notice and making a termination payment to the Company of $5.1 million on December 1, 2010. Deliveries to West Fraser in the months of January and February of 2010 accounted for 2.5 percent of the Company's total gas deliveries and 2.2 percent of total revenues.

The Company delivers gas to its other large industrial customer, BC Hydro, under an interruptible sales/service agreement for emergency electric power generation at BC Hydro's facility in Prince Rupert. Deliveries to BC Hydro in 2010 amounted to 71 TJ compared to 14 TJ in 2009. In both years, BC Hydro operated its station on an intermittent basis to ensure the station was in a ready to operate mode in case of an emergency. However, the higher deliveries in 2010 compared to 2009 were due to BC Hydro operating the facility at the request of the Company to facilitate the use of an in-line pipeline inspection tool.

Customer Additions

There was a net increase of 292 to the ending number of customers in 2010 as the Northeast system service area experienced a net gain of 479 customers and the Western system service area experienced a net loss of 187 customers.

There are few remaining candidates for conversion to natural gas in the existing building stock and limited opportunity remains to extend gas mains into unserviced rural areas in the Western system service area. The Company added approximately 100 new customers in 2010 in the community of Tomslake in the Dawson Creek division as it finalizes the new gas distribution system in this rural area and also added an additional 69 new service installations in this area. The Company did expect to see some customer losses in Kitimat and surrounding areas due to the closure of West Fraser's Kitimat paper mill.

Natural Gas Supply

The Company's large industrial customers, the majority of its small industrial customers and a number of commercial customers arrange their own gas supply and contract for gas transportation service on the Company's pipeline systems. Some of these customers also purchase gas from the Company to supplement their gas supply as may be required from time to time and subject to gas supply availability from the Company.

All of the Company's residential customers, most of its commercial customers and a number of its small industrial customers purchase gas from the Company at rates which include the gas commodity cost and the Company's cost of delivering gas to the customers' premises. The gas commodity cost paid by the Company to its gas suppliers is passed through to these customers without mark-up.

The Commission reviews the gas commodity portion of the Company's rates on a quarterly basis to ensure close alignment with the Company's costs of purchasing natural gas. Any variances in gas costs incurred by the Company relative to the gas cost recovery charges included in current retail rates are deferred for subsequent refund to or recovery from customers. To moderate the variability of the gas supply commodity prices paid, the Company uses financial instruments under a gas price management plan that is filed with the Commission on an annual basis.

For 2010, approximately 42 percent of gas purchases were hedged pursuant to the Company's gas price management plan (for further information as of December 31, 2010 see "Financial Instruments and Other Instruments").

A gas supply contracting plan is prepared annually and filed with the Commission for review prior to finalizing annual gas purchase arrangements. The gas contracting plan is designed to ensure the Company has adequate gas supplies to meet the requirements of its customers on the coldest day of the year, normally referred to as "the peak day". Contracted gas that is surplus to customer requirements on any particular day is sold into other markets at prevailing market prices through off-system gas sales. Most of the Company's contracted gas supply is produced in British Columbia.

Most of the Company's gas supply is comprised of the pooled gas stream available from the Spectra Energy transmission pipeline system. This includes all of the supply to the Company's transmission line serving its Western system service area and, during 2010, approximately 76 percent of the supply for the Fort St. John and Dawson Creek service areas.

In addition to the supply from the Spectra Energy system, the Fort St. John system incorporates two interconnections with Canadian Natural Resources Limited's West Stoddart pipeline, providing 34 percent of the Fort St. John system's requirements in 2010. In Dawson Creek, approximately 5 percent of the required 2010 supply was received from a local producer of sweet (pipeline quality) gas at a point where its system intersects the Company's transmission line. In Tumbler Ridge, all of the gas supply is obtained in the form of raw gas production from Canadian Natural Resources Limited and the Company operates its own gas processing facilities.

In 2010, gas was purchased under a number of short term seasonal, base load and spot gas supply arrangements. Short term gas supply contracts are in keeping with current industry practices.

Regulatory Activities

The Company's natural gas sales and delivery services are subject to regulation under the *Utilities Commission Act* (British Columbia). The Commission regulates these business activities, including the construction and operation of major facilities, the issuance of securities, the determination of rates for the sale and transportation of gas, and the terms and conditions of service.

In approving rates, the Commission must determine that the rates reflect a fair and reasonable charge for the nature and quality of service provided to customers. The rates should be sufficient to enable the Company to earn a fair and reasonable compensation for its services and a fair and reasonable return on the value of its property.

The Commission determines customer rates on the basis of forecasts of both the cost of service and the volumes of gas delivered through the transmission and distribution systems. The cost of service consists of the cost of transporting all gas delivered, including operating, maintenance and administrative expenses, depreciation of facilities, income and other taxes and a return on rate base. Rate base is the sum of the depreciated cost of plant, property and equipment that is used or useful in serving the Company's customers, plus a reasonable allowance for working capital. The Commission determines the allowable return on rate base after considering a variety of factors, including the degree of risk associated with the Company's business and the cost of capital.

Revenue requirements applications for all service areas are submitted to the Commission, generally on an annual basis. The Commission may consider these applications through a public hearing process (either oral or written), or through Commission staff supervised negotiations between the Company and its customers under negotiated settlement guidelines issued by the Commission. Settlements are subject to final approval by the Commission.

2011 REVENUE REQUIREMENTS APPLICATIONS

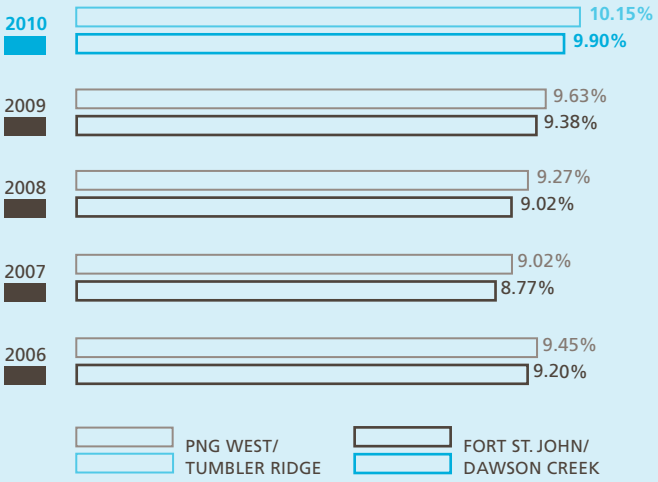
In late November 2010, the Company filed its 2011 revenue requirements applications for all divisions. The applications sought approval to increase rates on an interim basis effective January 1, 2011 pending the Commission's review of the applications. The Commission approved interim rates effective January 1, 2011 at the levels set forth in the applications.

The Company amended the applications in mid-January 2011 to reflect changes to the treatment of a number of deferral accounts in response to being advised that the Commission had directed other utilities to reflect changes in response to the deferred implementation of IFRS for rate-regulated entities effective January 1, 2012, rather than January 1, 2011 (see "Changes in Accounting Policies – Future Accounting Pronouncements"). The 2011 revenue deficiency projected for the Western system under the amended application is approximately $2.7 million.

PNG (N.E.)'s Fort St. John/Dawson Creek division has a forecast 2011 revenue deficiency of close to $2.4 million while the Tumbler Ridge division forecast revenue deficiency for 2011 is negligible. The applied for delivery charge increases compared to October 2010 delivery rates for an average residential customer in each service area are 8.3 percent for the Western system ($72 per year), 25.4 percent for the Fort St. John/Dawson Creek division ($93 per year) and 0.5 percent for the Tumbler Ridge division ($2 per year).

A negotiated settlement process is expected to be conducted with respect to the 2011 revenue requirements applications in the second quarter of 2011.

ALLOWED RETURN ON COMMON EQUITY



SUMMARY OF QUARTERLY RESULTS

The following financial information has been prepared in accordance with Canadian GAAP and is shown in Canadian dollars.

$ in thousands, except per share data (unaudited)	Mar. 31	June 30	Sept. 30	Dec. 31
		2010		
Revenues	**40,235**	**15,166**	**9,682**	**30,081**
Net income (loss) attributable to shareholders	**5,488**	**(146)**	**(2,238)**	**3,984**
Earnings (loss) per common share – basic	**1.51**	**(0.06)**	**(0.64)**	**1.10**
Earnings (loss) per common share – diluted	**1.48**	**(0.06)**	**(0.64)**	**1.06**

$ in thousands, except per share data (unaudited)	Mar. 31	June 30	Sept. 30	Dec. 31
		2009		
Revenues	48,318	14,141	10,500	31,172
Net income (loss) attributable to shareholders	5,156	(400)	(1,660)	3,436
Earnings (loss) per common share – basic	1.39	(0.13)	(0.49)	0.95
Earnings (loss) per common share – diluted	1.38	(0.13)	(0.49)	0.93

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% 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.

The Company's renewable energy business is also seasonal, with revenues from electricity sales highly correlated to the amount of precipitation, as well as the timing of snow pack melt in the catchment area of the McNair Creek hydroelectric power plant. The Company expects that almost 40 percent of its annual production will occur in the second quarter, only 10 percent will occur in the third quarter, with the first and fourth quarters providing the remainder of the production relatively equally.

LIQUIDITY

Cash and cash equivalents at December 31, 2010 of $1.9 million were $0.4 million higher than at December 31, 2009. Accounts receivable at December 31, 2010 of $23.0 million were $1.4 million higher than at December 31, 2009 even though deliveries to customers were lower in 2010 compared to 2009. The increase in accounts receivable is mainly due to the higher delivery rates in 2010, the timing of customer payments, and the inclusion of a receivable from BC Hydro for the McNair operations at the end of 2010. Prepaid expenses of $1.1 million at December 31, 2010 remained at levels similar to those at the end of the prior year.

Accounts payable and accrued liabilities of $19.1 million at December 31, 2010 were lower by $2.5 million compared to December 31, 2009, mainly due to lower gas purchase costs in December 2010 as a result of lower gas commodity prices. At December 31, 2010, there is a $1.3 million income tax recoverable balance compared to an income tax payable amount of $1.0 million at December 31, 2009. This is mainly due to tax-deductible rate rider credits refunded to customers from the gas purchase variance account during 2010 and the recognition of non-taxable revenues through the RSAM account due to the warmer temperatures in 2010. Other taxes payable at December 31, 2010 remained at similar levels as at December 31, 2009.

The gas purchase variance recoverable account has increased by $3.3 million resulting in a net recoverable amount of $4.5 million at December 31, 2010, compared to the net recoverable balance of $1.2 million at December 31, 2009. This increase was mainly due to the following three items: the net liability fair value of the Company's derivative financial instruments recorded in the gas purchase variance account increased to a net liability position of $6.1 million at December 31, 2010, up $2.2 million from $4.0 million at December 31, 2009 due to decreasing market commodity prices; the gas purchase variance account increased by $2.4 million as the Company refunded amounts to customers via rate rider credits; and gas commodity costs paid by the Company in 2010 were less than the gas commodity cost rates paid by customers resulting in a decrease in the gas purchase variance account by $1.2 million.

Following a December 31, 2009 actuarial valuation of the Company's pension plan completed in September 2010, the Company made funding contributions in 2010 to its pension plan of $2.4 million ($1.3 million in 2009) and expects similar contributions will be required in 2011 and onwards. The Company does not expect this to have a material impact on the Company's liquidity.

CONTRACTUAL OBLIGATIONS

The purchase obligations in the table below represent commitments by the Company to purchase natural gas or transportation service from third parties. The Company enters into a number of arrangements to purchase gas on a seasonal basis for resale to its customers during the heating season.

		Payments Due by Period as of December 31, 2010			
$ in thousands	**Total**	**Less than 1 year**	**1 - 3 years**	**4 - 5 years**	**After 5 years**
Bank indebtedness	**4,836**	**4,836**	**–**	**–**	**–**
Accounts payable and accrued liabilities	**19,106**	**19,106**	**–**	**–**	**–**
Long-term debt (principal repayments)	**91,567**	**8,192**	**6,476**	**23,416**	**53,483**
Derivative financial liabilities	**6,172**	**5,696**	**476**	**–**	**–**
Purchase obligations	**24,878**	**19,837**	**4,893**	**52**	**96**
Total contractual obligations	**146,559**	**57,667**	**11,845**	**23,468**	**53,579**

Funding Requirements

The Company's capital expenditures, acquisition costs, working capital needs, dividend payments and debt repayments are funded from a combination of sources. During 2010, the primary sources of funding were $9.9 million of net cash provided by operating activities and a $10.0 million draw on the Company's 5-year revolving term facility.

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

Financial Ratio – Interest Coverage

For the year ending December 31, 2010, interest coverage using earnings before interest, income taxes, depreciation, and amortization was 3.77 times compared to 4.00 times in the prior year.

Funding Costs

INTEREST EXPENSE

$ in thousands	**2010**	2009
Long-term interest expense	**6,100**	5,653
Short-term interest expense	**102**	81
Imputed interest on regulatory accounts	**202**	(91)
Total	**6,404**	5,643
Effective blended cost of debt	**6.7%**	7.3%

The decrease in the effective blended cost of debt in 2010 relative to 2009 is due mainly to the changing mix of debt instruments in the Company's portfolio. In particular, the fixed-rate debentures issued by the Company continue to amortize and are becoming a smaller portion of the Company's debt portfolio while lower-cost floating-rate debt is becoming an increasing portion of the portfolio.

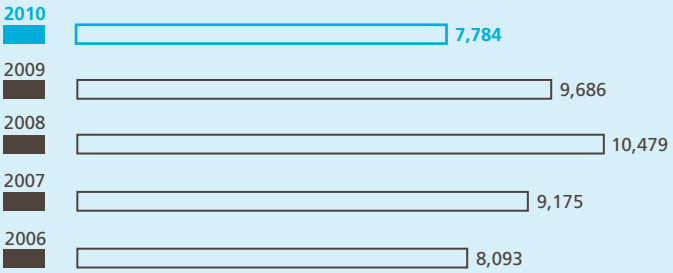
Capital Expenditures

$ in thousands	**2010**	2009
Transmission system	**1,714**	4,470
Distribution system	**4,545**	4,049
Processing plant	**273**	1,010
Other	**1,252**	157
Total	**7,784**	9,686

Total capital expenditures of $7.8 million in 2010 were 20 percent or $1.9 million lower than those incurred in 2009, and 14 percent below the average level of expenditures for the last five years. This decrease primarily resulted from the need to defer the rehabilitation of a tunnel through which one of the Company's pipelines runs, as access to the construction site was not possible due to lower than normal water levels in the Skeena River.

Expenditures incurred in 2010 related primarily to scheduled capital projects necessary to ensure the ongoing integrity of the Company's transmission system. During 2010, the Company completed the installation of the new rural gas distribution system in the Tomslake area south of Dawson Creek. The Tomslake work commenced in 2009 with the installation of approximately 97,000 metres of main, and concluded in 2010 with the installation of an additional 33,000 meters of main. The Company also completed 543 new distribution service line installations in 2010, compared with 261 installations in 2009. Most of these new service lines were installed in the Northeast system, reflecting continued strong economic activity in this area.

HISTORY OF CAPITAL EXPENDITURES ($000'S)



Planned capital spending for 2011 is forecast to be approximately $7.6 million and is primarily focused on installation of distribution mains and services in the Northeast system as well as transmission mainline rehabilitation in the Western system. 2011 planned capital activities also include the tunnel rehabilitation deferred in 2010. Contractual commitments have yet to be made for major planned capital expenditures for 2011. These capital expenditures will be funded from cash flow from operations and, if required, draws on the Company's debt facilities.

CAPITAL RESOURCES

Composition of Capital Structure

(Percent)	December 31, 2010	December 31, 2009
Preferred shareholders' equity	**2.6**	3.0
Common shareholders' equity	**46.9**	51.0
Short-term debt	**2.6**	1.5
Long-term debt, including current portion	**47.9**	44.5
	100.0	100.0

For rate determination purposes, the Company is permitted to earn a return on its invested capital to the extent of its approved rate base. Rate base is composed of the depreciated book value of plant, property and equipment, plus unamortized deferred charges, plus an allowance for working capital, less deferred income taxes. The Commission sets customer rates at a level that is intended to allow the Company to earn its allowed rate of return on common equity. Rates for 2010 were based on 40 percent of rate base being financed by common equity for the Fort St. John/Dawson Creek and Tumbler Ridge divisions and 45 percent for the Western system.

Equity

The book value of the Company's common shares at December 31, 2010 was $24.63 per share, compared to $24.03 per share at December 31, 2009.

The Company's preferred shares are currently rated Pfd-3(low) by Dominion Bond Rating Service ("DBRS").

Dividends

Preferred dividends totaling $1.6875 per preferred share were paid in 2010, the same as in 2009. Common dividends totaling $1.14 per common share were paid in 2010, compared to $0.96 per common share in 2009. Total dividend payments in 2010 for both preferred and common shares were $4.4 million, compared to payment of $3.8 million in 2009.

Credit Facilities

The Company has credit facilities which include a $25 million operating line, two risk management facilities each secured by the pledge of a $20 million debenture issued by the Company and a $35 million committed 5-year term revolving debt facility.

The first risk management facility has a single financial covenant requiring the Company's debt leverage not to exceed 65 percent. The Company added a second risk management facility in January 2010. This facility has two financial covenants, one which requires the Company's debt leverage not to exceed 65 percent and the second which requires the Company to maintain a minimum interest coverage of 1.5 times using earnings before interest, income taxes and expenditures on the KSL Project to a maximum of $10 million. Further, if the Company's secured debt rating is less than BBB (low) or the Company has no debt rating, the interest coverage requirement is 2.0 times or higher.

The risk management facilities are utilized by 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. Under either facility, to the extent the credit exposure of the facility provider exceeds $20 million (where exposure is calculated by the facility provider using its standard methodology), the Company is required to provide cash collateral for the exposure in excess of $20 million. Neither hedge facility provider is obligated to enter into any transactions with the Company under the terms of the facilities. Each hedge transaction must be agreed between the parties. The provider of one of the risk management facilities has documented its intention not to enter into transactions under its facility in the event that the provider's exposure would exceed $15 million.

Short-term Debt

In November 2010, the Company completed a renegotiation and extension of its bank operating facility. Under this facility, $25.0 million is available for working capital purposes. The November 2010 amendments included deletion of the previous borrowing base limitation to availability under the operating facility. As a result, the $25.0 million is available to the Company at all times subject to a requirement that borrowings be reduced to zero for 30 days each calendar year. The Company covenants under the facility to maintain its debt leverage at 65% or less. At December 31, 2010 the Company's actual debt leverage was 50.4 percent. The operating line is collateralized by a pledge of the Company's accounts receivables and inventories.

Borrowings under the operating facility bear interest at prime rate or bankers' acceptance rates plus an applicable credit spread. The renegotiated terms included reduced credit spreads to 1 percent over prime and 2.25 percent over bankers' acceptances, previously 1.5 percent and 3 percent respectively, as well as a reduction in the stand-by fee to 0.35 percent from 0.5 percent. The renewed facility has a term of 18 months, expiring May 28, 2012. The Company may also issue letters of credit under the operating facility. As of December 31, 2010, the actual utilization of the operating line was $8.6 million.

Long-term Debt

On February 2, 2010 the Company amended its revolving term facility to increase the amount available under the facility to $35 million (previously $20 million) and to extend its maturity date to January 30, 2015. Concurrent with these amendments, the fees and interest rate spreads under the facility were amended to reflect current market conditions. The standby fee on the facility was increased to 50 basis points on undrawn amounts and the interest rate spread over the Canadian Dealer Offered Rate ("CDOR") was increased to 307.5 basis points from 132.5 basis points. The facility contains a financial covenant requiring the Company's debt leverage not to exceed 65 percent and, if the Company's secured debt rating is less than BBB (low) or the Company has no debt rating, the Company must maintain an interest coverage of 2.0 times or higher using earnings before interest, income taxes and expenditures on the KSL Project to a maximum of $10 million.

$16.0 million was outstanding under the revolving term facility at December 31, 2010 under Bankers Acceptance equivalent loans. Additional funds available under the facility will be used for general corporate purposes including the Company's capital program and debt repayments.

On May 17, 2010, DBRS confirmed the Company's secured debt ratings at BBB (low).

OFF-BALANCE SHEET ARRANGEMENTS

As of December 31, 2010, the Company had no off-balance sheet arrangements.

TRANSACTIONS WITH RELATED PARTIES

The Company had no significant transactions with related parties during 2010 or 2009.

FOURTH QUARTER 2010

The following table compares the results for the fourth quarters of 2010 and 2009:

$ in thousands, except TJ, customer, per GJ, per share and percent figures	Q4 2010	Q4 2009	Percent change
Deliveries (TJ)			
Sales	**2,127**	2,334	(8.9)
Transportation service	**1,040**	1,514	(31.3)
Total deliveries	**3,167**	3,848	(17.7)
Customers at period end	**39,405**	39,113	0.8
Weighted average cost of gas purchased (per GJ)	**4.85**	6.35	(23.6)
Revenues	**30,081**	31,172	(3.5)
Operating margin, consisting of revenues less cost of gas	**16,024**	13,916	15.1
Income before income taxes	**5,098**	4,446	14.7
Net income attributable to shareholders	**3,984**	3,436	16.0
Net cash provided by operating activities	**5,480**	2,074	164.2
Basic earnings per common share	**1.10**	0.95	15.7
Dividends paid per common share	**0.30**	0.25	20.0

Revenues in the fourth quarter of 2010 decreased to $30.1 million as compared with $31.2 million in the same period in 2009. The decrease in revenues is mainly due to a $1.4 million decrease in off system gas sales in the fourth quarter of 2010 compared to the fourth quarter of 2009, offset by new revenues from the McNair operations in 2010.

Operating margin in the fourth quarter of 2010 increased to $16.0 million from $13.9 million in the corresponding period in 2009. This increase can be attributed to the higher common equity component in 2010 compared to 2009, new revenues from the 2010 McNair acquisition and the higher delivery rates in 2010 compared to 2009 mainly to recover the loss of the Methanex termination payment credit amortization which ended in October 2009.

Net income for the quarter ended December 31, 2010 was $4.0 million, compared with $3.4 million for the quarter ended December 31, 2009. Included in the results for the fourth quarter of 2010 are reorganization charges, net of income taxes, totaling $0.1 million or $0.03 per share relating to the Company's restructuring of the McNair acquisition group of companies, compared to the inclusion of the Company's share of KSL Project after-tax development expenses of $0.04 million or $0.01 per share in the corresponding period in 2009.

After providing for preferred share dividends, earnings per common share in the fourth quarter of 2010 were $1.10, compared with $0.95 for the quarter ended December 31, 2009.

Capital expenditures in the fourth quarter of 2010 were $2.9 million, compared to $4.2 million in the comparable period in 2009.

SUBSEQUENT EVENT

On February 7, 2011, the Company announced it had entered into an agreement to sell its 50 percent interest in PTP (see "Business Overview – KSL Project") to Apache Canada and EOG Canada, the Company's partners in the KSL Project, for payments of up to $50 million. The transaction closed on March 2, 2011.

The sale transaction has two elements, including an initial payment of $30 million paid on closing and a second payment of $20 million to be paid contingent on the purchasers making a decision to proceed with construction of the Kitimat LNG facility. The Company can give no assurances that construction of the Kitimat LNG facility will be completed or that the $20 million payment will be made.

In connection with the sale, the Company has reached agreement on the terms for a 20-year transportation service agreement with Apache Canada and EOG Canada that will significantly increase the utilization of the Company's current pipeline in the event that LNG Partners does not claim this capacity first. The Company will operate the KSL Project pipeline under an operating and maintenance agreement negotiated with Apache Canada and EOG Canada. The operating and maintenance agreement will have an initial term of seven years beginning in 2015, with renewal provisions, and will be subject to approval by the Commission. These agreements are expected to generate incremental revenue for the Company, with substantial benefits flowing back to the Company's customers in the form of reduced gas delivery rates, with rate reductions similar to those that would have prevailed had the Company continued to own a 50 percent stake in PTP.

CRITICAL ACCOUNTING ESTIMATES

The preparation of the Company's consolidated financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and the related disclosures. These estimates are based on historical experience, current assumptions, and actual results may differ from these estimates under different assumptions and conditions.

Regulatory Assets and Liabilities

Certain regulatory assets represent future revenues associated with certain costs, incurred in the current period or in prior periods that are expected to be recovered from customers in future periods through the rate-setting process. Regulatory liabilities represent future reductions or limitations of increases in revenues associated with amounts that are expected to be refunded to customers as a result of the rate-setting process. In the absence of rate regulated accounting, generally accepted accounting principles would not likely permit recognition of regulatory assets and certain liabilities and therefore the earnings impact would be recorded in the period incurred or recovered. These regulatory assets and liabilities have been recorded based on previous, existing or expected regulatory orders or decisions. Certain estimates are necessary since amounts recorded are often estimates until these amounts are finalized pursuant to regulatory decisions or proceedings.

Depreciation of Plant, Property and Equipment

The Company depreciates plant, property and equipment on a straight-line basis over the estimated useful life of the assets. The estimated useful lives are largely based on formal depreciation studies and are approved by the Commission. Changes in estimates can have a significant impact on depreciation expense.

Unbilled Revenues

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. These estimates are made assuming normal consumption patterns, which may differ from actual consumption patterns. The estimates of unbilled operating revenue comprise 10.6 percent of the Company's revenues for 2010. Through future meter readings, the usage estimates are replaced with actual delivered volumes, which become reflected in the Company's financial results at that time.

Asset Retirement Obligations

The Company is required to recognize the fair value of asset retirement obligations associated with the retirement of long-lived assets in the period which they can be reasonably determined. The Company's natural gas transmission and distribution long-lived assets are comprised principally of mains, service lines, compressors, and measuring and regulating equipment. No amount has been recorded for asset retirement obligations relating to the Company's assets as it is not possible to make a reasonable estimate of the fair value of the liability due to the indeterminate timing and scope of the asset retirements. Management expects that all retirement costs associated with the regulated assets will be recovered through tolls in future periods.

Employee Future Benefit Plans

The Company provides a defined benefit pension plan and other post retirement benefits to the majority of its employees. The determination of these expenses and obligations is dependent on management's assumptions including the discount rate for the accrued benefit obligation and the expected long-term rate of return on plan assets.

The assumed discount rate to determine the Company's accrued pension and non-pension benefit obligations at December 31, 2010 was 5.3 percent and is based on the market interest rates as of September 30, 2010 for high-quality corporate bonds. The comparative discount rate as at December 31, 2009 was 6.5 percent.

The assumed long-term rate of return on the defined benefit pension plan assets for the purposes of estimating pension expense for both 2010 and 2009 was 7.0 percent. The pension plan assets are comprised primarily of equity and fixed income investments. Fluctuations in actual market returns and changes in interest rates may result in increases or decreases to future pension expenses.

CHANGES IN ACCOUNTING POLICIES

Changes Applicable in 2010

BUSINESS COMBINATIONS, CONSOLIDATED FINANCIAL STATEMENTS AND NON-CONTROLLING INTERESTS

Effective January 1, 2010, the Company early adopted the pronouncements of CICA Handbook Section 1582, *Business Combinations*, Section 1601, *Consolidated Financial Statements*, and Section 1602, *Non-Controlling Interests*.

Section 1582 was introduced to replace Section 1581, *Business Combinations*, and provides the Canadian equivalent to International Financial Reporting Standard IFRS 3 (revised), *Business Combinations*. Section 1582 specifies a number of changes, including: an expanded definition of a business, a requirement to measure all business acquisitions at fair value, a requirement to measure non-controlling interests at fair value, and a requirement to recognize acquisition related costs as expenditures in the period incurred.

Section 1601 and Section 1602 were introduced together to replace Section 1600, *Consolidated Financial Statements*, and provide the Canadian equivalent to the corresponding provisions of International Accounting Standard IAS 27 (revised), *Consolidated and Separate Financial Statements*. Section 1601 establishes standards for the preparation of consolidated financial statements and Section 1602 specifies that non-controlling interests be treated as a separate component of equity, instead of a liability or other item outside of equity.

The early adoption of these standards by the Company resulted in additional disclosure related to a business acquisition that closed on April 19, 2010 and the expensing of the related acquisition costs incurred of $0.5 million, rather than their inclusion as part of the cost of the business acquisition.

Future Accounting Pronouncements

TRANSITION TO INTERNATIONAL FINANCIAL REPORTING STANDARDS

The Canadian Accounting Standards Board ("AcSB") has determined that publicly accountable enterprises are required to prepare financial statements in accordance with International Financial Reporting Standards for years beginning on or after January 1, 2011. The transition to IFRS will require the restatement for comparative purposes of amounts reported for the year prior to the transition date.

RECENT DEVELOPMENTS

In September 2010, the International Accounting Standards Board ("IASB") concluded that it could not quickly resolve the matters arising from its rate-regulated activities ("RRA") Exposure Draft and the resulting subsequent discussions. In 2011, the IASB will be considering the development of an agenda proposal on this issue for consideration on its future projects agenda. In October 2010, the AcSB issued an amendment to Part I of the CICA Handbook allowing for a one-year deferral for first-time adoption of IFRS for qualifying entities with rate-regulated activities. The Canadian Securities Administrators' regulations have also been amended to incorporate the AcSB's one-year deferral.

The Company meets the requirements of a qualifying entity and has elected to take the optional one-year deferral as allowed by the AcSB. The Company's revised IFRS conversion date is January 1, 2012.

IFRS PROJECT

As previously disclosed, the Company originally planned to begin reporting under IFRS effective January 1, 2011, and the Company's IFRS conversion plan was proceeding as planned to this conversion date. Given the recent decision to defer adoption of IFRS for one year, the Company's IFRS plan has been amended as following:

IFRS 1, First-Time Adoption of IFRS

Previously, the adjustments required under IFRS 1 were evaluated in anticipation of a January 1, 2010 transition. Due to the one-year deferral, these first-time adjustments will now be evaluated and determined to be effective for the opening IFRS balance sheet as at January 1, 2011.

- **Employee Benefits**
  The Company will elect to recognize all cumulative actuarial gains and losses and all unamortized transitional obligations of defined benefit plans through opening retained earnings at January 1, 2011. The amount of this adjustment will be determined in the first quarter of 2011.
- **Property, Plant and Equipment and Intangible Assets**
  In April 2010, the IASB approved an IFRS 1 exemption which allows the Company to use the carrying amount of rate-regulated property, plant and equipment and intangible assets, as calculated under Canadian GAAP, as the deemed cost for IFRS on the date of transition. The Company will elect to use this exemption for the significant majority of its property, plant and equipment and intangible assets used in rate-regulated operations. The amount of this adjustment will be determined in the first quarter of 2011.

Rate-regulated Activities

The Company, in accordance with Canadian GAAP, follows specific accounting policies unique to a rate-regulated entity. These accounting policies for rate-regulated activities are pervasive and significant to the Company's business model and performance measurement.

As noted above, there is no separate IFRS standard for RRA and the current interpretation of existing IFRS guidance generally does not allow accounting for RRA in the manner historically permitted under Canadian GAAP. The Company will continue to monitor both developments in IFRS and decisions made by other rate-regulated entities.

The Company has amended its IFRS conversion plan to include an assessment of changes required if accounting for RRA is no longer available under IFRS, including:

- Determination of the adjustment required upon derecognition of regulatory assets and regulatory liabilities effective January 1, 2011;
- Determination of the impact on debt covenants if accounting for RRA is no longer available under IFRS; and
- Development of a communication plan to internal and external stakeholders.

However, for rate-setting purposes, the Company will continue to make use of deferral accounts. Therefore, the Company plans to maintain two sets of accounts and will be assessing the processes and resources required to maintain two sets of accounting records.

Property, Plant and Equipment

The Company is currently developing accounting polices that will be IFRS compliant. These policies will differ from the Company's current accounting policies and are expected to be finalized during the first half of 2011.

Employee Future Benefit Plans

The Company is continuing with its assessment of policy choices available under the current IFRS standard for employee future benefits and is monitoring the ongoing developments related to this standard.

Presentation and Disclosure

The Company completed the initial preparation and review of pro forma annual IFRS financial statements, identifying changes to presentation and additional disclosures required under IFRS. The pro forma financial statements had included regulatory assets and regulatory liabilities. The Company is in the process of updating the pro forma statements to eliminate these balances and the effects of the underlying transactions.

Derivative Financial Instruments

The Company currently records the fair value of a fixed-price natural gas supply contract at each reporting date and includes this amount in the fair value of its derivative financial instruments. Under IFRS, the Company's fixed-price natural gas supply contract is a contract to buy or sell a non-financial item in accordance with the Company's expected purchase, sale or usage and qualifies for a scope exemption from being recognized as a financial instrument at fair value. Accordingly, for the opening IFRS balance sheet as at January 1, 2011, the application of this exemption will result in a $0.7 million decrease in derivative financial instrument liability.

In addition to planning for the deferred adoption of IFRS, the Company continues to monitor changes to standards that may become effective during or shortly after the implementation phase. The Company will continue to follow the proposals contained in IASB exposure drafts and to assess potential impacts of new IFRS that may be applicable as at the January 1, 2011 transition date.

The Company is satisfied that its transition plans are on schedule and will be providing further updates on the status of key activities in the Company's 2011 interim MD&A.

COMPREHENSIVE REVALUATION OF ASSETS AND LIABILITIES

In August 2009, the CICA amended Handbook Section 1625, *Comprehensive Revaluation of Assets and Liabilities,* as a result of issuing Sections 1582*, Business Combinations,* 1601, *Consolidated Financial Statements,* and 1602, *Non-Controlling Interests,* in January 2009. The amendments require that when push-down accounting is used following the acquisition of an enterprise, the assets and liabilities are to be measured at the values used in accounting for the purchase transaction or transactions in accordance with Section 1582. The amendments also require that, when a future income tax asset that arose prior to the date of a comprehensive revaluation and that was not recognized in the comprehensive revaluation is subsequently recognized, the benefit should be recognized in accordance with Section 1582 and Section 3465, *Income Taxes*. The amendments apply prospectively to comprehensive revaluations of assets and liabilities occurring in fiscal years beginning on or after January 1, 2011. The adoption of the amendments to Section 1625 is not expected to have a material impact on the Company's financial statements.

FINANCIAL INSTRUMENTS – RECOGNITION AND MEASUREMENT

In June 2009, the CICA provided a clarification to Handbook Section 3855, *Financial Instruments – Recognition and Measurement,* with respect to the embedded prepayment option. The Section has been amended to clarify when an embedded prepayment option is separated from its host instrument for accounting purposes. The amendment states that if the exercise price of a prepayment option compensates the lender for an amount equivalent to the present value of the lost interest for the remaining term of the host instrument, the feature is considered closely related to the host contract in which it is embedded. The amendment applies to interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. The adoption of the amendments to Section 3855 is not expected to have a material impact on the Company's financial statements.

MULTIPLE DELIVERABLE REVENUE ARRANGEMENTS

In December 2009, the CICA issued EIC-175, *Multiple Deliverable Revenue Arrangements*, replacing EIC-142, *Revenue Arrangements with Multiple Deliverables.* The changes were made in response to changes made to Accounting Standards Codification Topic 605-25, *Revenue Recognition – Multiple Element Arrangements,* under US GAAP, and more closely aligns the accounting requirements for multiple-element arrangements under Canadian GAAP with IFRS. EIC-175 addresses how to determine whether an arrangement involving multiple deliverables contains more than one accounting unit and, if so, how the consideration specified in the multiple element arrangement should be distributed between different accounting units. These recommendations are to be applied prospectively to revenue arrangements with multiple deliverables entered into or materially modified in the first annual fiscal period beginning on or after January 1, 2011. The Company is currently assessing the impact of adopting EIC-175 on its financial statements.

FINANCIAL INSTRUMENTS AND OTHER INSTRUMENTS

The Company utilizes natural gas commodity hedging contracts in order to manage the volatility inherent in the prices of its natural gas purchases. It may also utilize interest rate hedging contracts to reduce the volatility of the interest expense associated with its floating rate debt instruments. As of December 31, 2010, the Company had no interest rate hedging contracts outstanding.

During the second quarter of 2010, the Company completed its annual gas contracting and gas price risk management plan and filed it with the Commission for review and acceptance. The annual gas contracting plan covered proposed gas purchases over the November 1, 2010 to October 31, 2011 period, while the gas price risk management plan provided for hedging gas purchases over the November 1, 2010 through October 31, 2012 period. The Company proposed implementing the hedges in stages over the May 2010 to February 2012 period. The Commission accepted the plan as filed. Each hedging transaction is approved by the Company's price risk management plan committee and is reported to the Commission on a monthly basis.

At December 31, 2010, the Company had outstanding fixed-price, natural gas swap and collar contracts relating to natural gas supply as follows:

Financial instrument	Notional quantity (GJ)	Percent of annual gas purchases (%)	Delivery period	Price range (per GJ)	Estimated net fair value payable ($000's)
Fixed-price contracts	900,000	9.4	Jan 2011 – Mar 2011	$4.23	(678)
Natural gas swap contracts	3,846,600	40.2	Jan 2011 – Oct 2012	$4.16 to $7.26	(5,453)
Collar contracts	53,500	0.6	Apr 2012 – Oct 2012	$3.80 (floor) – $5.81 (cap)	(8)
	4,800,100	50.2			(6,139)

The fair value reflects the estimated amounts that the Company would receive or pay at December 31, 2010 to terminate the fixed-price, natural gas swap and collar contracts 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 gas hedging instruments would be treated as part of the flow through of gas supply costs in customer rates.

At December 31, 2009, the Company had outstanding fixed-price, natural gas swap and collar contracts relating to natural gas supply as follows:

Financial instrument	Notional quantity (GJ)	Percent of annual gas purchases (%)	Delivery period	Price range (per GJ)	Estimated net fair value receivable (payable) ($000's)
Fixed-price contracts	900,000	9.2	Jan 2010 – Mar 2010	$4.03	1,021
Natural gas swap contracts	3,954,850	40.6	Jan 2010 – Oct 2011	$4.96 to $10.87	(4,568)
Collar contracts	308,650	3.2	Jan 2010 – Oct 2010	$5.26 to $8.38 (floors) $6.76 to $11.46 (caps)	(429)
	5,163,500	53.0			(3,976)

The fair value reflects the estimated amounts that the Company would receive or pay at December 31, 2009 to terminate the fixed price, natural gas swap and collar contracts based on the estimated net cash flows under the terms of each contract.

Natural gas prices for 2011, based on forward gas prices as at March 2, 2011, and gas purchases by the Company in 2011, are forecast to be approximately 15.6 percent ($0.82 per GJ) lower than the actual corresponding prices in 2010.

CERTIFICATION OF DISCLOSURE CONTROLS AND PROCEDURES AND INTERNAL CONTROL OVER FINANCIAL REPORTING

The Company's management is responsible for establishing and maintaining disclosure controls and procedures ("DC&P") and internal controls over financial reporting ("ICFR"), as those terms are defined in National Instrument 52-109, Certification of Disclosure in Issuers' Annual and Interim Filings. The objective of this instrument is to improve the quality, reliability and transparency of information that is filed or submitted under securities legislation.

Management, with the participation of the Chief Executive Officer and Vice President, Finance, acting as the Chief Financial Officer, have designed DC&P and ICFR to provide reasonable assurance that material information is reported to them on a timely basis; that financial reporting is reliable; and that financial statements prepared for external reporting purposes are in accordance with Canadian GAAP.

Management, under the supervision of the Chief Executive Officer and Vice President, Finance, acting as the Chief Financial Officer, have evaluated the effectiveness of the Company's DC&P and ICFR and based on that evaluation have concluded that DC&P and ICFP were effective as at December 31, 2010.

There have been no changes in the Company's ICFR during the year ended December 31, 2010 which have materially affected, or are reasonably likely to materially affect, ICFR.

The Chief Executive Officer and Vice President, Finance, acting as the Chief Financial Officer, have limited the scope of their certification in accordance with National Instrument 52-109 for the design and effectiveness of DC&P and ICFP to exclude controls, policies and procedures resulting from the acquisition of McNair on April 19, 2010. The business acquired is described under "Business of the Company – Renewable Energy Business". The Company's financial results for the year ended December 31, 2010 include revenues of $1.3 million and a net loss of $0.55 million, and its consolidated balance sheet includes $21.2 million in assets and $12.4 million in liabilities as at December 31, 2010 related to McNair.

With respect to the acquisition of McNair, where the scope of the Chief Executive Officer and Vice President, Finance, acting as the Chief Financial Officer, has been limited in accordance with National Instrument 52-109, the Company's management, under the supervision of the Chief Executive Officer and Vice President, Finance, acting as the Chief Financial Officer, has evaluated the overall risk, reviewed the results of operations with operating management and confirmed that consistent controls have operated since the Company's acquisition of McNair and continued to operate at year end. Management is confident in the reliability of financial reporting and the preparation of financial statements included in the Company's consolidated results. In 2011, the Company will certify that the internal controls over financial reporting and the disclosure controls and procedures for McNair are designed and effective under National Instrument 52-109.

OUTSTANDING SHARE DATA

At March 3, 2011 there were 200,000 preferred shares and 3,615,144 common shares outstanding. The common shares are the only issued voting securities of the Company, and there are no securities outstanding which may be converted into voting or equity securities.

RISK FACTORS

Usage Risk and Impact of Changes in Economic Conditions

Natural gas competes with other forms of energy available to the Company's customers and end-users, including electricity, wood and coal and, in the case of certain industrial customers, wood waste. The primary competitive factor is price. Changes in the availability or price of natural gas and other forms of energy, economic conditions, the level of business activity, conservation, legislation, governmental regulations, the ability to convert to alternative fuels, weather and other factors affect the demand for natural gas in the Company's service areas. In addition, because electricity prices in British Columbia for residential and certain other customer classes have been set based primarily on the historical average cost of production, they have been artificially low compared to market priced natural gas. This distortion in pricing signal may be addressed in response to the British Columbia government's Energy Plan electricity conservation goals.

Over the past several years the average amount of natural gas consumed by residential customers has declined. This decline is attributable to a number of factors, including the replacement of older heating equipment by newer, more efficient equipment, more energy efficient housing, and energy conservation measures in response to higher gas prices and poor economic conditions in the Western system region.

Economic conditions in the Company's service areas can negatively affect the Company's results of operations and financial condition. Deliveries are affected by economic factors such as changes in employment levels, personal disposable income and level of business activity. New customer additions are related to the level of business activity, population growth and housing starts in the service area. Management cannot estimate the level of growth or contraction for the economy as a whole or for the economy of any particular region the Company serves. Adverse changes in the Company's financial condition and results of operations may occur as a result of continuing negative economic conditions, a decline in business activity, unemployment, contraction of credit availability or other factors affecting economic conditions generally.

Industrial Customer Concentration and Potential for Termination of Large Industrial Contracts

In 2010, 12 percent of energy deliveries were made to the Company's three largest industrial customers, compared to 23 percent in 2009. West Fraser ceased operations at its Kitimat mill in January 2010 and provided a contract termination notice to the Company in May 2010 which resulted in a $5.1 million termination payment received on December 1, 2010. Deliveries to West Fraser accounted for approximately 2.5 percent of annual deliveries in 2010 compared to 15.1% in 2009. Lower demand and lower prices for forest products in North America resulted in the lower deliveries to the forest sector again in 2010. The forest sector has been facing significant issues with low lumber prices, the mountain pine beetle infestation and the strength of the Canadian dollar in 2010. Management can give no assurances that these issues will be resolved.

The initial term of the Company's agreement with Rio Tinto Alcan ended November 1, 2004, but the agreement automatically continues in effect from contract year to contract year unless either party gives twelve months' notice of termination. No termination notice has been given. During 2010, deliveries to Rio Tinto Alcan accounted for 9.1 percent of the Company's total gas deliveries and 2.8 percent of revenues.

The Company's ability to negotiate new contracts and to renegotiate existing contracts could be impacted by factors it cannot control, including reduced demand due to higher gas prices, the financial strength of major customers and the availability and price competitiveness of alternative energy sources. The risk of non-performance by one or more of the large industrial customers may be analyzed and managed, but it cannot be entirely eliminated.

The Company's service area is largely dependent upon industrial customers for its economic stability. These customers produce commodities that are subject to world commodity price fluctuations and are impacted by economic conditions. Gas deliveries to these customers have been and may in the future be affected by their ability to continue to operate in negative economic conditions and during sustained periods of low commodity prices, as has transpired in the past. A prolonged decline in a sector affects all customer classes. For example, in the Western system service area many of the Company's industrial customers are involved in the forest sector. A prolonged decline in the forest sector could negatively impact gas deliveries to lumber mills, as well as negatively impacting delivery requirements of commercial and residential customers who directly or indirectly provide services to such mills.

Commodity Price and Supply Risk

The commodity cost of natural gas can be highly volatile. The Company's average cost of natural gas in 2010 was approximately 14.3 percent lower than in 2009 and 30.6 percent lower than in 2008. When prices are low, the prospects of fuel-switching and increased energy conservation pose a lesser risk. Fluctuations in the price of natural gas may increase the Company's working capital financing requirements and related costs for accounts receivable, and may give rise to higher bad debt costs.

Adequate supplies of natural gas may not be available to satisfy committed obligations as a result of economic events, natural occurrences, and/or failure of a counterparty to perform.

Regulatory Risk

The Company's asset base is subject to regulation by the Commission (see "Regulatory Activities"). Changes in the regulatory environment may be beyond the Company's control and may impact the viability of the assets, including the Company's ability to sustain or increase its profitability.

As part of the regulatory process, the Company maintains a number of deferral accounts including, without limitation, a gas cost variance account, the rate stabilization adjustment mechanism account, an industrial customer deliveries account and accounts for pipeline repair and rehabilitation.

The gas cost variance account is utilized to record variances in the Company's actual purchase cost of gas relative to the gas supply cost recovery charges included in customers' rates. At times, the gas supply cost recovery charges included in customers' rates can be below the actual purchase cost of gas resulting in a significant balance in the account which must be recovered from customers in future rates.

The Company's rates are set on the basis of forecast gas deliveries using normal heating degree-days. To the extent that actual degree-days are less than normal (that is, the weather is warmer than normal), revenues may be less than forecast. The revenue for residential and small commercial customers is protected by the rate stabilization adjustment mechanism deferral account approved by the Commission in 2003 to record differences between forecast and actual deliveries. When deliveries to customers are less than forecast, there may be significant balances in the account which are subject to recovery in future rates to customers.

The industrial customer deliveries deferral account records the extent to which margin recovery from actual deliveries to Alcan and BC Hydro varies from forecast margin recovery used for rate making purposes based on forecast deliveries.

The Commission requires the Company to record certain temporary pipeline repair and rehabilitation costs in deferral accounts for amortization into customer rates over a period of ten years on the basis that the customers benefit from such expenditures over that period of time.

The recovery of the Company's accumulated deferral accounts has an impact on liquidity requirements. Recovery of the deferral accounts through rates charged to customers is dependent upon regulatory approval and the ability to set rates high enough to recover such balances while maintaining the competitiveness of retail gas prices, and is therefore at risk.

Liquidity, Cash Flow, and Capital Availability Risks

The Company's credit facilities include a $25 million operating line, two risk management facilities secured with $20 million debentures issued by the Company and a $35 million committed 5-year term revolving debt facility. In order to ensure that the operating line is utilized for its intended working capital purposes, the Company covenants to reduce its borrowings under the line to zero for a 30 day consecutive period each fiscal year. In addition, the credit facilities are subject to financial covenants that may act to restrict the amounts that can be borrowed under the operating line and the 5-year term revolving debt facility.

The Company's operating line and risk management facilities are subject to renewal after 18 months with the operating line and one risk management facility maturing on May 28, 2012 and the other risk management facility maturing on July 21, 2012.

Any constraint on the Company's ability to raise capital, including a credit downgrade, may negatively impact its investment and development activities, capital expenditures and hedging program.

Facility and Insurance Risk

The Company carries on business in a geographic area of British Columbia where a large portion of its pipeline transmission system is located in extremely difficult terrain and where outages have, from time to time, been experienced in the past. Depending on circumstances, such outages may result in loss of revenues or increased maintenance or capital costs.

The Company maintains insurance against exposures to the physical loss of its pipeline, compressors and other above ground facilities as well as loss of earnings insurance relating to revenues from its large industrial customers. Based on past insurance claims for damage to the pipeline caused by slides, washouts, and other natural events, the Company's deductibles

have remained high. Depending on the number and severity of future outages, the financial impact on the Company could be material.

Environmental and Safety Risks

The Company is required to comply with existing environmental laws and regulations. It is possible that increasingly strict environmental laws, regulations and enforcement policies, and potential claims for damages and injuries to property, employees, other persons and the environment resulting from current or discontinued operations, could result in substantial costs and liabilities in the future. In particular, the Company could be exposed to significant operational disruptions and environmental liability in the event of an accident involving natural gas. The Company believes that it has taken all reasonable and prudent steps to minimize its exposure in the case of safety or environmental incidents.

The number of existing and proposed greenhouse gas ("GHG") legislation, cap and trade programs and emissions regulations in North America and the world is expanding rapidly. In Canada, the federal government has delayed its implementation of a proposed national GHG cap-and-trade system until 2012 in order to harmonize with U.S. plans. As a partner in the Western Climate Initiative ("WCI"), British Columbia has enacted legislation and developed regulations aligned with the principles agreed to by the WCI partners. British Columbia has implemented reporting regulations that harmonize with the WCI draft requirements and support the planned for cap-and-trade program. The *Mandatory Reporting of Greenhouse Gas Emissions Regulation* requires facilities and/or entities with emissions in most source categories to submit data on greenhouse gas emissions to the Minister of Environment, which will provide a foundation for the development and implementation of a cap and trade system and other climate policies to reduce greenhouse gases. Under the proposed regulation, facilities emitting more than 10,000 tonnes CO2 equivalents per year will be required to report their annual GHG emissions beginning with the 2010 calendar year, with the first report due April 1, 2011.

Based on the applicable emissions thresholds set out in the draft federal and existing provincial regulations, the Company expects its compliance obligations to be small. However, as the federal regulations remain in development, it is not possible at this time to assess the full extent of their impact on the Company. In addition, the effects of climate change on the Company's service territories over the long term may manifest themselves in changes to customers' consumption patterns, as well as to changes in the level and nature of geotechnical and hydrological threats to the Company's pipeline systems. The Company recognizes the entire spectrum of influences that climate change may exert on its operations and continues to monitor, and influence as appropriate, related policies, regulations and developments.

Acquisition and Integration Strategies

As part of its business strategy, the Company may pursue strategic acquisitions. There can be no assurance that the Company will find additional attractive acquisition candidates or succeed at effectively maintaining the integration of any businesses acquired in the future.

Acquisitions involve a number of risks, including: (a) the possibility that the Company, as a successor owner, may be legally and financially responsible for liabilities of prior owners; (b) the possibility that the Company may pay more than the acquired company or assets are worth; (c) the possibility of incurring additional expenses associated with completing an acquisition and amortizing any acquired intangible assets; (d) the difficulty of integrating the operations and personnel of an acquired business; (e) the challenge of implementing standard controls, procedures and policies throughout an acquired business; (f) the inability to integrate, train, retain and motivate key personnel of an acquired business; and (g) the potential disruption of the Company's ongoing business and the distraction of management from its day-to-day operations. These risks and difficulties, if they materialize, could disrupt the Company's ongoing business, distract management, result in the loss of key personnel, increase expenses and otherwise have an adverse effect on the Company's business, results of operations and financial performance.

In addition, as the Company seeks to grow and diversify its operations, the risk profile of its business may change. There may be greater economic exposure and more "at risk" capital with the expansion of the Company's business activities. While the Company will pursue growth initiatives by incurring risk that is felt to be justified by expected returns and managed effectively, there can be no assurances that such risks can be avoided.

Renewable Energy Business Risks

The revenue earned by McNair Creek is proportional to the amount of electrical energy generated from the facility. The electricity generation is directly related to the levels of precipitation in the catchment area of McNair Creek which can vary from year to year. This facility is also subject to risks related to premature wear or failure, defects in design, material or workmanship and longer than anticipated down times for

maintenance and repair. These risks are partially mitigated by the proven nature of the technology employed, and the regular maintenance and the design of the facility.

All of the electricity generated by the McNair Creek facility is sold to BC Hydro under a long-term energy purchase agreement. This energy purchase agreement will expire in 2024 and there can be no assurance that the Company will be able renegotiate or enter into another energy purchase agreement on terms that are commercially reasonable.

Derivatives Risk

The Company uses derivative and other financial instruments in connection with the management of gas supply prices and interest rates. Forward, future, swap, fixed price and option contracts are used to manage the impact of market fluctuations on assets, liabilities or other contractual commitments. The Company could, however, incur financial losses in the future as a result of market or price volatility. Furthermore, because the valuation of these financial instruments can involve estimates, changes in the assumptions underlying these estimates can occur, changing the Company's valuation and potentially resulting in financial losses. This risk could affect the Company's liquidity, and regulatory approval would be required for the recovery of related costs through future rate adjustments.

Employee Future Benefits Plan Risk

The Company has a defined benefit pension plan for the majority of its employees and retirees. Contributions to the plan are established by actuarial valuations prepared every three years and filed with the appropriate regulatory authorities. The most recently filed valuation was prepared as at December 31, 2009. The Company's actuaries were engaged to prepare this valuation. Should investment returns be less than the actuarial assumption or declining discount rates drive up the solvency liabilities in future valuations, this may lead to increased pension costs in future years. The next valuation is required to be prepared as at December 31, 2012 and will determine the contributions required from 2013 onwards.

Human Resources Risks

Most of the employees of the Company are members of a union. Labour disruptions associated with the collective bargaining process could impact the Company's ongoing operations. In addition, the Company is dependent on maintaining its ability to attract and retain employees with the requisite skill and capabilities to operate in the complex and competitive energy industry.

First Nations Matters

First Nations groups have claimed rights and title over a substantial portion of the lands on which the Company's facilities in British Columbia and the gas supply areas served by those facilities are located. The existence of these claims, which range from the assertion of rights of limited use to aboriginal title, has given rise to some uncertainty regarding access to these lands. As well, approximately three kilometres of the Company's main pipeline and approximately nine kilometres of lateral transmission pipelines cross reserves established under the *Indian Act* (Canada). The impact upon the Company of treaties or settlements with First Nations groups is uncertain.

Share Price Volatility

A number of factors could influence the volatility in the trading of the Company's common shares, including changes in the economy or in the financial markets, and in particular the current global financial issues, industry-related developments, the impact of changes in the Company's operations and regulatory decisions affecting the Company, including decisions relating to return on equity and deemed equity. In addition, variations in earnings estimates by securities analysts and the market prices of the securities of companies in the same industry as the Company may also lead to fluctuations in the trading price of the common shares.

Transition to International Financial Reporting Standards

As previously discussed under "Changes in Accounting Policies – Future Accounting Pronouncements", the Company makes use of specific policies under Canadian GAAP to account for its rate-regulated activities. This includes the use of regulatory assets and regulatory liabilities which allow the economic impact of rate-regulated activities to be recognized in the financial statements in a manner consistent with the timing by which amounts are reflected in customer rates.

Effective January 1, 2012, the Company is required to report under IFRS, including the presentation of IFRS-compliant comparative figures for fiscal 2011. Under existing IFRS guidance and practice, the Company's current accounting policies for rate-regulated activities are not allowed. Financial results under IFRS will be prepared without the use of regulatory deferral accounts and this may result in increased volatility in the Company's reported financial results.

The Company will develop and present a communications strategy to its shareholders and other stakeholders explaining the impacts of IFRS adoption and the rate-setting process on its financial results and financial position.

Management's Report

TO THE SHAREHOLDERS OF PACIFIC NORTHERN GAS LTD.

Management is responsible for the preparation of the accompanying consolidated financial statements and all other information contained in this Annual Report. The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles and, where appropriate, include amounts that are based on management's best estimates and judgments.

Management is also responsible for establishing and maintaining a system of internal controls and formal policies and procedures to provide reasonable assurance that transactions are authorized, assets are safeguarded, and financial records are reliable for the preparation and presentation of the consolidated financial statements.

The Board of Directors is responsible for ensuring management fulfills its responsibilities for financial reporting and internal control. The Board of Directors is assisted in exercising this responsibility through its Audit Committee. The Audit Committee meets regularly with the independent auditors, the internal auditors and management to discuss auditing and accounting matters and to review the consolidated financial statements and the independent auditor's report to satisfy itself that management's responsibilities are properly discharged. The Audit Committee reports its findings to the Board of Directors for consideration in approving the consolidated financial statements for issuance to the shareholders and for filing with the relevant securities commissions.

Deloitte & Touche LLP serves as the Company's independent auditor. Deloitte & Touche LLP's audit report on the accompanying consolidated financial statements follows. Their report outlines the scope of their examination as well as their opinion on the consolidated financial statements.

ROY G. DYCE
President and Chief Executive Officer

JANET P. KENNEDY
Vice President Finance

March 3, 2011

Independent Auditor's Report

TO THE SHAREHOLDERS OF PACIFIC NORTHERN GAS LTD.

We have audited the accompanying consolidated financial statements of Pacific Northern Gas Ltd., which comprise the consolidated balance sheets as at December 31, 2010 and 2009 and the consolidated statements of income and comprehensive income, equity and cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

MANAGEMENT'S RESPONSIBILITY FOR THE CONSOLIDATED FINANCIAL STATEMENTS

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

AUDITOR'S RESPONSIBILITY

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

OPINION

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Pacific Northern Gas Ltd. as at December 31, 2010 and 2009, and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

EMPHASIS OF MATTER

Without qualifying our opinion, we draw attention to note 2 to the consolidated financial statements which describes Pacific Northern Gas Ltd.'s early adoption of CICA Handbook Section 1582, Business Combinations, Section 1601, Consolidated Financial Statements, and Section 1602, Non-controlling Interests.

Deloitte & Touche LLP

DELOITTE & TOUCHE LLP
Chartered Accountants
March 3, 2011
Vancouver, British Columbia

Consolidated Statements of Income and Comprehensive Income

Years ended December 31 ($ in thousands, except per share data)	2010	2009
Revenues		
Gas sales and transportation services	**76,323**	82,921
Off system sales	**14,988**	14,839
Other	**3,853**	6,371
	95,164	104,131
Cost of gas		
Gas sales	**29,125**	42,400
Off system sales	**14,988**	14,839
	44,113	57,239
	51,051	46,892
Operating and maintenance	**12,571**	12,338
Administrative and general (note 3)	**9,041**	7,262
Depreciation and amortization	**8,752**	8,118
Municipal and other taxes	**4,765**	4,584
	35,129	32,302
	15,922	14,590
Interest expense (note 17)	**6,404**	5,643
Investment and other income	**(3)**	(34)
Project development expenses (note 16)	**566**	181
Income before income taxes	**8,955**	8,800
Income taxes (note 9)	**1,877**	2,268
Net income and comprehensive income	**7,078**	6,532
Net loss and comprehensive loss attributable to non-controlling interest (note 3)	**10**	–
Net income and comprehensive income attributable to shareholders	**7,088**	6,532
Earnings per common share (note 18)		
Basic	**1.88**	1.72
Diluted	**1.83**	1.71

The accompanying notes to the consolidated financial statements are an integral part of these financial statements.

Consolidated Balance Sheets

As at December 31 ($ in thousands)	2010	2009
ASSETS		
Current assets		
Cash and cash equivalents (note 24)	**1,894**	1,511
Accounts receivable (note 20)	**23,017**	21,618
Gas purchase variance recoverable (note 4)	**4,498**	1,165
Income taxes recoverable	**1,305**	–
Inventories of natural gas and supplies (note 5)	**764**	1,079
Prepaid expenses	**1,056**	940
Derivative financial instruments (note 19)	**–**	1,029
Future income taxes (note 9)	**1,105**	1,288
	33,639	28,630
Plant, property and equipment (note 6)	**196,860**	178,420
Intangible assets (note 7)	**1,766**	1,795
Regulatory and other assets (notes 4 and 8)	**17,659**	11,364
	249,924	220,209
LIABILITIES		
Current liabilities		
Bank indebtedness (note 10)	**4,836**	2,579
Accounts payable and accrued liabilities	**19,106**	21,617
Income taxes payable	**–**	1,041
Other taxes payable	**3,388**	3,525
Derivative financial instruments (note 19)	**5,696**	4,298
Long-term debt, current (note 11)	**8,192**	2,800
	41,218	35,860
Long-term debt, non-current (note 11)	**82,761**	71,779
Regulatory and other liabilities (notes 4 and 12)	**10,892**	5,684
Future income taxes (note 9)	**20,736**	16,450
	155,607	129,773
EQUITY		
Preferred shares (note 14a)	**5,000**	5,000
Common shares (note 14b)	**9,038**	8,890
Contributed surplus (notes 14b and 15)	**4,515**	3,699
Retained earnings	**75,490**	72,847
Total shareholders' equity	**94,043**	90,436
Non-controlling interest	**274**	–
	94,317	90,436
	249,924	220,209

Commitments and guarantees (notes 19 and 22), Subsequent event (note 25)

The accompanying notes to the consolidated financial statements are an integral part of these financial statements.

On behalf of the Board:

Roy G. Dyce, Director

Robert F. Chase, Director

Consolidated Statements of Equity

Years ended December 31 ($ in thousands)	2010	2009
Preferred shares		
Balance, beginning and end of year	**5,000**	5,000
Common shares		
Balance, beginning of year	**8,890**	9,161
Share repurchase under normal course issuer bid (note 14b)	**–**	(306)
Employee stock options exercised	**148**	35
Balance, end of year	**9,038**	8,890
Contributed surplus		
Balance, beginning of year	**3,699**	3,610
Stock option expense (note 15)	**96**	92
Share repurchase under normal course issuer bid (note 14b)	**–**	(98)
Employee stock options exercised	**720**	95
Balance, end of year	**4,515**	3,699
Retained earnings		
Balance, beginning of year	**72,847**	71,502
Net income attributable to shareholders	**7,088**	6,532
Dividends – preferred shares	**(337)**	(337)
Dividends – common shares	**(4,108)**	(3,448)
Share repurchase under normal course issuer bid (note 14b)	**–**	(1,402)
Balance, end of year	**75,490**	72,847
Total shareholders' equity, end of year	**94,043**	90,436
Non-controlling interest		
Balance, beginning of year	**–**	–
Contribution from non-controlling interest	**284**	–
Net loss attributable to non-controlling interest	**(10)**	–
Balance, end of year	**274**	–
Total equity, end of year	**94,317**	90,436

The accompanying notes to the consolidated financial statements are an integral part of these financial statements.

Consolidated Statements of Cash Flows

Years ended December 31 ($ in thousands)	2010	2009
OPERATING ACTIVITIES		
Net income	**7,088**	6,532
Add (deduct) items not involving cash:		
Future income taxes (note 9)	**1,629**	105
Depreciation and amortization (note 24)	**8,691**	8,226
Amortization of termination payment deferral (note 4)	**(143)**	(5,466)
Share-based compensation (note 15)	**570**	311
Imputed interest on regulatory assets and liabilities	**202**	(91)
	18,037	9,617
Changes in operating assets and liabilities (note 24)	**(8,179)**	9,259
Net cash provided by operating activities	**9,858**	18,876
INVESTING ACTIVITIES		
Additions to plant, property and equipment (note 6)	**(7,399)**	(9,538)
Acquisition, net of cash acquired (note 3)	**(8,026)**	–
Additions to intangible assets (note 7)	**(22)**	(63)
Decrease in restricted cash	**400**	–
Other	**(231)**	–
Net cash used in investing activities	**(15,278)**	(9,601)
FINANCING ACTIVITIES		
Increase (decrease) in bank indebtedness	**2,257**	(419)
Debt refinancing costs	**(115)**	–
Issuance of long-term debt	**10,000**	2,939
Repayment of long-term debt	**(3,046)**	(5,400)
Share repurchase under normal course issuer bid (note 14b)	**–**	(1,806)
Employee stock options exercised (note 15)	**868**	130
Dividends paid (notes 14a and 14b)	**(4,445)**	(3,785)
Contribution from non-controlling interest (note 3)	**284**	–
Net cash provided by (used in) financing activities	**5,803**	(8,341)
Increase in cash and cash equivalents	**383**	934
Cash and cash equivalents, beginning of year	**1,511**	577
Cash and cash equivalents, end of year	**1,894**	1,511

Supplemental cash flow information (note 24)

The accompanying notes to the consolidated financial statements are an integral part of these financial statements.

Pacific Northern Gas Ltd. (the "Company") and its wholly-owned subsidiary, Pacific Northern Gas (N.E.) Ltd. ("PNG (N.E.)"), are engaged in the transportation and distribution of natural gas in northern British Columbia, Canada. The Company and PNG (N.E.) are subject to regulation (see note 1 and note 4) by the British Columbia Utilities Commission (the "Commission") which, among other things, approves rates charged to customers.

The Company operates a transmission and distribution system in the west-central portion of northern British Columbia ("Western system") and PNG (N.E.) operates a distribution system in northeastern British Columbia ("Northeast system"). Together, the Company and PNG (N.E.) operate over 3,500 kilometres of transmission and distribution pipeline and serve a base of more than 39,000 residential, commercial and industrial customers.

In April 2010, the Company and Skookum Power Holdings Corp. acquired a 100% interest in a 9.8 megawatt 'run of river' hydro-electricity generation facility ("McNair Creek") located on British Columbia's Sunshine Coast (see note 3). Through a series of restructuring transactions completed in December 2010, the Company and Skookum Power Holdings Corp., directly and respectively, own 97.1% and 2.9% of McNair Creek Hydro Limited Partnership and its general partner, McNair Creek Hydro Holding Corp. McNair Creek is a non-regulated business and currently operates under a long-term supply agreement with BC Hydro. The investment in McNair Creek represents the launch of the Company's renewable power business as part of its business diversification strategy. The key elements of this strategy are to diversify the Company's risk profile, grow its asset base and enhance its earnings and cash flows.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of presentation

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"), including selected accounting treatments that differ from those used by entities not subject to rate regulation. The timing of the recognition of certain assets, liabilities, revenue and expenses may be different as a result of regulation from what might be anticipated using GAAP by entities not subject to rate regulation. These differences are described in this note under the headings "Regulation", "Use of estimates", "Revenue recognition", "Inventories of natural gas and supplies", "Regulatory assets and liabilities", "Plant, property and equipment" and "Financial instruments", and in note 4.

All financial figures are presented in Canadian dollars unless otherwise stated.

Principles of consolidation

These consolidated financial statements include the accounts of the Company, its wholly-owned subsidiary PNG (N.E.), its 97.1% interest in McNair Creek (see note 3), as well as the Company's proportionate share of its 50% interest in the assets, liabilities, revenue and expenses of both Pacific Trail Pipelines Limited Partnership and its general partner, Pacific Trail Pipelines Management Inc. (see note 16 and note 25).

The results of operations, cash flows, financial position and non-controlling interest of McNair Creek have been included in these financial statements from the date of acquisition, April 19, 2010.

All intercompany transactions and balances are eliminated, including, on a pro-rata basis, those related to the entities which have been proportionately consolidated.

Regulation

The regulated activities of the Company and its subsidiary, PNG (N.E.), are subject to the authority of the Commission. The Commission administers acts and regulations pursuant to the *Utilities Commission Act* (British Columbia), covering matters such as rates, including rate of return on equity and capital structure, construction and operation of facilities, accounting practices, tolls, charges, and contractual agreements with customers.

The Company and its subsidiary operate under a cost-of-service regulatory model whereby customer rates are set based on revenues that allow for the recovery of forecast costs plus an established rate of return on deemed common equity. Under cost-of-service regulation, it is the responsibility of the Company to demonstrate to the Commission the prudence of the costs it has incurred. Forecast costs include gas commodity and transportation, operation and maintenance, depreciation, property taxes, interest and income taxes. The rate base is the average level of investment in all recoverable assets used in gas transmission and distribution, and an allowance for working capital.

Applications for changes to rates are made annually and are submitted to the Commission for their review and approval.

For 2010, the Company's average approved rate of return on the rate base was 8.16% after tax, and the average approved rate of return on deemed common equity was 10.09% after tax, based on a weighting of the respective rate bases of the Company and its subsidiary (2009 – 7.52% and 9.58%, respectively).

Accounting records and practices related to regulated activities are maintained and conform to the requirements of the Commission. As noted previously, in order to comply with these requirements, the timing of recognition of certain assets, liabilities, revenues and expenses may differ from that which would otherwise be required under GAAP for non rate-regulated entities. The financial effects of rate regulation relate principally to balances and accounting policies related to:

- Regulatory assets and liabilities;
- Plant, property and equipment and related depreciation rates; and
- Hedges, derivatives and other financial instruments.

Disclosure of the impact of rate regulation on these balances and policies are included in note 4.

Use of estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, expenses and disclosure of contingent assets and liabilities. Estimates are based on historical experience, current conditions and various other assumptions believed to be reasonable under the circumstances, and are subject to review on a periodic basis and adjusted as necessary. Significant balances impacted by estimates include revenues, which incorporate estimates of customer usage from the last meter reading date to the end of the reporting period, accounts receivable, which are recorded net of an estimated allowance for doubtful accounts and the purchase price allocation process for business acquisitions. Other significant estimates include depreciation of plant, property and equipment, amortization of intangibles, asset retirement obligations and employee future benefit plans.

The regulatory environment in which the Company operates also requires that certain estimates be made and amounts recorded pending finalization of the regulatory approval process. Accordingly, regulatory assets and liabilities also involve significant estimates. As the estimation process is inherently uncertain, actual future outcomes could differ from current estimates and assumptions, potentially having material effects on future financial statements.

Revenue recognition

The Company's gas sales and transportation services are subject to rate regulation and accordingly there are circumstances where the revenues recognized do not match the amounts billed. Revenue is recognized in a manner that is consistent with the underlying rate-setting mechanism as mandated by the Commission. Differences between amounts billed and rates approved may result in the recognition of regulatory assets and liabilities.

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. Operating revenues also include transportation services revenues that are recorded as service is provided, as well as the sale of gas surplus to the needs of the Company's sales customers ("off system sales") that are recognized when the gas is delivered. Other revenues include energy sales from the McNair Creek hydroelectric facility which are recognized on the accrual basis at the time electrical energy is delivered.

Cash and cash equivalents

Cash and cash equivalents include cash and term deposits with original maturities of less than three months and are presented at fair value.

Accounts receivable

Accounts receivable are recorded at amortized cost, net of a provision for doubtful accounts that is based on expected collectibility.

Inventories of natural gas and supplies

Inventories of natural gas ("line-pack") are valued at weighted-average cost. The volume of natural gas reported as line-pack represents the difference between natural gas received on behalf of the transportation service customers and natural gas delivered to them.

Inventories of supplies are valued at the lower of cost determined on a first-in, first-out basis and net realizable value.

Regulatory assets and liabilities

The Company defers certain charges and credits which the Commission may require or permit to be recovered or refunded through future customer rates. These regulatory assets and liabilities are amortized over various periods as approved by the Commission, depending on the nature of the charges or credits (see note 4).

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Development activities

The costs related to development activities are expensed up until the point in time that commercial viability of the underlying venture has been established and the Company has reasonable assurance that these costs will be recovered in the future.

Plant, property and equipment

Plant, property and equipment are recorded at cost less contributions in aid of construction. Cost may include an allocation of depreciation expense when the Company's own assets are used in the construction of new assets and may include an allowance for funds used during construction calculated at the Company's cost of capital. As directed by the Commission, the cost of depreciable assets retired, together with removal costs less salvage, is charged to accumulated depreciation. Gains or losses on disposal are not taken into income unless the disposal is outside the normal course of business or involves a major item of plant.

The depreciation of assets used in regulated activities is taken on plant in service and is calculated on a straight-line basis at the commencement of each fiscal year at Commission-approved rates (see note 6). Depreciation of property, plant and equipment used in non-regulated activities, including McNair Creek, is recorded when the asset enters productive use and is calculated on a straight-line basis over the asset's estimated useful life.

Intangible assets

Intangible assets mainly include land rights and computer software not directly attributable to the operation of plant, property and equipment and are recorded at cost less accumulated amortization. These assets are amortized on a straight-line basis at rates approved by the Commission (see note 7).

Impairment of long-lived assets subject to amortization

The Company reviews the valuation of long-lived assets subject to amortization when events or changes in circumstances may indicate or cause its carrying value to exceed the total undiscounted cash flows expected from its use and eventual disposition. An impairment loss, if any, would be recorded as the excess of the carrying value of the asset over its fair value.

Asset retirement obligations

The fair value of asset retirement obligations associated with the retirement of long-lived assets is recognized in the period when it can be reasonably determined. The Company's natural gas transmission and distribution long-lived assets are comprised principally of mains, service lines, compressors, and measuring and regulating equipment. The fair value of asset retirement obligations, which approximates the cost a third party would charge in performing the tasks necessary to retire such assets, is recognized at the present value of expected future cash flows and is added to the carrying value of the associated asset and depreciated over the asset's useful life. The liability is accreted over time through periodic charges to earnings and is reduced by actual costs of decommissioning and reclamation.

No amount has been recorded for asset retirement obligations relating to the Company's long-lived assets as it is not possible to make a reasonable estimate of the fair value of the liability due to the indeterminate timing and scope of the asset retirements. Management expects that all retirement costs associated with the regulated assets will be recovered through tolls in future periods.

Income taxes

The Company records future income tax assets and liabilities where temporary differences exist between the carrying amounts of assets and liabilities on the balance sheet and their tax bases. Future tax assets and liabilities are measured using substantively enacted tax rates expected to apply when the temporary differences reverse. The effect on future tax assets and liabilities of a change in tax rates is recognized in the period in which the change is substantively enacted.

A regulatory asset or liability is recognized for future taxes on temporary differences not included in current customer rates, but for which management expects to recover from or return to customers in future rates.

The income tax provision includes current and future income tax portions. The current income tax expense represents the estimated income taxes payable or receivable for the current reporting period. Future income tax expense is recognized for the change in future income tax assets and liabilities related to non-regulated assets and liabilities and the changes in temporary differences on regulated assets and liabilities that are recovered through current customer rates as prescribed by the Commission.

Employee future benefit plans

The Company accrues its obligations under employee pension benefit plans and the related costs, net of plan assets. The actuarial determination of the accrued benefit obligation for these plans uses the projected benefit method prorated on service and management's best estimate of future salary levels, other cost escalations, retirement ages of employees and other actuarial factors. For the purpose of calculating the expected return on plan assets, those assets are valued at a market-related value. The market-related value of assets is determined as the average of the fair value of plan assets and four projected values. The projected values are determined by projecting the fair value as at a particular time (1 year, 2 years, 3 years and 4 years prior to the measurement date) to the measurement date using actual non-investment cash flows and an assumed investment return equal to the average market-related value return on three-month treasury bills plus 2.5%.

Actuarial gains or losses arise from the difference between the actual long-term rate of return on plan assets for the period and the expected long-term rate of return on plan assets for the period, or from changes in actuarial assumptions used to determine the accrued benefit obligation. The excess of the net unamortized cumulative actuarial gain or loss over 10% of the greater of the benefit obligation and the market value of the plan asset at the beginning of the year is amortized over the average remaining service period of the active employees. Past service costs from plan amendments are amortized on a straight-line basis over the average remaining service period of employees active at the date of amendment. The average remaining service period of the active employees covered by the pension plan is 13 years.

For the defined contribution plan maintained by the Company, contributions payable by the Company are expensed as pension costs in the period to which they relate.

The non-pension post-retirement benefit plans include non-contributory health care and life insurance plans. The Company accrues its obligations under employee benefit plans and the related costs, net of plan assets. The actuarial determination of the accrued benefit obligation uses the projected benefit method prorated on service and management's best estimate of future salary levels, other cost escalations, retirement ages of employees and other actuarial factors. For the purpose of calculating the expected return on plan assets, those assets are valued at a market-related value. The market-related value of assets is determined as the average of the fair value of plan assets and four projected values.

The current service costs and the benefits paid are expensed and recovered in customer rates. The accrued benefit obligation for the non-pension post-retirement benefit plan is included on the balance sheet under regulatory and other liabilities, with a corresponding and offsetting regulatory asset for amounts expected to be recovered from customers in future rates (see note 4).

Financial instruments

FINANCIAL ASSETS AND LIABILITIES

The Company has classified its cash, cash equivalents and derivative financial instruments as held-for-trading assets and liabilities and has recorded them at their fair value, with gains and losses arising on the revaluation at the end of each reporting period included in net income subject to regulatory deferral treatment.

Accounts receivable from customers are classified as loans and receivables and are recorded at amortized cost.

Bank indebtedness, accounts payable and accrued liabilities, other taxes payable and long-term debt have been classified as other financial liabilities. Other financial liabilities are initially presented at their fair value, with subsequent measurements at amortized cost.

Transaction costs directly attributable to the issuance of short-term debt instruments are expensed in the period in which the instrument is issued, subject to regulatory deferral treatment, if applicable. Transaction costs that are directly attributable to the issuance of a long-term debt instrument are deducted from the obligation's initial carrying amount and are amortized using the effective interest rate method.

DERIVATIVE FINANCIAL INSTRUMENTS

The Company uses derivative and other financial instruments in connection with the management of gas supply prices. 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 indices of market prices which vary on a daily or monthly basis. The instruments used make it possible to fix, or define, the price of natural gas for delivery to customers. The gains or losses on these instruments are included in gas supply costs as these costs are recognized and are recovered through the gas supply rate in accordance with the method approved by the Commission.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

EMBEDDED DERIVATIVES

Derivatives may be embedded in other financial and non-financial instruments (the "host instrument"). 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 as an element of administrative and general expenses. The Company currently has no contracts with embedded derivatives that are required to be separated from the host instrument.

CREDIT RISK

The determination of fair value of the Company's financial assets, including cash, cash equivalents and derivative instruments, takes into account the Company's own credit risk and the credit risk of the counterparty. The Company trades only with recognized, credit-worthy third parties and does not enter into derivatives to manage its credit risk. The Company's exposure to credit risk arises from default of the counter party with a maximum exposure equal to the carrying amount of these instruments. Derivative counterparties and cash transactions are limited to high credit-quality financial institutions. The Company has policies that limit the amount of credit exposure to any one financial institution.

DISCLOSURES

Determination of fair value requires the use of observable market data whenever available. For disclosure purposes, all financial instruments measured at fair value on the balance sheet must be categorized into one of three hierarchy levels based on the transparency of the inputs used to measure the fair values. The classification of a financial instrument in the hierarchy is based upon the lowest level of input that is significant to the measurement of fair value of assets and liabilities.

The three broad levels of inputs within the hierarchy are as follows:

Level 1	Inputs are unadjusted quoted prices of identical instruments in active markets;
Level 2	Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly; and
Level 3	One or more significant inputs used in a valuation technique are unobservable in determining fair values of the instruments.

The disclosures required under this framework are disclosed in note 19.

Earnings per share

Basic earnings per common share amounts are calculated using the weighted-average number of common shares outstanding during the reporting period. Diluted earnings per common share are calculated using the treasury stock method whereby the weighted-average number of common shares outstanding during the year is adjusted to reflect the potential exercise of dilutive share purchase options.

Share-based compensation

The Company has established share-based compensation plans for eligible directors, officers and employees as described in note 15. The compensation expense for stock options granted under the Company's stock option plan is measured at fair value at the grant date computed using the Black-Scholes option pricing model and amortized over the vesting period of the underlying options, with an offsetting credit to contributed surplus. Consideration paid by plan participants on the exercise of stock options is credited to common share capital for an amount up to the $2.50 par value per common share, with any excess credited to contributed surplus.

The Company also has a deferred share unit plan for non-employee directors whereby such directors may elect to allocate all or a portion of their annual compensation as deferred share units. This plan makes use of notional common share units that are valued based on the Company's common share price on the Toronto Stock Exchange and are marked-to-market at the end of each reporting period. Changes in the value of the units as a result of fluctuations in the Company's share price and new issues are recognized in administrative and general expenses with the corresponding liability recorded in accounts payable and accrued liabilities in the consolidated balance sheet.

Comprehensive income

Comprehensive income represents the change in equity of an enterprise during a period from transactions and other events arising from non-owner sources, including gains and losses arising on self-sustaining foreign operations, gains and losses from changes in fair value of available for sale financial assets and changes in fair value of the effective portion of cash flow hedging instruments. The Company has not recognized any adjustments through other comprehensive income for the years ended December 31, 2010 and 2009, and as of December 31, 2010 and 2009, has no accumulated other comprehensive income.

2. CHANGES IN ACCOUNTING POLICIES

Applied in 2010

BUSINESS COMBINATIONS, CONSOLIDATED FINANCIAL STATEMENTS AND NON-CONTROLLING INTERESTS

Effective January 1, 2010, the Company early adopted the pronouncements of CICA Handbook Section 1582, *Business Combinations,* Section 1601*, Consolidated Financial Statements,* and Section 1602*, Non-Controlling Interests.*

Section 1582 was introduced to replace Section 1581, *Business Combinations*, and provides the Canadian equivalent to International Financial Reporting Standard IFRS 3 (revised), *Business Combinations*. Section 1582 specifies a number of changes, including: an expanded definition of a business, a requirement to measure all business acquisitions at fair value, a requirement to measure non-controlling interests at fair value, and a requirement to recognize acquisition related costs as expenditures in the period incurred.

Section 1601 and Section 1602 were introduced together to replace Section 1600, *Consolidated Financial Statements*, and provide the Canadian equivalent to the corresponding provisions of International Accounting Standard IAS 27 (revised), *Consolidated and Separate Financial Statements*. Section 1601 establishes standards for the preparation of consolidated financial statements and Section 1602 specifies that non-controlling interests be treated as a separate component of equity, instead of a liability or other item outside of equity.

The early adoption of these standards by the Company resulted in additional disclosure related to a business acquisition that closed during 2010 (see note 3), as well as the expensing of related acquisition costs incurred of $0.5 million, rather than the inclusion of these amounts as part of the cost of the business acquisition.

Future accounting pronouncements

INTERNATIONAL FINANCIAL REPORTING STANDARDS

The Canadian Accounting Standards Board ("AcSB") has determined that publicly accountable enterprises are required to prepare financial statements in accordance with International Financial Reporting Standards ("IFRS") for years beginning on or after January 1, 2011. The transition to IFRS will require the restatement for comparative purposes of amounts reported for the year prior to the transition date.

In August 2009, the International Accounting Standards Board ("IASB") issued an exposure draft on rate-regulated activities. In September 2010, the IASB concluded that it could not resolve the rate-regulated activities matter quickly and that it would consider the development of an agenda proposal on this issue in 2011 for future consideration. Also in September 2010, the AcSB issued an amendment to Part I of the CICA Handbook allowing a one-year deferral of first-time adoption of IFRS for qualifying entities with rate-regulated activities.

The Company is a qualifying entity for purposes of this amendment and has elected to make use of the one-year deferral, with a revised IFRS conversion date for reporting under IFRS of January 1, 2012. Accordingly, the Company will present its financial statements for 2011 in accordance with Part V of the CICA Handbook.

During 2011, the Company will reassess policy choices available under IFRS, and will continue to evaluate the impacts of the transition to IFRS on the Company's financial statements.

COMPREHENSIVE REVALUATION OF ASSETS AND LIABILITIES

In August 2009, the CICA amended Handbook Section 1625, *Comprehensive Revaluation of Assets and Liabilities*, as a result of issuing Sections 1582, *Business Combinations*, 1601, *Consolidated Financial Statements*, and 1602, *Non-Controlling Interests*, in January 2009. The amendments require that when push-down accounting is used following the acquisition of an enterprise, the assets and liabilities are to be measured at the values used in accounting for the purchase transaction or transactions in accordance with Section 1582. The amendments also require that, when a future income tax asset that arose prior to the date of a comprehensive revaluation and that was not recognized in the comprehensive revaluation is subsequently recognized, the benefit should be recognized in accordance with Section 1582 and Section 3465, *Income Taxes*. The amendments apply prospectively to comprehensive revaluations of assets and

2. CHANGES IN ACCOUNTING POLICIES (CONTINUED)

liabilities occurring in fiscal years beginning on or after January 1, 2011. The adoption of the amendments to Section 1625 is not expected to have a material impact on the Company's financial statements.

FINANCIAL INSTRUMENTS – RECOGNITION AND MEASUREMENT

In June 2009, the CICA provided a clarification to Handbook Section 3855, *Financial Instruments – Recognition and Measurement*, with respect to the embedded prepayment option. The Section has been amended to clarify when an embedded prepayment option is separated from its host instrument for accounting purposes. The amendment states that if the exercise price of a prepayment option compensates the lender for an amount equivalent to the present value of the lost interest for the remaining term of the host instrument, the feature is considered closely related to the host contract in which it is embedded. The amendment applies to interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. The adoption of the amendments to Section 3855 is not expected to have a material impact on the Company's financial statements.

MULTIPLE DELIVERABLE REVENUE ARRANGEMENTS

In December 2009, the CICA issued EIC-175, *Multiple Deliverable Revenue Arrangements*, replacing EIC-142, *Revenue Arrangements with Multiple Deliverables*. The changes were made in response to changes made to Accounting Standards Codification Topic 605-25, *Revenue Recognition – Multiple Element Arrangements*, under US GAAP, and more closely aligns the accounting requirements for multiple-element arrangements under Canadian GAAP and IFRS. EIC-175 addresses how to determine whether an arrangement involving multiple deliverables contains more than one accounting unit and, if so, how the consideration specified in the multiple element arrangement should be distributed between different accounting units. These recommendations are to be applied prospectively to revenue arrangements with multiple deliverables entered into or materially modified in the first annual fiscal period beginning on or after January 1, 2011. The Company is currently assessing the impact of adopting EIC-175 on its financial statements.

3. ACQUISITION

As noted in the preamble to these notes to the consolidated financial statements, the Company acquired a 97.1% interest in McNair Creek during 2010. Payments made for this acquisition included $7.3 million in cash on closing (net of cash acquired) and an additional $0.7 million in cash on finalization of post-closing adjustments. As part of the acquisition, contingent payments are required to be made to a former shareholder of McNair Creek equal to 0.75% of future revenues. Acquisition and restructuring costs of $0.9 million have been expensed and are included in administrative and general costs for 2010.

The Company has accounted for this acquisition as a purchase business combination with the subsidiary as the acquirer. The purchase price has been allocated to the assets acquired and liabilities assumed based on the estimated fair values on the acquisition date. Estimated fair values are based on discounted cash flows, quoted market prices and estimates made by management. Management engaged a third party to review the valuation of the assets acquired and liabilities assumed. The table that follows summarizes the final fair values of the identifiable assets acquired and liabilities assumed in this acquisition.

Final purchase price allocation

($ in thousands)

Assets	
Current assets	132
Plant, property and equipment [1]	19,467
Intangible assets	15
Restricted cash	570
	20,184
Liabilities	
Current liabilities	179
Long-term debt [2]	9,413
Future income taxes	2,386
	11,978
Net assets acquired	8,206
Purchase price	
Cash paid on closing, net of cash acquired	7,329
Cash paid post-closing	697
	8,026
Contingent consideration	180
	8,206

1 PLANT, PROPERTY AND EQUIPMENT

Prior to being acquired by the Company, McNair Creek entered into a long-term contract to sell 100% of its electricity generation to BC Hydro through to 2024, at a fixed price equal to the then prevailing market price, adjusted annually for inflation. At the acquisition date, the contract was an unfavourable operating lease as the price for electricity sold under the contract was less than the then current market price for electricity. The fair value of the unfavourable lease has been included in the determination of the acquisition-date fair value of the property, plant and equipment acquired.

2 LONG-TERM DEBT

Long-term debt assumed in this transaction is due November 1, 2024, bears interest at 7.386% and has monthly principal and interest payments of $0.1 million. As a condition of the long-term debt, McNair Creek was required to maintain two reserve accounts held by the lender on contingency of certain events, including a hydrology cash reserve fund which will be used by the lender in the event that cash flows from the facility are insufficient to fund debt repayments and a maintenance reserve fund which will be used in the event that a major maintenance cost is incurred. In April 2010, the Company secured the release of the requirement for the hydrology cash reserve fund with the issuance of a letter of credit in the amount of $1.4 million. The maintenance reserve fund had a balance of $0.2 million at December 31, 2010 and is included in regulatory and other assets on the balance sheet (see note 8).

Accounting policies

BUSINESS COMBINATIONS

As per note 2, early adoption of these standards has resulted in additional disclosure related to the transaction, as well as the expensing of transaction costs of $0.5 million in administration and general expense.

LEASES

The electricity purchase agreement with BC Hydro has been assessed as an operating lease for accounting purposes. Revenues from this operating lease are recognized on the same basis as energy deliveries under this agreement as this pattern is considered most representative of how benefits from the underlying assets are realized.

SEGMENT REPORTING

With the acquisition of McNair Creek, the Company has entered a new business segment, the generation and sale of electricity. This change has resulted in the Company presenting segmented information as disclosed in note 23.

Operating results

The operating results of McNair Creek have been included in these consolidated financial statements from April 19, 2010, the date of acquisition, and include $1.3 million in revenue and a net loss of $0.5 million related to these operations (see note 23). On a pro-forma basis, had the acquisition occurred on January 1, 2010, the Company's revenue from this operation would have been $2.0 million and net loss for the period would have been $0.4 million.

Non-controlling interest

The 2.9% interest in McNair Creek held by Skookum Power Holdings Corp. has been reflected as a non-controlling interest in these consolidated financial statements as a component of equity.

4. FINANCIAL STATEMENT EFFECTS OF RATE REGULATION

Regulatory assets and liabilities

Regulatory assets and liabilities arise as a result of the rate-setting process. In order to recognize the economic effects of the actions or expected actions of the regulator, the timing of recognition of certain revenues and expenses may differ from that otherwise expected under GAAP for non rate-regulated entities. All amounts deferred as regulatory assets and liabilities are subject to future regulatory approval. As such, the regulator could alter amounts subject to deferral, at which time the change would be reflected in the financial statements. Certain remaining recovery and settlement periods are those expected by management and may differ from the actual recovery or settlement periods ultimately approved by the regulator. In the absence of rate-regulated accounting, GAAP would not permit the recognition of regulatory assets and liabilities and therefore the earnings impact would be recorded in the period in which the related event occurs.

Regulatory assets represent future revenues associated with certain costs incurred that will be or are expected to be recovered from customers in future periods through the rate setting process. Regulatory liabilities represent future reductions or limitations on future increase in revenues associated with amounts that will be or are expected to be refunded to customers through the rate-setting process.

4. FINANCIAL STATEMENT EFFECTS OF RATE REGULATION (CONTINUED)

The following table summarizes the continuity of regulatory assets and liabilities expected to be recovered from or refunded to customers in future periods:

Year Ended December 31, 2010 ($ in thousands)

Description	Note	Balance, beginning of year	Net (deferral) recovery of amounts	Amortization	Balance end of year
SUBJECT TO RATE REGULATION AND APPROVAL FOR RECOVERY IN RATES					
Amounts included in rate base					
Rate stabilization adjustment mechanism [1]		(889)	2,418	–	1,529
Pipeline rehabilitation costs [2]		1,226	483	(212)	1,497
Other [3]		834	398	(253)	979
		1,171	3,299	(465)	4,005
Amounts excluded from rate base					
Deactivated assets [4]		3,337	122	(625)	2,834
Other [5]		(65)	369	213	517
		3,272	491	(412)	3,351
	8	4,443	3,790	(877)	7,356
Other regulatory assets (liabilities) excluded from rate base					
Gas purchase variance recoverable [6]		1,165	3,333	–	4,498
LNG Partners option fees deferral [7]	12	(2,385)	(214)	99	(2,500)
West Fraser termination payment deferral [8]	12	–	(5,151)	143	(5,008)
		(1,220)	(2,032)	242	(3,010)
Sub-total		3,223	1,758	(635)	4,346
SUBJECT TO RATE REGULATION BUT NOT YET APPROVED FOR RECOVERY IN RATES					
Other regulatory assets excluded from rate base					
Future recovery of income taxes [9]	8	3,546	1,384	–	4,930
Future recovery of non-pension post-retirement benefits [10]	8	2,373	124	–	2,497
		5,919	1,508	–	7,427
Total net regulatory assets		9,142	3,266	(635)	11,773

Year Ended December 31, 2009 ($ in thousands)

Description	Note	Balance, beginning of year	Net (deferral) recovery of amounts	Amortization	Balance end of year
SUBJECT TO RATE REGULATION AND APPROVAL FOR RECOVERY IN RATES					
Amounts included in rate base					
Rate stabilization adjustment mechanism [1]		955	(1,844)	–	(889)
Pipeline rehabilitation costs [2]		1,079	329	(182)	1,226
Other [3]		293	635	(94)	834
		2,327	(880)	(276)	1,171
Amounts excluded from rate base					
Deactivated assets [4]		3,824	134	(621)	3,337
Other [5]		(22)	(258)	215	(65)
		3,802	(124)	(406)	3,272
	8	6,129	(1,004)	(682)	4,443
Other regulatory assets (liabilities) excluded from rate base					
Gas purchase variance recoverable [6]		3,588	(2,423)	–	1,165
LNG Partners option fees deferral [7]	12	–	(2,385)	–	(2,385)
Methanex termination payment deferral [11]		(5,401)	5,401	–	–
		(1,813)	593	–	(1,220)
Sub-total		4,316	(411)	(682)	3,223
SUBJECT TO RATE REGULATION BUT NOT YET APPROVED FOR RECOVERY IN RATES					
Other regulatory assets excluded from rate base					
Future recovery of income taxes [9]	8	4,393	(847)	–	3,546
Future recovery of non-pension post-retirement benefits [10]	8	2,190	183	–	2,373
		6,583	(664)	–	5,919
Total net regulatory assets		10,899	(1,075)	(682)	9,142

1 RATE STABILIZATION ADJUSTMENT MECHANISM

The Company is authorized by the Commission to maintain a rate stabilization adjustment mechanism ("RSAM") regulatory account to mitigate the effect on its earnings of volatility in deliveries to certain customers caused principally by volatility in weather and in the cost of natural gas. The RSAM account accumulates the margin impact of variations in the actual versus forecast use for residential and small commercial customers. Balances in the RSAM account are recovered in customer rates over a three-year period based on forecast deliveries. During 2010, approximately $0.4 million before income taxes of the December 31, 2010 RSAM balance was recovered in customer rates (2009 – $0.5 million).

2 PIPELINE REHABILITATION COSTS

The cost of carrying out temporary repairs of pipeline breaks, as well as the related undepreciated net book value of pipeline assets destroyed as a result of pipeline breaks, are recorded in regulatory accounts for future recovery from customers. In addition, the cost of investigative work and repair of pipeline assets at risk due to stress, corrosion, cracking or other material defects is deferred for future recovery in customer rates. Amounts added to the pipeline rehabilitation cost regulatory account are recovered in customer rates over a ten-year period.

4. FINANCIAL STATEMENT EFFECTS OF RATE REGULATION (CONTINUED)

3 OTHER AMOUNTS INCLUDED IN RATE BASE

The balance of other amounts included in rate base is comprised of various items, each less than $0.5 million, that are approved for recovery from customers in future rates and are subject to a regulatory return. Items making up this balance include a regulatory account for the recovery of lost margin from certain industrial customers whose actual deliveries varied from deliveries forecast for rate-setting purposes, and a regulatory account to recover the difference between actual and forecast property taxes. Amounts added to these accounts are recovered in customer rates over varying periods, from one to ten years.

4 DEACTIVATED ASSETS

Subsequent to the closure of Methanex Corporation's Kitimat methanol plant in January 2006, the Company identified certain plant, property and equipment as no longer required on an ongoing basis to provide service to its customers. In 2006, the Commission approved the removal from rate base of compressor facilities, pipeline loops and various other fixed assets with a net book value of $5.0 million. This amount was transferred to a non-rate-base, interest-bearing regulatory account effective December 31, 2005, and is being amortized on a straight-line basis over a ten-year period commencing 2006.

5 OTHER AMOUNTS EXCLUDED FROM RATE BASE

The balance of other amounts excluded from rate base is comprised of various items, each less than $0.5 million, that are approved for recovery from customers in future rates, but are not subject to a regulatory return. Items making up this balance include an interest deferral mechanism approved by the Commission to mitigate exposure to fluctuations in floating interest rates on short- and long-term debt, and provisions for recovery of the net book value of assets no longer in service. Amounts added to these regulatory accounts are recovered in customer rates over varying periods, from one to ten years.

6 GAS PURCHASE VARIANCE RECOVERABLE

Gas purchase variance recoverable amounts arise due to unanticipated commodity cost and demand fluctuations between actual natural gas costs and forecast natural gas costs as recovered in rates. As directed by the Commission, gas purchase variance amounts are recovered from or refunded to customers on a straight-line basis generally over a one year period. This balance also includes the fair value of derivative financial instruments used in hedging future gas costs. For 2010, amounts refunded and credited to cost of sales was $2.3 million before income taxes (2009 – $4.0 million).

7 LNG PARTNERS OPTION FEES DEFERRAL

In 2009, Merrill Lynch paid $2.5 million in option and extension fees to the Company to secure excess firm pipeline capacity. In 2010, further deposits totaling $2.0 million were paid to the Company and the agreement between the Company and Merrill Lynch was assigned and novated by Merril Lynch to LNG Partners, LLC ("LNG Partners"). Pursuant to the Commission approved negotiated settlement agreement for the Western system 2009 revenue requirements application, the Company has recorded these amounts as an interest bearing, non-rate base regulatory liability to be credited to cost of service in future years. Also pursuant to the negotiated settlement, the Company has drawn down $2.0 million of the LNG Partners option fees deferral to offset the full balance of the Western system's common equity deferral account that was set up during 2009 and 2010 following the Capital Structure and Equity Risk Premium Application.

8 WEST FRASER TIMBER CO. LTD. TERMINATION PAYMENT DEFERRAL

On May 31, 2010, West Fraser Timber Co. Ltd. ("West Fraser") provided the Company with the required six months cancellation notice to terminate the transportation service agreement related to its Kitimat B.C. linerboard mill. West Fraser continued to pay the monthly demand charge due under the transportation agreement until November 30, 2010 and then made a termination payment of just over $5 million on December 1, 2010. The Company anticipates the termination payment would be amortized over the remaining life of the agreement, consistent with the regulatory treatment accorded the Methanex termination payment. In addition, as was the case with the closure of the Methanex plant, lost future revenues from the West Fraser contract are expected to be recoverable through standard rate applications to the Commission. If this is the case, the Company anticipates limited impact on future earnings.

9 FUTURE RECOVERY OF INCOME TAXES

This balance represents future income taxes that are not recovered through the current rate-making methodology as prescribed by the Commission. This regulatory asset is adjusted to reflect changes in the underlying temporary differences and for changes in future income tax rates. Management expects that this regulatory asset will be recovered through future rates.

10 FUTURE RECOVERY OF NON-PENSION POST-RETIREMENT BENEFITS

This balance represents the non-pension post-retirement liability that is not recovered through the current rate-making methodology as prescribed by the Commission. Management expects that this regulatory asset will be recovered through future rates.

11 METHANEX CORPORATION 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. As approved by the Commission, the termination payment was recorded as an interest-bearing regulatory liability and was amortized into income over the period from March 1, 2006 to October 31, 2009. During 2009, the remaining $5.5 million of this termination payment was amortized and credited to other operating revenues.

Financial statement effect of rate regulation

In order to comply with the regulatory requirements of the Commission, the timing of recognition of certain revenues and expenses may differ from that which would otherwise be required under GAAP for non rate-regulated entities. The following table illustrates the effect of the deferral treatment allowed under rate-regulated accounting as compared to the corresponding treatment under GAAP for non rate-regulated entities on income before income taxes for both 2010 and 2009:

Year Ended December 31, 2010 ($ in thousands)	**Net deferral (recovery) of amounts**	**Amortization**	**Increase (decrease) in income before income taxes**
Rate stabilization adjustment mechanism	**(2,418)**	**–**	**(2,418)**
Pipeline rehabilitation costs	**(483)**	**212**	**(271)**
Other amounts included in rate base	**(398)**	**253**	**(145)**
Deactivated assets	**(122)**	**625**	**503**
Other amounts excluded from rate base	**(369)**	**(213)**	**(582)**
Gas purchase variance recoverable	**(3,333)**	**–**	**(3,333)**
LNG Partners option fees deferral	**214**	**(99)**	**115**
West Fraser termination payment deferral	**5,151**	**(143)**	**5,008**
Future recovery of income taxes	**(1,384)**	**–**	**(1,384)**
Future recovery of non-pension post-retirement benefits	**(124)**	**–**	**(124)**
	(3,266)	**635**	**(2,631)**

Year Ended December 31, 2009 ($ in thousands)	Net deferral (recovery) of amounts	Amortization	Increase (decrease) in income before income taxes
Rate stabilization adjustment mechanism	1,844	–	1,844
Pipeline rehabilitation costs	(329)	182	(147)
Other amounts included in rate base	(635)	94	(541)
Deactivated assets	(134)	621	487
Other amounts excluded from rate base	258	(215)	43
Gas purchase variance recoverable	2,423	–	2,423
Merrill Lynch option fees deferral	2,385	–	2,385
Methanex termination payment deferral	(5,401)	–	(5,401)
Future recovery of income taxes	847	–	847
Future recovery of non-pension post-retirement benefits	(183)	–	(183)
	1,075	682	1,757

4. FINANCIAL STATEMENT EFFECTS OF RATE REGULATION (CONTINUED)

Other items affected by rate regulation

ALLOWANCE FOR FUNDS USED DURING CONSTRUCTION ("AFUDC")

AFUDC is included in the cost of plant, property and equipment and is depreciated over future periods as part of the total cost of the related asset. AFUDC includes both an interest component and a cost of equity component, as approved by the Commission. In the absence of rate regulation, generally accepted accounting principles would permit the capitalization of only the interest component. Therefore, the recording of the cost of equity component as a capitalized asset and the corresponding earnings recognized during the construction phase would not be recognized nor would the subsequent depreciation of the capitalized cost of equity component. It is not possible to make a reasonable estimate of the carrying value of the cost of equity component of AFUDC included in plant, property and equipment. The Company did not capitalize any AFUDC in 2010 or 2009.

DEEMED INTEREST CAPITALIZATION

The Company is permitted to earn or charge a short-term interest return on regulatory assets and liabilities excluded from rate base. For 2010, interest was capitalized at 3.99% (2009 – 3.78%) on these amounts. In the absence of rate regulation, GAAP would not permit the capitalization of interest on deferrals. Therefore, the recording of capitalized interest as a component of regulatory assets or liabilities and the corresponding earnings adjustment would not be recognized nor would the subsequent amortization of the capitalized interest component. The amortization of capitalized interest resulted in a debit to income of $0.2 million in 2010 (2009 – credit to income of $0.1 million).

OVERHEAD AND DEPRECIATION CAPITALIZATION

With the approval of the Commission, the Company capitalizes a percentage of certain operating, administrative and general costs into the rate base on an ongoing basis. Such treatment is accorded in recognition of the significance of plant, property and equipment constructed by the Company. The Company is also authorized to capitalize depreciation on equipment used in the construction of assets. The Company is allowed to earn a rate of return on the net book value of such capitalized costs in future years. In the absence of rate-regulated accounting, these costs would be charged to the consolidated statement of income in the period in which they occurred. In 2010, the Company capitalized $1.9 million of overhead costs (2009 – $1.9 million) and $0.3 million of depreciation expense (2009 – $0.3 million) to plant, property and equipment.

GAINS AND LOSSES ON DISPOSAL OF PLANT, PROPERTY AND EQUIPMENT

As directed by its regulator, when a fixed asset is retired or otherwise disposed of, the Company does not reflect a gain or loss in income. Entities not subject to rate regulation write off the net book value of the retired asset and include any resulting gain or loss in current operating results. Since the Company does not calculate depreciation expense for individual assets, it cannot identify or quantify gains or losses on the retirement of a fixed asset in any given year which would have been recorded had the Company not been subject to rate regulation.

DERIVATIVE INSTRUMENTS AND HEDGING

To be recorded as a hedging instrument under GAAP for non rate-regulated entities, a derivative instrument has to be designated as such and meet certain criteria for effectiveness. If a derivative instrument does not meet the designation criterion, the effectiveness criterion or the documentation requirements necessary for designation as a hedging instrument, it is recorded at its fair value and any resulting realized or unrealized gains and losses are included in income. In the absence of rate regulation, the Company would have had to consider whether to adopt hedge accounting as outlined in CICA Handbook Section 3865, Hedges, and ensure its documentation and effectiveness testing met the specified criteria. Since the accounting for these derivative instruments is determined by rate regulation, the Company has chosen not to pursue the required designations, nor to fulfill the documentation and effectiveness criteria required to account for these instruments as hedging instruments under GAAP for non rate-regulated entities.

5. INVENTORIES OF NATURAL GAS AND SUPPLIES

($ in thousands)	**2010**	2009
Natural gas (line-pack)	**681**	995
Materials and supplies	**83**	84
	764	1,079

6. PLANT, PROPERTY AND EQUIPMENT

As at December 31, 2010 ($ in thousands)	Average depreciation rate (%)	Cost	Accumulated depreciation	Net book value
Transmission plant	**2.7**	**191,476**	**92,738**	**98,738**
Distribution plant	**2.5**	**102,346**	**40,737**	**61,609**
General plant	**4.4**	**23,282**	**9,509**	**13,773**
Hydroelectric plant (note 3)	**2.5**	**19,471**	**339**	**19,132**
Processing plant	**1.7**	**1,466**	**401**	**1,065**
Construction in progress	**–**	**1,440**	**–**	**1,440**
Subtotal	**2.9**	**339,481**	**143,724**	**195,757**
Capital supplies inventory	**–**	**1,103**	**–**	**1,103**
	2.9	**340,584**	**143,724**	**196,860**

As at December 31, 2009 ($ in thousands)	Average depreciation rate (%)	Cost	Accumulated depreciation	Net book value
Transmission plant	2.7	189,852	87,634	102,218
Distribution plant	2.6	98,342	38,746	59,596
General plant	4.6	22,941	8,886	14,055
Processing plant	1.4	1,218	365	853
Construction in progress	–	641	–	641
Subtotal	2.8	312,994	135,631	177,363
Capital supplies inventory	–	1,057	–	1,057
	2.8	314,051	135,631	178,420

The following table provides information on the changes in the balance of plant, property and equipment cost:

($ in thousands)	**2010**	2009
Cost, beginning of year	**312,994**	304,574
Acquisition of McNair Creek (note 3)	**19,467**	–
Capital expenditures, net of contributions in aid of construction	**7,788**	9,682
Depreciation capitalized	**321**	290
Transfer to regulatory asset	**(6)**	(484)
Plant retirements	**(1,083)**	(1,068)
Cost, end of year	**339,481**	312,994

6. PLANT, PROPERTY AND EQUIPMENT (CONTINUED)

The following table provides information on the changes in the balance of accumulated depreciation for plant, property and equipment:

($ in thousands)	**2010**	2009
Accumulated depreciation, beginning of year	**135,631**	128,331
Depreciation expense	**8,808**	8,271
Depreciation capitalized	**321**	290
Transfer to regulatory asset	**(4)**	(252)
Plant retirements	**(1,083)**	(1,068)
Salvage on plant retirements	**51**	59
Accumulated depreciation, end of year	**143,724**	135,631

During the year, the Company received contributions in aid of construction of $0.7 million (2009 – $1.3 million), which have been recorded as a reduction of distribution plant.

7. INTANGIBLE ASSETS

As at December 31, 2010 ($ in thousands)	**Average amortization rate (%)**	**Cost**	**Accumulated amortization**	**Net book value**
Land rights	**0.3**	**1,527**	**81**	**1,446**
Computer software	**7.2**	**847**	**527**	**320**
		2,374	**608**	**1,766**

As at December 31, 2009 ($ in thousands)	Average amortization rate (%)	Cost	Accumulated amortization	Net book value
Land rights	0.3	1,512	76	1,436
Computer software	7.8	825	466	359
		2,337	542	1,795

The following table provides information on the changes in the balance of the cost of intangible assets:

($ in thousands)	**2010**	2009
Cost, beginning of year	**2,337**	2,274
Purchase of intangibles	**22**	63
Acquisition of McNair Creek (note 3)	**15**	–
Cost, end of year	**2,374**	2,337

Amortization of these intangible assets for the year was $0.1 million (2009 – $0.1 million).

8. REGULATORY AND OTHER ASSETS

($ in thousands)	2010	2009
Regulatory assets (note 4)	**7,356**	4,443
Future recovery of income taxes (note 4)	**4,930**	3,546
Future recovery of non-pension post-retirement benefits (notes 4 and 12)	**2,497**	2,373
Accrued pension benefit asset (note 13)	**2,473**	1,002
Other	**403**	–
	17,659	11,364

9. INCOME TAXES

($ in thousands)	2010	2009
Current income taxes	**248**	2,163
Future income taxes	**1,629**	105
	1,877	2,268

Income tax expense varies from the amount that would be expected if current statutory rates were applied to income before income taxes for the following reasons:

(Percent)	2010	2009
Combined Canadian federal and provincial statutory income tax rates, including surtaxes	**28.5**	30.0
Increase (decrease) in income taxes resulting from:		
Regulatory adjustment	**(4.4)**	(1.3)
Non-taxable income	**(2.9)**	(3.1)
Other items	**(0.2)**	0.2
Effective rate of income taxes	**21.0**	25.8

Future income taxes

Future income tax assets and liabilities are comprised of the following:

($ in thousands)	2010	2009
Future income tax asset (liability):		
Plant, property and equipment	**(18,672)**	(15,220)
Deactivated assets	**(955)**	(1,145)
Employee future benefits	**(815)**	(336)
Gas purchase variance account	**468**	801
Regulatory assets and liabilities	**(1,709)**	565
West Fraser termination payment deferral	**1,427**	–
Other	**625**	173
	(19,631)	(15,162)
Comprised of:		
Current future income tax assets	**1,105**	1,288
Non-current future income tax liabilities	**(20,736)**	(16,450)
	(19,631)	(15,162)

10. BANK INDEBTEDNESS

In November 2010, the Company completed a renegotiation and extension of its bank operating facility. Under the facility, $25.0 million is available for working capital purposes (2009 – $25.0 million) through cash draws and the issuance of letters of credit. The November 2010 amendments included deletion of the borrowing base limitation of availability under the operating facility such that the $25.0 million is available to the Company at all times subject to a requirement that borrowings be reduced to zero for 30 days each calendar year. The Company covenants under the facility to maintain its debt leverage at 65% or less.

The bank operating facility has a term of 18 months, expiring May 28, 2012, and is collateralized by a charge on the Company's accounts receivable and inventories. Draws on the operating facility bear interest at prime rate or bankers' acceptance rates plus an applicable credit spread (December 31, 2010 – 4.00% interest rate; December 31, 2009 – 3.75% interest rate). At December 31, 2010, $4.8 million (2009 – $2.6 million) had been drawn as prime-rate advances and an additional $3.8 million (2009 – $5.7 million) was utilized for the issuance of letters of credit securing the Company's obligations under its Supplemental Retirement Plan and to secure certain obligations related to McNair Creek.

11. LONG-TERM DEBT

($ in thousands)	2010	2009
Secured Debentures – regulated activities [a]		
5-year Revolver due January 30, 2015, bearing interest at a floating rate (December 31, 2010 – 4.371%). [b]	**16,000**	–
5-year Revolver due August 3, 2012, bearing interest at a floating rate (December 31, 2009 – 1.758%). [b]	**–**	6,000
RoyNat Debenture due September 15, 2017, bearing interest at a floating rate (December 31, 2010 – 3.689%; December 31, 2009 – 2.896%), payable in monthly installments of $0.1 million, beginning on September 15, 2010, with a final installment of $6.6 million at maturity.	**14,600**	15,000
2011 Series Debenture, 10.75% due December 13, 2011, payable with an installment of $0.8 million in 2010, with a final installment of $5.0 million at maturity.	**5,000**	5,799
2018 Series Debenture, 8.75% due November 15, 2018, payable in annual installments of $0.6 million through to 2013 and $1.0 million in each of the years 2014 to 2017, with a final installment of $7.0 million at maturity.	**12,800**	13,400
2025 Series Debenture, 9.30% due July 18, 2025, payable in annual installments of $0.5 million, with a final installment of $9.5 million at maturity.	**16,500**	17,000
2027 Series Debenture, 6.90% due December 2, 2027, payable in annual installments of $0.5 million, with a final installment of $9.5 million at maturity.	**17,500**	18,000
	82,400	75,199
Secured Debentures – non-regulated activities [c]		
2024 CFI Debenture, 7.39% due November 1, 2024, payable in monthly blended principal and interest mortgage-style installments that total to $1.1 million annually.	**9,167**	–
	91,567	75,199
Less: Debt issue costs	**(614)**	(620)
	90,953	74,579
Long-term debt due within one year [d]	**8,192**	2,800
	82,761	71,779

(a) Collateral for the Secured Debentures consists of a specific first mortgage on substantially all of the Company's plant, property and equipment and gas purchase and gas sales contracts, and a first floating charge on other property, assets and undertakings.

(b) At December 31, 2009, the Company had a $20.0 million, 5-year revolving term facility arranged through Canadian Western Bank and RoyNat Inc. On February 2, 2010, this facility was amended to make $35.0 million available under the facility and to extend the maturity date to January 30, 2015.

(c) Collateral for the 2024 CFI Debenture consists of first fixed specific and floating charges and a security interest over all the assets and undertakings of McNair Creek and a first security interest over all the interests of the Company and its partner in partnership interests and shares in McNair Creek.

(d) Principal repayments of long-term debt during the next five years and thereafter are as follows:

($ in thousands)	
2011	8,192
2012	3,222
2013	3,254
2014	3,689
2015	19,727
Thereafter	53,483
	91,567

12. REGULATORY AND OTHER LIABILITIES

($ in thousands)	2010	2009
LNG Partners option fees deferral (note 4)	**2,500**	2,385
West Fraser Timber Co. Ltd. termination payment deferral (note 4)	**5,008**	–
Accrued non-pension post-retirement benefit liability (note 13)	**2,497**	2,373
Derivative financial instruments – non-current (note 19)	**476**	707
Other	**411**	219
	10,892	5,684

13. EMPLOYEE FUTURE BENEFIT PLANS

The Company and its subsidiary have a number of funded and unfunded defined benefit plans, as well as defined contribution plans, that provide pension, other retirement and post-employment health and life insurance benefits for most employees.

Total cash payments for employee future benefits included the following:

($ in thousands)	2010	2009
Defined benefit plans	**2,312**	1,237
Defined contribution plans	**77**	68
Non-pension post-retirement plans	**150**	156
Non-pension post-retirement benefits paid	**243**	233
	2,782	1,694

(a) Defined benefit pension plans

The measurement dates of the funded plans, as well as the effective dates of the most recent actuarial valuations and the next required actuarial valuations for the purpose of funding the funded plans are as follows:

	2010	2009
Measurement date of the plan assets and accrued benefit obligation	**September 30, 2010**	September 30, 2009
Effective date of the most recent actuarial valuation report for funding purposes	**December 31, 2009**	December 31, 2006
Effective date of the next required actuarial valuation report for funding purposes	**December 31, 2012**	December 31, 2009

Benefits earned under the defined benefit plans are principally based on years of service and average earnings. Information about the Company's defined benefit pension plans is as follows:

($ in thousands)	2010	2009
Accrued benefit obligations		
Balance, beginning of year	**23,370**	22,049
Current service cost	**761**	752
Employees' contributions	**15**	15
Interest cost	**1,512**	1,427
Benefits paid	**(1,004)**	(970)
Actuarial losses	**4,621**	97
Balance, as at measurement date	**29,275**	23,370
Plan assets		
Fair value, beginning of year	**19,316**	18,035
Actual return on plan assets	**1,489**	929
Employer contributions	**2,063**	1,307
Employees' contributions	**15**	15
Benefits paid	**(1,004)**	(970)
Fair value, as at measurement date	**21,879**	19,316
Funded status		
Plan deficit	**(7,396)**	(4,054)
Unamortized net actuarial losses	**9,355**	4,789
Unamortized transitional asset	**(38)**	(36)
Accrued benefit asset, as at measurement date	**1,921**	699
Employer contributions between measurement date and end of year	**552**	303
Accrued benefit asset, end of year (note 8)	**2,473**	1,002

13. EMPLOYEE FUTURE BENEFIT PLANS (CONTINUED)

The following is a summary of the significant actuarial assumptions used in measuring the Company's accrued pension benefit obligations:

(Percent)	2010	2009
Accrued benefit obligation as of December 31, with a measurement date of September 30:		
Discount rate	**5.30**	6.50
Rate of compensation increase	**3.25**	3.25
Benefit cost for years ended December 31, with a measurement date of September 30:		
Discount rate	**6.50**	6.50
Expected long-term rate of return on plan assets	**7.00**	7.00
Rate of compensation increase	**3.25**	3.25

The following table shows the allocation of the pension plan assets at the measurement dates:

(Percent)	2010	2009
Asset category:		
Equity securities	**62**	62
Debt securities	**35**	36
Other	**3**	2
	100	100

The Company's pension plan expense is as follows:

($ in thousands)	2010	2009
Current service cost	**761**	752
Interest cost	**1,512**	1,427
Expected return on plan assets	**(1,481)**	(1,391)
Amortization of net actuarial loss	**47**	26
Amortization of transitional asset	**2**	2
Net defined benefit pension plan expense	**841**	816
Defined contribution pension plan expense	**77**	68
Total pension expense	**918**	884

(b) Non-pension post-retirement benefits

The following is a summary of the significant actuarial assumptions used in measuring the Company's accrued non-pension post-retirement benefit obligations:

(Percent)	2010	2009
Accrued benefit obligation as of December 31, with a measurement date of September 30:		
Discount rate	**5.30**	6.50
Benefit cost for years ended December 31, with a measurement date of September 30:		
Discount rate	**6.50**	6.50
Expected long-term rate of return on plan assets	**3.50**	3.50

Information about the Company's non-pension post-retirement benefit obligation is as follows:

($ in thousands)	2010	2009
Accrued benefit obligations		
Balance, beginning of year	**4,930**	4,891
Current service cost	**150**	156
Interest cost	**317**	315
Benefits paid	**(243)**	(233)
Actuarial (gain) loss	**1,377**	(199)
Balance, as at measurement date	**6,531**	4,930
Plan assets		
Fair value, beginning of year	**943**	779
Actual return on plan assets	**28**	1
Employer contributions	**394**	396
Benefits paid	**(243)**	(233)
Fair value, as at measurement date	**1,122**	943
Funded status		
Plan deficit	**(5,409)**	(3,987)
Unamortized net actuarial losses	**1,889**	466
Unamortized transitional obligation	**986**	1,109
Benefit liability, as at measurement date	**(2,534)**	(2,412)
Employer contributions between measurement date and end of year	**37**	39
Accrued benefit liability, end of year (note 12)	**(2,497)**	(2,373)

The assumed extended health care cost trend used for measurement purpose is 10.0% per annum, grading down over 5 years to 5.0% and remaining at that level thereafter. The assumed dental premium trend used for measurement purposes is 7.0% per annum for the first 10 years and 6.0% per annum thereafter.

The Company's non-pension post-retirement benefit expense is as follows:

($ in thousands)	2010	2009
Current service cost	**150**	156
Interest cost	**317**	315
Expected return on plan assets	**(36)**	(30)
Amortization of transitional obligation	**123**	123
Amortization of net actuarial loss	**1**	15
Non-pension post-retirement benefit plan expense, accrual method	**555**	579

For 2010, $0.4 million (2009 – $0.4 million) of the non-pension post-retirement benefit plan expense has been recovered in customer rates and is recognized in the Company's administration and general expense. The difference of $0.1 million (2009 – $0.2 million) is recorded as an increase in the future recovery of non-pension post-retirement benefits asset (see note 8).

For 2010, the effects of a one percentage point change in assumed health-care cost trend rates would have the following effects:

($ in thousands)	1% increase in rate	1% decrease in rate
Increase (decrease) in accrued benefit obligation	968	(759)
Increase (decrease) in current service and interest costs	58	(49)

14. SHARE CAPITAL

(a) Preferred shares

($ in thousands)		2010	2009
Authorized			
1,400,000	Cumulative redeemable junior preferred shares with a par value of $10		
200,000	6.75% cumulative redeemable preferred shares with a par value of $25 each		
Issued			
200,000	6.75% preferred shares	**5,000**	5,000

The 6.75% preferred shares are entitled to the payment of fixed cumulative preferential cash dividends. These shares are non-voting and are redeemable at the option of the Company at $26.00 per share plus any accrued and unpaid dividends at the date of redemption. Dividends of $1.6875 per preferred share were declared and paid on preferred shares in 2010 (2009 – $1.6875).

(b) Common shares

($ in thousands)		2010	2009
Authorized			
Unlimited	Voting common shares with a par value of $2.50 each		
Issued			
3,615,144	Common shares (2009 – 3,555,964)	**9,038**	8,890

The Company issued 59,180 common shares in 2010 upon the exercise of employee share options (2009 – 13,800).

The holders of ordinary shares are entitled to receive dividends as declared by the Company from time to time. In 2010, dividends of $1.14 per common share were declared and paid on common shares (2009 – $0.96).

In March 2009, the Company obtained approval from the Toronto Stock Exchange ("TSX") to commence a normal course issuer bid which terminated on March 8, 2010. No share purchases were made under the bid during the year ended December 31, 2010. For the year ended December 31, 2009, the Company had purchased and cancelled an aggregate of 122,416 common shares. When the cost of common shares repurchased by the Company is greater than their assigned value, the cost is allocated first to share capital in an amount equal to the stated or assigned value of the shares and any difference is allocated to contributed surplus and retained earnings. In connection with the common shares repurchased in 2009, $0.3 million was allocated to common share capital, $0.1 million was allocated to contributed surplus and $1.4 million was allocated to retained earnings.

15. SHARE-BASED COMPENSATION

Stock option plan

The Company has a stock option incentive plan under which share options are granted to certain of its employees. Share options are granted at an exercise price equal to the closing price of the common shares on the Toronto Stock Exchange determined as of the trading day immediately preceding the date of the option grant. Share options generally vest in five equal stages with the first stage vesting on the date of the grant, and the remainder in four equal annual stages commencing on the first anniversary of the date of the grant. The maximum term of options awarded is ten years.

As of December 31, 2010, 361,514 (2009 – 355,596) shares were available to be reserved for issuance pursuant to options granted under the stock option incentive plan.

The Company uses the fair-value method of accounting for stock-based compensation. The fair value of each option grant is estimated on the date of the grant using the Black-Scholes option pricing model. The following weighted-average assumptions were used in computing the fair value of stock options granted for the periods noted:

	2010	2009
Dividend yield	**4.9%**	7.5%
Expected volatility (annualized)	**20.2%**	22.3%
Risk-free interest rate	**3.2%**	2.2%
Expected life (years)	**7.5**	7.5

Options granted in 2010 had an individual fair value of $2.66 per option (2009 – $0.80 per option). The Company recognized a stock-based compensation expense of $0.1 million for the year ended December 31, 2010 (2009 – $0.1 million).

A summary of the changes to the Company's stock option plan during the years ended December 31, 2010 and 2009 is as follows:

	2010		2009	
	Number of options	**Weighted-average exercise price ($)**	Number of options	Weighted-average exercise price ($)
Outstanding, beginning of year	**332,240**	**15.85**	296,720	16.70
Granted	**38,300**	**22.72**	62,800	12.24
Exercised	**(59,180)**	**14.66**	(13,800)	9.43
Forfeited	**–**	**–**	(280)	18.10
Expired	**–**	**–**	(13,200)	24.50
Outstanding, end of year	**311,360**	**16.90**	332,240	15.85
Options exercisable, end of year	**228,934**	**16.79**	237,500	16.16
Weighted-average remaining contractual life of outstanding options	**5.6 years**		5.7 years	

The following table summarizes information about stock options outstanding and exercisable as at December 31, 2010:

Exercise price ($)	Number of options outstanding	Weighted-average remaining exercise price ($)	Weighted-average remaining contractual life (years)	Number of options exercisable
10.00 – 14.99	129,400	13.05	4.7	93,880
15.00 – 19.99	125,360	18.57	5.9	109,094
20.00 – 24.50	56,600	22.10	7.2	25,960
	311,360	16.90	5.6	228,934

Deferred share unit plan

Effective January 1, 2007, the Company initiated a deferred share unit ("DSU") plan for non-employee directors whereby such directors may elect to allocate all or a portion of their annual compensation as deferred share units. The units vest upon issuance and the number of units to be issued is based on the participant's compensation payable on that date divided by the fair market value of a common share of the Company. These units accumulate dividend equivalents in the form of additional units based upon the dividends paid on the Company's common shares. Units are redeemable for cash or shares only following termination of service on the Board of Directors. The value of the deferred share units when converted to cash will be equivalent to the market value of the Company's common shares at the time the conversion takes place.

15. SHARE-BASED COMPENSATION (CONTINUED)

DSU is a term used to describe a method of paying an incentive to participants. DSU's are not securities and do not entitle participants to the exercise of voting rights, the receipt of dividends or the exercise of any other rights attached to ownership of shares. Shares delivered under the DSU plan to departing participants are purchased in the open market by a trustee on behalf of the participant.

Details of the DSU Plan are as follows:

Continuity (Units)	2010	2009
Outstanding, beginning of year	**24,545**	17,824
Issued during year	**6,601**	9,116
Redemptions	**–**	(2,395)
Outstanding, end of year	**31,146**	24,545

Liability ($ in thousands)	2010	2009
Balance, beginning of year	**460**	241
Expensed	**474**	249
Redemptions	**–**	(30)
Balance, end of year	**934**	460

16. JOINT VENTURES

In 2006, the Company formed Pacific Trail Pipelines Limited Partnership ("PTP"), an equal partnership between the Company and Galveston LNG Inc., the parent company of Kitimat LNG Inc., for the purpose of developing a project to loop its main line transmission system from Kitimat to Summit Lake (the "KSL Project"). During 2010, Apache Canada Ltd. acquired a 25.5% interest in PTP from Galveston LNG Inc. The Company continued to hold a 50% interest in the partnership and Galveston LNG Inc. retained a 24.5% interest throughout the year ended December 31, 2010.

In the third quarter of 2010, the Company commenced the detailed design phase of the KSL Project and commenced capitalization of expenditures including $0.7 million relating to engineering and technical studies.

The following amounts represent the Company's proportionate interest in PTP and its general partner, Pacific Trail Pipelines Management Inc. at December 31, 2010 and 2009:

($ in thousands)	2010	2009
Balance Sheet		
Current assets	**595**	32
Non-current assets	**684**	–
Current liabilities	**197**	9
Non-current liabilities	**–**	–
Income Statement		
Revenues	**–**	–
Expenses	**566**	181
Net loss	**566**	181
Cash Flow		
Cash provided by (used in):		
Operations	**(551)**	(181)
Investing	**(499)**	–
Financing	**1,614**	100
Proportionate share of increase (decrease) in cash of the joint venture	**564**	(81)

As described in note 25, subsequent to December 31, 2010, the Company entered into an agreement to sell its 50% interest in PTP to Apache Canada Ltd. and EOG Resources Canada Inc., the Company's partners in the KSL Project.

17. INTEREST EXPENSE

($ in thousands)	2010	2009
Interest on long-term debt	**6,100**	5,653
Interest on short-term debt	**102**	81
	6,202	5,734
Imputed interest on regulatory assets and liabilities	**202**	(91)
	6,404	5,643

18. EARNINGS PER COMMON SHARE

($ in thousands, except share and per share amounts)	2010	2009
Net income attributable to shareholders	**7,088**	6,532
Dividends on preferred shares	**(337)**	(337)
Net income attributable to common shares	**6,751**	6,195
Basic weighted-average number of shares outstanding	**3,598,335**	3,594,522
Effect of dilutive securities:		
Stock options	**98,786**	31,346
Diluted weighted-average number of shares outstanding	**3,697,121**	3,625,868
Net income per common share		
Basic	**$ 1.88**	$ 1.72
Diluted	**$ 1.83**	$ 1.71

For the year ended December 31, 2010, no stock options were excluded from the computation of diluted securities because the exercise prices of these options were lower than the average market price of the Company's common shares during the year. For the year ended December 31, 2009, 163,240 stock options were excluded from the computation of diluted securities because the options' exercise prices were greater than the average market price of the common shares.

19. FINANCIAL INSTRUMENTS

Financial instruments by category

The fair value of the Company's financial instruments, including derivatives, reflects a point in time estimate based on information about the instruments as at the balance sheet dates. The estimates involve uncertainties and judgment and may not be relevant in predicting future earnings or cash flows.

NON-DERIVATIVE FINANCIAL INSTRUMENTS

The Company has designated its non-derivative financial instruments as follows:

($ in thousands)	December 31, 2010		December 31, 2009	
	Carrying value	Estimated fair value	Carrying value	Estimated fair value
Held for trading				
Cash and cash equivalents	**1,894**	**1,894**	1,511	1,511
Loans and receivables				
Accounts receivable	**23,017**	**23,017**	21,618	21,618
Other financial liabilities				
Bank indebtedness	**4,836**	**4,836**	2,579	2,579
Accounts payable and accrued liabilities	**19,106**	**19,106**	21,617	21,617
Long-term debt, including current portion	**90,953**	**100,735**	74,579	82,674

19. FINANCIAL INSTRUMENTS (CONTINUED)

The fair values of financial instruments included in current assets and current liabilities in the Company's consolidated balance sheets approximate their fair value, reflecting the short-term maturity of these instruments. The fair value of the Company's long-term debt is estimated by reference to quoted market prices for similar instruments, taking into account credit risk.

DERIVATIVE FINANCIAL INSTRUMENTS

The Company hedges exposures to fluctuations in natural gas prices through the use of derivative financial instruments. The Company has two hedge lines of credit, each is secured by the pledge of a $20.0 million debenture. One line is with the provider of the Company's bank operating line and the other is with another Canadian bank. Under either hedge line if the credit exposure of the provider exceeds $20.0 million, the Company is required to provide cash collateral to the extent of the excess credit exposure.

The facility with the Company's operating line provider has one financial covenant which requires the Company's debt leverage not to exceed 65 percent. The second facility, arranged in January 2010, has two financial covenants, one which requires the Company's debt leverage not to exceed 65 percent, and the second which requires the Company to maintain a minimum interest coverage of 1.5 times using earnings before interest, income taxes and expenditures on the KSL Project to a maximum of $10.0 million. Further, if the Company's secured debt rating is less than BBB (low) or the Company has no debt rating, the interest coverage requirement is 2.0 times or higher.

The risk management facilities allow 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.

The following table summarizes the valuation of the Company's derivative financial instruments related to natural gas supply as at December 31:

As at December 31, 2010

Financial instrument	Notional quantity (gigajoules)	Percent of annual gas purchases (%)	Delivery period	Price range (per gigajoule)	Estimated net fair value payable ($000's)
Fixed-price contracts	**900,000**	**9.4**	**Jan 2011 – Mar 2011**	**$ 4.23**	**(678)**
Natural gas swap contracts	**3,846,600**	**40.2**	**Jan 2011 – Oct 2012**	**$ 4.16 to $ 7.26**	**(5,453)**
Collar contracts	**53,500**	**0.6**	**Apr 2012 – Oct 2012**	**$ 3.80 (floor) to $ 5.81 (cap)**	**(8)**
	4,800,100	**50.2**			**(6,139)**

As at December 31, 2009

Financial instrument	Notional quantity (gigajoules)	Percent of annual gas purchases (%)	Delivery period	Price range (per gigajoule)	Estimated net fair value receivable (payable) ($000's)
Fixed-price contracts	900,000	9.2	Jan 2010 – Mar 2010	$ 4.03	1,021
Natural gas swap contracts	3,954,850	40.6	Jan 2010 – Oct 2011	$ 4.96 to $ 10.87	(4,568)
Collar contracts	308,650	3.2	Jan 2010 – Oct 2010	$ 5.26 to $ 8.38 (floors) $ 6.76 to $ 11.46 (caps)	(429)
	5,163,500	53.0			(3,976)

The fair values reflect the estimated amounts that the Company would receive or pay at December 31 to terminate the fixed-price, swap or collar contracts and call options based on the estimated future net cash flows under the terms of each contract.

These estimated fair market values have no impact on earnings due to the regulated nature of the Company's operations. Based on the current regulatory process, any gains or losses arising from utility related financial instruments would be treated as part of the cost of gas.

As a result of the recognition of these derivative assets and liabilities, the gas cost variance payable account at December 31, 2010 reflects a decrease of $6.1 million (decreased by $4.0 million at December 31, 2009) in accordance with specific regulatory treatment.

Fair value hierarchy

The classification within the fair value hierarchy of the Company's financial is summarized in the following table:

December 31, 2010 ($ in thousands)	Level 1	Level 2	Level 3	Total
Assets				
Cash and cash equivalents	**1,894**	**–**	**–**	**1,894**
Derivative financial instruments	**–**	**33**	**–**	**33**
	1,894	**33**	**–**	**1,927**
Liabilities				
Derivative financial instruments – current	**–**	**5,696**	**–**	**5,696**
Derivative financial instruments – non-current (note 12)	**–**	**476**	**–**	**476**
	–	**6,172**	**–**	**6,172**

December 31, 2009 ($ in thousands)	Level 1	Level 2	Level 3	Total
Assets				
Cash and cash equivalents	503	1,008	–	1,511
Derivative financial instruments	–	1,029	–	1,029
	503	2,037	–	2,540
Liabilities				
Derivative financial instruments – current	–	4,298	–	4,298
Derivative financial instruments – non-current (note 12)	–	707	–	707
	–	5,005	–	5,005

The Company uses valuation models to determine the fair value of its derivative instruments. The inputs to these models are primarily external observable inputs such as natural gas forward prices.

20. RISK MANAGEMENT

Credit risk

The Company is exposed to credit risk in the event that a customer or counterparty to a financial instrument fails to meet its contractual obligations and arises mainly from its accounts receivable and derivative financial instruments. In accordance with established credit approval practices, the Company deals only with recognized high credit quality institutions as counterparties to its derivative instruments and physical off system gas sales and does not expect any counterparties to fail to meet its obligations. Should the Company incur a financial loss with respect to its regulated operations as a result of the failure of counterparty to meet its obligations, the Company would require regulatory approval to recover related costs through future rate adjustments.

The Company's credit policy requires a review of each customer for creditworthiness and often will require residential and commercial customers to pay a customer deposit based on two times the highest estimated monthly gas consumption prior to the installation of service. For industrial customers, the Company has the right to require securities such as letters of credit should a customer fail to pay its bills. No letters of credit or alternate security are currently in place with any individual industrial customer.

20. RISK MANAGEMENT (CONTINUED)

The Company establishes an allowance for doubtful accounts that represents its estimate of accounts receivable which may not be recoverable. The main components of this allowance are a specific provision that relates to individual significant exposures and a general provision for the core market (residential and commercial) customers based on past experience. The Company actively reviews the adequacy of its allowance for doubtful accounts.

The following table shows the breakdown of accounts receivables by major customer class:

($ in thousands)	**2010**	2009
Core market – residential and commercial	**19,581**	18,746
Industrial customers	**779**	948
Off-system sales customers	**3,167**	3,831
Other	**339**	137
	23,866	23,662
Less: Allowance for doubtful accounts	**(849)**	(2,044)
	23,017	21,618

The following table sets forth details of the aging of accounts receivables:

($ in thousands)	**2010**	2009
Unbilled revenues	**11,991**	10,729
Past due 0 to 30 days (current)	**11,119**	10,747
Past due 31 to 90 days	**303**	384
Past due over 91 days	**453**	1,802
	23,866	23,662
Less: Allowance for doubtful accounts	**(849)**	(2,044)
	23,017	21,618

Changes in the allowance for doubtful accounts are as follows:

($ in thousands)	**2010**	2009
Balance, beginning of year	**2,044**	1,735
Provision for doubtful accounts	**265**	313
Write-off of bad debts, net of recoveries, and other	**(1,460)**	(4)
Balance, end of year	**849**	2,044

Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet obligations associated with financial liabilities and commitments as they become due. The Company manages liquidity risk through the management of its capital structure and financial leverage. It also regularly monitors actual and projected cash flows. The Company believes that future cash flows generated from operations and access to additional liquidity through capital and banking markets will be adequate to meet its financial obligations in the foreseeable future. The Company's overall liquidity risk has improved slightly from December 31, 2009, with the increase in the availability of credit under its risk management facilities, 5-year term revolving debt facility and its operating line.

As at December 31, 2010, the Company had utilized $8.6 million of its $25 million operating line facility (see note 10) and $16.0 million of the $35.0 million available under its revolving term facility (see note 11).

The Company maintains regular dialogue with the financial institution that provides these facilities and has no reason to believe the facilities will not be renewed upon maturity. See "Market Risk – Interest Rates" below for additional information on how this may impact the Company's future results.

REPAYMENTS OF FINANCIAL LIABILITIES

The Company's financial liabilities as at December 31, 2010 and as at December 31, 2009 include its bank indebtedness, accounts payable and accrued liabilities, natural gas derivatives and long-term debt. The tables below summarize the Company's financial liabilities in relevant maturity groupings based on the remaining period from the balance sheet dates to the contractual maturity date. As the amounts disclosed in the tables are contractual undiscounted cash flows (including interest payments where applicable), these balances may not necessarily agree with the amounts disclosed in the balance sheets.

($ in thousands)	Expected payments by period, as at December 31, 2010					
Description	Within 1 year	2 to 3 years	4 to 5 years	More than 5 years	Total contractual cash flows	Carrying amount
Non-derivative financial liabilities						
Bank indebtedness	4,836	–	–	–	4,836	4,836
Accounts payable and accrued liabilities	19,106	–	–	–	19,106	19,106
Long-term debt, including current portion	14,502	17,392	32,812	79,682	144,388	90,953
Derivative financial liabilities						
Fixed-price contracts	678	–	–	–	678	678
Natural gas swap contracts	5,018	468	–	–	5,486	5,486
Collar contracts	–	8	–	–	8	8
	44,140	17,868	32,812	79,682	174,502	121,067

($ in thousands)	Expected payments by period, as at December 31, 2009					
Description	Within 1 year	2 to 3 years	4 to 5 years	More than 5 years	Total contractual cash flows	Carrying amount
Non-derivative financial liabilities						
Bank indebtedness	2,579	–	–	–	2,579	2,579
Accounts payable and accrued liabilities	21,617	–	–	–	21,617	21,617
Long-term debt, including current portion	7,957	25,703	13,729	77,012	124,401	74,579
Derivative financial liabilities						
Natural gas swap contracts	3,869	707	–	–	4,576	4,576
Collar contracts	429	–	–	–	429	429
	36,451	26,410	13,729	77,012	153,602	103,780

Market risk

Market risk is the risk that changes in market prices, including foreign exchange, interest rates and commodity prices will affect the fair value of the Company's financial instruments. The Company is not exposed to any foreign exchange risks on its earnings. The Company's overall market risk has not changed significantly from the prior year.

MARKET RISK – COMMODITY PRICES

The commodity cost of natural gas can be highly volatile. The Company utilizes derivative and other financial instruments in connection with the management of gas supply. The Company enters into forward, future, swap, fixed-price and option contracts to manage the impact of market fluctuations on assets, liabilities or other contractual commitments. 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.

For illustrative purposes, a one dollar per gigajoule decrease in the underlying forecast price of natural gas at December 31, 2010, with all other variables remaining constant, would result in the estimated net fair value payable related to natural gas commodity

20. RISK MANAGEMENT (CONTINUED)

derivatives (see note 19) increasing from $6.1 million to $10.9 million and an increase in the gas purchase variance recoverable account. Conversely, a one dollar per gigajoule increase in the underlying forecast price of natural gas would result in the estimated net fair value payable decreasing from $6.1 million to a payable of $1.4 million and a decrease in the gas purchase variance recoverable account.

At December 31, 2009, a one dollar per gigajoule decrease in the underlying forecast price of natural gas would result in the estimated net fair value payable related to natural gas commodity derivatives (see note 19) increasing from $4.0 million to $9.2 million and an increase in the gas purchase variance recoverable account. Conversely, a one dollar per gigajoule increase in the underlying forecast price of natural gas would result in the estimated net fair value payable decreasing from $4.0 million to a receivable of $1.1 million and a decrease in the gas purchase variance recoverable account.

MARKET RISK – INTEREST RATES

While underlying interest rates, such as prime and bankers' acceptances rates are subject to changes in the future, as are interest rate spreads on borrowings by the Company, the Company does not expect these changes to have a material impact on its financial results. As directed by the Commission, the Company has an interest deferral mechanism that mitigates exposure to fluctuations in floating rates on both short-term and long-term debt instruments (see note 4).

21. CAPITAL MANAGEMENT

The Company's objective in managing capital remains largely unchanged from December 31, 2009. The capital structure consisted of the following components at December 31, 2010: bank indebtedness, long-term debt and shareholders' equity, totaling $189.9 million (2009 – $167.6 million).

The Company's objectives with its capital structure are:

- to maintain the amount of common equity in its capital structure at the level approved by the Commission for the purpose of determining rates for the Company's regulated operations plus sufficient equity to support investments in the Company's non-regulated businesses; and
- to maintain a credit rating at which the Company has sufficient access to capital and to natural gas and other supplies on reasonable terms to be able to provide safe, secure and reliable service to its customers, which in turn is critical to the Company's ongoing prosperity.

Prior to the second quarter of 2010, the Company was not able to meet both objectives as the proportion of common equity approved by the Commission was not sufficient to allow the Company to maintain a satisfactory credit rating. The Company was carrying approximately $20 million (22%) more common equity on its balance sheet than was allowed by the Commission for the purpose of determining rates ("excess equity") in order to maintain a minimum investment grade credit rating. In 2009 the Company filed a Capital Structure and Equity Risk Premium Application (the "CAP/ROE Application") with the Commission to, among other things, increase its deemed common equity.

In the second quarter of 2010, the Commission approved the CAP/ROE Application negotiated settlement agreement resulting in the common equity used for the purpose of determining rates for the Company's regulated operations increasing by approximately $8 million. In addition, the Company reduced its excess equity by another $8 million through acquisition of the McNair Creek facility. The Company is now closer to meeting its capital structure objectives and further positive movement is possible through additional renewable power investments provided that the Company is able to maintain its credit rating.

During the fiscal year ending December 31, 2010 the Company added a second hedge facility, extended and increased the amount available under its revolving term facility and extended and amended its operating line. The hedge facility, arranged in January 2010, has two financial covenants, one which requires the Company's debt leverage not to exceed 65 percent, and the second which requires the Company to maintain an interest coverage of 1.5 times or higher using earnings before interest, income taxes and expenditures on the KSL Project to a maximum of $10.0 million. Further, if the Company's secured debt rating is less than BBB (low) or the Company has no debt rating, the interest coverage requirement is 2.0 times or higher.

The amendment to the operating line included an increase to $25.0 million of the credit available to the Company as well as increases in stand-by fees and interest rate spreads to reflect then current market conditions. No changes were made to the financial covenant under the operating line.

The $25.0 million operating line and $35.0 million 5-year revolving term facility are subject to a financial covenant requiring the Company's debt leverage not to exceed 65%. The 5-year revolving term facility contains an additional covenant which states that if the Company's secured debt rating is less than BBB (low) or the Company has no debt rating, the Company must maintain an interest coverage of 2.0 times or higher using earnings before interest, income taxes and expenditures on the KSL Project to a cumulative maximum of $10.0 million. On May 17, 2010 Dominion Bond Rating Services ("DBRS") confirmed the Company's secured debt ratings at BBB (low). The Company is in compliance with its debt covenants as at December 31, 2010.

22. COMMITMENTS AND GUARANTEES

Gas purchase commitments

The Company has long-term natural gas purchase arrangements all of which are transacted at market prices and in the normal course of business. The Company's purchase commitments as at December 31, 2010 under various gas supply contracts expiring through 2015 were as follows:

($ in thousands)	
2011	19,837
2012	4,893
2013	52
2014	52
2015	44
Total	24,878

These obligations are based on market prices that vary with gas commodity indices. The amounts disclosed reflect index prices that were in effect as at December 31, 2010.

Indemnifications

Under the terms of its gas transportation and supply agreements with certain customers, the Company has provided an indemnity for all damages, claims or actions arising from any act or accident in connection with the installation, presence, maintenance and operations of the Company's plant, property and equipment, or in connection with the presence of gas deemed to be in the possession and control of the Company, and carries insurance to cover losses in the event of any claims under these provisions. The Company has also provided an environmental indemnity to certain secured debenture holders for any losses arising from non-compliance by the Company with applicable environmental laws.

23. SEGMENTED INFORMATION

Historically, the Company has operated in one business and in one geographic segment, the transmission and distribution of natural gas within Canada, and the consolidated financial statements have not been segmented. In the second quarter of 2010, the Company acquired an interest in McNair Creek hydroelectric facility (see note 3), and with this acquisition has entered into a new business segment, the generation and sale of electricity from renewable resources. The Company continues to operate in a single geographic segment.

Segmented results

The following tables provide segmented financial information for the year ended December 31, 2010. Comparative information has not been presented as the Company operated in a single business segment during the prior year.

23. SEGMENTED INFORMATION (CONTINUED)

Year ended December 31, 2010 ($ in thousands)	Gas Transmission and Distribution	Renewable Energy	**Consolidated**
Revenues	93,848	1,316	**95,164**
Cost of gas	44,113	–	**44,113**
	49,735	1,316	**51,051**
Operating and maintenance	12,388	183	**12,571**
Administrative and general	8,064	977	**9,041**
Depreciation and amortization	8,413	339	**8,752**
Municipal and other taxes	4,691	74	**4,765**
	33,556	1,573	**35,129**
Finance fees	5,889	512	**6,401**
Project development expenditures	566	–	**566**
Income (loss) before income taxes and non-controlling interest	9,724	(769)	**8,955**
Income tax expense (recovery)	2,084	(207)	**1,877**
Net income (loss) and comprehensive income (loss)	7,640	(562)	**7,078**
Net loss attributable to non-controlling interest	–	10	**10**
Net income (loss) and comprehensive income (loss) attributable to shareholders	7,640	(552)	**7,088**

Other segment information regarding capital expenditures, assets and liabilities is as follows:

As at and for the year ended December 31, 2010 ($ in thousands)	Gas Transmission and Distribution	Renewable Energy	**Consolidated**
Capital expenditures	7,395	4	**7,399**
Plant, property and equipment	177,728	19,132	**196,860**
Assets	228,753	21,171	**249,924**
Liabilities	143,231	12,376	**155,607**

24. SUPPLEMENTAL CASH FLOW INFORMATION

($ in thousands)	**2010**	2009
Cash and cash equivalents:		
Cash	**1,894**	503
Cash equivalents	**–**	1,008
	1,894	1,511

Cash equivalents are comprised of highly-liquid term investments with original maturities of 90 days or less.

($ in thousands)	2010	2009
Depreciation and amortization:		
Depreciation and amortization, per income statement	**8,752**	8,118
Amortization of debt issue costs included in long-term interest expense	**(61)**	108
Total depreciation and amortization	**8,691**	8,226
Changes in operating assets and liabilities:		
(Increase) decrease in:		
Accounts receivable	**(1,268)**	6,429
Gas purchase variance recoverable	**–**	935
Income taxes recoverable	**(1,305)**	555
Inventories of supplies and natural gas	**315**	1,148
Prepaid expenses	**(115)**	18
Increase (decrease) in:		
Accounts payable and accrued liabilities	**(3,523)**	(2,629)
Gas purchase variance payable	**(1,332)**	–
Income taxes payable	**(1,041)**	–
Other taxes payable	**(157)**	(539)
Change in regulatory assets and liabilities	**1,718**	3,763
Contributions to defined benefit plans in excess of expense	**(1,471)**	(421)
Attributable to operating activities	**(8,179)**	9,259
Interest and tax payments:		
Income taxes paid	**2,594**	1,746
Interest paid	**6,176**	5,529
Non-cash transactions:		
Plant, property and equipment purchases included in accounts payable and accrued liabilities	**382**	133

25. SUBSEQUENT EVENT

On February 7, 2011, the Company announced it had entered into an agreement to sell its 50% interest in PTP to Apache Canada Ltd. and EOG Resources Canada Inc., the Company's partners in the KSL Project (see note 16), for payments of up to $50 million.

The sale transaction has two elements, including an initial payment of $30 million to be paid on closing and a second payment of $20 million to be paid contingent on the purchasers making a decision to proceed with construction of a liquefied natural gas facility in Kitimat, BC. The transaction was subject to standard industry conditions and consents and closed on March 2, 2011.

The Company has recorded $7.3 million of KSL Project expenditures from its inception to December 31, 2010, of which $6.6 million has been expensed and $0.7 million has been capitalized.

26. COMPARATIVE FIGURES

Certain of the prior year's comparative figures have been reclassified to conform to the financial presentation adopted in the current year.

Five Year Review

YEARS ENDED DECEMBER 31

OPERATING DATA	2010	2009	2008	2007	2006
Sales volume (TJ)					
Residential	**2,858**	3,221	3,210	3,213	3,066
Commercial	**2,430**	2,851	2,657	2,510	2,706
Small industrial	**400**	471	455	494	710
Large industrial	**7**	187	356	450	523
	5,695	6,730	6,678	6,667	7,005
Transportation volume (TJ)					
Commercial	**274**	230	350	394	157
Small industrial	**2,347**	2,595	2,594	2,740	2,774
Large industrial	**1,171**	2,590	2,920	3,409	2,459
	3,792	5,415	5,864	6,543	5,390
TOTAL DELIVERIES	**9,487**	12,145	12,542	13,210	12,395
Customers at year end	**39,405**	39,113	39,113	39,024	38,969
Degree days					
Actual	**5,130**	5,296	5,245	5,083	4,856
Normal	**5,004**	5,010	4,983	5,038	5,070
Actual as a percent of normal	**103%**	106%	105%	101%	96%

Degree day is a measure of coldness. It is calculated by accumulating for each day in the fiscal period the total number of degrees by which the daily mean temperature fell below 18 degrees Celsius. The figures given are the average for all service areas, weighted by deliveries.

FINANCIAL DATA ($ in thousands)	2010	2009	2008	2007	2006
Sales					
Residential	**37,642**	39,783	44,937	41,589	44,919
Commercial	**25,927**	29,600	31,974	28,373	34,241
Small industrial	**3,152**	3,830	4,486	4,327	7,152
Large industrial	**858**	2,477	4,025	4,451	5,087
	67,579	75,690	85,422	78,740	91,399
Transportation					
Commercial	**1,814**	1,330	1,794	1,472	630
Small industrial	**3,093**	2,709	2,832	2,998	3,308
Large industrial	**3,837**	3,193	3,268	2,939	4,767
	8,744	7,232	7,894	7,409	8,705
Off-system sales	**14,988**	14,839	32,508	36,083	32,713
Termination payment amortization	**143**	5,466	6,592	6,752	5,552
Other	**3,710**	904	423	480	479
TOTAL REVENUES	**95,164**	104,131	132,839	129,464	138,848
Expenses					
Cost of sales	**44,113**	57,239	86,124	84,446	91,118
Operating	**21,612**	19,600	18,524	18,105	17,026
Interest	**6,967**	5,790	7,732	8,904	9,673
Municipal and other taxes	**4,765**	4,584	4,709	4,567	4,755
Depreciation and amortization	**8,752**	8,118	8,621	8,111	8,378
Income taxes	**1,877**	2,268	1,192	958	2,947
TOTAL EXPENSES	**88,086**	97,599	126,902	125,091	133,897
NET INCOME	**7,078**	6,532	5,937	4,373	4,951
Net income applicable to common shares	**6,751**	6,195	5,600	4,036	4,614

FINANCIAL DATA ($ in thousands, except as noted)	2010	2009	2008	2007	2006
Cash flow data					
Operating activities (including working capital)	**9,858**	18,876	17,959	(2,730)	17,574
Investing activities	**(15,278)**	(9,601)	(10,373)	(7,884)	(8,362)
Issue of long-term debt	**10,000**	2,939	4,000	16,622	–
Repayment of long-term debt	**(3,046)**	(5,400)	(2,300)	(17,660)	(4,881)
Dividends paid on common shares	**(4,108)**	(3,448)	(3,225)	(2,923)	(2,907)
Capitalization					
Regulatory and other liabilities	**10,892**	5,684	217	4,016	8,573
Long-term debt	**90,953**	74,579	76,933	75,121	76,559
Future income taxes	**20,736**	16,450	–	–	–
Deferred income taxes	**–**	–	13,630	14,530	15,430
Preferred shares	**5,000**	5,000	5,000	5,000	5,000
Common equity	**89,043**	85,436	83,724	81,229	79,777
	208,432	184,349	177,104	177,596	180,459
Utility plant					
In service (net)	**195,420**	177,779	175,335	174,134	172,403
Construction in progress	**1,440**	641	642	1,100	593
	196,860	178,420	175,977	175,234	172,996
Financial ratios					
Return on average shareholders' equity [1]	**7.6%**	7.3%	6.7%	5.0%	5.8%
Return on average capital employed [2]	**5.8%**	5.7%	5.9%	5.1%	6.4%
Earnings coverage of interest [3]	**2.5**	2.6	2.1	2.1	2.5
Dividend payout ratio	**60.6%**	55.8%	57.5%	72.1%	63.0%
Allowed return on common equity					
Western system	**10.15%**	9.63%	9.27%	9.02%	9.45%
Fort St. John/Dawson Creek division	**9.90%**	9.38%	9.02%	8.77%	9.20%
Tumbler Ridge division	**10.15%**	9.63%	9.27%	9.02%	9.45%
Per common share data ($ per share)					
Earnings applicable to common shareholders	**1.88**	1.72	1.53	1.11	1.27
Dividends declared on common shares	**1.14**	0.96	0.88	0.80	0.80
Common share trading (TSX)					
High	**30.00**	19.40	18.65	19.00	19.75
Low	**18.75**	11.40	12.11	17.50	16.96
Close	**30.00**	18.75	13.54	18.75	18.05
Volume (in shares)	**801,443**	1,063,264	792,293	1,378,446	1,601,034

[1] Net income applicable to common shareholders divided by average common equity (weighted quarterly during the year).

[2] Sum of net income and after-tax interest expense divided by average capital employed (weighted quarterly during the year). Capital employed is equal to the sum of shareholders' equity, future income tax liabilities, deferred income taxes, deferred credits and total debt.

[3] Earnings before interest and taxes divided by total interest.

Corporate Information

DIRECTORS / PRINCIPAL OCCUPATION & RESIDENCE

DIRECTORS	PRINCIPAL OCCUPATION & RESIDENCE
WAYNE M. BINGHAM [2,3] Director since 2007	**Executive Vice President and Chief Financial Officer** Superior Plus Corp. Calgary, Alberta
ROBERT F. CHASE [1,4] Director since 1995	**Corporate Director** West Vancouver, British Columbia
ROY G. DYCE Director since 1982	**President and Chief Executive Officer** Pacific Northern Gas Ltd. Surrey, British Columbia
DIANE M. FULTON [1,2] Director since 2005	**Vice President and Chief Investment Officer** Vancouver Foundation Vancouver, British Columbia
ROBERT B. JOHNSTON [4] Director since 2008	**Executive Vice President** and Chief Strategy Officer The InterTech Group Isle of Palms, South Carolina, USA
DAVID G. UNRUH [3,4] Director since 2002	**Corporate Director** West Vancouver, British Columbia
ARTHUR H. WILLMS [1,4] Director since 1983	**Corporate Director** Vancouver, British Columbia
JANET P. WOODRUFF [2,3] Director since 2006	**Vice President and Special Advisor** BC Hydro West Vancouver, British Columbia

1 Executive Committee
2 Audit Committee
3 Environment, Health and Safety Committee
4 Compensation and Governance Committee

OFFICERS

R.F. Chase	Chair of the Board
R.G. Dyce	President and Chief Executive Officer
G.B. Weeres	Vice President, Operations and Engineering
J.P. Kennedy	Vice President, Finance
K.R. Teitge	Vice President, Corporate Development and Treasurer
C.P. Donohue	Director, Regulatory Affairs & Gas Supply and Assistant Secretary
K.E. Stark-Anderson	Secretary

INVESTOR INFORMATION

STOCK EXCHANGE, SECURITIES AND SYMBOLS

Common and preferred shares are listed on the Toronto stock exchange under the symbols: PNG and PNG.PR.A, respectively.

ANNUAL MEETING

The Annual Meeting of the Shareholders of Pacific Northern Gas Ltd. will be held at The Terminal City Club, 837 West Hastings Street, Vancouver, British Columbia on May 11, 2011 at 10:30 a.m. (Pacific Daylight Time).

ANNUAL INFORMATION FORM

The Company's 2010 Annual Information Form, as filed with Canadian securities commissions, is available on our website at www.png.ca.

REGISTRAR AND TRANSFER AGENT

Computershare Investor Services Inc.
(Vancouver, Calgary, Winnipeg, Toronto and Montreal)

SHAREHOLDER ASSISTANCE

If you are a registered shareholder and have questions regarding your account, please contact our transfer agent in writing, by telephone, fax or email at:

Computershare Investor Services Inc.,
100 University Avenue, 9th Floor, Toronto, Ontario, Canada M5J 2Y1

Phone:	Toll free North America 1 800 564 6253	International 514 982 7555
Fax:	Toll free North America 1 866 249 7775	International 416 263 9524
Email:	service@computershare.com	
Internet:	www.computershare.com – the Investor Services section offers enrolment for self-service account management for registered shareholders through the Investor Centre Self-Service Web Tool.	

If you hold your shares in a brokerage account (beneficial shareholder), questions should be directed to your broker on all administrative matters.

The Company's corporate and financial information, including quarterly reports, news releases, and utilities regulatory applications is available on our website at www.png.ca.

CORPORATE GOVERNANCE

Please refer to the Company's Notice of 2011 Annual Meeting of Common Shareholders and Management Information Circular for the Company's report on corporate governance. The Audit Committee of the Board of Directors has established an anonymous and confidential toll-free telephone number and web-based reporting tool for employees, contractors and others to call with respect to accounting irregularities and ethical violations. The telephone number is 1-800-661-9675 and the web address is www.png-eweb.com.

Additional information relating to the Company is filed with securities regulators at www.sedar.com.

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APPENDIX 2

BOND RATING REPORTS - PNG

Press Release

Insight beyond the rating.

Date of Release: May 15, 2007

DBRS Maintains Pacific Northern Gas Ratings Under Review with Negative Implications
Bloomberg: DBRS Maintains Pacific Northern Gas Under Review - Negative

Industry Group: Corporates
Sub-Industry: Canadian Utilities

DBRS continues to maintain Pacific Northern Gas Ltd's (PNG or the Company) ratings Under Review with Negative Implications. The last rating action was driven by Methanex's announcement to close its Kitimat, British Columbia, methanol plant permanently due to the negative impact of rising natural gas prices, the prevalence of dual-heating source customers, and the increasing volatility of natural gas prices. At that time, DBRS stated that it would base its rating decision on the outcome of the regulatory decision regarding the treatment of the loss of Methanex, as well as the longer-term commodity cost impact on the Company's customer base and expected future earnings.

Prior to the termination of the Methanex contract, Methanex accounted for approximately 62% of PNG's throughput volume and approximately 22% of net revenue ($10.4 million lost margin in 2006). The termination of the contract provided PNG with a one-time payment of $23.3 million in 2006, which is being amortized over the life of the former contract until October 2009. In the August 2006 Revenue Requirement decision, the British Columbia Utilities Commission (BCUC) permitted PNG full cost recovery of $4.8 million (representing the difference between lost margin and a portion of the termination payment realized as income for 2006). Even though PNG had intended its 2006 rate application to be subject to a negotiated settlement process, issues raised by its key intervenor, the BC Old Age Pensioners Organization (BCOAPO) led to a full written process. The BCOAPO argued that its key issue in the proceeding was whether the *Utilities Commission Act (BC)* required the BCUC to allocate all of the revenue shortfall arising from the closure of the Methanex Kitimat plant to ratepayers. The BCUC determined that PNG was entitled to recover its costs of service by increasing rates to cover the revenue shortfall, and that the increase in rates would not result in an over-recovery for PNG. DBRS views this decision as positive, as it confirmed that once the cost of providing service has been established (including the rate of return) the Commission is required by law to fix rates that are sufficient to enable the utility to recover all of those costs.

Based on the 2006 decision, DBRS would expect that the BCUC will set rates that will allow PNG to fully recover its costs of service, albeit spread over smaller customer volumes for

2010, when the Methanex amortization is completed in 2009. While PNG is entitled under current law to full cost recovery, there remains a risk that PNG may apply for rates which result in less than full cost recovery if necessary to remain competitive with substitute energy sources. On the positive side, however, though the termination of the Methanex contract led to a significant reduction in transportation volumes in 2006, the Company's residential and commercial base remained stable year over year.

The competitiveness of natural gas as a fuel source remains a concern for PNG in the current environment, and the Company has experienced some switching of its small industrial customers to wood waste. However, wood waste as a source of fuel remains labour intensive and is not expected to be a significant threat in the residential sector and commercial sectors where electricity is the main alternative energy source. Electricity rates are also expected to rise in the near term according to BC Hydro's Service Plan for 2007/08 to 2009/10. The Company has also recently experienced modest increase in its residential base after several years of slow decline, with potential growth in the service area also expected. DBRS notes that material switching could occur if natural gas prices were to spike.

PNG's financial profile and credit metrics were reasonably stable and strong in 2006 due to the amortization of the Methanex payment. It is important that the Company maintains a reasonably strong and stable financial profile to offset its business risk. EBIT interest coverage, adjusted debt-to-capital and cash flow-to-adjusted debt were 2.61 times, 50% and 12.5%, respectively, compared to 2.59 times, 53.4% and 16.8% in 2005. PNG is in the development stage of constructing a 470-km pipeline from Kitimat to Summit Lake (KSL Project), through a 50/50 partnership with Kitimat LNG, at an estimated cost of $900 million to $1.2 billion. PNG's cash flow from operations and cash flow metrics were impacted by $3 million of KSL Project development costs. PNG will continue to expense its share of the development costs until suitable commercial agreements are in place. In the event that this does not happen by the end of 2007, the Company has stated that it will scale down development expenditures.

DBRS has gained some comfort regarding the issues that led to the Company originally being placed under review. However, PNG currently has a bank credit facility, which matures this summer, that limits its financial flexibility. To the extent that PNG reaches an agreement on a restructured credit facility with the appropriate level of flexibility, DBRS would expect to confirm the ratings at BBB (low) and Pfd-3 (low), both with Negative trends. In the event the bank facility is not satisfactorily restructured, both ratings would likely be downgraded. If confirmed at the current rating levels with Negative trends, DBRS would look to resolve the trend within the next twelve months, with DBRS's review focusing on a number of items, including PNG maintaining a reasonably stable and strong financial

Insight beyond the rating.

profile, economic stability in its service areas, a stable customer base (including PNG's two large industrial customers, West Fraser Timber Co. Ltd. and Alcan Inc.) and whether suitable commercial arrangements have been made to allow the KSL Project to proceed.

Note:
All figures are in Canadian dollars unless otherwise noted.

Issuer	Debt Rated	Rating Action	Rating	Trend
Pacific Northern Gas Ltd	Secured Debentures	Maintained Under Review - Negative	BBB (low)	--
Pacific Northern Gas Ltd	Cumulative Redeemable Preferred Shares	Maintained Under Review - Negative	Pfd-3 (low)	--

For more information on this credit or on this industry, visit www.dbrs.com or contact us at info@dbrs.com.

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Rating Report

Report Date: October 22, 2007
Press Release: July 24, 2007
Previous Report: January 28, 2005

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Pacific Northern Gas Ltd.

Rating

Debt Rated	Rating Action	Rating	Trend
Secured Debentures	Trend Change	BBB (low)	Negative
Cumulative Redeemable Preferred Shares	Trend Change	Pfd-3 (low)	Negative

Rating History

	Current	2006	2005	2004	2003
Secured Debentures	BBB (low)	BBB (low)	BBB (low)	BBB (low)	BBB (low)
Cumulative Redeemable Preferred Shares	Pfd-3 (low)	Pfd-3 (low)	Pfd-3 (low)	Pfd-3 (low)	Pfd-3 (low)

Rating Update

On July 24, 2007, DBRS confirmed the ratings of Pacific Northern Gas Ltd.'s (PNG or the Company) Secured Debentures and Cumulative Redeemable Preferred Shares at BBB (low) and Pfd-3 (low) respectively, both with Negative trends. This resolved the prior status of the ratings at Under Review with Negative Implications, where they were initially placed on September 1, 2005, as a result of Methanex's announcement to permanently close its Kitimat, British Columbia, methanol plant due to the negative impact of rising natural gas prices; the prevalence of dual-heating source customers; and the increasing volatility of natural gas prices.

The current ratings reflect the Company's continued stable operating results and successful renegotiation of a new operating credit facility with less restrictive covenants. The Company's stable financial profile in 2006 was due to the August 2006 Revenue Requirement decision by the British Columbia Utilities Commission (BCUC), which was positive for PNG as it supported the position that once the cost of providing service has been established (including the rate of return), the BCUC approves rates that are sufficient to enable the utility to recover all of those costs. Furthermore, the improved terms of the new operating line, including the elimination of the financial performance covenants, improves PNG's financial flexibility. The new operating credit facility has only one financial covenant where the Company's debt-to-capitalization ratio is not to exceed 65%, or approximately the same level approved by the BCUC. The Company's debt-to-capitalization ratio was 47.4% as of June 2007. (Continued on Page 2.)

Rating Considerations

Strengths

- Regulated operations provide earnings and cash flow stability.
- Supportive regulatory environment in British Columbia.
- Existence of Industrial Customer Deliveries Deferral Account (ICDDA) and Rate Stabilization Adjustment Mechanism (RSAM) provides additional financial stability.

Challenges

- Economic development in PNG's Western system service area.
- Competitiveness of natural gas versus alternative fuel sources.
- Potential cancellation of remaining industrial contracts and resulting regulatory treatment.
- Low interest rate environment negatively impacts earnings through approved return on equity.
- Deemed equity component viewed as low.

Financial Information

	12 mos ended	For the year ended December 31				
CAD Millions	Jun 30 '07	2006	2005	2004	2003	2002
Fixed-charges coverage (times)	2.33	2.53	2.42	2.11	2.14	2.37
% debt in capital structure (2)	47.4%	50.0%	53.4%	54.7%	55.8%	57.0%
Cash flow / Total debt (times) (1)	11.5%	14.6%	16.6%	15.3%	14.6%	14.7%
Cash flow / CAPEX (times)	0.81	1.50	2.29	1.27	2.56	2.36
Net income (adj. for non-recurring, after prefs)	6.2	6.7	6.3	5.1	5.3	4.3
Operating cash flow (adj. for non-recurring, after prefs)	8.8	12.1	15.5	14.3	13.8	14.1
Approved ROE (Western system)	9.02%	9.45%	9.68%	9.80%	10.07%	9.88%
Approved ROE (Fort St. John/Dawson Creek)	8.77%	9.20%	9.43%	9.55%	9.82%	9.63%
Approved ROE (Tumbler Ridge division)	9.02%	9.45%	9.68%	9.80%	10.07%	9.88%

(1) Adjusted for equity treatment of preferred shares.

(2) Cumulative redeemable preferred shares are treated as 70% equity and 30% debt.

The Company

Pacific Northern Gas Ltd. is a regulated utility involved in natural gas transportation and distribution in west-central and north-eastern British Columbia. PNG serves approximately 40,000 residential, commercial and industrial customers.

RATING UPDATE (Continued from Page 1.)

While DBRS has gained some comfort regarding the issues that led to PNG being placed under review, a number of issues still need to be resolved in the near term in order to resolve the Negative trend. Some of the issues include but are not limited to: (1) PNG maintaining a reasonably strong and stable financial profile to offset its business risk. DBRS expects the company to keep its debt-to-capitalisation ratio in the 50% range and for its credit metrics to remain adequate for its credit rating, especially post-2009 when the Methanex amortization is completed. (2) Continued economic stability/development in PNG's service areas and a stable customer base. (3) Whether the Company's Kitimat Summit Project (KSL) will proceed, and if it does, the impact this will have on the Company's structure and financial profile going forward. PNG is expected to complete the environmental permitting process for KSL in early 2008 and subsequently will only proceed with further development of the KSL Project once commercial arrangements are completed for the expanded pipeline capacity.

DBRS expects PNG's coverage and cash flow-to-debt ratios to deteriorate slightly in 2007 due to lower operating margins from lower approved return on common equity awarded for 2007 and lower revenue requirement. However, they are expected to remain adequate for the Company's credit ratings. It is also expected that the Company will generate small deficits over the near term which are expected to be manageable and financed with its operating credit facility.

DBRS notes that the decision by the BCUC to address PNG's customer rates when the Methanex amortization concludes at the end of 2009 will be significant, as this will impact the company's financial and credit profile in the long term. Nevertheless, the precedent set in the August 2006 decision is expected to mitigate the regulatory risk of PNG not being able to recover its full cost of service. PNG is expected to continue to take all prudent steps to manage and reduce its costs to remain competitive. Furthermore, DBRS expects PNG will continue to manage its dividend policy in light of its CAPEX program and in a way that preserves its financial and credit profile.

RATING CONSIDERATIONS

Strengths

(1) The Company's regulated operations provide earnings and cash flow stability. The use of formula-based ROE also minimizes the cost burden and contributes to reduced regulatory lag. Regulation also allows for the recovery (and/or remittance to customers) of variances from forecasts in prudently incurred gas costs. Gas cost variances are recovered over a one year period, with price adjustments allowed on a quarterly basis.

(2) The regulatory environment in British Columbia remains quite supportive as evidenced by the decision handed down by the BCUC in the Methanex case in August 2006. The BCUC determined that PNG was entitled to recover its costs of service by increasing rates to cover the margin shortfall, and that the increase in rates would not result in an over-recovery for PNG. This resulted in stable financial results for PNG in 2006 despite the loss of the Methanex contract. DBRS views this decision as positive, as it supports the position that once the cost of providing service has been established (including the rate of return), the Commission approves rates that are sufficient to enable the utility recover all of those costs.

   (a) Based on the 2006 decision, DBRS would expect that the BCUC will set rates that will allow PNG to fully recover its costs of service when the Methanex amortization is completed in 2009. However, there remains a risk that PNG may need to apply for rates that may result in less than full cost recovery if necessary to remain competitive with alternative energy sources.

(3) The rate stabilization adjustment mechanism approved by the BCUC allows PNG to use deferral accounts that help smooth earnings and reduce business and operating risks: (a) Industrial Customers Deliveries Deferral Account (ICDDA) which is a deferral account for variances in large industrial customer delivery margins (i.e., the difference between the forecast and actual large industrial customer deliveries); and (b) Rate Stabilization Adjustment Mechanism (RSAM) is a deferral account for variances from forecast in deliveries for residential and small commercial customers. Both accounts are amortized and recovered in future rates. These deferral accounts do not impact cash flows and can artificially inflate interest coverage ratios over the short term (i.e., during periods of warmer-than-normal temperatures), but the impact is reversed as deferral balances are recovered.

Challenges

(1) Economic conditions in PNG's Western service area have been quite challenging prior to 2006, mainly due to the challenges the forestry sector has faced from weak wood prices and the strong Canadian dollar. However the area is beginning to show improvement as evidenced by the various projects recently completed or underway. PNG's Western service area encompasses B.C.'s northern gateway to Asia-Pacific trade and as such, is the focus of substantial investment in new port infrastructure, manufacturing, energy, pipeline and mining projects. Some of the large projects underway in the Western region include:

(a) Alcan's announcement of a USD1.8 billion modernisation of its aluminium smelter at Kitimat, to increase production capacity by 40%. Alcan recently signed a long-term power deal with BC Hydro but it is still working with federal and provincial officials on permits needed for the expansion. Additionally, local opposition to the power deal continues.

(b) The $500 million Prince Rupert Port Expansion expected to be completed in 2010. Phase 1 commenced operation in September 2007.

(c) The $195 million Forest Kerr Hydroelectric Project, which has an uncertain completion date.

(d) The $400 million Northwest transmission line project, with an estimated completion date of fall 2011.

PNG's northeast service area also continues to see significant economic activity, with large projects such as a new $100 million hotel, convention and gaming centre under construction in Fort St. John; and the Peace Canyon Gas Turbine Upgrade for $112 million expected to be completed in 2009. The B.C. Central Credit Union projects employment growth in northern British Columbia of 2% per annum through 2008.

PNG's service areas are expected to experience modest economic growth over the near- to medium-term and as such keep residents in the region, however, a prolonged downturn in the forestry sector could dampen economic growth.

(2) PNG's Western service area continued to experience a slow decline in population growth in the period from 2001 to 2006, primarily due to reduced employment in the forestry sector. This decline in population has been offset by strong growth in its Northeast service region. B.C. Stats reports expected population growth of 0.7% annually from 2005 to 2015 in the Western service area and annual growth of 0.8% in population in the north-eastern region.

(3) The competitiveness of natural gas as a fuel and heating source remains a concern for PNG in the current environment, and the Company has experienced some switching of its small industrial customers to wood waste. However, wood waste as a source of fuel remains labour intensive and is not expected to be a significant threat in the residential and commercial sectors where electricity is the main alternative energy source. Electricity rates and commercial rates are also expected to rise in the near term according to BC Hydro's Service Plan for 2007-2008 to 2009-2010. The Company has also recently experienced a modest increase in its residential base after several years of slow decline, with potential growth in the service area expected. DBRS notes that some switching could occur if natural gas prices were to significantly increase over a period of time.

(4) The potential for cancellation of remaining industrial contracts remains a credit concern for PNG. West Fraser is now PNG's largest industrial customer, accounting for approximately 16% of 2006 delivery volume, followed by Alcan which accounts for approximately 8% of annual volume. Together they represent about 9% of the consolidated margin of the Company. The potential impact of termination of either of these contracts would be much less than that of Methanex, given their smaller sizes.

(5) PNG's earnings and cash flows are sensitive to interest rates through approved ROEs. Approved ROEs have generally been trending downward over the past decade, consistent with the trend in long-term interest rates, negatively impacting earnings, cash flows and interest coverage ratios over the period.

(6) PNG's deemed equity component (40%) is viewed as low given its business risk level; however, the Company has an actual equity component of 52% and 36% in its Western and Northeast service systems, respectively, which is well above the regulatory approved level.

EARNINGS AND OUTLOOK

CAD Millions	12 mos. ended Jun 30 '07	For the year ended December 31 2006	2005	2004	2003	2002
Net revenues (1)	45.8	47.7	48.7	48.8	49.3	52.2
EBITDA	23.9	25.9	27.4	26.1	26.9	28.8
EBIT	15.7	17.6	18.6	17.5	18.5	19.2
Gross interest expense	6.5	6.7	7.2	7.8	8.1	7.6
Pre-tax income	9.1	10.9	11.2	9.5	10.4	11.5
Net income (avail. to common)	3.7	4.6	6.3	5.1	5.3	4.3
Throughput volumes (TJ)	n.a.	12,395	32,844	38,971	36,638	39,463
Approved ROE (West)	9.02%	9.45%	9.68%	9.80%	10.07%	9.88%
Approved ROE (Tumbler Ridge)	9.02%	9.45%	9.68%	9.80%	10.07%	9.88%
Approved ROE (Fort St. John/Dawson Creek)	8.77%	9.20%	9.43%	9.55%	9.82%	9.63%
Return on average common equity	7.71%	8.45%	8.48%	6.97%	7.59%	5.94%

(1) Includes amortized Methanex termination payment.
n.a. = not available on an interim basis

Summary

- PNG's EBIT and EBITDA have remained reasonably stable over the past few years despite the termination of the Methanex contract.
  - The termination of the contract resulted in a termination payment to PNG of approximately $23.3 million on February 28, 2006, the effective date of the termination. The BCUC authorised PNG to record the payment in an interest bearing credit deferral account, to be amortised into income over the period from March 1, 2006, to October 31, 2009, the original date of expiry of the transportation contract, thus resulting in PNG's earnings being stable.
  - The credit to the cost of service in 2007 is $6.8 million, reflecting a 12-month amortization of the termination payment compared to a ten-month amortization in 2006. As a result, the credit in 2007 is $1.2 million higher than in 2006.
- Lower earnings for the 12 months ended June 30, 2007, can be attributed to reduction in its annual cost of service for 2007 as well as expenditures on the KSL Project.
- Lower deliveries to large commercial and small industrial customers in the last quarter (primarily to customers in the forestry industry) also resulted in lower margins for the Company. Small industrial customers declined due to the closure of the Terrace Lumber Company and the installation of a wood waste burning system by Canfor's Houston's sawmill in early 2007.
- The Company's natural gas distribution business is very seasonal, with a substantial portion of its gas sales used for space heating, thus resulting in PNG earning more in the first and fourth quarters of the year.
- The Company's gross interest expense has declined slowly over the past few years from its peak of $8.1 million in 2003 to $6.5 million as of June 2007, as a result of scheduled debt amortization instalments.

Outlook

- PNG's earnings are expected to decline modestly in 2007 due to the lower return on common equity awarded in 2007.
- Despite the termination of the Methanex contract, PNG's earnings are expected to remain stable in the near to medium term. However, post 2009 when the Methanex amortization is completed, DBRS expects that the BCUC will continue to set rates that will allow PNG to fully recover its costs of service.
  - There remains a risk that PNG may apply for rates which may result in less than full cost recovery if necessary to remain competitive with substitute energy sources.
- The Company's overall customer base is expected to remain stable in 2007, even though PNG forecasts declining natural gas usage for residential and small commercial customers in its Western service area. The residential and commercial customer bases remain exposed to the risk of fuel switching to alternative fuel sources should the commodity price of natural gas significantly increase over a prolonged period of time.
- In the medium term, DBRS is also of the opinion that the Company, as directed by the BCUC, will continue to take all prudent steps

to manage and reduce its costs to remain competitive and as such DBRS expects the Company's earnings will remain stable.

– The BCUC has urged PNG to continue to seek opportunities to reduce its property tax burden, by continuing discussions with the provincial government and by way of retaining a property tax specialist to review assessments in relation to the nature of existing assets to ensure PNG is not overpaying at current rates.

FINANCIAL PROFILE

CAD Millions	12 mos. ended Jun 30 '07	For the year ended December 31 2006	2005	2004	2003	2002
EBITDA	23.9	25.9	27.4	26.1	26.9	28.8
Net income before extras, after prefs	6.2	6.7	6.4	5.1	5.3	4.3
Depreciation & amortization	8.3	8.5	8.9	8.8	8.5	9.7
Amortization of Methanex Payment (net tax)	(4.7)	(3.9)	-	-	-	-
Deferred income taxes	(2.2)	0.0	0.0	0.0	0.0	0.0
Other recurring non-cash adjustments	1.1	0.8	0.1	0.4	0.0	0.1
Operating Cash Flow	8.8	12.1	15.5	14.3	13.8	14.1
Capital expenditures	(10.9)	(8.1)	(6.8)	(11.3)	(5.4)	(6.0)
Common dividends	(2.9)	(2.9)	(2.9)	(2.9)	(12.7)	0.0
Free Cash Flow Before Working Capital Changes	(5.0)	1.1	5.8	0.1	(4.3)	8.1
Working capital changes	(9.9)	7.2	(3.8)	1.7	(1.9)	(1.8)
Net Free Cash Flow	(15.0)	8.3	2.0	1.8	(6.3)	6.3
Adjustment for non-recurring	(2.6)	(2.0)	-	-	-	-
Deferrals (3)	1.1	15.1	(1.7)	(1.1)	(2.5)	(0.4)
Net debt financing	(4.9)	(10.0)	(0.3)	(1.2)	(1.0)	3.7
Net common equity financing	0.2	0.2	0.2	0.1	0.0	0.2
Net change in cash	(21.1)	11.6	0.2	(0.3)	(9.7)	9.9
Fixed-charges coverage (times)	2.33	2.53	2.42	2.11	2.14	2.37
EBIT interest coverage	2.41	2.61	2.59	2.25	2.27	2.54
EBITDA interest coverage	3.67	3.85	3.81	3.36	3.30	3.81
Cash flow / Total debt (1) (2)	11.5%	14.6%	16.6%	15.3%	14.6%	14.7%
% debt in capital structure (2)	47.4%	50.0%	53.4%	54.7%	55.8%	57.0%
Cash flow / CAPEX (1)	0.81	1.50	2.29	1.27	2.56	2.36

(1) Cash flows is after preferred dividends.
(2) Cumulative redeemable preferred shares are treated as 70% equity and 30% debt.
(3) Includes Methanex termination payment of $15.4 million (after-tax).

Summary

- PNG's cash flow from operations have remained stable over the past few years, however, the Company expensed $3 million of KSL development costs in 2006 which led to a modest decline in its cash flow from operations. Nevertheless, the Company's cash flow from operations remained sufficient to cover both capital expenditure (CAPEX) and dividends in 2006.
- For the 12 months ended June 2007, PNG's cash flow from operations further declined due to the increase in the Methanex amortization, the increased cash requirements for the KSL Project and deferred income tax amortization which causes a reduction in PNG's revenue requirement.
  – These factors coupled with the increase in CAPEX for 2007 will result in a modest deficit of net internally generated cash for 2007, which is expected to be funded with a combination of cash on hand and drawdown on the new operating facility.
- The Company's capital expenditures have generally been funded with cash from operations due to the prior restriction on its former operating facility. CAPEX in 2008 is expected to be moderately higher due to the permanent repair of its mainline transmission pipe which was damaged during the extreme flooding in the spring of 2007. Going forward, PNG's CAPEX is expected to remain within the $8 million to $9 million range.
- PNG's overall debt has declined slowly over the past five years due to the amortization of some of its long-term debt.

- The decline in debt-to-capital from 53.4% in 2005 to 50% in 2006 was a result of the Company applying a portion of the Methanex payment in 2006 to short-term debt, while investing the rest in secure short term instruments.

Outlook

- PNG's cash flow from operation is not expected to be sufficient to fund its CAPEX and dividend payments in 2008. The deficit is expected to be modest and will be financed with its operating credit facility. DBRS expects PNG will continue to post small but manageable deficits over the next two years.
- Despite the deficits, DBRS expects PNG to maintain a stable financial profile over the medium term to offset its business risk. Even though its cash flow metrics are expected to decline in 2007, they are expected to remain adequate for the credit rating.
- The Company's recent ability to renegotiate a new operating credit facility with less restrictive covenants and a new five-year revolving term facility for CAPEX purposes also increases its financial flexibility.
  - While PNG does not have a stated dividend policy, it has paid the same amount over the past four years. The company's debt-to-capital ratio, however, is expected to remain at 50%.
  - DBRS expects PNG will continue to manage its dividend policy in light of its CAPEX program and in a way that preserves its financial and credit profile.
- DBRS also notes that should PNG decide to proceed with the KSL Project, the Company's structure and financial profile will likely change and implications on the credit rating will be evaluated at that time.

LONG-TERM DEBT MATURITIES AND BANK LINES

Long-term Secured Debt and Principal Repayment Following Refinancing in July 2007

	Interest Rate	Amount ($MM)		Principal Repayment ($MM)
			2007	2.7
RoyNat Debentures due 2017 (floating rate) *	7.09%	15.0	**2008**	2.3
2011 Series Debenture due Dec. 13, 2011	10.75%	8.0	**2009**	2.4
2018 Series Debenture due Nov. 15, 2018	8.75%	15.2	**2010**	2.8
2025 Series Debenture due July 18, 2025	9.30%	18.5	**2011**	7.8
2027 Series Debenture due Dec. 2, 2027	6.90%	19.5	**Thereafter**	58.2
Total		**76.2**	**Total**	**76.2**

* Issued July 25, 2007 in connection with the refinancing of $14 million debentures that were scheduled to mature in 2011 and 2012.

Summary

- PNG has been able to restructure relatively comprehensive credit facilities with less restrictive covenants. The new facilities include a new restructured $20 million operating line and a $15 million risk management facility, both with 364-day maturities and a $20 million committed senior secured five-year revolving term loan repayable at maturity for general corporate purposes including capital expenditure.
- PNG was also able to refinance about $14 million of its 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 repayments until mid-2010. The Trust Indenture governing the new debenture has a covenant that restricts PNG from issuing additional debentures unless its EBIT to interest (including interest on the new debentures) coverage is at least 2 times.
- However, the new operating facility remains subject to a borrowing base and only one financial covenant.
  - The financial covenant requires that PNG's debt-to-capitalization ratio is not to exceed 65% or approximately the same level currently approved by the Commission.
  - The Company had a cash balance of $5.8 million at the end of June 2007 and as such had no outstanding balance under its operating facility.
- The risk management facility allows the PNG to hedge natural gas purchases in accordance with its annual gas contracting and gas supply price risk management. The facility is secured by a pledge of a $20 million debenture issued by the Company.

- The revolving term loan is secured by a pledge of a demand debenture in the principal amount of $20 issued under a supplemental indenture to PNG's Trust Deed. The financial covenants in the credit agreement are not expected to restrict the Company's operations.
- All other secured debentures continue to have debt retirement provisions, whereby the Company must make regular principal instalments until the entire obligation is paid down.

REGULATION

- PNG is regulated by the BCUC based on a cost of service/rate of return methodology.
- The approved ROE for 2007 has been reduced to 9.02% from 9.45% in 2006 in the Western service area and from 9.02% to 8.77% for Fort St. John/Dawson Creek. The Tumbler Ridge division remains the same at 9.02%.
  - According to the BCUC, the allowed ROE for a low-risk utility benchmark in 2007 is 8.37%, which is 43 basis points lower than in 2006.
- The common equity approved for the Western system and the north east divisions in 2007 remain the same at 40% and 36%, respectively.
- The regulatory environment remains quite supportive as evidenced by the August 2006 Methanex decision and the uncertainty associated with rate hearings is minimized by various approved adjustment mechanisms including:
  - A forward-looking test year that is used in the rate setting process;
  - Deferral accounts for both large industrial customers and residential/small customers with respect to variances in actual sales relative to forecast sales used in the Company's revenue requirement application.
- In September 2005 the BCUC granted conditional approval for PNG to convert to an income trust; however, the Company has indicated it will no longer pursue conversion because of its decision to undertake the KSL project as well as the Federal Government's announced changes to income trust taxation.
  - In its 2007 rate application decision, the BCUC denied the recovery of the 2005 income trust hearing costs.

Pacific Northern Gas Ltd.

Balance Sheet

($ millions)	As at	As at December 31			As at	As at December 31	
Assets	June 30 '07	2006	2005	**Liabilities and Equity**	June 30 '07	2006	2005
Cash	5.8	11.6	0.0	Payables,accr'ds,deferals	15.0	39.7	25.3
Receivables	10.1	29.9	29.2	Derivative instruments	4.5	-	-
Inventories	1.8	2.6	2.7	Short-term debt	-	5.1	10.2
Prepaid expenses	3.0	4.3	1.8	L.t. debt due 1 year	4.9	4.9	4.9
Current Assets	20.7	48.4	33.7	**Current Liabilities**	24.4	49.6	40.3
Net fixed assets	173.9	173.0	171.4	Deferreds & other	21.5	24.0	15.7
Deactivated assets	4.5	4.7	5.1	Long-term debt	69.9	71.7	76.6
Gas cost variance & rate stabilization	2.5	2.9	2.3	Preferred shares	5.0	5.0	5.0
Deferred charges and other	0.7	1.0	2.8	Shareholders' equity	81.3	79.8	77.7
Total	202.2	230.1	215.2	**Total**	202.2	230.1	215.2

	12 mos. ended	For the years ended December 31				
Liquidity & Leverage Ratios	Jun 30 '07	2006	2005	2004	2003	2002
Current ratio	0.85	0.98	0.84	0.81	0.97	1.00
Debt / EBITDA (2)	3.19	3.20	3.40	3.57	3.52	3.33
% debt in capital structure (2)	47.4%	50.0%	53.4%	54.7%	55.8%	57.0%
Accum. depreciation / Gross fixed assets	n/a	39.7%	38.9%	39.3%	38.1%	36.0%
Cash Flow Ratios						
Cash flow / Total debt (1) (2)	11.5%	14.6%	16.6%	15.3%	14.6%	14.7%
Cash flow / CAPEX (1)	0.81	1.50	2.29	1.27	2.56	2.36
(Cash flow - Common div) / CAPEX (1)	0.54	1.14	1.86	1.01	0.20	2.36
Coverage Ratios (3)						
EBIT interest coverage	2.41	2.61	2.59	2.25	2.27	2.54
EBITDA interest coverage	3.67	3.85	3.81	3.36	3.30	3.81
Fixed-charges coverage	2.33	2.53	2.42	2.11	2.14	2.37
Earnings Quality						
Operating margin	34.3%	36.8%	38.2%	35.9%	37.5%	36.7%
Net margin (before extras., after pfds.)	13.6%	13.9%	13.2%	10.4%	10.8%	8.1%
Return on common equity (before extras, after prefs)	7.7%	8.5%	8.5%	7.0%	7.6%	5.9%
Common dividend payout (before extras.)	46.9%	43.7%	45.1%	56.8%	53.8%	231.6%
Rate base ($ millions)	n/a	162	165	167	165	164
Regulatory						
Approved ROE (Western system)	9.02%	9.45%	9.68%	9.80%	10.07%	9.88%
Approved ROE (Tumbler Ridge)	9.02%	9.45%	9.68%	9.80%	10.07%	9.88%
Approved ROE (Fort St. John & Dawson Creek)	8.77%	9.20%	9.43%	9.55%	9.82%	9.63%
Deemed common equity (Western system)	40%	40%	40%	36%	36%	36%
Deemed common equity (Northeast system)	36%	36%	36%	36%	36%	36%

(1) Cash flows is after preferred dividends.
(2) Cumulative redeemable preferred shares are treated as 70% equity and 30% debt.
(3) Before capitalized interest, allowance for funds used during construction (AFUDC), and debt amortizations.

Operating Statistics

	For years ended December 31					
Deliveries (Terajoules)	2006	2005	2004	2003	2002	2001
Residential	3,066	3,135	3,279	3,464	3,503	3,470
Commercial	2,863	2,720	2,715	2,909	2,967	2,936
Small Industrial	3,484	3,576	3,736	3,589	3,805	3,592
Large Industrial	2,982	23,413	29,241	26,676	29,188	21,783
Total	12,395	32,844	38,971	36,638	39,463	31,781
Customers						
Residential	34,302	34,189	34,242	34,078	34,251	34,261
Commercial	5,156	5,047	4,993	4,969	4,941	4,902
Small Industrial	50	55	52	55	58	62
Large Industrial	3	4	4	4	4	5
Total	39,511	39,295	39,291	39,106	39,254	39,230
Net Revenue by Segment (Thousands of $)						
Gas Sales	32,994	29,741	29,888	27,863	24,803	22,770
Transportation	8,705	18,411	18,402	20,919	26,769	31,598
Realization of deferred Methanex payment	5,552	-	-	-	-	-
Other	479	479	511	511	528	671
Total	47,730	48,631	48,801	49,293	52,100	55,039

Note:
All figures are in Canadian dollars unless otherwise noted.

Rating Report

Report Date:
January 29, 2009

Previous Report:
October 22, 2007

Pacific Northern Gas Ltd

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The Company

Pacific Northern Gas Ltd. is a regulated utility involved in natural gas transportation and distribution in west-central and north-eastern British Columbia. PNG serves approximately 40,000 residential, commercial and industrial customers.

Rating

Debt	Rating	Rating Action	Trend
Secured Debentures	BBB (low)	Confirmed	Negative
Cumulative Redeemable Preferred Shares	Pfd-3 (low)	Confirmed	Negative

Rating Update

DBRS has today confirmed the Secured Debentures and Cumulative Redeemable Preferred Share ratings of Pacific Northern Gas Ltd. (PNG or the Company) at BBB (low) and Pfd-3 (low) respectively, both with Negative trends. The Company's financial profile has remained stable year-over-year, although at lower levels than prior to 2006, which was expected. Debt-to-capitalization remains under 50%, with cash flow-to-debt of 11% and EBIT interest coverage of 2.31x, which all remain adequate for the current credit rating. While PNG does not have a stated dividend policy, DBRS expects it will continue to manage its dividend policy in light of its CAPEX program and in a way that preserves its financial and credit profile.

PNG's customer base has remained stable year-over-year despite the challenging economic conditions in its Western service area, mainly due to the challenges in the forestry sector. PNG's Northeast service area continues to experience growth due to the oil and gas sector, which has offset the weakness in its Western system. DBRS expects the Company's service areas to experience modest economic growth over the near to medium term and, as such, keep residents in the region; however, most of the growth is expected to come from the Northeast service area.

The competitiveness of natural gas as a fuel and heating source also remains a concern for PNG in the Western service area; however, residential and commercial electricity rates are expected to rise in the near term according to B.C. Hydro's Service Plan. (Continued on page 2.)

Rating Considerations

Strengths

(1) Regulated operations provide earnings and cash flow stability.
(2) Supportive regulatory environment in British Columbia.
(3) Existence of regulatory accounts.

Challenges

(1) Future outcome of BCUC's decision on rates when Methanex amortisation ends in 2009.
(2) Economic conditions in PNG's Western system service area remains challenging.
(3) Competitiveness of natural gas versus alternative fuel sources.
(4) Low interest rate environment negatively impacts earnings through approved return on equity.
(5) Deemed equity component viewed as low.

Financial Information

	12 mos. ended	For the year ended December 31			
CAD Millions	Sep. 30, 2008	2007	2006	2005	2004
Fixed-charges coverage (times)	2.15	2.12	2.53	2.42	2.11
% debt in capital structure (2)	48.7%	50.2%	50.0%	53.4%	54.7%
Cash flow / Total debt (times) (1)	11.1%	9.1%	14.6%	16.6%	15.3%
Cash flow / CAPEX (times)	0.83	0.85	1.50	2.29	1.27
Net income (adj. for non-recurring, after prefs)	5.8	5.2	6.7	6.3	5.1
Operating cash flow (adj. for non-recurring, after prefs)	8.9	7.8	12.1	15.5	14.3
Approved ROE (Western system)	9.27%	9.02%	9.45%	9.68%	9.80%
Approved ROE (Fort St. John/Dawson Creek)	9.02%	8.77%	9.20%	9.43%	9.55%
Approved ROE (Tumbler Ridge division)	9.27%	9.02%	9.45%	9.68%	9.80%

(1) Adjusted for equity treatment of preferred shares.
(2) Cumulative redeemable preferred shares are treated as 70% equity and 30% debt.

Rating Update (Continued from page 1.)

The proposed electricity price increase is expected to keep PNG's delivered natural gas rates, including the Methanex impact, competitive with electricity rates in PNG's Western system.

While PNG continues to pursue the Kitimat to Summit Lake Looping Project (KSL), no commercial arrangements have been made, and the Company continues to expense its share of the development expenditure, which is immaterial. DBRS also notes that should PNG decide to proceed with KSL, the Company's structure and financial profile will likely change and implications on the credit rating will be evaluated at that time.

PNG has maintained stable credit metrics since 2006, as well as generally stable service territories. These represent two of the three factors pertaining to the Negative trend as outlined in DBRS's October 22, 2007 report. The third factor was if PNG's KSL Project proceeded, and the impact it would have on the Company's structure and credit profile. Whether the project proceeds remains unclear, although this uncertainty does not preclude resolution of the trend (due to the immaterial development expenditures being incurred). The favourable 2006 British Columbia Utilities Commission (BCUC) decision on the Methanex termination was key in maintaining PNG's financial and credit profile. However, the Methanex amortization approved by the BCUC expires in October 2009 and the outcome of PNG's recently filed rate application for increased rates to recover the lost revenue upon expiration remains critical to maintaining a stable financial profile and the current credit rating in the long term.

DBRS has confirmed the ratings and maintained the negative trend, but will look to resolve the trend when the BCUC decision has been rendered. A favorable decision by the BCUC is likely to result in a positive action (change in trend from Negative to Stable), while a negative decision would likely lead to a downgrade of the ratings. Based on the precedent set in the 2006 decision, DBRS expects that PNG will be allowed to recover its full cost of service.

PNG's liquidity is adequate for the ratings, with debt maturities well spread out and no maturities until 2011. The Company's liquidity is supported by three bank lines totaling $55 million, which mature in 2009 and 2012.

Rating Considerations Details

Strengths

(1) The Company's regulated operations provide a degree of earnings and cash flow stability. The use of a formula-based ROE also minimizes the cost burden and contributes to reduced regulatory lag. Regulation also allows for the recovery (and/or remittance to customers) of variances from forecasts in prudently incurred gas costs. Gas cost variances are recovered over a one-year period, with price adjustments allowed on a quarterly basis.

(2) The regulatory environment in British Columbia remains quite supportive as shown by the decision handed down by the BCUC in the Methanex case in August 2006. The BCUC determined that PNG was entitled to recover its costs of service by increasing rates to cover the margin shortfall, and that the increase in rates would not result in an over-recovery for PNG. DBRS views this decision as positive, as it supports the position that once the cost of providing service has been established (including the rate of return), the Commission approves rates that are sufficient to enable the utility recover all of those costs. Based on the 2006 decision, DBRS would expect the BCUC to set rates that would allow PNG to fully recover its costs of service when the Methanex amortization is completed in October 2009. However, there remains a risk that PNG may need to apply for rates that may result in less than full cost recovery, if necessary, to remain competitive with alternative energy sources.

(3) The BCUC allows PNG to use deferral accounts that help smooth earnings and reduce business and operating risks: (a) Industrial Customers Deliveries Deferral Account (ICDDA), which is a deferral account for variances in large industrial customer delivery margins (i.e., the difference between the forecast and actual

large industrial customer deliveries); and (b) Rate Stabilization Adjustment Mechanism (RSAM), which is a deferral account for variances from forecast in deliveries for residential and small commercial customers. Both accounts are amortized and recovered in future rates. These deferral accounts do not affect cash flows and can artificially inflate interest coverage ratios over the short term (i.e., during periods of warmer-than-normal temperatures), but the impact is reversed as deferral balances are recovered.

Challenges

(1) The BCUC's future decision on PNG's rate application for increased rates to recover the lost revenue when the Methanex amortization expires in October 2009 remains critical to maintaining a stable financial profile and the current credit rating. The company has filed a rate application for 2009 that addresses the revenue deficiency from the expiration of the Methanex amortization in October 2009.

(2) Economic conditions in PNG's Western service remain challenging, mainly due to the challenges the forestry sector has faced. This has led to the closure of some mills or a reduction in output, and a decline in the number of residential customers in the service area. Despite the weakness in the forestry sector, a number of initiatives and prospects in the Western system service area that could have a positive impact on the economic conditions – if they were to proceed – include:

(a) Construction of phase 2 of a new container handling facility at the Port of Prince Rupert to commence in late 2010, a delay of about 18 months. Phase 1 commenced operations in September 2007. According to the B.C government, the project is expected to produce 1,000 new jobs every year until 2010.
(b) Rio Tinto's announcement of a US$2.5 billion modernization of its aluminum smelter at Kitimat, B.C. to increase production capacity by 60%. Rio Tinto has to date earmarked a total of US$500 million for this project, but the timing is unclear.
(c) The 195 MW Forest Kerr Hydroelectric Project, which has an uncertain completion date.

PNG's Northeast service area continues to experience growth in the oil and gas sector, which has offset the weakness in its Western system. PNG's service areas are expected to experience modest economic growth over the near to medium term and, as such, keep residents in the region; however, most of the growth is expected from the Northeast service region.

(3) PNG's Western service area continues to experience a slow decline in population and is one of the least-populated areas in British Columbia. Unemployment in the region is high, at 6.8%, compared with the average B.C. unemployment rate of 4.7%. This decline in population has been offset by growth in its Northeast service region.

(4) The competitiveness of natural gas as a fuel and heating source remains a concern for PNG in the current environment, and the Company continues to experience some switching of its small industrial customers to wood waste. However, wood waste as a source of fuel remains labour intensive and is not expected to be a significant threat in the residential and commercial sectors where electricity is the main alternative energy source. Conservation measures undertaken by consumers in the Western service area has also led to a reduction in average gas consumption. Residential and commercial electricity rates are expected to rise in the near term, according to B.C. Hydro's Service Plan, to reflect the true cost of hydroelectricity in British Columbia. The proposed increase is expected to keep rates in PNG's Western system competitive with electricity rates.

(5) PNG's earnings and cash flows are sensitive to interest rates through approved ROEs. Approved ROEs have generally been trending downward over the past decade, consistent with the trend in long-term interest rates, negatively impacting earnings, cash flows and interest coverage ratios over the period. PNG's deemed equity component of 40% in the Western system and 36% in the Northeast system is viewed as low, given its business risk level; however, the Company has actual equity components of 56% and 36% in its Western and Northeast service systems. PNG expects to file a capital structure/rate of return application in 2009 with the objective of establishing the most efficient combination of capital structure and rate of return that would allow PNG the opportunity to earn a fair and reasonable return on its investment.

(6) The potential for cancellation of the remaining industrial contracts still remains a credit concern for PNG. West Fraser is now PNG's largest industrial customer, accounting for approximately 20% of 2007 delivery volume, followed by Alcan, which accounts for approximately 8% of annual volume. Together, they represent about 9% of the consolidated operating margin of the Company. The West Fraser contract expires at the end of 2013 and may be terminated prior to that date upon payment of an amount described in the contract. The potential impact of termination of either of these contracts would be much less than that of Methanex, given their smaller sizes.

Earnings and Outlook

	12 mos. ended		For the year ended December 31		
CAD Millions	Sep. 30, 2008	2007	2006	2005	2004
Net revenues (1)	46.0	45.0	47.7	48.7	48.8
EBITDA	23.2	22.3	25.9	27.4	26.1
EBIT	14.7	14.3	17.6	18.6	17.5
Gross interest expense	6.3	6.5	6.7	7.2	7.8
Net interest expense	6.6	6.7	6.7	7.4	8.0
Pre-tax income	8.1	7.6	10.9	11.2	9.5
Net income (avail. to common)	5.5	4.0	4.6	6.3	5.1
Throughput volumes (TJ)	n.a.	n.a.	12,395	32,844	38,971
Approved ROE (West)	9.27%	9.02%	9.45%	9.68%	9.80%
Approved ROE (Tumbler Ridge)	9.02%	9.02%	9.45%	9.68%	9.80%
Approved ROE (Fort St. John/Dawson Creek)	9.27%	8.77%	9.20%	9.43%	9.55%
Return on average common equity	7.15%	6.50%	8.45%	8.48%	6.97%

(1) Includes amortized Methanex termination payment.
n.a. = not available on an interim basis

Summary

- PNG's earnings have remained reasonably stable despite the termination of the Methanex contract in 2006.
- PNG continues to experience a decline in deliveries to small industrial customers relating to customers in the forestry industry, e.g., the closure of the Pope and Talbot sawmills. Deliveries to large industrial customers were also lower for the 12 months ended September 30, 2008, due mainly to lower deliveries a the pulp mill owned by West Fraser Mills Ltd. in Kitimat.
- The Company's natural gas distribution business is very seasonal, with a substantial portion of its gas sales used for space heating, resulting in PNG earning more in the first and fourth quarters of the year.
- Gross interest expense has declined modestly since 2005 when some of the proceeds of the Methanex termination payment were used to repay $10 million of short-term debt.

Outlook

- PNG's earnings are expected to remain stable in 2009 and track 2008 levels with limited regulated business growth opportunities.
- The Company's overall customer base is also expected to remain stable in the near to medium term, even though PNG continues to experience declining natural gas usage for residential and small industrial customers in its Western service area due to conservation measures and poor economic conditions. Growth in the company's Northeast system area is expected to offset this weakness.
- PNG has filed a rate application that addresses, among other things, the expected expiration of the Methanex amortisation in October 2009. The outcome of the rate application remains key to PNG's stable financial profile and credit rating and, as such, DBRS expects that the BCUC will continue to set rates that will allow PNG to fully recover its costs of service. However, there remains a risk that PNG may apply for rates that may result in less than full cost recovery, if necessary. to remain competitive with substitute energy sources. The expected increase in B.C. electricity rates is expected to mitigate this risk.
- In the medium term, DBRS is also of the opinion that the Company, as directed by the BCUC, will continue to take all prudent steps to manage and reduce its costs to remain competitive and, as such, DBRS expects the Company's earnings to remain stable.

Financial Profile

CAD Millions	12 mos. Ended Sep. 30, 2008	For the year ended December 31 2007	2006	2005	2004
EBITDA	23.2	22.3	25.9	27.4	26.1
Net income before extras, after prefs	5.8	5.2	6.7	6.4	5.1
Depreciation & amortization	8.6	8.2	8.5	8.9	8.8
Amortization of Methanex Payment (net tax)	(4.7)	(4.6)	(3.9)	-	-
Deferred income taxes	(0.5)	(1.0)	0.0	0.0	0.0
Other recurring non-cash adjustments	(0.3)	0.0	0.8	0.1	0.4
Operating Cash Flow	8.9	7.8	12.1	15.5	14.3
Capital expenditures	(10.8)	(9.2)	(8.1)	(6.8)	(11.3)
Common dividends	(3.2)	(2.9)	(2.9)	(2.9)	(2.9)
Free Cash Flow Before Working Capital Changes	(5.0)	(4.3)	1.1	5.8	0.1
Working capital changes	0.7	(9.6)	7.2	(3.8)	1.7
Net Free Cash Flow	(4.3)	(13.9)	8.3	2.0	1.8
Adjustment for non-recurring	(0.4)	(1.2)	(2.0)	-	-
Deferrals	1.4	1.2	15.1	(1.7)	(1.1)
Net debt financing	4.2	2.8	(10.0)	(0.3)	(1.2)
Net common equity financing	0.0	0.3	0.2	0.2	0.1
Net change in cash	0.9	(10.8)	11.6	0.2	(0.3)
Fixed-charges coverage (times)	2.15	2.12	2.53	2.42	2.11
EBIT interest coverage	2.31	2.21	2.61	2.59	2.25
EBITDA interest coverage	3.65	3.46	3.85	3.81	3.36
Cash flow / Total debt (1) (2)	11.1%	9.1%	14.6%	16.6%	15.3%
% debt in capital structure (2)	48.7%	50.2%	50.0%	53.4%	54.7%
Cash flow / CAPEX (1)	0.83	0.85	1.50	2.29	1.27

Summary

- Cash flow has stabilised at lower levels since 2006, with the reduction attributable to the termination of the Methanex contract.
- Despite the modest year-over-year increase in cash flow from operations, cash flow (CFO) remained insufficient to cover both capex and dividends resulting in a modest deficit which was funded with short-term debt.
- Capex was modestly higher for the 12 months ended September 30, 2008 due to the permanent repair of its mainline transmission pipe, which was damaged during the extreme flooding in the spring of 2007, and growth in the Northeast system.
- PNG's debt-to-capital declined modestly year over year due to the refinancing done in late 2007 and scheduled amortisation payments. Key credit metrics such as cash flow to debt, EBIT interest coverage and fixed charge coverage also modestly improved from 2007, but remain below 2006 levels.

Outlook

- The Company's capital expenditures are expected to remain within the $8 million to $9 million range in 2009 with approximately 50% going to maintenance capex and 50% going to growth capex. Growth capex will mostly be invested in PNG's Northeast system area.
- DBRS expects PNG to maintain a stable financial profile over the medium term to offset its business risk. The company's cash flow metrics are also expected to remain adequate for the credit rating even after the amortisation of the Methanex payment at the end of 2009.
- The Company's ability to renegotiate a new operating credit facility with less restrictive covenants and a new five-year revolving term facility for capex purposes late in 2007 was key in increasing its financial flexibility.
- While PNG does not have a stated dividend policy, it increased its dividend by 10% commencing 2008, the first increase in five years. The company's debt-to-capital ratio, however, is expected to remain at 50% or below for the medium term. DBRS expects PNG to continue to manage its dividend policy in light of its capex program and in a way that preserves its financial and credit profile.
- DBRS also notes that should PNG decide to proceed with KSL, the Company's structure and financial profile will likely change and implications on the credit rating will be evaluated at that time. Though PNG continues to expense its share of the KSL development expenditure, the amount is immaterial.

- PNG recently filed an application with the BCUC for approval to provide LNG Partners, LLC with an option to contract a minimum amount of firm gas transportation service using existing capacity on PNG's Western pipeline system. If LNG Partners pays the $1.5 million non-refundable fee to PNG, it will have exclusive six-month option to contract firm gas transportation capacity for a three- to five-year primary term, with a right to renew for an additional three- to five-year term. Alternatively, LNG Partners may extend the initial option period for another six months on payment of an additional non-refundable option fee of $1.5 million.
- PNG estimates that if LNG Partners purchases and exercises its option, the PNG pipeline system would be at full capacity utilization, generating almost $15 million per year of incremental revenue for the benefit of PNG and its customers, compared with approximately $12 million previously received annually from Methanex. The commencement date for the transportation service is expected to be at the beginning of 2011.

Debt and Liquidity

Long-term Secured Debt and Principal Repayment as of September 30, 2008

	Interest Rate	Amount ($MM)		Principal Repayment ($MM)
2011 Series Debenture due Dec. 13, 2011	10.75%	7.3	**2009**	2.4
5 year Revolver due Aug. 13, 2012	6.14%	2.0	**2010**	2.8
RoyNat Debentures due 2017 (floating rate)	7.09%	15.0	**2008**	2.3
2018 Series Debenture due Nov. 15, 2018	8.75%	14.6	**2011**	7.8
2025 Series Debenture due July 18, 2025	9.30%	18.0	**2012**	4.8
2027 Series Debenture due Dec. 2, 2027	6.90%	19.0	**Thereafter**	55.8
Total		**75.9**	**Total**	**75.9**

Summary of Debt

- PNG has credit facilities that include a $20 million operating line and a $15 million risk management facility that matures on July 8, 2009, and a $20 million five-year revolving term facility that matures August 13, 2012. The operating line remains subject to a borrowing base and only one financial covenant that requires that PNG's debt-to-capitalization ratio not exceed 65% or approximately the same level currently approved by the Commission. Total outstanding under the $55 million of facilities was $8.4 million, as of September 30, 2008.
- The risk management facility allows PNG to hedge natural gas purchases in accordance with its annual gas contracting and gas supply price risk management. The facility is secured by a pledge of a $20 million security debenture issued by the Company.
- The revolving term loan is secured by a pledge of a demand debenture of $20 million issued under a supplemental indenture to PNG's Trust Deed. It also contains a financial covenant requiring the Company's debt-to-capitalisation ratio not to exceed 65% and, if the Company's secured debt rating is less than BBB (low) or the Company has no debt rating, the Company must maintain an interest coverage of 2.0 times or higher using earning before interest, income taxes and expenditures on KSL to a cumulative maximum of $10 million. PNG's long-term maturities are well spread out, with the next debenture maturing in 2011.

Regulation

- PNG is regulated by the BCUC, based on a cost of service/rate of return methodology.
  The approved ROE for 2008 was increased to 9.27% from 9.02% in 2007 in the Western service area and to 9.02% from 8.77% for Fort St. John/Dawson Creek. The Tumbler Ridge division also increased to 9.27% from 9.02%. According to the BCUC, the allowed ROE for a low-risk utility benchmark in 2008 is 8.62%, higher than 8.37% in 2007.
- The common equity approved for the Western system and the north-east divisions in 2008 remains the same at 40% and 36%, respectively.
- The regulatory environment remains quite supportive, as shown by the August 2006 Methanex decision, and the uncertainty associated with rate hearings is minimized by various approved adjustment mechanisms including:
  - A forward-looking test year that is used in the rate-setting process;
  - Deferral accounts for both large industrial customers and residential/small customers with respect to variances in actual sales relative to forecast sales used in the Company's revenue requirement application.

Pacific Northern Gas Ltd.

Report Date:
January 29, 2009

Pacific Northern Gas Ltd.

Balance Sheet

($ millions)	As at	As at December 31			As at	As at December 31	
Assets	Sep. 30, 2008	2007	2006	**Liabilities and Equity**	Sep. 30, 2008	2007	2006
Cash	0.5	0.8	11.6	Payables,accr'ds,deferals	16.8	25.7	39.7
Receivables	9.7	33.4	29.9	Derivative instruments	2.7	5.3	-
Inventories	2.3	2.1	2.6	Short-term debt	4.5	8.9	5.1
Prepaid expenses	4.2	2.0	4.3	L.t. debt due 1 year	2.3	2.3	4.9
Current Assets	16.7	38.3	48.4	**Current Liabilities**	26.3	42.2	49.6
Net fixed assets	176.1	174.3	173.0	Deferreds & other	14.5	18.5	24.0
Deactivated assets	3.9	4.3	4.7	Long-term debt	72.4	72.8	71.7
Gas cost variance & rate stabilization	1.2	1.9	2.9	Preferred shares	5.0	5.0	5.0
Deferred charges and other	1.8	1.1	1.0	Shareholders' equity	81.5	81.2	79.8
Total	199.7	219.8	230.1	**Total**	199.7	219.8	230.1

	12 mos. Ended	For the years ended December 31						
Liquidity & Leverage Ratios	Sep. 30, 2008	2007	2006	2005	2004	2003	2002	2001
Current ratio	0.63	0.91	0.98	0.84	0.81	0.97	1.00	0.73
Debt / EBITDA (2)	3.48	3.83	3.20	3.40	3.57	3.52	3.33	2.97
% debt in capital structure (2)	48.7%	50.2%	50.0%	53.4%	54.7%	55.8%	57.0%	54.3%
Accum. depreciation / Gross fixed assets	n/a	n/a	39.7%	38.9%	39.3%	38.1%	36.0%	33.9%
Cash Flow Ratios								
Cash flow / Total debt (1) (2)	11.1%	9.1%	14.6%	16.6%	15.3%	14.6%	14.7%	16.8%
Cash flow / CAPEX (1)	0.83	0.85	1.50	2.29	1.27	2.56	2.36	4.12
(Cash flow - Common div) / CAPEX (1)	0.53	0.53	1.14	1.86	1.01	0.20	2.36	4.12
Coverage Ratios (3)								
EBIT interest coverage	2.31	2.21	2.61	2.59	2.25	2.27	2.54	2.24
EBITDA interest coverage	3.65	3.46	3.85	3.81	3.36	3.30	3.81	3.40
Fixed-charges coverage	2.15	2.12	2.53	2.42	2.11	2.14	2.37	2.12
Earnings Quality								
Operating margin	31.9%	31.7%	36.8%	38.2%	35.9%	37.5%	36.7%	37.1%
Net margin (before extras., after pfds.)	12.7%	11.6%	13.9%	13.2%	10.4%	10.8%	8.1%	9.7%
Return on common equity (before extras, after prefs)	7.1%	6.5%	8.5%	8.5%	7.0%	7.6%	5.9%	14.5%
Common dividend payout (before extras.)	51.5%	55.8%	43.7%	45.1%	56.8%	53.8%	231.6%	0.0%
Rate base ($ millions)	n/a	n/a	162	165	167	165	164	168
Regulatory								
Approved ROE (Western system)	9.27%	9.02%	9.45%	9.68%	9.80%	10.07%	9.88%	10.00%
Approved ROE (Tumbler Ridge)	9.27%	9.02%	9.45%	9.68%	9.80%	10.07%	9.88%	10.00%
Approved ROE (Fort St. John & Dawson Creek)	9.02%	8.77%	9.20%	9.43%	9.55%	9.82%	9.63%	9.75%
Deemed common equity (Western system)	40%	40%	40%	40%	36%	36%	36%	36%
Deemed common equity (Northeast system)	36%	36%	36%	36%	36%	36%	36%	36%

(1) Cash flows is after preferred dividends.
(2) Cumulative redeemable preferred shares are treated as 70% equity and 30% debt.
(3) Before capitalized interest, allowance for funds used during construction (AFUDC), and debt amortizations.

Operating Statistics

	For years ended December 31						
Deliveries (Terajoules)	2007	2006	2005	2004	2003	2002	2001
Residential	3,213	3,066	3,135	3,279	3,464	3,503	3,470
Commercial	2,904	2,863	2,720	2,715	2,909	2,967	2,936
Small Industrial	3,234	3,484	3,576	3,736	3,589	3,805	3,592
Large Industrial	3,859	2,982	23,413	29,241	26,676	29,188	21,783
Total	13,210	12,395	32,844	38,971	36,638	39,463	31,781
Customers							
Residential	34,394	34,302	34,189	34,242	34,078	34,251	34,261
Commercial	5,121	5,156	5,047	4,993	4,969	4,941	4,902
Small Industrial	55	50	55	52	55	58	62
Large Industrial	3	3	4	4	4	4	5
Total	39,573	39,511	39,295	39,291	39,106	39,254	39,230
Net Revenue by Segment (Thousands)							
Gas Sales	30,377	32,994	29,741	29,888	27,863	24,803	22,770
Transportation	7,409	8,705	18,411	18,402	20,919	26,769	31,598
Realization of deferred Methanex payment	6,752	5,552	-	-	-	-	-
Other	480	479	479	511	511	528	671
Total	45,018	47,730	48,631	48,801	49,293	52,100	55,039

Pacific Northern Gas Ltd.

Report Date:
January 29, 2009

Rating

Debt	Rating	Rating Action	Trend
Secured Debentures	BBB (low)	Confirmed	Negative
Cumulative Redeemable Preferred Shares	Pfd-3 (low)	Confirmed	Negative

Rating History

	Current	2008	2007	2006	2005	2004
Secured Debentures	BBB (low)	BBB (low)	BBB (low)	BBB (low)	BBB (low)	BBB (low)
Cumulative Redeemable Preferred Shares	Pfd-3 (low)	Pfd-3 (low)	Pfd-3 (low)	Pfd-3 (low)	Pfd-3 (low)	Pfd-3 (low)

Note:
All figures are in Canadian dollars unless otherwise noted.

Press Release

Date of Release: August 11, 2009

DBRS Confirms Pacific Northern Gas, Trend Changed to Stable

Industry: Utilities & Independent Power

DBRS has today confirmed the Secured Debentures and Cumulative Redeemable Preferred Shares ratings of Pacific Northern Gas Ltd. (PNG or the Company) at BBB (low) and Pfd-3 (low), respectively, and changed the trends to Stable from Negative. DBRS noted in its February 2, 2009, report that resolution of the Negative trend could occur once the British Columbia Utilities Commission (BCUC) decision on 2009 rates was rendered, with a favourable decision likely to result in a change in trend to Stable. The trend has been changed based on our review of the BCUC decision and PNG's second quarter financial results, as well as our expectation that PNG will maintain a capital structure similar to its current profile.

The recently negotiated settlement for PNG-West's 2009 rates (as approved by the BCUC) included a rate increase that incorporates the impact of the end of the Methanex termination payment amortization in October 2009. While the rate increase only reflects two months of the year (November and December), the trend change incorporates the assumption that 2010 rates will be increased to substantially account for the remaining impact of the end of the Methanex termination payment amortization.

The Company's financial profile has remained reasonably stable over the past three years, with key metrics adequate for the ratings and currently at: debt-to-capitalization under 50%, cash flow-to-debt of 11%, and EBIT interest coverage of 2.4 times. While these levels are generally consistent with those seen among higher-rated utilities in Canada, PNG's rating remains low-investment grade due to its higher level of business risk, largely attributable to a challenging service territory. DBRS expects PNG to continue to manage its dividend policy and modest share repurchase program in a way that preserves its financial and credit profiles.

While PNG's Western service area remains a challenge – due largely to the struggling forestry sector – weakness in the area has been somewhat offset by the Northeast service area, which has benefited from strong activity in the oil and gas sector.

PNG continues to develop the Kitimat to Summit Lake project (KSL) to loop its mainline pipeline through its 50% interest in Pacific Trail Pipelines Limited Partnership (PTP). PTP would provide up to 1 bcf/day of gas transportation services, primarily for Kitimat LNG Inc.'s proposed liquefied natural gas export terminal. If KSL proceeds, it would be a transformational transaction for PNG given its significant size and cost ($1.2 billion total based on 2006 estimates). As no commercial

arrangements have been finalized and the project is not yet a certainty, the implications for PNG's credit rating of undertaking KSL would be evaluated when and if it were to proceed.

Notes:
All figures are in Canadian dollars unless otherwise noted.

The applicable methodology is Rating Utilities (Electric, Pipelines & Gas Distribution), which can be found on our website under Methodologies.

This is a Corporate rating.

Issuer	Debt Rated	Rating Action	Rating	Trend	Latest Event
Pacific Northern Gas Ltd.	Secured Debentures	Trend Change	BBB (low)	Stb	Aug 11, 2009
Pacific Northern Gas Ltd.	Cumulative Redeemable Preferred Shares	Trend Change	Pfd-3 (low)	Stb	Aug 11, 2009

For more information on this credit or on this industry, visit www.dbrs.com or contact us at info@dbrs.com.

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Rating Report

Report Date:
May 17, 2010

Previous Report:
February 2, 2009

DBRS
Insight beyond the rating.

Pacific Northern Gas Ltd.

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The Company

Pacific Northern Gas Ltd. is a regulated utility involved in natural gas transportation and distribution in west-central and north-eastern British Columbia. PNG serves approximately 40,000 residential, commercial and industrial customers.

Rating

Debt	Rating	Rating Action	Trend
Secured Debentures	BBB (low)	Confirmed	Stable
Cumulative Redeemable Preferred Shares	Pfd-3 (low)	Confirmed	Stable

Rating Update

DBRS has confirmed the Secured Debentures and Cumulative Redeemable Preferred Share ratings of Pacific Northern Gas Ltd. (PNG or the Company) at BBB (low) and Pfd-3 (low) respectively, both with Stable trends. The rating reflects PNG's stable financial profile and the continued supportive regulatory environment in British Columbia. In August 2009, DBRS changed the trends on the debentures and preferred share ratings to stable from negative following the favourable regulatory decision which included a negotiated rate increase that incorporated the impact of the end of the Methanex termination payment amortization in October 2009. The full impact of the negotiated settlement and the subsequent regulatory decision to increase the low-risk utility benchmark return on equity (ROE) to 9.50% from 8.47% are both expected to be positive for PNG's financial profile in the near to medium term.

PNG continues to maintain a stable credit profile with debt-to-capitalization under 50%, cash flow-to-debt of 17% and an EBIT coverage ratio of 2.6 times. While these financial metrics are generally consistent with those seen among higher-rated utilities in Canada, PNG's rating remains low-investment grade due to its higher level of business risk, largely attributable to a challenging service territory. Economic conditions in the Western system remain challenging as many of the company's industrial customers are engaged in the forestry sector which has been challenged globally. PNG has stated that prolonged decline in the forestry sector could negatively impact gas deliveries to lumber mills, as well as commercial and residential customers who directly or indirectly provide service to such mills. This weakness has been offset somewhat by growth in the Northeast service area, which has benefitted from strong activity in the oil and gas sector. (Continued on page 2.)

Rating Considerations

Strengths

(1) Regulated operations provide earnings and cash flow stability
(2) Supportive regulatory environment in British Columbia
(3) Existence of regulatory accounts

Challenges

(1) Economic conditions in PNG's Western system service area remain challenging.
(2) Potential loss of residential and commercial customers in the Western system service area
(3) Deemed equity component viewed as low for business risk profile.
(4) Competitiveness of natural gas versus alternative fuel sources

Financial Information

	12 mons. Ended	For the year ended December 31				
CAD Millions	March 31, 2010	2009	2008	2007	2006	2005
Fixed-charges coverage (times)	2.6	2.4	2.0	2.1	2.5	2.4
% debt in capital structure	45%	46%	47%	49%	49%	53%
Cash flow / Total debt (times)	17%	12%	11%	10%	15%	17%
Cash flow / CAPEX (times)	1.4	0.9	0.9	0.9	1.5	2.3
Net income (adj. for non-recurring, after prefs)	6.8	6.3	6.2	5.4	6.7	6.3
Operating cash flow (adj. for non-recurring, after prefs)	12.8	9.0	9.0	8.0	12.1	15.5
Approved ROE (Western system)	9.89%	9.63%	9.27%	9.02%	9.45%	9.68%
Approved ROE (Fort St. John/Dawson Creek)	9.64%	9.38%	9.02%	8.77%	9.20%	9.43%
Approved ROE (Tumbler Ridge division)	9.89%	9.63%	9.27%	9.02%	9.45%	9.68%

Rating Update (Continued from page 1.)

While DBRS expects that PNG will continue to maintain a stable financial profile, it also expects that the Company will continue to seek out prudent growth opportunities that will bring about diversification in such a way that its regulated debt-to-capital ratio remains at or below 50%. In pursuing that strategy, PNG recently announced the acquisition of the 9.8 MW McNair Creek "run of river" hydro-electric generation facility in British Columbia for $17 million. The acquisition cost will be funded by way of assumption of existing non-recourse debt of $9 million as well as utilization of PNG's existing credit facilities for the remainder. The facility is located on the B.C. Sunshine Coast and has operated for more than five years, with generation sold under a long-term contract to B.C. Hydro. The transaction is expected to be accretive to earnings and cash flow positive in 2011. PNG's debt-to-capital ratio is expected to increase to 50% from the current level of 45%, while its cash flow-to-debt and EBIT coverage metrics remain stable. The credit metrics are expected to remain adequate for the credit rating. Furthermore, DBRS expects PNG to continue to manage its dividend policy in light of its capex program and business risk profile in a way that preserves its financial and credit profile.

While the closure of West Fraser Timber Co. Ltd.'s Eurocan paper mill in Kitimat, B.C. is expected to negatively impact PNG's Western service area, Euruocan is a much smaller industrial customer than Methanex. The Eurocan mill was closed in January 2010, however, West Fraser has not yet given PNG notice that it is cancelling transportation service.

In the longer term, the competitiveness of natural gas as a fuel and heating source still remains a focus for PNG in the Western service area; however, residential and commercial electricity rates are expected to rise in the near term according to B.C. Hydro's Service Plan. The proposed electricity price increase and current low price gas environment are expected to keep PNG's delivered natural gas rates competitive with electricity rates in PNG's Western system.

While PNG continues to pursue the Kitimat to Summit Lake Looping Project (KSL), no commercial arrangements have been made, and the Company continues to expense its share of the development expenditure, which is immaterial. DBRS also notes that should PNG decide to proceed with KSL, the Company's structure and financial profile will likely change and implications for the credit rating will be evaluated at that time.

PNG's liquidity remains adequate for the ratings, supported by three bank credit facilities totaling $55 million, which mature in 2011, and a $35 million five-year revolving term facility that matures in 2015.

Rating Considerations Details

Strengths

(1) The Company's regulated operations provide a degree of earnings and cash flow stability. Regulation also allows for the recovery (and/or remittance to customers) of variances from forecasts in prudently incurred gas costs. Gas cost variances are recovered over a one-year period, with price adjustments allowed on a quarterly basis.

(2) The regulatory environment in British Columbia remains quite supportive as shown by the negotiated settlement for PNG-West's 2009 rates and the recent decision handed down in December 2009. The British Columbia Utilities Commission (BCUC) issued a decision on an application by Terasen Gas Utilities that resulted in the benchmark ROE being increased to 9.50% from 8.47% effective July 1, 2009. This resulted in increased ROEs for PNG's Western and Northeast systems. PNG`s recent negotiated settlement on its capital structure/rate of return application is expected to be positive for the Company's credit profile. The settlement agreement however remains subject to the BCUC's approval.

(3) The BCUC allows PNG to use deferral accounts that help smooth earnings and reduce business and operating risks. The two main deferral accounts are: (a) Gas Cost Variance Account (GCVA), which is a deferral account for variances in the cost of gas (i.e., the difference between the forecast gas cost the Company charges its customers and the actual gas cost incurred by the Company) and (b) Rate Stabilization Adjustment Mechanism (RSAM), which is a deferral account for variances from forecast in deliveries for residential and small commercial customers. Both accounts are amortized and recovered in future rates. These deferral accounts do not affect cash flows and can artificially inflate interest coverage ratios over the short term (i.e., during periods of warmer-than-normal temperatures), but the impact is reversed as deferral balances are recovered. Another deferral account called the return on equity deferral account is being applied for by PNG to capture the difference between the approved Western system 2009 cost of service for the Company and the cost of service determined for 2009 on the basis of the applied-for increase in the deemed common equity and risk premium. The deferred amount would be recovered in future rates.

Challenges

(1) Economic conditions in PNG's Western service remain challenging, mainly due to the challenges facing the forestry sector. In 2009, the sector continued to face challenges including low lumber prices, the mountain pine beetle infestation and the strength of the Canadian dollar. This led to the decision by West Fraser, one of PNG's large industrial customers, to permanently close its Eurocan paper mill in Kitimat in January 2010. The transportation service agreement with West Fraser was scheduled to expire in December 2013, however West Fraser is entitled to cancel its obligations by providing PNG with a six-month cancellation notice and a termination payment that would recover almost 80% of the lost revenues under the remaining term of the agreement. The six-month cancellation notice has not been provided to PNG and as such, the Company has not yet received the termination payment and scheduled payments continue to be made.

DBRS notes that the potential impact of the termination of this contract would be much less than that of Methanex, given its smaller size. Furthermore, based on the precedent set by the BCUC on the Methanex case in 2006, we expect that the cancellation of this contract will be given the same regulatory treatment as that of Methanex.

- In addition to the weakness in the forestry sector, progress on Rio Tinto's proposed US$2.5 billion modernization of its aluminum smelter in Kitimat, B.C. has slowed down considerably following the global recession and timing remains uncertain.
- Nevertheless, construction of phase 2 of a new container handling facility at the Port of Prince Rupert, expected to commence in late 2010 when the environmental assessments are finalized, remains on track.
- PNG's Northeast service area continues to experience modest growth in the oil and gas sector, which has offset the weakness in its Western system.

(2) Another challenge that could result from the prolonged decline in the forestry sector, and particularly the closure of the West Fraser Mill, is the associated direct and/or indirect impact on residential and commercial customers. West Fraser employed more than 500 people at the paper mill, and PNG expects to see modest customer losses in Kitimat and surrounding areas due to the closure of the paper mill. PNG's Western service area also continues to experience a slow decline in population and is one of the least-populated areas in British Columbia.

(3) Approved ROEs have generally been trending downward over the past decade, consistent with the trend in long-term interest rates, negatively impacting earnings, cash flows and interest coverage ratios over the period. However, the recent increase in approved ROE and the recent negotiated settlement on PNG's capital structure/rate of return application is expected to be positive for the Company's credit profile.

(4) In the longer term, though the competitiveness of natural gas as a fuel and heating source remains a focus for PNG, the current natural gas price environment which is being driven by the development of shale gas plays in North America has made PNG's retail rates more competitive relative to alternative heating sources, particularly electricity. Residential and commercial electricity rates have risen according to B.C. Hydro's Service Plan, to more closely reflect the true cost of hydroelectricity in British Columbia, and are expected to continue to rise over time. After the recent increase in rates in PNG's Western system, gas currently remains competitive with electricity rates.

Pacific Northern Gas Ltd.

Report Date:
May 17, 2010

Earnings and Outlook

CAD Millions	12 mons. Ended March 31, 2010	For the year ended December 31 2009	2008	2007	2006	2005
Net revenues [1]	47.8	46.9	46.7	45.0	47.7	48.7
EBITDA	23.3	22.7	23.5	22.3	25.9	27.4
EBIT	15.1	14.6	14.9	14.3	17.6	18.6
Gross interest expense	5.7	5.6	7.0	6.5	6.7	7.2
Net interest expense	5.7	5.6	6.9	6.7	6.7	7.4
Pre-tax income	9.4	9.0	8.0	7.6	10.9	11.2
Net income (avail. to common)	6.5	6.2	5.6	4.0	4.6	6.3
Throughput volumes (TJ)	n.a.	12,145	12,542	13,210	12,395	32,844
Approved ROE (West)	9.89%	9.63%	9.27%	9.02%	9.45%	9.68%
Approved ROE (Tumbler Ridge)	9.89%	9.63%	9.27%	9.02%	9.45%	9.68%
Approved ROE (Fort St. John/Dawson Creek)	9.64%	9.38%	9.02%	8.77%	9.20%	9.43%
Return on average common equity	7.75%	7.47%	7.52%	6.75%	8.45%	8.48%

(1) Includes amortized Methanex termination payment.
n.a. = not available on an interim basis

Summary

PNG's earnings have remained stable year-over-year due to its stable customer base and higher weighted average allowed a return on deemed common equity of 9.58% in 2009 compared with 9.22% in 2008.

PNG continued to experience a decline in deliveries to small industrial customers relating to customers in the forestry industry due to planned shutdowns and reduced lumber production levels in 2009. Deliveries to large industrial customers were also lower by 18% in 2009 when compared to 2008, due mainly to lower deliveries at the pulp mill owned by West Fraser Mills Ltd.

The Company's natural gas distribution business is very seasonal, with a substantial portion of its gas sales used for space heating, resulting in PNG earning more in the first and fourth quarters of the year.

Gross interest expense continues to decline due to lower interest rates on the Company's floating rate short- and long-term debt.

Outlook

PNG's earnings are expected to increase modestly following the higher approved ROE for both the Western and Northeast system in 2009.

The Company recently reached a negotiated settlement of the capital structure and equity risk premium application it filed with the BCUC last year. The application reflected the impact of the higher 2009 benchmark ROE of 9.50% following the BCUC's December 2009 Regulatory Decision. PNG requested a common equity component of 47.5% and an allowed return on common equity of 10.25% for its Western system and 42.5% and 10.25% for the other divisions. The settlement agreement allows the Western system's common equity thickness to be increased to 45% effective January 1, 2009, and the Northeast division to be increased to 40% effective January 1, 2010, with no change to the relative risk premium of both. The settlement agreement however remains subject to the BCUC's approval.

DBRS expects that the Company will continue to take all prudent steps to manage and reduce its costs to remain competitive and, as such, expects the Company's earnings to remain stable.

Pacific Northern Gas Ltd.

Report Date:
May 17, 2010

Financial Profile

CAD Millions	12 mons. Ended March 31, 2010	2009	2008	2007	2006	2005
		For the year ended December 31				
EBITDA	23.3	22.7	23.5	22.3	25.9	27.4
Net income before extras, after prefs	6.8	6.3	6.2	5.4	6.7	6.4
Depreciation & amortization	8.3	8.2	8.7	8.2	8.5	8.9
Amort. of Methanex Pmt. (net tax)	(3.8)	(5.5)	(6.6)	(4.6)	(3.9)	-
Deferred income taxes	1.6	0.1	0.9	(1.0)	0.0	0.0
Other recurring non-cash adj.	(0.1)	(0.2)	(0.3)	0.0	0.8	0.1
Operating Cash Flow	12.8	9.0	9.0	8.0	12.1	15.5
Capital expenditures	(9.3)	(9.6)	(10.4)	(9.2)	(8.1)	(6.8)
Common dividends	(3.6)	(3.4)	(3.2)	(2.9)	(2.9)	(2.9)
Free Cash Flow Before W/C	(0.1)	(4.1)	(4.6)	(4.1)	1.1	5.8
Working capital changes	0.1	9.7	8.1	(9.6)	7.2	(3.8)
Net Free Cash Flow	0.1	5.6	3.5	(13.7)	8.3	2.0
Adjustment for non-recurring	(0.3)	(0.1)	(0.6)	(1.4)	(2.0)	-
Deferrals	0.0	0.0	1.1	1.2	15.1	(1.7)
Net debt financing	(3.1)	(2.9)	(4.2)	2.8	(10.0)	(0.3)
Net common equity financing	(0.9)	(1.7)	0.0	0.3	0.2	0.2
Net change in cash	(4.2)	0.9	(0.2)	(10.8)	11.6	0.2
Fixed-charges coverage (times)	2.63	2.38	2.00	2.12	2.53	2.42
EBIT interest coverage (1)	2.63	2.59	2.13	2.21	2.61	2.59
EBITDA interest coverage (1)	4.06	4.02	3.36	3.46	3.85	3.81
Cash flow / Total debt (2)	16.6%	11.7%	11.2%	9.5%	14.8%	16.9%
% debt in capital structure	44.7%	46.0%	47.4%	49.4%	49.1%	52.6%
Cash flow / CAPEX (2)	1.38	0.94	0.86	0.87	1.50	2.29

(1) Before capitalized interest, allowance for funds used during construction (AFUDC), and debt amortizations.
(2) Cash flows is after preferred dividends.

Summary

PNG has maintained reasonably stable cash flow from operations year-over-year following the termination of the Methanex contract in 2006.

Despite stable cash flow from operations, cash flow (CFO) remained insufficient to cover both capex and dividends resulting in a modest free cash flow deficit.

Capex was 7.6% lower in 2009 compared with 2008 but was higher than the average level over the past five years due to growth in the Northeast system. Capex for 2010 is estimated at approximately $7.9 million and will be directed primarily toward the installation of distribution mains and services in the Northeast system as well as transmission mainline rehabilitation in the Western system.

Outlook

The Company's capital expenditures are expected to remain within the $7 million to $9 million range in the medium term and forecasted to be $7.9 million in 2010. Planned capex in 2010 is primarily directed toward the installation of distribution mains and service in the Northeast system as well as transmission mainline rehabilitation in the Western system.

Economic conditions in the Western system remain challenging as many of the company's industrial customers are engaged in the forestry sector which has been challenged globally. PNG has stated that a prolonged decline in the forestry sector could negatively impact gas deliveries to lumber mills, as well as commercial and residential customers who directly or indirectly provide service to such mills. Hence, DBRS expects that PNG will continue to maintain a stable and strong financial profile to offset its business risk.

Following the recent acquisition of the 9.8 MW McNair Creek "run of river" hydro-electric generation facility in British Columbia for $17 million, PNG's debt-to-capital ratio is expected to increase to 50% from the current level of 45%, while its cash flow-to-debt and EBIT coverage metrics remain stable. The acquisition cost will be funded by way of assumption of existing non-recourse debt of $9 million as well as utilization of PNG's current bank facility for the remainder. The company's credit metrics, after taking into account the acquisition, are also expected to remain adequate for the credit rating.

While PNG does not have a stated dividend policy, it increased its dividend by 10% commencing in 2008, the first increase in five years. DBRS expects the Company's debt-to-capital ratio to remain in the 50% range for the medium term and for PNG to continue to manage its dividend policy in light of its capex program and business risk profile in a way that preserves its financial and credit profile.

DBRS also notes that should PNG decide to proceed with KSL, the Company's structure and financial profile will likely change and implications for the credit rating will be evaluated at that time. Though PNG continues to expense its share of the KSL development expenditure, the amount is immaterial. The Company expects its 50% share of the KSL project development costs in 2010 to total approximately $5.5 million of which approximately 90% would be capitalized. These costs would primarily relate to additional engineering and technical studies for the KSL project.

In 2009, PNG filed an application with the BCUC for approval to provide Merrill Lynch with an option to contract a minimum amount of firm gas transportation service using existing capacity on PNG's Western pipeline system. A non-refundable option fee of $1.5 million was paid to the Company by Merrill Lynch and a further $1.0 million option extension fee was paid in December 2009 to extend to June 30, 2010 the exclusive option granted in 2009. PNG estimates that if Merrill Lynch exercises its option, the PNG pipeline system would be at full capacity utilization, generating almost $15 million per year of incremental revenue for the benefit of PNG and its customers, compared with approximately $12 million previously received annually from Methanex. The commencement date for the transportation service (if taken up) is expected to be between 2012 and 2013.

Debt and Liquidity

Long-term Secured Debt and Principal Repayment as of December 31, 2009

	Interest Rate	Amount ($MM)		Principal Repayment ($MM)
2011 Series Debenture due Dec. 13, 2011	10.75%	5.8	**2010**	2.8
5 year Revolver due Aug. 13, 2015 (floating rate)	1.76%	6.0	**2011**	7.8
RoyNat Debentures due 2017 (floating rate)	7.09%	15.0	**2012**	8.8
2018 Series Debenture due Nov. 15, 2018	8.75%	13.4	**2013**	2.8
2025 Series Debenture due July 18, 2025	9.30%	17.0	**2014**	3.2
2027 Series Debenture due Dec. 2, 2027	6.90%	18.0	**Thereafter**	49.8
Total		**75.2**	**Total**	**75.2**

Summary of Debt

PNG has credit facilities that include a $25 million operating line and two $15 million gas supply risk management facilities that mature in 2011, and a $35 million five-year revolving term facility that matures on February 2, 2015. The Company recently added the second $15 million risk management facility and increased its five-year term facility to $35 million from $20 million and extended the maturity from 2012 to 2015.

DBRS remains comfortable with PNG's liquidity and believes that the Company will be able to refinance upcoming maturities that come due in the near term.

The operating line remains subject to a borrowing base and only one financial covenant that requires that PNG's debt-to-capitalization ratio not exceed 65% or approximately the same level currently approved by the BCUC.

The risk management facilities allow PNG to hedge natural gas purchases in accordance with its annual gas contracting and gas supply price risk management. The facilities are each secured by a pledge of a $20 million security debenture issued by the Company.

The revolving term loan is secured by a pledge of a demand debenture of $35 million issued under a supplemental indenture to PNG's Trust Deed. It also contains a financial covenant requiring the Company's debt-to-capitalization ratio not to exceed 65% and, if the Company's secured debt rating is less than BBB (low) or the Company has no debt rating, the Company must maintain an interest coverage of 2.0 times or higher using earnings before interest, income taxes and expenditures on KSL to a cumulative maximum of $10 million. PNG's long-term maturities are well spread out, with ample liquidity required to meet scheduled debt repayments. Under the revolving term facility, $6 million was outstanding at the end of March 2010.

Regulation

PNG is regulated by the BCUC, based on a cost of service/rate of return methodology. The approved ROE for 2009 was increased to 9.63% from 9.27% in 2008 in the Western service area and to 9.38% from 9.02% for Fort St. John/Dawson Creek. The Tumbler Ridge division was also increased to 9.63% from 9.27%. According to the BCUC, the 2010 allowed ROE for a low-risk utility benchmark is 9.50% compared with the previous 8.47%.

The common equity approved for the Western system and the Northeast divisions in 2009 remained the same at 40% and 36%, respectively. The Company recently reached a negotiated settlement on the capital structure and equity risk premium application it filed with the BCUC last year. PNG requested a common equity component of 47.5% and an allowed return on common equity of 10.25% for its Western system and 42.5% and 10.25% for the other divisions. The settlement agreement allows the Western system common equity thickness to be increased to 45% effective January 1, 2009, and the Northeast division to be increased to 40% effective January 1, 2010, with no change to the relative risk premium of both. The settlement agreement however remains subject to the BCUC's approval.

The regulatory environment remains quite supportive, as shown by the August 2006 Methanex decision, and the uncertainty associated with rate hearings is minimized by various approved adjustment mechanisms including:

- A forward-looking test year that is used in the rate-setting process;
- Deferral accounts for both large industrial customers and residential/small customers with respect to variances in actual sales relative to forecast sales used in the Company's revenue requirement application.

Pacific Northern Gas Ltd.

Report Date:
May 17, 2010

Balance Sheet
($ millions)

Assets	**As at March 31, 2010**	As at December 31 2009	2008	**Liabilities and Equity**	**As at March 31, 2010**	As at December 2009	2008
Cash	0.9	1.5	0.6	Payables,accr'ds,deferals	17.2	26.2	32.2
Receivables	22.3	22.8	32.2	Derivative instruments	6.3	4.3	7.3
Inventories	0.9	1.1	2.2	Short-term debt	2.5	2.6	3.0
Prepaid expenses	1.8	3.3	2.8	L.t. debt due 1 year	2.8	2.8	2.4
Current Assets	25.9	28.6	37.8	**Current Liabilities**	28.7	35.9	44.9
Net fixed assets	177.2	178.4	177.8	Deferreds & other	23.3	22.1	13.8
Deactivated assets	0.0	0.0	3.8	Long-term debt	71.7	71.8	74.5
Gas cost variance & rate stabilization	14.2	11.4	1.9	Preferred shares	5.0	5.0	5.0
Deferred charges and other	1.8	1.8	0.7	Shareholders' equity	90.4	85.4	83.7
Total	219.1	220.2	222.0	**Total**	219.1	220.2	222.0

Liquidity & Leverage Ratios	12 mons. Ended March 31, 2010	For the years ended December 31 2009	2008	2007	2006	2005	2004
Current ratio	0.90	0.80	0.84	0.91	0.98	0.84	0.81
Debt / EBITDA	3.31	3.40	3.40	3.76	3.15	3.35	3.51
% debt in capital structure	44.7%	46.0%	47.4%	49.4%	49.1%	52.6%	53.8%
Accum. depreciation / Gross fixed assets	n/a	43.3%	42.0%	41.0%	39.7%	38.9%	39.3%
Cash Flow Ratios							
Cash flow / Total debt (1)	16.6%	11.7%	11.2%	9.5%	14.8%	16.9%	15.6%
Cash flow / CAPEX (1)	1.38	0.94	0.86	0.87	1.50	2.29	1.27
(Cash flow - Common div) / CAPEX (1)	0.99	0.58	0.55	0.55	1.14	1.86	1.01
Coverage Ratios (2)							
EBIT interest coverage	2.63	2.59	2.13	2.21	2.61	2.59	2.25
EBITDA interest coverage	4.06	4.02	3.36	3.46	3.85	3.81	3.36
Fixed-charges coverage	2.63	2.38	2.00	2.12	2.53	2.42	2.11
Earnings Quality							
Operating margin	31.5%	31.1%	31.8%	31.7%	36.8%	38.2%	35.9%
Net margin (before extras., after pfds.)	14.3%	13.5%	13.3%	12.1%	13.9%	13.2%	10.4%
Return on common equity (before extras, after prefs)	7.8%	7.5%	7.5%	6.8%	8.5%	8.5%	13.7%
Common dividend payout (before extras.)	53.0%	54.5%	52.0%	53.8%	43.7%	45.1%	56.8%
Rate base ($ millions)	n/a	169	168	165	162	165	167
Regulatory							
Approved ROE (Western system)	9.89%	9.63%	9.27%	9.02%	9.45%	9.68%	9.80%
Approved ROE (Tumbler Ridge)	9.89%	9.63%	9.27%	9.02%	9.45%	9.68%	9.80%
Approved ROE (Fort St. John & Dawson Creek)	9.64%	9.38%	9.02%	8.77%	9.20%	9.43%	9.55%
Deemed common equity (Western system)	40%	40%	40%	40%	40%	40%	36%
Deemed common equity (Northeast system)	36%	36%	36%	36%	36%	36%	36%

(1) Cash flows is after preferred dividends.
(2) Before capitalized interest, allowance for funds used during construction (AFUDC), and debt amortizations.

Operating Statistics

Deliveries (Terajoules)	12 mons. Ended March 31, 2010	For years ended December 31 2009	2008	2007	2006	2005	2004
Residential	n/a	3,221	3,210	3,213	3,066	3,135	3,279
Commercial	n/a	3,081	3,007	2,904	2,863	2,720	2,715
Small Industrial	n/a	3,066	3,049	3,234	3,484	3,576	3,736
Large Industrial	n/a	2,777	3,276	3,859	2,982	23,413	29,241
Total	n/a	12,145	12,542	13,210	12,395	32,844	38,971
Customers							
Residential	n/a	33,910	33,862	34,394	34,302	34,189	34,242
Commercial	n/a	5,142	5,190	5,121	5,156	5,047	4,993
Small Industrial	n/a	58	58	55	50	55	52
Large Industrial	n/a	3	3	3	3	4	4
Total		39,113	39,113	39,573	39,511	39,295	39,291

Pacific Northern Gas Ltd.

Report Date:
May 17, 2010

Rating

Debt	Rating	Rating Action	Trend
Secured Debentures	BBB (low)	Confirmed	Stable
Cumulative Redeemable Preferred Shares	Pfd-3 (low)	Confirmed	Stable

Rating History

	Current	2009	2008	2007	2006	2005
Secured Debentures	BBB (low)	BBB (low)	BBB (low)	BBB (low)	BBB (low)	BBB (low)
Cumulative Redeemable Preferred Shares	Pfd-3 (low)	Pfd-3 (low)	Pfd-3 (low)	Pfd-3 (low)	Pfd-3 (low)	Pfd-3 (low)

Note:
All figures are in Canadian dollars unless otherwise noted.

Rating Report

Report Date:
June 10, 2011

Previous Report:
May 17, 2010

Pacific Northern Gas Ltd.

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The Company

Pacific Northern Gas Ltd. is a regulated utility involved in natural gas transportation and distribution in west-central and north-eastern British Columbia. PNG serves approximately 40,000 residential, commercial and industrial customers.

Recent Actions

March 4, 2011
DBRS Comments on PNG Special Dividend

Rating

Debt	Rating	Rating Action	Trend
Secured Debentures	BBB (low)	Confirmed	Stable
Cumulative Redeemable Preferred Shares	Pfd-3 (low)	Confirmed	Stable

Rating Update

DBRS has confirmed the Secured Debentures and Cumulative Redeemable Preferred Share ratings of Pacific Northern Gas Ltd. (PNG or the Company) at BBB (low) and Pfd-3 (low), respectively, both with Stable trends. The rating reflects PNG's stable financial profile and the continued supportive regulatory environment in British Columbia (B.C.). The impact of the regulatory decision to increase the low-risk utility benchmark return on equity (ROE) to 9.50% and the British Columbia Utilities Commission's (BCUC or the Commission) approval of PNG's 2010 negotiated settlements continues to be positive for the Company's financial profile.

While PNG maintains a stable financial profile, it still has a higher level of business risk when compared with other DBRS-rated utilities. Economic conditions in PNG's Western system remain weak, but are showing signs of improvement, albeit at a slow pace. Signs of economic improvement in the region include Rio Tinto Ltd.'s (Rio Tinto) announcement of an additional $300 million investment on preconstruction activities for the US$2.5 billion proposed modernization of its aluminum smelter in Kitimat, B.C.; the proposed Phase 2 of a new container handling facility at the Port of Prince Rupert; and continued modest growth in the oil and gas sector in the Northeast system area.

The closure of the West Fraser Kitimat paper mill in 2010 resulted in some loss of customers in the region, which was offset by the increase in customers in the Northeast system service area. Despite the challenges in the Western system area, PNG has been able to maintain a stable customer base. (Continued on page 2.)

Rating Considerations

Strengths

(1) Regulated operations provide earnings and cash flow stability
(2) Supportive regulatory environment in British Columbia
(3) Existence of regulatory accounts

Challenges

(1) Economic conditions in PNG's Western system remain weak, but are improving slowly
(2) Competitiveness of natural gas versus alternative fuel sources.
(3) Low return on equity for business risk profile

Financial Information

	12 mons. Ended	For the year ended December 31			
CAD Millions	March 31, 2011	2010	2009	2008	2007
Fixed-charges coverage (times)	1.9	2.5	2.4	2.0	2.1
% debt in capital structure	45%	50%	46%	47%	49%
Cash flow / Total debt (times)	19%	20%	12%	11%	10%
Cash flow / CAPEX (times)	2.4	2.5	0.9	0.9	0.9
Net income (adj. for non-recurring, after prefs)	24.2	7.9	6.3	6.2	5.4
Operating cash flow (adj. for non-recurring, after prefs)	17.0	18.8	9.0	9.0	8.0
Approved ROE (Western system)	10.15%	10.15%	9.63%	9.27%	9.02%
Approved ROE (Fort St. John/Dawson Creek)	9.90%	9.90%	9.38%	9.02%	8.77%
Approved ROE (Tumbler Ridge division)	10.15%	10.15%	9.63%	9.27%	9.02%

Rating Update (Continued from page 1.)

In the longer term, the competitiveness of natural gas as a fuel and heating source still remains a key focus for PNG, especially in the Western service area; however, residential and commercial electricity rates are expected to rise in the near term according to BC Hydro's Service Plan. The proposed electricity price increase and current low gas price environment are expected to keep PNG's delivered natural gas rates competitive with electricity rates in PNG's Western system.

In March 2011, PNG completed the sale of its 50% stake in Pacific Trail Pipelines Limited Partnership (PTP) for a gross consideration of $30 million. The Company has declared special dividends of approximately $22 million, which represents all of the initial payment. A final cash payment of $20 million will be paid if the purchasers make a decision to proceed with the construction of the Kitimat LNG export facility in British Columbia. There is no guarantee that the final payment will be made.

Going forward, if the net proceeds from the second payment are retained and reinvested in the Company, this could have a longer-term positive impact on PNG's creditworthiness. However, the extent of any credit impact will depend entirely on the amounts to be retained and how they are reinvested.

DBRS expects that the Company will continue to pursue expansion opportunities to diversify its business risk profile and increase utilization on its Western system, which both have the potential to increase PNG's margins and lower the average cost of transporting gas for all customers. The Company also continues to evaluate and advance growth opportunities through electricity and renewable energy generation. In 2010, it acquired the 9.8 MW McNair Creek "run of river" hydroelectric generation facility in British Columbia for $17 million. It also recently formed Narrows Inlet Limited Partnership with Skookum Power Corp. to undertake an investment of up to $2.5 million to advance the Narrows Inlet Project to the start of construction. The $190 million project was awarded a 30-year energy purchase agreement with British Columbia Hydro & Power Authority (BC Hydro) in spring 2010. If the Partnership elects to proceed with funding construction, approximately $20 million of equity will be required from PNG. DBRS notes that there are no assurances that PNG will be successful in realizing value from this opportunity or any of those described in the Outlook section on page 4 of this report. However, it is expected that the Company will continue to take all prudent steps to manage and reduce its costs to remain competitive and ensure that earnings remain stable.

PNG's debt-to-capital ratio is expected to remain at approximately 50% over the medium term while its cash flow-to-debt and EBIT coverage metrics remain stable for the current rating. DBRS requires that PNG maintain a credit profile that is stronger than its peers, to offset its higher business risk profile. Furthermore, we expect PNG to continue to manage its dividend policy in light of its capex program and business risk profile in a way that preserves its financial and credit profiles.

PNG's liquidity remains adequate for the ratings, supported by three bank credit facilities totalling $55 million, which mature in 2012, and a $35 million five-year revolving term facility that matures in 2015.

Rating Considerations Details

Strengths

(1) The Company's regulated operations provide a degree of earnings and cash flow stability. Regulation also allows for the recovery (and/or remittance to customers) of variances from forecasts in prudently incurred gas costs. Gas cost variances are recovered over a one-year period, with price adjustments allowed on a quarterly basis.

(2) The regulatory environment in British Columbia remains quite supportive, as shown by the negotiated settlement for PNG-West's 2009 rates. As a result of an increase in the benchmark ROE to 9.50% by the BCUC in December 2009, ROEs for PNG's Western and Northeast systems also increased to 10.15% and 9.90%/10.15%, respectively. Negotiated settlements of the Company's 2011 revenue requirements applications have been reached between PNG and customer representatives in respect of all divisions. The BCUC is currently reviewing the settlements.

(3) The BCUC allows PNG to use deferral accounts that help smooth earnings and reduce business and operating risks. The two main deferral accounts are: (a) Gas Cost Variance Account (GCVA), which is a deferral account for variances in the cost of gas (i.e., the difference between the forecast gas cost the Company charges its customers and the actual gas cost incurred by the Company) and (b) Rate Stabilization Adjustment Mechanism (RSAM), which is a deferral account for variances from forecast in deliveries for residential and small commercial customers. Both accounts are amortized and recovered in future rates. These deferral accounts do not affect cash flows and can artificially inflate interest coverage ratios over the short term (i.e., during periods of warmer-than-normal temperatures), but the impact is reversed as deferral balances are recovered.

Challenges

(1) Economic conditions in PNG's Western system remain weak, but are showing signs of improvement, albeit at a slow pace. The closure of the West Fraser Kitimat paper mill in 2010 resulted in some loss of customers in the region; this was offset by the increase in customers in the Northeast system service area. West Fraser terminated its contract with PNG permanently, effective November 2010, and made a contract termination payment of $5.1 million which is being amortized into earnings over the remaining life of the agreement. PNG continues to pursue opportunities to increase capacity on the Western system. PNG's Western service area also continues to experience a slow decline in population and is one of the least-populated areas in British Columbia.

Signs of economic improvement in the region include Rio Tinto's announcement of an additional $300 million to be spent on preconstruction activities for the US$2.5 billion proposed modernization of its aluminum smelter in Kitimat. Construction and project activity are expected to increase substantially in 2011 as a result of these new funds. PNG has started providing gas service to the construction camp that houses temporary workers for the project. The final schedule for completion and commissioning still requires Rio Tinto's board approval for the complete project, which should be obtained in 2011.

- The Port of Prince Rupert has also reported higher container traffic as it supports the Asia Pacific Gateway and Corridor Initiative. The proposed Phase 2 of a new container handling facility at the Port is expected to be completed by 2014, at an estimated cost of $600 million. This is expected to quadruple the terminal's capacity and contribute to job generation, in addition to ongoing operations support.
- PNG's Northeast service area continues to experience modest growth in the oil and gas sector, adding to the Company's customer base in that area. The Northeast area experienced a net gain of 479 customers in 2010.
- The proposed KSL Project, a natural gas pipeline from Summit Lake, B.C. to Kitimat, B.C. expected to serve the planned Kitimat LNG facility, is being developed by Apache Canada Ltd., EOG Resources Canada Inc. and Encana Corporation. The project is expected to bring significant economic activity to the region if it proceeds and also increase the throughput on PNG's existing pipeline.

(2) In the longer term, though the competitiveness of natural gas as a fuel and heating source remains a focus for PNG, the current natural gas price environment which is being driven by the development of shale gas plays in North America has made PNG's retail rates more competitive relative to alternative heating sources, particularly electricity. Residential and commercial electricity rates have risen according to BC Hydro's Service Plan, to more closely reflect the true cost of hydroelectricity in British Columbia, and are expected to continue to rise over time. Despite the impact of carbon tax on natural gas, and the closure of the West Fraser paper mill, PNG expects that its retail gas rates will remain relatively competitive with electricity rates.

(3) Approved ROEs had generally been trending downward over the past decade, consistent with the trend in long-term interest rates, negatively affecting earnings, cash flows and interest coverage ratios over the period. However, the increase in approved 2010 ROE and negotiated settlement agreements (CAP/ROE) were positive for the Company's credit profile.

Earnings and Outlook

CAD Millions	12 mons. Ended March 31, 2011	For the year ended December 31 2010	2009	2008	2007
Net revenues [1]	51.6	51.1	46.9	46.7	45.0
EBITDA	24.6	24.7	22.7	23.5	22.3
EBIT	16.5	15.9	14.6	14.9	14.3
Gross interest expense	6.8	6.4	5.6	7.0	6.5
Net interest expense	6.8	6.4	5.6	6.9	6.7
Pre-tax income	9.7	9.5	9.0	8.0	7.6
Net income (avail. to common)	28.0	6.7	6.2	5.6	4.0
Throughput volumes (TJ)	9,793	9,487	12,145	12,542	13,210
Approved ROE (West)	10.15%	10.15%	9.63%	9.27%	9.02%
Approved ROE (Tumbler Ridge)	10.15%	10.15%	9.63%	9.27%	9.02%
Approved ROE (Fort St. John/Dawson Creek)	9.90%	9.90%	9.38%	9.02%	8.77%
Return on average common equity	28.77%	9.00%	7.47%	7.52%	6.75%

(1) Includes amortized Methanex termination payment which ended in October 2010.

Summary

- PNG's earnings improved year-over-year mainly due to higher weighted average allowed return on deemed common equity (ROE) of 10.1%, up from 9.58% in 2009; the 5% increase in the equity component for the Western service area and the inclusion of revenue from the McNair operations.
- Net income for the 12 months ended March 31, 2011, increased significantly as a result of the $21.5 million after-tax proceeds received from the sale of the Company's interest in the Kitimat to Summit Lake Looping Project KSL project. In March 2011, PNG completed the sale of its stake in PTP and received the first cash payment of $30 million. The final cash payment of $20 million will be paid if the purchasers make a decision to proceed with the construction of the Kitimat LNG export facility in British Columbia. There is no guarantee that the final payment will be made.
- PNG's customer base remained stable in 2010 despite the closure of the West Fraser mill. However, deliveries to large industrial customers were 36% lower in 2010 than in 2009, due mainly to the closure of the West Fraser mill. West Fraser accounted for about 2.2% of PNG's total revenue. Small industrial deliveries were also lower due to reduced consumption levels among small industrial customers in the forestry sector.
- The Company's natural gas distribution business is very seasonal, with a substantial portion of its gas sales used for space heating, resulting in PNG earning more in the first and fourth quarters of the year.
- Gross interest expense increased due to higher draws on the Company's five-year revolving term facility to fund the acquisition of the 9.8 MW McNair Creek "run of river" hydroelectric generation facility.

Outlook

- PNG's EBITDA and EBIT, excluding the impact of the one-time payment, are expected to increase modestly over the near to medium term as a result of higher approved ROE in both service areas.
- DBRS expects the Company will continue to pursue expansion opportunities to increase the utilization rates on its Western system, which has the potential to increase PNG's margins. In that light, PNG has received option fees of $4.5 million from LNG Partners to secure the exclusive option under an approved transportation service agreement until the end of June 2011 to contract for firm gas transportation for two to five years, with a right to renew for three additional five-year terms. LNG Partners may extend the option period by up to two further six-month periods, with payment of $1 million for each extension.
- Furthermore, as part of the sale of the stake in PTP, PNG and the PTP buyers (Apache Canada Ltd (Apache Canada) and EOG Resources Canada Inc.) reached a 20-year transportation services agreement that would increase the utilization of PNG's currently under-utilized pipeline if the Kitimat LNG facility and PTP were to proceed (and LNG Partners does not exercise its option on this capacity). If this were to occur, it will increase the utilization capacity and reduce customer rates in PNG's Western service area, making rates more competitive. Apache Canada also agreed to engage PNG as the operator of the PTP pipeline for an initial term of seven years. Services under the agreement would commence with commercialization of the Kitimat LNG facility, which is expected to occur in 2015.

- In pursuit of its renewable energy strategy, PNG also recently formed Narrows Inlet Limited Partnership with Skookum Power Corp. to undertake an investment of up to $2.5 million to advance the Narrows Inlet Project to the start of construction. The $190 million project was awarded a 30-year energy purchase agreement with BC Hydro in spring 2010. If the Partnership elects to proceed with funding construction, approximately $20 million of equity will be required from PNG.
- DBRS expects that the Company will continue to take all prudent steps to manage and reduce its costs to remain competitive and, as such, expects earnings to remain stable.

Financial Profile

CAD Millions	12 mons. Ended March 31, 2011	For the year ended December 31 2010	2009	2008	2007
EBITDA	24.6	24.7	22.7	23.5	22.3
Net income before extras, after prefs	8.1	7.9	6.3	6.2	5.4
Depreciation & amortization	8.2	8.7	8.2	8.7	8.2
Amort. of termination payment deferral	(0.6)	(0.1)	(5.5)	(6.6)	(4.6)
Deferred income taxes	0.6	1.6	0.1	0.9	(1.0)
Other recurring non-cash adj.	0.6	0.8	(0.2)	(0.3)	0.0
Operating Cash Flow	17.0	18.8	9.0	9.0	8.0
Capital expenditures	(7.2)	(7.4)	(9.6)	(10.4)	(9.2)
Common dividends	(4.4)	(4.1)	(3.4)	(3.2)	(2.9)
Free Cash Flow Before W/C	5.4	7.3	(4.1)	(4.6)	(4.1)
Working capital changes	(1.3)	(8.2)	9.7	8.1	(9.6)
Net Free Cash Flow	4.2	(0.9)	5.6	3.5	(13.7)
Adjustment for non-recurring	26.1	(1.1)	(0.1)	(0.6)	(1.4)
Special Dividends	(11.0)	-	-	-	-
Acquisitions/Dispositions	(8.0)	(8.0)	-	-	-
Deferrals	0.1	0.2	0.0	1.1	1.2
Net debt financing	4.2	9.2	(2.9)	(4.2)	2.8
Net common equity financing	2.4	1.0	(1.7)	0.0	0.3
Net change in cash	17.9	0.4	0.9	(0.2)	(10.8)
Fixed-charges coverage (times)	2.42	2.49	2.38	2.00	2.12
EBIT interest coverage (1)	2.42	2.49	2.59	2.13	2.21
EBITDA interest coverage (1)	3.61	3.85	4.02	3.36	3.46
Cash flow / Total debt (2)	18.8%	19.6%	11.7%	11.2%	9.5%
% debt in capital structure	45.0%	50.4%	46.0%	47.4%	49.4%
Cash flow / CAPEX (2)	2.37	2.54	0.94	0.86	0.87

(1) Before capitalized interest, allowance for funds used during construction (AFUDC), and debt amortizations.
(2) Cash flows is after preferred dividends.

Summary

- PNG's cash flow from operations increased in 2010 over 2009 as a result of the increase in ROE and the West Fraser contract termination payment of $5.1 million received in December 2010. The payment is expected to be amortized into earnings over the remaining life of the agreement (which ends in 2013), similar to the treatment of the Methanex termination payment.
- The Company declared a special dividend in March 2011, which represented approximately $11 million of the net proceeds of the sale of its stake in PTP.
- Capex was 20% lower in 2010 compared with 2009, and 14% below the average level over the past five years. Most of the expenditure occurred in the Northeast service area, reflecting continued economic activity in the area.
- Although the Company's debt-to-capital ratio increased to 50% in 2010 from 46% in 2009 as a result of the hydroelectric generation acquisition, its credit metrics remain in line with the current ratings.

Outlook

- Capex for 2010 is estimated at approximately $7.4 million and will be directed primarily toward the installation of distribution mains and services in the Northeast system, as well as transmission mainline rehabilitation in the Western system. The Company is also expected to spend up to $2.5 million on its renewable energy initiatives during 2011 and part of 2012.

- DBRS expects the Company's customer base to remain stable in the near to medium term as economic activity starts to pick up in the Western system service area from projects like Rio Tinto's $2.5 billion modernization of its aluminium smelter; expansion of the container handling facility at the Port of Prince Rupert and continued growth in the Company's Northeast system service area from the oil and gas sector.
- We also expect continued regulatory support from the BCUC, as PNG seeks the regulator's approval to recover the future loss of margins from the termination of the West Fraser contract through standard rate applications to the Commission. DBRS notes that the increases being sought in gas delivery rates are not as significant as those sought under the Methanex application. PNG's customer overall rates continue to benefit from the continued low gas price environment.
- PNG's debt-to-capital ratio is expected to remain at approximately 50% over the medium term while its cash flow-to-debt and EBIT coverage metrics remain stable for the current rating. DBRS requires that PNG maintain a credit profile that is stronger than its peers, to offset its higher business risk profile.
- While PNG does not have a stated dividend policy and has increased its dividend since 2009, DBRS expects PNG to continue to manage its dividend policy in light of its capex program and business risk profile in a way that preserves its financial and credit profiles.
- The $22 million in total special dividend payments have no impact on PNG's credit ratings and was consistent with the existing capital structure. Going forward, if the second payment ($20 million) is received and a significant amount of the net proceeds is retained and reinvested in the Company, this could have a longer-term positive impact on PNG's creditworthiness. However, the extent of any credit impact will depend entirely on the amounts to be retained and how they are reinvested.

Debt and Liquidity

Long-term Secured Debt and Principal Repayment as of December 31, 2010

	Interest Rate	Amount ($MM)	Principal Repayment ($MM)	
2011 Series Debenture due Dec. 13, 2011	10.75%	5.0	**2011**	8.2
5 year Revolver due Jan. 30, 2015 (floating rate)	4.37%	16.0	**2012**	3.2
RoyNat Debentures due 2017 (floating rate)	3.69%	14.6	**2013**	3.3
2018 Series Debenture due Nov. 15, 2018	8.75%	12.8	**2014**	3.7
2025 Series Debenture due July 18, 2025	9.30%	16.5	**2015**	19.7
2027 Series Debenture due Dec. 2, 2027	6.90%	17.5	**Thereafter**	53.5
2024 CFI Debenture due Nov. 1, 2024 (non-recourse)	7.39%	9.2	**Total**	**91.6**
Total		**91.6**		

Summary of Debt

- PNG has credit facilities that include a $25 million bank operating facility, two risk management facilities each secured by the pledge of a $20 million debenture issued by the Company, and a $35 million committed five-year revolving term facility that matures on January 30, 2015. The bank operating facility has a term of 18 months and expires on May 28, 2012, of which $3.8 million was outstanding at the end of March 2011.
- The borrowing base restriction under the operating facility was removed in November 2010, such that the $25 million is available to the Company at all times subject to a requirement that borrowings be reduced to zero for 30 days each calendar year. The financial covenant under the facility requires that PNG's debt-to-capitalization ratio not exceed 65% or approximately the same level currently approved by the BCUC.
- The revolving term loan is secured by a pledge of a demand debenture of $35 million issued under a supplemental indenture to PNG's Trust Deed. It also contains a financial covenant requiring the Company's debt-to-capitalization ratio not to exceed 65% and, if the Company's secured debt rating is less than BBB (low) or the Company has no debt rating, the Company must maintain an interest coverage of 2.0 times or higher using earnings before interest and income taxes.
- PNG's long-term maturities are well spread out, with ample liquidity required to meet scheduled debt repayments. Under the revolving term facility, $16 million was outstanding at the end of March 2011.

Regulation

PNG is regulated by the BCUC, based on a cost of service/rate of return methodology. The approved 2010 ROE and common equity component for the Company's three service areas are as follows: These are expected to remain the same for 2011.

	2010
Western system	
Rate base	$133.1 mm
Common equity component	45%
Allowed return on common equity	10.15%
Fort St. John/Dawson Creek	
Rate base	$39.2 mm
Common equity component	40%
Allowed return on common equity	9.90%
Tumbler Ridge division	
Rate base	$2.2 mm
Common equity component	40%
Allowed return on common equity	10.15%

- Negotiated settlements of the Company's 2011 revenue requirements applications were reached in April 2011 between the Company and customer representatives for all divisions. The BCUC is currently reviewing the settlements and the Company expects a decision shortly.

- The regulatory environment remains quite supportive, and the uncertainty associated with rate hearings is minimized by various approved adjustment mechanisms including:
  - A forward-looking test year that is used in the rate-setting process.
  - Deferral accounts for both large industrial customers and residential/small customers with respect to variances in actual sales relative to forecast sales used in the Company's revenue requirement application.

Pacific Northern Gas Ltd.

Report Date:
June 10, 2011

Pacific Northern Gas Ltd.

Balance Sheet

($ millions)	March 31	As at December 31			March 31	As at December	
Assets	2011	2010	2009	**Liabilities and Equity**	2011	2010	2009
Cash	18.1	1.3	1.5	Payables,accr'ds,deferals	23.7	22.5	26.2
Receivables	24.9	28.8	22.8	Derivative instruments	3.1	5.7	4.3
Inventories	0.9	0.8	1.1	Short-term debt	-	4.8	2.6
Prepaid expenses	1.8	2.8	3.3	L.t. debt due 1 year	8.2	8.2	2.8
Current Assets	45.6	33.6	28.6	**Current Liabilities**	35.0	41.2	35.9
Net fixed assets	197.0	196.2	178.4	Deferreds & other	30.4	31.6	22.1
Deactivated assets	0.0	0.0	0.0	Long-term debt	82.4	82.8	71.8
Gas cost variance & rate stabilization	14.0	17.7	11.4	Preferred shares	5.0	5.0	5.0
Deferred charges and other	1.8	2.5	1.8	Shareholders' equity	105.7	89.3	85.4
Total	258.4	249.9	220.2	**Total**	258.4	249.9	220.2

	12 mons. Ended	For the year ended December 31				
Liquidity & Leverage Ratios	March 31, 2011	2010	2009	2008	2007	2006
Current ratio	1.31	0.82	0.80	0.84	0.91	0.98
Debt / EBITDA	3.69	3.88	3.40	3.40	3.76	3.15
% debt in capital structure	45.0%	50.4%	46.0%	47.4%	49.4%	49.1%
Accum. depreciation / Gross fixed assets	n/a	n/a	43.3%	42.0%	41.0%	39.7%
Cash Flow Ratios						
Cash flow / Total debt (1)	18.8%	19.6%	11.7%	11.2%	9.5%	14.8%
Cash flow / CAPEX (1)	2.37	2.54	0.94	0.86	0.87	1.50
(Cash flow - Common div) / CAPEX (1)	0.22	1.98	0.58	0.55	0.55	1.14
Coverage Ratios (2)						
EBIT interest coverage	2.42	2.49	2.59	2.13	2.21	2.61
EBITDA interest coverage	3.61	3.85	4.02	3.36	3.46	3.85
Fixed-charges coverage	2.42	2.49	2.38	2.00	2.12	2.53
Earnings Quality						
Operating margin	31.9%	31.2%	31.1%	31.8%	31.7%	36.8%
Net margin (before extras., after pfds.)	54.4%	15.4%	13.5%	13.3%	12.1%	13.9%
Return on common equity (before extras, after prefs)	28.8%	9.0%	7.5%	7.5%	6.8%	16.7%
Common dividend payout (before extras.)	55.0%	52.2%	54.5%	52.0%	53.8%	43.7%
Rate base ($ millions)		170	169	168	165	162
Regulatory						
Approved ROE (Western system)	10.15%	10.15%	9.63%	9.27%	9.02%	9.45%
Approved ROE (Tumbler Ridge)	10.15%	10.15%	9.63%	9.27%	9.02%	9.45%
Approved ROE (Fort St. John & Dawson Creek)	9.90%	9.90%	9.38%	9.02%	8.77%	9.20%
Deemed common equity (Western system)	45%	45%	40%	40%	40%	40%
Deemed common equity (Northeast system)	40%	40%	36%	36%	36%	36%

(1) Cash flows is after preferred dividends.
(2) Before capitalized interest, allowance for funds used during construction (AFUDC), and debt amortizations.

Operating Statistics

	12 mons. Ended	For years ended December 31				
Deliveries (Terajoules)	March 31, 2011	2010	2009	2008	2007	2006
Residential	3,061	2,858	3,221	3,210	3,213	3,066
Commercial	2,911	2,704	3,081	3,007	2,904	2,863
Small Industrial	2,858	2,747	3,066	3,049	3,234	3,484
Large Industrial	963	1,178	2,777	3,276	3,859	2,982
Total	9,793	9,487	12,145	12,542	13,210	12,395
Customers						
Residential	na	34163	33910	33862	34394	34,302
Commercial	na	5181	5142	5190	5121	5,156
Small Industrial	na	59	58	58	55	50
Large Industrial	na	2	3	3	3	3
Total	na	39,405	39,113	39,113	39,573	39,511

Pacific Northern Gas Ltd.

Report Date:
June 10, 2011

Rating

Debt	Rating	Rating Action	Trend
Secured Debentures	BBB (low)	Confirmed	Stable
Cumulative Redeemable Preferred Shares	Pfd-3 (low)	Confirmed	Stable

Rating History

	Current	2010	2009	2008	2007	2006
Secured Debentures	BBB (low)	BBB (low)	BBB (low)	BBB (low)	BBB (low)	BBB (low)
Cumulative Redeemable Preferred Shares	Pfd-3 (low)	Pfd-3 (low)	Pfd-3 (low)	Pfd-3 (low)	Pfd-3 (low)	Pfd-3 (low)

Note:
All figures are in Canadian dollars unless otherwise noted.

Rating Report

Report Date:
March 12, 2012

Previous Report:
June 10, 2011

DBRS
Insight beyond the rating.

Pacific Northern Gas Ltd.

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The Company

Pacific Northern Gas Ltd. (PNG) is a regulated utility involved in natural gas transportation and distribution in west-central and north-eastern British Columbia. It is a wholly owned subsidiary of AltaGas Utility Holdings (Pacific) Inc. and is indirectly owned by AltaGas. PNG serves approximately 40,000 residential, commercial and industrial customers.

Recent Actions

October 31, 2011
DBRS Places Pacific Northern Gas Under Review with Developing Implications

Rating

Debt	Rating	Rating Action	Trend
Secured Debentures	BBB (low)	Confirmed	Stable

Rating Update

DBRS has removed the Secured Debentures rating of Pacific Northern Gas Ltd. (PNG or the Company) from Under Review with Developing Implications, where it was placed on October 31, 2011, following the close of its acquisition by AltaGas (rated BBB and Pfd-3 with Stable trends) for $230 million in December 2011. At the same time, the rating has been confirmed at BBB (low) with a Stable trend.

The confirmation reflects DBRS's view that PNG will continue to maintain a conservative capital structure and financial profile, driven by its stable regulated operations and continued supportive regulatory environment in British Columbia (B.C.). PNG's debt-to-capital ratio is expected to remain at approximately 50% over the medium term (more conservative than the regulated deemed capital structure), while its cash flow-to-debt and EBIT coverage metrics remain stable for the current rating. DBRS requires that PNG maintains a credit profile that is stronger than its peers to offset its higher business risk profile in order to maintain its investment-grade ratings. Furthermore, we expect PNG to continue to manage its dividend policy in light of its business risk profile in a way that preserves its financial and credit profiles.

While economic conditions in PNG's Western system continue to show signs of growth, DBRS continues to assess the pace and magnitude of the various economic projects announced to date. If announced projects (approximately $7.5 billion) proceed as expected, significant economic activity will be experienced in PNG's service territories. In the longer term, the competitiveness of natural gas as a fuel and heating source still remains a key focus for PNG, especially in the Western service area. At present, the current natural gas price environment, which is being driven by the development of shale gas plays in North America, has made PNG's retail rates more competitive relative to alternative heating sources, particularly electricity.

PNG's liquidity remains adequate for the ratings, supported by three bank credit facilities totalling $55 million, which mature in 2012, and a $35 million five-year revolving term facility that matures in 2015.

Rating Considerations

Strengths
(1) Strong financial profile
(2) Supportive regulatory environment in B.C.
(3) Existence of regulatory accounts
(4) Strong sponsorship in AltaGas

Challenges
(1) Economic conditions in PNG's Western system
(2) Competitiveness of natural gas versus electricity
(3) Potential for lower return on equity

Financial Information

	For the year ended December 31				
CAD Millions	2011	2010	2009	2008	2007
Fixed-charges coverage (times)	1.4	2.3	2.4	2.0	2.1
% debt in capital structure	51%	50%	46%	47%	49%
Cash flow / Total debt (times)	13%	19%	12%	11%	10%
Cash flow / CAPEX (times)	1.3	2.6	0.9	0.9	0.9
Net income (adj. for non-recurring, after prefs)	6.7	7.1	6.3	6.2	5.4
Operating cash flow (adj. for non-recurring, after prefs)	12.6	17.9	9.0	9.0	8.0
Approved ROE (Western system)	10.15%	10.15%	9.63%	9.27%	9.02%
Approved ROE (Fort St. John/Dawson Creek)	9.90%	9.90%	9.38%	9.02%	8.77%
Approved ROE (Tumbler Ridge division)	10.15%	10.15%	9.63%	9.27%	9.02%

Rating Considerations Details

Strengths

(1) **Strong financial profile:** The Company's regulated operations provide earnings and cash flow stability, enabling PNG to maintain a stable financial profile.

(2) **Supportive regulatory environment in B.C.:** The regulatory environment in B.C. remains quite supportive. Currently, PNG's Western and Northeast systems have a return on equity (ROE) of 10.15% and 9.90%/10.15%, respectively. This is based on the benchmark ROE of 9.50% set by the British Columbia Utilities Commission (BCUC), which will be reviewed this year.

(3) **Existence of regulatory accounts:** The BCUC allows PNG to use deferral accounts that help smooth earnings and reduce business and operating risks. The two main deferral accounts are (a) the Gas Cost Variance Account (GCVA), which is a deferral account for variances in the cost of gas (i.e., the difference between the forecast gas cost the Company charges its customers and the actual gas cost incurred by the Company) and (b) the Rate Stabilization Adjustment Mechanism (RSAM), which is a deferral account for variances from forecast in deliveries for residential and small commercial customers. Both accounts are amortized and recovered in future rates. These deferral accounts do not affect cash flows and can artificially inflate interest coverage ratios over the short term (i.e., during periods of warmer-than-normal temperatures), but the impact is reversed as deferral balances are recovered.

(4) **Strong sponsorship:** PNG is now owned by AltaGas, which has a stronger business risk profile and is more diversified than PNG. It is expected that AltaGas would provide the necessary financial support needed to PNG.

Challenges

(1) **Economic conditions in PNG's Western system:** While economic conditions in PNG's Western system continue to show signs of growth, DBRS continues to assess the pace and magnitude of the various economic projects announced to date. These projects (listed below) are expected to drive the region's economic future. PNG's Western service area also continues to experience a slow decline in population and is one of the least-populated areas in B.C.

(2) **Competitiveness of natural gas versus electricity:** In the longer term, though the competitiveness of natural gas as a fuel and heating source remains a focus for PNG, the current natural gas price environment, which is being driven by the development of shale gas plays in North America, has made PNG's retail rates more competitive relative to alternative heating sources, particularly electricity. Residential and commercial electricity rates have risen, according to British Columbia Hydro & Power Authority's (BC Hydro) Service Plan, to more closely reflect the true cost of hydroelectricity in B.C. These electricity rates are expected to continue to rise over time. PNG continues to monitor the competitiveness of its rate on an ongoing basis and is prepared to address the situation promptly should an increase in gas prices result in non-competitive bundled gas rates.

(3) **Potential for lower return on equity**: PNG's current approved 2011 ROE remains higher than the BCUC benchmark ROE due to the Company's higher business risk profile. Though the recent 2012 revenue requirement application put forward by PNG recommends that the current ROE and deemed common equity thickness remain unchanged, the likelihood of this trending downwards is high, which could impact earnings, cash flows and interest coverage ratios.

Major Economic Projects Announced in Northwest B.C.

- Rio Tinto's USD 2.7 billion proposed modernization of its aluminum smelter in Kitimat, B.C., received board approval in December 2011 and is expected to be completed in 2014. The smelter has been a major catalyst for the economic development of northwest B.C.
- The Port of Prince Rupert continues to report high container traffic as it supports the Asia-Pacific Gateway and Corridor Initiative. The proposed Phase 2 of a new container handling facility at the Port is expected to be completed by 2014, at an estimated cost of $600 million. This is expected to quadruple the terminal's capacity and contribute to job generation, in addition to ongoing operations support.

- BC Hydro's proposed $404 million Northwest Transmission Line is expected to be completed in the spring of 2014.
- The proposed KSL Project, a natural gas pipeline from Summit Lake, B.C. to Kitimat, expected to serve the planned Kitimat liquefied natural gas (LNG) facility, is being developed by Apache Canada Ltd., EOG Resources Canada Inc. and Encana Corporation. The project is expected to bring significant economic activity to the region if it proceeds and also increase the throughput on PNG's existing pipeline.
- PNG's Northeast service area continues to experience modest growth in the oil and gas sector (development of shale gas).

Earnings and Outlook

	For the year ended December 31				
CAD Millions	2011*	2010	2009	2008	2007
Net revenues (1)	49.4	51.1	46.9	46.7	45.0
EBITDA	16.1	24.7	22.7	23.5	22.3
EBIT	10.5	15.9	14.6	14.9	14.3
Gross interest expense	7.0	6.4	5.6	7.0	6.5
Net interest expense	6.8	6.4	5.6	6.9	6.7
Pre-tax income	3.7	9.5	9.0	8.0	7.6
Net income before extraordinary items	6.7	7.1	6.3	6.2	5.4
Net income (avail. to common)	23.9	6.7	6.2	5.6	4.0
Throughput volumes (TJ)	9,408	9,487	12,145	12,542	13,210
Approved ROE (West)	10.15%	10.15%	9.63%	9.27%	9.02%
Approved ROE (Tumbler Ridge)	10.15%	10.15%	9.63%	9.27%	9.02%
Approved ROE (Fort St. John/Dawson Creek)	9.90%	9.90%	9.38%	9.02%	8.77%
Return on average common equity	7.38%	8.15%	7.47%	7.52%	6.75%

*EBITDA and EBIT includes one-time acquisition and restructuring costs. After-tax sales transaction costs were $3.7 million

(1) Includes amortized Methanex termination payment which ended in October 2010.

Summary

- PNG's net income before extraordinary items has remained relatively stable year over year due to higher weighted-average allowed ROE and a modest increase in rate base.
- Net income for 2011 increased significantly as a result of the $21.5 million after-tax proceeds received from the sale of the Company's interest in the Kitimat to Summit Lake Looping (KSL) Project. In March 2011, PNG completed the sale of its stake in Pacific Trail Pipelines (PTP) and received the first cash payment of $30 million. The final cash payment of $20 million will be paid if the purchasers make a decision to proceed with the construction of the Kitimat LNG export facility in B.C. There is no guarantee that the final payment will be made.

Outlook

- PNG's EBITDA and EBIT, excluding the impact of the one-time payment associated with the acquisition and restructuring on the sale of the Company to AltaGas, are expected to increase modestly over the near to medium term as a result of a modest increase in its rate base.
- DBRS expects that the Company will continue to pursue expansion opportunities to increase the utilization rates on its Western system, which has the potential to increase PNG's margins. In that light, PNG has received option fees of $6.5 million from LNG Partners to secure the exclusive option under an approved transportation service agreement until June 30, 2012, to contract for firm gas transportation capacity for a two- to five-year primary term, with a right to renew for three additional five-year terms..
- Furthermore, as part of the sale of the stake in PTP, PNG and the PTP buyers (Apache Canada Ltd. (Apache Canada), EOG Resources Canada Inc. and Encana Corp.) reached a 20-year transportation services agreement that would increase the utilization of PNG's currently under-utilized pipeline if the Kitimat LNG facility and PTP were to proceed (and LNG Partners does not exercise its option on this capacity). If this were to occur, it would increase the utilization capacity and reduce customer rates in PNG's Western service area, making

rates more competitive. Apache Canada also agreed to engage PNG as the operator of the PTP pipeline for an initial term of seven years. Services under the agreement would commence with commercialization of the Kitimat LNG facility, which is expected to occur in 2015. The National Energy Board (NEB) granted PTP a 20-year export license for the proposed LNG project in October 2011. This was the final major regulatory authorization needed for the project to proceed.

- In pursuit of its renewable energy strategy, PNG also recently formed Narrows Inlet Limited Partnership (the Partnership) with Skookum Power Corp. to undertake an investment of up to $2.5 million to advance the Narrows Inlet Project to the start of construction. The $190 million project was awarded a 30-year energy purchase agreement with BC Hydro in the spring of 2010. If the Partnership elects to proceed with funding construction, approximately $20 million of equity will be required from PNG. PNG has only invested $2.4 million to date. DBRS believes PNG's new owner, AltaGas, has the financial capacity to provide the equity required if it decides to go ahead with the project.
- DBRS expects that the Company will continue to take all prudent steps to manage and reduce its costs to remain competitive and, as such, expects earnings to remain stable.

Financial Profile

	For the year ended December 31				
CAD Millions	2011	2010	2009	2008	2007
EBITDA	16.1	24.7	22.7	23.5	22.3
Net income before extras, after prefs	6.7	7.1	6.3	6.2	5.4
Depreciation & amortization	5.6	8.8	8.2	8.7	8.2
Amort. of termination payment deferral	(1.7)	(0.1)	(5.5)	(6.6)	(4.6)
Deferred income taxes	0.8	1.5	0.1	0.9	(1.0)
Other recurring non-cash adj.	1.2	0.7	(0.2)	(0.3)	0.0
Operating Cash Flow	12.6	17.9	9.0	9.0	8.0
Capital expenditures	(9.7)	(6.9)	(9.6)	(10.4)	(9.2)
Common dividends	(4.5)	(4.1)	(3.4)	(3.2)	(2.9)
Free Cash Flow Before W/C	(1.6)	6.9	(4.1)	(4.6)	(4.1)
Working capital changes	2.0	(8.2)	9.7	8.1	(9.6)
Net Free Cash Flow	0.4	(1.3)	5.6	3.5	(13.7)
Adjustment for non-recurring	20.9	(0.4)	(0.1)	(0.6)	(1.4)
Special Dividends	(22.6)	-	-	-	-
Acquisitions/Dispositions	-	(8.0)	-	-	-
Deferrals	(0.4)	0.2	0.0	1.1	1.2
Net debt financing	2.2	9.2	(2.9)	(4.2)	2.8
Net common equity financing	(0.2)	0.9	(1.7)	0.0	0.3
Net change in cash	0.3	0.5	0.9	(0.2)	(10.8)
Fixed-charges coverage (times)	1.44	2.32	2.38	2.00	2.12
EBIT interest coverage (1)	1.51	2.49	2.59	2.13	2.21
EBITDA interest coverage (1)	2.32	3.85	4.02	3.36	3.46
Cash flow / Total debt (2)	12.9%	18.7%	11.7%	11.2%	9.5%
% debt in capital structure	50.5%	50.4%	46.0%	47.4%	49.4%
Cash flow / CAPEX (2)	1.30	2.59	0.94	0.86	0.87

(1) Before capitalized interest, allowance for funds used during construction (AFUDC), and debt amortizations.
(2) Cash flows is after preferred dividends.

Summary

- Though PNG's cash flow from operations remained strong for 2011, it remained insufficient to cover capex and regular dividend payments. Cash flow from operations was lower in 2011 compared to 2010 as a result of the lower cost of service in 2011 as a result of lower depreciation expense and lower electricity sales.

- The Company declared two special dividends in 2011, which represented approximately $22.6 million of the net proceeds of the sale of its stake in PTP. While PNG does not have a stated dividend policy and has increased its dividend steadily since 2009, DBRS expects PNG to continue to manage its dividend policy in light of its capex program and business risk profile in a way that preserves its financial and credit profiles.
- Capex has remained relatively stable at approximately $9 million over the past five years
- The Company's credit ratios remain in line with its business risk profile and assigned rating category.

Outlook

DBRS expects the Company's customer base to remain stable in the near to medium term as economic activity starts to pick up in the Western system service area from projects such as Rio Tinto's $2.7 billion modernization of its aluminum smelter, expansion of the container handling facility at the Port of Prince Rupert and continued growth in the Company's Northeast system service area from the oil and gas sector.

- According to the Company's 2012 revenue requirement application, capex for 2012 is estimated at approximately $8.4 million for both the Western and Northeast systems, which are expected to be funded with cash flow from operations and draws on its debt facilities.
- PNG's debt-to-capital ratio is expected to remain at approximately 50% over the medium term, while its cash flow-to-debt and EBIT coverage metrics remain stable for the current rating. DBRS requires that PNG maintain a credit profile that is stronger than its peers to offset its higher business risk profile.

Debt and Liquidity

Long-term Secured Debt and Principal Repayment as of December 31, 2011

	Interest Rate	Amount ($MM)	Principal Repayment ($MM)	
5 year Revolver due Jan. 30, 2015 (floating rate)	4.37%	20.0	**2012**	3.2
RoyNat Debentures due 2017 (floating rate)	3.69%	13.4	**2013**	3.3
2018 Series Debenture due Nov. 15, 2018	8.75%	12.2	**2014**	3.7
2025 Series Debenture due July 18, 2025	9.30%	16.0	**2015**	23.7
2027 Series Debenture due Dec. 2, 2027	6.90%	17.0	**2016**	3.8
2024 CFI Debenture due Nov. 1, 2024 (limited recourse)	7.39%	8.8	**Thereafter**	49.7
Total		**87.4**	**Total**	**87.4**

Summary of Debt

- DBRS believes that PNG has ample liquidity to meet its financial obligations as they come due.
- PNG repaid the $5 million 10.75% 2011 Series Debenture due December 13, 2011, by utilizing its revolving term facility.
- PNG has credit facilities that include a $25 million bank operating facility, two risk management facilities each secured by the pledge of a $20 million debenture issued by the Company that matures on July 21, 2012, and a $35 million committed five-year revolving term facility that matures on January 30, 2015. The five-year revolver had $20 million outstanding at the end of December 2011.
- The bank operating facility, of which $11 million was outstanding at the end of 2011, has a term of 18 months and expires on May 28, 2012.
- The financial covenant under the operating facility requires that PNG's debt-to-capitalization ratio not exceed 65%, or approximately the same level currently approved by the BCUC, and that borrowings be reduced to zero for 30 days each calendar year.
- The revolving term loan is secured by a pledge of a demand debenture of $35 million issued under a supplemental indenture to PNG's Trust Deed. It also contains a financial covenant requiring that the Company's debt-to-capitalization ratio not exceed 65% and, if the Company's secured debt rating is less than BBB (low) or the Company has no debt rating, the Company must maintain an interest coverage of 2.0 times or higher using earnings before interest and income taxes. One risk management facility has an additional covenant which requires the Company to maintain minimum interest coverage of 1.5 times.
- PNG redeemed all of its outstanding 6.75% Cumulative Redeemable Preferred Shares on February 27, 2012, for an aggregate redemption price equal to $5.25 million.

Regulation

PNG is regulated by the BCUC, based on a cost of service/rate of return methodology. The approved 2011 ROE and common equity component for the Company's three service areas are as follows:

	2011
Western system	
Rate base (mid-year)	$130.8 mm
Common equity component	45%
Allowed return on common equity	10.15%
Fort St. John/Dawson Creek	
Rate base (mid-year)	$41.1 mm
Common equity component	40%
Allowed return on common equity	9.90%
Tumbler Ridge division	
Rate base (mid-year)	$2.3 mm
Common equity component	40%
Allowed return on common equity	10.15%

Source: 2012 Revenue Requirement Application to the BCUC

- In November 2011, PNG submitted its 2012 revenue requirement application to the BCUC seeking a modest increase in its rates effective January 1, 2012. The BCUC is currently reviewing the application. Negotiated settlements of the Company's 2011 revenue requirement applications were reached in April 2011 between the Company and customer representatives for all divisions.
- PNG is requesting that the capital structure and ROE for its Western and Northeast systems remain unchanged from 2011. Deferral accounts for both large industrial customers and residential/small customers with respect to variances in actual sales relative to forecast sales are expected to remain unchanged.
- The BCUC intends to conduct a Generic Cost of Capital Proceeding with the intention of reviewing the following:
  - The appropriate cost of capital for a benchmark low-risk utility.
  - Establishing a return on equity automatic adjustment mechanism.
  - Establishing a deemed capital structure and deemed cost of capital methodology, particularly for those utilities without third-party debt.
- The Commission stated that, since the issuance of the 2009 Capital Structure Decision, changes have occurred in the financial markets and, as such, a review is now appropriate.
- Though DBRS continues to view the regulatory environment as supportive, the review could have an impact on PNG's future earnings and cash flow.

Pacific Northern Gas Ltd.

Report Date:
March 12, 2012

Pacific Northern Gas Ltd.

Balance Sheet
($ millions)

Assets	As at December 31 2011	2010	2009
Cash	1.5	1.3	1.5
Receivables	24.4	28.8	22.8
Inventories	0.9	0.8	1.1
Prepaid expenses	1.4	2.8	3.3
Current Assets	28.3	33.6	28.6
Net fixed assets	200.4	196.2	178.4
Deactivated assets	0.0	0.0	0.0
Gas cost variance & rate stabilization	16.4	17.7	11.4
Deferred charges and other	1.8	2.5	1.8
Total	246.9	249.9	220.2

Liabilities and Equity	As at December 31 2011	2010	2009
Payables,accr'ds,deferals	22.7	22.5	26.2
Derivative instruments	4.7	5.7	4.3
Short-term debt	11.3	4.8	2.6
L.t. debt due 1 year	3.2	8.2	2.8
Current Liabilities	41.9	41.2	35.9
Deferreds & other	30.3	31.6	22.1
Long-term debt	83.6	82.8	71.8
Preferred shares	-	5.0	5.0
Shareholders' equity	91.1	89.3	85.4
Total	246.9	249.9	220.2

	For the year ended December 31 2011	2010	2009	2008	2007	2006
Liquidity & Leverage Ratios						
Current ratio	0.68	0.82	0.80	0.84	0.91	0.98
Debt / EBITDA	6.09	3.88	3.40	3.40	3.76	3.15
% debt in capital structure	50.5%	50.4%	46.0%	47.4%	49.4%	49.1%
Accum. depreciation / Gross fixed assets	n/a	n/a	43.3%	42.0%	41.0%	39.7%
Cash Flow Ratios						
Cash flow / Total debt (1)	12.9%	18.7%	11.7%	11.2%	9.5%	14.8%
Cash flow / CAPEX (1)	1.30	2.59	0.94	0.86	0.87	1.50
(Cash flow - Common div) / CAPEX (1)	0.83	1.99	0.58	0.55	0.55	1.14
Coverage Ratios (2)						
EBIT interest coverage	1.51	2.49	2.59	2.13	2.21	2.61
EBITDA interest coverage	2.32	3.85	4.02	3.36	3.46	3.85
Fixed-charges coverage	1.44	2.32	2.38	2.00	2.12	2.53
Earnings Quality						
Operating margin	21.3%	31.2%	31.1%	31.8%	31.7%	36.8%
Net margin (before extras., after pfds.)	6.0%	14.0%	13.5%	13.3%	12.1%	13.9%
Return on common equity (before extras, after prefs)	7.4%	8.2%	7.5%	7.5%	6.8%	16.7%
Common dividend payout (before extras.)	151.7%	57.7%	54.5%	52.0%	53.8%	43.7%
Rate base ($ millions)	170	170	169	168	165	162
Regulatory						
Approved ROE (Western system)	10.15%	10.15%	9.63%	9.27%	9.02%	9.45%
Approved ROE (Tumbler Ridge)	10.15%	10.15%	9.63%	9.27%	9.02%	9.45%
Approved ROE (Fort St. John & Dawson Creek)	9.90%	9.90%	9.38%	9.02%	8.77%	9.20%
Deemed common equity (Western system)	45%	45%	40%	40%	40%	40%
Deemed common equity (Northeast system)	40%	40%	36%	36%	36%	36%

(1) Cash flows is after preferred dividends.
(2) Before capitalized interest, allowance for funds used during construction (AFUDC), and debt amortizations.

Operating Statistics

	For the years ended December 31 2011	2010	2009	2008	2007	2006
Deliveries (Terajoules)						
Residential	2,933	2,858	3,221	3,210	3,213	3,066
Commercial	2,802	2,704	3,081	3,007	2,904	2,863
Small Industrial	2,847	2,747	3,066	3,049	3,234	3,484
Large Industrial	826	1,178	2,777	3,276	3,859	2,982
Total	9,408	9,487	12,145	12,542	13,210	12,395
Customers						
Residential	34302	34163	33910	33862	34394	34,302
Commercial	5208	5181	5142	5190	5121	5,156
Small Industrial	63	59	58	58	55	50
Large Industrial	2	2	3	3	3	3
Total	39,575	39,405	39,113	39,113	39,573	39,511

Pacific Northern Gas Ltd.

Report Date:
March 12, 2012

Rating

Debt	Rating	Rating Action	Trend
Secured Debentures	BBB (low)	Confirmed	Stable

Rating History

	Current	2011	2010	2009	2008	2007
Secured Debentures	BBB (low)	BBB (low)	BBB (low)	BBB (low)	BBB (low)	BBB (low)
Cumulative Redeemable Preferred Shares	N/A	Pfd-3 (low)	Pfd-3 (low)	Pfd-3 (low)	Pfd-3 (low)	Pfd-3 (low)

Related Research

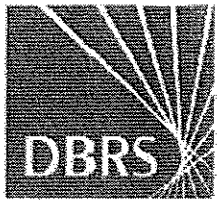
- DBRS Places Pacific Northern Gas Under Review with Developing Implications Following AltaGas's Announcement, October 31, 2011.

Note:
All figures are in Canadian dollars unless otherwise noted.

APPENDIX 3

BOND RATING REPORTS – ALTAGAS (parent)

Press Releases



Insight beyond the rating.

Date of Release: October 31, 2011

DBRS Confirms AltaGas at BBB and Pfd-3, Trends Stable

October 31, 2011

DBRS has today confirmed the ratings on the Medium-Term Notes (MTNs) and Preferred Shares - Cumulative of AltaGas Ltd. (AltaGas or the Company) at BBB and Pfd-3, respectively, both with Stable trends.

The rating actions follow the announcement today that AltaGas has offered to acquire all of the issued and outstanding shares of Pacific Northern Gas Ltd. (PNG; rated BBB (low) and Pfd-3 (low)) and that both parties have executed an Acquisition Agreement. The takeover offer of $36.75 per PNG share represents a 20% premium over the closing price of $30.50 per share on October 28, 2011. The proposed purchase price of approximately $230 million, including assumed debt of approximately $85 million and preferred shares of $5 million, represents approximately 1.2 times the regulated rate base of $174 million. The regulated assets earn an allowed rate of return of approximately 10.1% with a weighted average equity thickness of approximately 44%. The transaction value equates to approximately 9.6 times PNG's EBITDA, which is reasonable. AltaGas expects the acquisition to be immediately accretive to earnings and cash flow. Closing is expected on or about December 16, 2011, subject to regulatory and PNG shareholder approvals.

DBRS expects the impact of the proposed acquisition on AltaGas's credit profile to be slightly positive. DBRS believes that the PNG acquisition would modestly improve AltaGas's business-risk profile through the addition of relatively low-risk, regulated natural gas distribution assets in British Columbia, increasing the combined rate base of its Utilities operations by more than 50% to more than $500 million. It would also increase the Company's relative exposure to regulated natural gas distribution in its Utilities segment (from 14% to 20% of segment EBITDA pro forma the acquisition for the 12 months ending September 30, 2011).

Conversely, DBRS expects moderate deterioration in the Company's credit metrics as a result of the acquisition funding through existing credit facilities (plus assumed PNG debt). DBRS estimates that the Company's total debt-to-capital ratio would rise from 47% to 52% and its cash flow-to-debt ratio would fall from 20% to 17% pro forma the acquisition as at September 30, 2011. As noted previously (see the DBRS press release dated October 4, 2011), DBRS expects

some deterioration in the Company's key credit metrics during its 2011 to 2014 growth phase, with recovery toward the end of the period as expected cash shortfalls are to be primarily funded by debt. DBRS expects AltaGas to manage the construction period risks (e.g., cost overruns, completion delays, large financing requirements and potential deterioration of credit metrics) for all of its projects and for the PNG acquisition within the context of its current BBB rating, with total debt-to-capital in the low 50% target range and adequate cash flow to support its increasing debt load. DBRS views the PNG acquisition as a component of the Company's growth phase, which is expected to grow and diversify earnings and cash flow while reducing its relative business risk.

Note:
All figures are in Canadian dollars unless otherwise noted.

The applicable methodology is Rating North American Pipeline and Diversified Energy Companies, which can be found on our website under Methodologies.

For more information on this credit or on this industry, visit www.dbrs.com or contact us at info@dbrs.com.

Ratings

Issuer	Debt Rated	Rating Action	Rating	Trend	Notes	Published	Issued
AltaGas Ltd.	Medium-Term Notes	Confirmed	BBB	Stb		Oct 31, 2011	CA
AltaGas Ltd.	Preferred Shares - Cumulative	Confirmed	Pfd-3	Stb		Oct 31, 2011	CA

US = USA Issued, NRSRO
CA = Canada Issued, NRSRO
EU = EU Issued
E = EU Endorsed

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Research

1. Fracking Our Way to Independence: The (North) American Dream
2. DBRS: Moving Toward a Tipping Point for Spain
3. DBRS Confirms Germany at AAA with a Stable Trend
4. DBRS Confirms Government of Canada at AAA and R-1 (high)
5. DBRS Publishes Canadian Real Estate Study, Q1 2012

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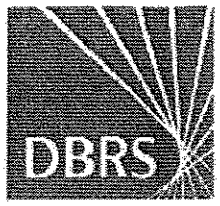

Insight beyond the rating.

Date of Release: February 1, 2012

DBRS Confirms AltaGas at BBB and Pfd-3, Trends Stable

February 1, 2012

DBRS has today confirmed the ratings on the Medium-Term Notes (MTNs) and Preferred Shares - Cumulative of AltaGas Ltd. (AltaGas or the Company) at BBB and Pfd-3, respectively, both with Stable trends.

The rating actions follow the announcement that AltaGas has agreed to acquire SEMCO Holding Corporation (SEMCO). SEMCO is the sole shareholder of SEMCO Energy, Inc., a regulated public utility company with natural gas distribution and storage operations in Michigan and Alaska. The proposed purchase price of approximately US$1.135 billion, including assumed debt of approximately US$355 million, represents about 1.5 times the combined regulated rate base of US$725 million. The transaction value equates to approximately 8.7 times SEMCO's expected EBITDA of approximately US$130 million in the first full year of ownership in 2013, which is reasonable. AltaGas expects the acquisition to be immediately accretive to earnings and cash flow per share by more than 10%. Approximately 99% of SEMCO's revenues are derived from regulated operations, with the balance from unregulated storage assets. SEMCO has no direct natural gas cost exposure due to pass-through mechanisms at both SEMCO natural gas distribution utilities. The transaction is subject to customary approvals, including regulatory approvals, and is expected to close in Q3 2012.

SEMCO's Michigan operations, which are regulated by the Michigan Public Service Commission (MPSC), are composed of: (1) a regulated natural gas distribution utility with approximately 286,000 customers, a rate base of approximately US$425 million, a prescribed 50% equity thickness and an allowed return on equity (ROE) of 10.35%; (2) five regulated underground storage facilities, with 4.9 billion cubic feet (bcf) of total capacity; and (3) a 50% interest in a 12.8 bcf non-regulated storage facility.

SEMCO's Alaska operations, which are regulated by the Regulatory Commission of Alaska (RCA), are composed of: (1) a natural gas distribution utility (ENSTAR Natural Gas Company), with approximately 132,000 customers, a rate base of approximately US$200 million, a prescribed 51.4% equity thickness and an allowed ROE of 12.55% and (2) a 65% interest in a natural gas storage utility (Cook Inlet Natural Gas Storage Alaska (CINGSA)) that is

constructing a natural gas storage facility that is expected to have an initial total capacity of 11 bcf upon being placed into service in Q2 2012, with potential future expansion to 18 bcf of storage capacity. CINGSA will earn a regulated ROE of 12.55% on a prescribed 50% equity thickness upon construction completion. SEMCO's share of CINGSA's rate base is approximately US$100 million.

AltaGas plans to initially finance the US$780 million cash portion of the transaction with $350 million in equity ($403 million if the 15% over-allotment option is exercised in full) through a subscription receipt bought deal offering, with the balance funded by debt financing through a combination of draws on a new one-year US$300 million unsecured credit facility (which ranks equally with all of AltaGas's other unsecured and unsubordinated indebtedness) and the existing revolving credit facilities of AltaGas. The Company intends to refinance any draws on its credit facilities through future debt and preferred share financings and is committed to maintaining its investment-grade credit rating.

DBRS expects the overall impact of the proposed acquisition on AltaGas's credit profile to be modestly positive. DBRS believes that the SEMCO acquisition would improve AltaGas's business risk profile through the addition of relatively low-risk, regulated natural gas distribution and storage assets in Michigan and Alaska, more than doubling the combined rate base of its Utilities segment operations to more than $1.2 billion. DBRS estimates that, combined with the December 20, 2011, acquisition of Pacific Northern Gas Ltd. (PNG), the Company's relative exposure to low-risk regulated natural gas distribution and storage operations in its Utilities segment would increase from 14% to 43% of segment EBITDA on a pro forma basis for the 12 months ending September 30, 2011. On the same basis, DBRS estimates that the Company's EBITDA contributions from its Gas and Power segments would decline from 52% and 34%, respectively, to 35% and 22%, respectively, resulting in a more-diversified and lower-risk asset portfolio. AltaGas estimates that, in 2013, two-thirds of its consolidated annualized EBITDA is expected to come from regulated or long-term contracted assets. DBRS expects the EBITDA mix to become more equally weighted over time as the Company completes various projects included in its long-term capital plans (see below).

DBRS expects a negative impact on the Company's key credit metrics as a result of the acquisition funding through existing and new credit facilities (plus assumed SEMCO debt), partly offset by the subscription receipt offering on a bought deal basis. DBRS estimates that, combined with the impact of the $144 million common share offering completed on November 15, 2011, and the December 20, 2011, PNG acquisition, the Company's total debt-to-capital ratio would rise from 47% to 54% and its cash flow-to-debt ratio would decline from 20% to 16% on a pro forma basis as at September 30, 2011.

As noted previously (see press releases dated October 4, 2011, and October 31, 2011), DBRS expects some deterioration in the Company's key credit metrics during its 2011 to 2014 growth phase, with recovery toward the end of the period as expected cash shortfalls are to be primarily funded by debt. DBRS expects AltaGas to manage the construction period risks (e.g., cost overruns, completion delays, large financing requirements and potential deterioration of credit

metrics) for all of its projects, and the PNG and SEMCO acquisitions, within the context of its current BBB rating and total debt-to-capital ratio in the low-50% target range, with cash flow-to -debt in the high-teens to low-20% range, as calculated by DBRS. If the Company's ratios do not move closer to the above-noted ranges (from the pro forma levels) over the near to medium term, its credit ratings could come under negative pressure.

DBRS views the PNG and SEMCO acquisitions as significant components of the Company's above-noted growth phase, which is expected to grow and diversify earnings and cash flow while reducing its relative business risk.

Note:
All figures are in Canadian dollars unless otherwise noted.

The applicable methodologies are Rating North American Pipeline and Diversified Energy Companies and Rating Companies in the North American Energy Utilities (Electric and Natural Gas) Industry, which can be found on our website under Methodologies.

For more information on this credit or on this industry, visit www.dbrs.com or contact us at info@dbrs.com.

Ratings

Issuer	Debt Rated	Rating Action	Rating	Trend	Notes	Published	Issued
AltaGas Ltd.	Medium-Term Notes	Confirmed	BBB	Stb		Feb 1, 2012	CA
AltaGas Ltd.	Preferred Shares - Cumulative	Confirmed	Pfd-3	Stb		Feb 1, 2012	CA

US = USA Issued, NRSRO
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1. Fracking Our Way to Independence: The (North) American Dream
2. DBRS: Moving Toward a Tipping Point for Spain
3. DBRS Confirms Germany at AAA with a Stable Trend
4. DBRS Confirms Government of Canada at AAA and R-1 (high)
5. DBRS Publishes Canadian Real Estate Study, Q1 2012

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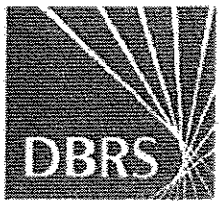
DBRS is a globally recognized provider of timely credit rating opinions that offer insight and transparency across a broad range of financial institutions, corporate entities, government bodies and various structured finance product groups.

Press Releases; New Issues



Insight beyond the rating.

Date of Release: April 11, 2012

DBRS Rates AltaGas Ltd.'s New Issue at BBB, Stable Trend

April 11, 2012

DBRS has today assigned a rating of BBB with a Stable trend to the $200 million 4.07% senior unsecured medium-term notes issue of AltaGas Ltd. maturing on June 1, 2020. The issue is expected to settle on April 13, 2012.

Net proceeds from the sale of the above-noted securities will be used for repayment of outstanding bank indebtedness and for general corporate purposes.

Notes:
All figures are in Canadian dollars unless otherwise noted.

The applicable methodology is Rating North American Pipeline and Diversified Energy Companies, which can be found on the DBRS website under Methodologies.

For more information on this credit or on this industry, visit www.dbrs.com or contact us at info@dbrs.com.

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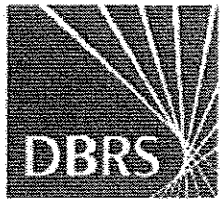

Insight beyond the rating.

Date of Release: May 31, 2012

DBRS Assigns Rating of Pfd-3 to AltaGas Ltd.'s Preferred Share Issue

May 31, 2012

DBRS has today assigned a rating of Pfd-3 with a Stable trend to AltaGas Ltd.'s (AltaGas or the Company) USD 200 million Cumulative Redeemable Five-Year Rate Reset Preferred Shares, Series C (Series C Preferred Shares), with a dividend rate of 4.40% per annum, payable quarterly for the initial fixed-rate period ending September 30, 2017. The dividend rate will reset on September 30, 2017, and every five years thereafter at a rate equal to the sum of the then five -year United States Government bond yield plus 3.58%. The Series C Preferred Shares are redeemable by AltaGas on September 30, 2017, and on September 30 every five years thereafter.

Holders of the Series C Preferred Shares will have the right, at their option, to convert their shares into cumulative redeemable preferred shares, Series D (Series D Preferred Shares), subject to certain conditions, on September 30, 2017, and on September 30 every five years thereafter. Holders of the Series D Preferred Shares will be entitled to receive cumulative quarterly dividends at a rate equal to the sum of the then three-month United States Treasury Bill rate plus 3.58%.

The Series C Preferred Shares are being issued under the Prospectus Supplement dated May 30, 2012, to the Short Form Base Shelf Prospectus dated December 7, 2012, and are expected to settle on or about June 6, 2012. The Series C Preferred Shares will rank equally with the Company's currently outstanding Cumulative Redeemable Five-Year Rate Reset Preferred Shares, Series A, and with any future preferred shares of the Company. Net proceeds from the offering will be used for repayment of outstanding bank indebtedness and for general corporate purposes.

Note:
The applicable methodology is Rating North American Pipeline and Diversified Energy Companies, which can be found on our website under Methodologies.

For more information on this credit or on this industry, visit www.dbrs.com or contact us at info@dbrs.com.

Contacts

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DBRS is a globally recognized provider of timely credit rating opinions that offer insight and transparency across a broad range of financial institutions, corporate entities, government bodies and various structured finance product groups.

Bulletin:

Announced Purchase Of Pacific Northern Gas Ltd. Credit Neutral For AltaGas Ltd.

Primary Credit Analyst:
Nicole Martin, Toronto (1) 416-507-2560; nicole_martin@standardandpoors.com

Secondary Contact:
Gavin MacFarlane, Toronto (1) 416-507-2545; gavin_macfarlane@standardandpoors.com

TORONTO (Standard & Poor's) Oct. 31, 2011--Standard & Poor's Ratings Services today said that it does not expect the announced acquisition of Pacific Northern Gas Ltd. (PNG; not rated) to affect the ratings on AltaGas Ltd. (BBB/Stable/--), or its approximately C$1.175 billion rated unsecured debt and C$200 million of preferred shares. The approximately C$230 million share purchase will include the assumption of about C$90 million in PNG debt. We expect that at the deal's close, about C$67 million in amortizing long-term secured debt at PNG will have priority over its assets, ahead of AltaGas' unsecured lenders. Although AltaGas will fund the cash purchase with existing credit facilities, we expect the company to refinance with long-term debt and equity, in keeping with its capital structure. We believe that regulation will support a strong-to-excellent business risk profile for the subsidiary's cash flow to AltaGas, but the transaction's small size is not sufficient to move the company's satisfactory business risk profile on its own.

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February 7, 2012

Research Update:

AltaGas Ltd. 'BBB' Ratings Affirmed Following Acquisition Of SEMCO Holding Corp; Outlook Stable

Primary Credit Analyst:
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Research Update:

AltaGas Ltd. 'BBB' Ratings Affirmed Following Acquisition Of SEMCO Holding Corp; Outlook Stable

Overview

- AltaGas Ltd. has announced it is acquiring SEMCO Holding Corp., the sole shareholder of SEMCO Holding Corp. from Continental Energy Systems LLC for about C$1.1 billion.
- We are affirming our ratings, including our 'BBB' long-term corporate credit rating, on AltaGas.
- In our view, SEMCO has an excellent business risk profile and a highly leveraged financial risk profile.
- We have revised AltaGas' business risk profile to strong from satisfactory and financial risk profile to significant from aggressive, assuming the transaction closes as expected.
- The stable outlook reflects our assessment of the company's business mix, which is increasingly diverse with a greater contribution from fee-based and regulated utility cash flows.

Rating Action

On Feb. 7, 2012, Standard & Poor's Ratings Services affirmed its ratings, including its 'BBB' long-term corporate credit rating, on Calgary, Alta.-based AltaGas Ltd. The outlook is stable.

The affirmation comes after the company announced the acquisition of SEMCO Holding Corp. (which owns SEMCO Energy Inc.) from Continental Energy Systems LLC for about C$1.1 billion. SEMCO owns regulated natural gas transmission assets in Michigan and Alaska, and is building a regulated natural gas storage facility in Alaska.

Rationale

We view the announced transaction as a positive for AltaGas' business risk profile, since the regulated utility business will diversify and improve the stability of the company's existing asset base. As a result, we have revised our business risk profile on AltaGas to strong from satisfactory and the financial risk profile to significant from aggressive. The company is financing the transaction consistent with its cash flow characteristics and existing capital structure, and we believe the cash flows' stable nature help to support the pro forma balance sheet. In our view, SEMCO has an excellent business risk profile and a highly leveraged financial risk profile. The highly leveraged financial risk profile stems from the consolidation of

Continental Energy Systems, which has debt and other subsidiary assets not being acquired.

Pro forma the transaction, we estimate that the proportion of EBITDA from direct commodity sales (fractionation margin and power generation) will be about 24%, down from 2010's 38%. We view this shift to be positive for credit.

However, we view AltaGas' balance sheet to be stretched, largely due to the continued high capex on long-term projects that will depress 2012 and 2013 financial metrics. The company has a combined capital spending program of more than C$1 billion on projects that we expect will contribute only partway into 2012 or future years. We recognize that more stable cash flows can support a higher degree of leverage.

We view the financial metrics overall as weak for the ratings, but do see improvements into next year as projects such as the Gordondale processing facility in the gas segment contribute to a full year's operating results. We forecast more significant improvements with the contribution of Forest Kerr in 2014; however, we note there remains approximately 10% of the project's C$725 million cost to be fixed. If the project timing slips, there would be a delay in the movement to a more appropriate financial profile for the ratings.

Liquidity

We view AltaGas's liquidity as adequate for the next six months, with sources less uses of C$239 million and sources covering uses 2.4x. We also believe liquidity is adequate for the next 12 months if we take into account the company's C$200 million accordion facility. AltaGas has put a C$300 million, 12-month revolver in place to provide liquidity for the transaction; however, due to the short duration, we exclude it from our calculations.

We believe that the company has good access to the capital markets, as evidenced by the announced C$350 million subscription receipt deal to partially finance the cash portion of the transaction.

Outlook

The stable outlook reflects our assessment of AltaGas' business mix, which is increasingly diverse with a greater contribution from fee-based and regulated utility cash flows. In our view, the near-term financial metrics are low for the ratings, although we recognize the cash flows are increasingly sustainable and predictable. We expect to see funds from operations-to-debt increase to the 13% range by 2014. We could take a negative rating action if the company's financial metrics do not improve as expected, or if capital projects and acquisitions are not executed and integrated on time. We also expect to see further capital projects and acquisitions financed in line with AltaGas' stated capital structure goals. We could raise the ratings as the business risk profile transitions to a lower level of commodity exposure and forecast financial ratios improve when long-term projects begin to contribute.

Related Criteria And Research

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Sept. 28, 2011
- Criteria Methodology: Business Risk/Financial Risk Matrix Expanded, May 27, 2009
- Rating Criteria for U.S. Midstream Energy Companies, Dec. 18, 2008
- 2008 Corporate Criteria: Analytical Methodology, April 15, 2008

Ratings List

Ratings Affirmed

AltaGas Ltd.	
Corporate credit rating	BBB/Stable/--
Senior unsecured debt	BBB
Preferred stock	
Global scale	BB+
Canada scale	P-3(High)

Complete ratings information is available to subscribers of RatingsDirect on the Global Credit Portal at www.globalcreditportal.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column.

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February 29, 2012

AltaGas Ltd.

Primary Credit Analyst:
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AltaGas Ltd.

Major Rating Factors

Corporate Credit Rating
BBB/Stable/--

Strengths:

- Cash flow stability from highly diversified asset base with regulated utility, power generation, and gas processing
- The SEMCO Energy Inc. acquisition, which materially increases regulated rate base and utility cash flow
- Solid portfolio of growth projects that will contribute materially to cash flow in coming years

Weaknesses:

- High capital expenditures on long-term growth projects, constraining financial metrics
- Construction and timing risk on the Forest Kerr hydro project

Rationale

The ratings on Calgary, Alta.-based AltaGas Inc. reflect Standard & Poor's Ratings Services' view of the company's diverse asset base that provides increasing levels of cash flow stability; and the SEMCO Energy Inc. (BBB-/Watch Pos/--) acquisition, which adds materially to the regulated rate base and diversifies away from commodity-based power generation and natural gas liquids extraction. In addition, we believe the company has a large portfolio of projects that will increase near-term cash flow during the next two years.

Offsetting these strengths, in our opinion, is the high capital expenditures required to bring the growth projects onstream. The expenditures are depressing financial metrics, and reduces the financial flexibility of AltaGas to withstand variations in its cash flows. Additionally, while partially mitigated by a high degree of costs that have been fixed, construction and timing risk on the Forest Kerr hydro project remain.

We view the announced transaction as a positive for AltaGas' business risk profile, since the regulated utility business will diversify and improve the stability of the company's existing asset base. As a result, we have revised our business risk profile on AltaGas to strong from satisfactory and the financial risk profile to significant from aggressive. The company is financing the SEMCO transaction consistent with its cash flow characteristics and existing capital structure, and we believe the cash flows' stable nature help to support the pro forma balance sheet. In our view, SEMCO has an excellent business risk profile and a highly leveraged financial risk profile. The highly leveraged financial risk profile stems from the consolidation of Continental Energy Systems LLC, which has debt and other subsidiary assets not being acquired.

Pro forma the SEMCO transaction, we estimate that the proportion of EBITDA from direct commodity sales (fractionation margin and power generation) to be 24%, down from 2010's 38%. We view this shift to be positive for credit.

However, we view AltaGas' balance sheet to be stretched, largely due to the continued high capex on long-term projects that will depress 2012 and 2013 financial metrics. The company has a combined capital spending program of more than C$1 billion on projects that we expect will contribute only partway into 2012 or beyond. We

recognize that more stable cash flows can support a higher degree of leverage.

We view the financial metrics overall as weak, but do expect improvements into next year as projects such as the Gordondale processing facility in the gas segment contribute to a full year's operating results. We forecast more significant improvements with the contribution of Forest Kerr in 2014; however, we note there remains approximately 10% of the project's C$725 million cost to be fixed. If the project timing slips, there would be a delay in the movement to a more appropriate financial risk profile for the ratings.

Liquidity

We view AltaGas' liquidity as adequate for the next six months, with sources minus uses of C$239 million and sources covering uses 2.4x. We also believe liquidity is adequate for the next 12 months if we take into account the company's C$200 million accordion facility. AltaGas has put a US$300 million, 12-month revolver in place to provide liquidity for the transaction; however, due to the short duration, we must exclude it from our calculations.

We believe that the company has good access to the capital markets, as evidenced by the announced C$403 million subscription receipt deal to partially finance the cash portion of the transaction.

Accounting

As of Jan. 1, 2012, AltaGas is preparing its financial statements in accordance with U.S. generally accepted accounting principles. Standard & Poor's makes adjustments to the company's financial statements, in line with published criteria. Some of these adjustments include adjusting the debt figure to take into account power purchase agreements and operating leases.

Outlook

The stable outlook reflects our assessment of AltaGas' business mix, which is increasingly diverse with a greater contribution from fee-based and regulated utility cash flows. In our view, the near-term financial metrics are low for the ratings, although we recognize the cash flows are increasingly sustainable and predictable. We could take a negative rating action if the company's financial metrics do not improve as expected, or if capital projects and acquisitions are not executed and integrated on time. We also expect to see further capital projects and acquisitions financed in line with AltaGas' stated capital structure goals. We could raise the ratings as the business risk profile transitions to an even lower level of commodity exposure and financial ratios improve when long-term projects begin to contribute.

Table 1

AltaGas Ltd.--Peer Comparison

Industry Sector: Natural Gas Cos

	--Fiscal year ended Dec. 31, 2010--				
(Mil. C$)	**AltaGas Ltd.**	**Pembina Pipeline Corp.**	**Inter Pipeline Fund**	**Veresen Inc.**	**Plains All American Pipeline L.P.**
Rating as of Feb. 29, 2012	BBB/Stable/--	BBB+/Watch Neg/--	BBB+/Stable/--	BBB/Stable/--	BBB-/Positive/--
Revenues	1,354.1	1,255.1	997.1	690.5	25,893.0
EBITDA	326.0	319.2	373.1	375.2	1,138.1
Net income from continuing operations	101.3	186.7	234.8	79.7	505.0
Funds from operations (FFO)	237.2	249.4	325.2	246.6	908.9

Table 1

AltaGas Ltd.--Peer Comparison (cont.)

Capital expenditures	207.5	229.8	330.3	51.0	497.1
Free operating cash flow	27.8	20.6	10.8	189.1	(193.3)
Discretionary cash flow	(122.0)	(233.5)	(183.7)	133.2	(885.3)
Cash and short-term investments	2.1	125.4	22.5	66.3	36.0
Debt	1,430.0	1,430.4	2,877.8	1,857.9	6,323.4
Equity	1,108.6	1,162.1	1,334.4	853.9	4,573.0
Adjusted ratios					
EBITDA margin (%)	24.1	25.4	37.4	54.3	4.4
EBITDA interest coverage (x)	4.1	4.2	6.3	3.2	4.0
EBIT interest coverage (x)	2.2	3.3	4.8	2.0	2.8
Return on capital (%)	6.4	9.8	6.4	7.9	7.6
FFO/debt (%)	16.6	17.4	11.3	13.3	14.4
Free operating cash flow/debt (%)	1.9	1.4	0.4	10.2	(3.1)
Debt/EBITDA (x)	4.4	4.5	7.7	5.0	5.6
Total debt/debt plus equity (%)	56.3	55.2	68.3	68.5	58.0

Table 2

AltaGas Ltd.--Financial Summary

Industry Sector: Natural Gas Cos

	--Fiscal year ended Dec. 31--				
(Mil. C$)	**2010**	**2009**	**2008**	**2007**	**2006**
Rating history	BBB/Stable/--	BBB/Stable/--	BBB-/Positive/--	BBB-/Stable/--	BBB-/Stable/--
Revenues	1,354.1	1,268.3	1,816.8	1,428.4	1,362.6
EBITDA	326.0	306.0	309.5	220.7	219.5
Net income from continuing operations	101.3	141.3	163.6	108.8	114.5
Funds from operations (FFO)	237.2	223.1	230.3	185.2	184.2
Capital expenditures	207.5	264.3	163.8	95.4	103.8
Dividends paid	149.8	168.7	144.3	118.1	110.0
Debt	1,430.0	1,476.6	1,002.0	705.3	758.0
Preferred stock	97.1	0.0	0.0	0.0	0.0
Equity	1,108.6	1,047.0	957.3	583.9	528.7
Debt and equity	2,538.6	2,523.6	1,959.3	1,289.2	1,286.7
Adjusted ratios					
EBITDA margin (%)	24.1	24.1	17.0	15.4	16.1
EBIT interest coverage (x)	2.2	3.1	3.6	4.1	4.0
FFO interest coverage (x)	3.7	4.3	4.6	6.0	5.7
FFO/debt (%)	16.6	15.1	23.0	26.3	24.3
Discretionary cash flow/debt (%)	(8.5)	(15.4)	(8.9)	(1.1)	(5.8)
Net cash flow/capex (%)	42.1	20.6	52.5	70.4	71.5
Debt/debt and equity (%)	56.3	58.5	51.1	54.7	58.9
Return on capital (%)	6.4	8.1	12.7	11.3	11.7

Table 2

AltaGas Ltd.--Financial Summary (cont.)					
Return on common equity (%)	9.0	13.4	20.8	19.5	22.7
Common dividend payout ratio (unadjusted; %)	145.2	120.9	89.9	108.5	96.0

Table 3

Reconciliation Of AltaGas Ltd. Reported Amounts With Standard & Poor's Adjusted Amounts (Mil. C$)

	--Fiscal year ended Dec. 31, 2010--									
AltaGas Ltd. reported amounts	**Debt**	**Shareholders' equity**	**Revenues**	**EBITDA**	**Operating income**	**Interest expense**	**Cash flow from operations**	**Cash flow from operations**	**Dividends paid**	**Capital expenditures**
Reported	904.5	1,211.0	1,354.1	241.1	151.9	48.8	192.6	192.6	151.8	157.0
Standard & Poor's adjustments										
Operating leases	13.6	N/A	N/A	0.7	0.7	0.7	4.4	4.4	N/A	5.0
Intermediate hybrids reported as equity	97.1	(97.1)	N/A	N/A	N/A	2.0	(2.0)	(2.0)	(2.0)	N/A
Postretirement benefit obligations	12.4	(5.4)	N/A	1.0	1.0	0.8	(1.3)	(1.3)	N/A	N/A
Capitalized interest	N/A	N/A	N/A	N/A	N/A	4.4	(4.4)	(4.4)	N/A	(4.4)
Share-based compensation expense	N/A	N/A	N/A	9.7	N/A	N/A	N/A	N/A	N/A	N/A
Power purchase agreements	373.9	N/A	N/A	70.7	20.7	20.7	49.9	49.9	N/A	49.9
Asset retirement obligations	28.5	N/A	N/A	2.9	2.9	2.9	(3.9)	(3.9)	N/A	N/A
Reclassification of working-capital cash flow changes	N/A	N/A	N/A	N/A	N/A	N/A	N/A	1.9	N/A	N/A
Total adjustments	525.5	(102.5)	0.0	84.9	25.3	31.6	42.7	44.7	(2.0)	50.5
Standard & Poor's adjusted amounts	**Debt**	**Equity**	**Revenues**	**EBITDA**	**EBIT**	**Interest expense**	**Cash flow from operations**	**Funds from operations**	**Dividends paid**	**Capital expenditures**
Adjusted	1,430.0	1,108.6	1,354.1	326.0	177.2	80.4	235.3	237.2	149.8	207.5

N/A--Not applicable.

Related Criteria And Research

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Sept. 28, 2011
- Criteria Methodology: Business Risk/Financial Risk Matrix Expanded, May 27, 2009
- Rating Criteria For U.S. Midstream Energy Companies, Dec. 18, 2008
- 2008 Corporate Criteria: Analytical Methodology, April 15, 2008

Ratings Detail (As Of February 29, 2012)	
AltaGas Ltd.	
Corporate Credit Rating	BBB/Stable/--
Preferred Stock (1 Issue)	BB+
Canadian Preferred Stock Rating (1 Issue)	P-3(High)
Senior Unsecured (6 Issues)	BBB
Corporate Credit Ratings History	
21-Apr-2009	BBB/Stable/--
10-Jul-2008	BBB-/Positive/--
20-Dec-2007	BBB-/Stable/--
12-Nov-2007	BBB-/Watch Dev/--
Business Risk Profile	Strong
Financial Risk Profile	Significant

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

APPENDIX 4

INVESTMENT ANALYST REPORTS – PNG

Pacific Northern Gas

(PNG-TSX)

Stock Rating: **Market Perform**
Industry Rating: **Underperform**

March 6, 2006
Research Comment
Gas & Electrical

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Assoc: Kevin Cheng

BCUC Increases Benchmark ROE; Market Perform Rating Unchanged

Event

On March 2, the British Columbia Utilities Commission issued its Decision relating to an application by Terasen Gas Inc. and Terasen Gas (Vancouver Island) Inc. to determine the appropriate return on equity and capital structure, and to review and revise the automatic adjustment mechanism. In the decision, the Commission increases the benchmark return on equity for 2006 to 8.80% versus 8.29% previously and alters the automatic adjustment mechanism (see our industry comment dated March 6 for additional information). Pacific Northern Gas is regulated by the Commission and is subject to the automatic adjustment mechanism and the established benchmark ROE.

Impact

Positive.

Forecasts

We have revised our financial model to reflect the change in the benchmark ROE. The operations of PNG West and Tumbler Ridge earn the benchmark return (8.80%) plus a 0.65% premium. The Ft. St. John and Dawson Creek divisions of the company receive the benchmark return of 8.80% plus a premium of 0.40%. Our 2006 and 2007 diluted EPS estimates therefore increase to $1.60 and $1.59 from $1.52 and $1.51 previously.

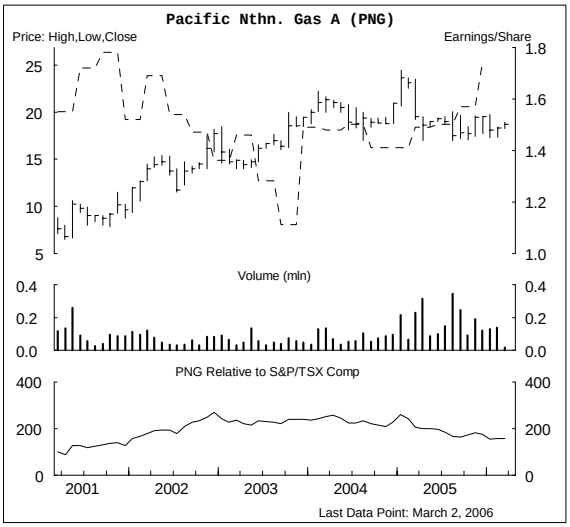
Valuation

Our target price of $19.00 reflects a 50/50 trust valuation of $18.75 and a fundamental value of $19.25 per share.

Recommendation

We believe that the shares are reasonably valued. Our rating is Market Perform.

Price (2-Mar)	$18.70	**52-Week High**	$23.50
Target Price	$19.00↑	**52-Week Low**	$17.00



(FY-Dec.)	2004A	2005A	2006E	2007E
EPS	$1.38	$1.71	$1.60↑	$1.59↑
P/E			11.7x	11.8x
CFPS	$4.55	$3.27	$4.25	$4.28
P/CFPS			4.4x	4.4x
Div.	$0.80	$0.80	$0.80	$0.80
EV ($mm)	$184	$183	$176	$172
EBITDA ($mm)	$26.3	$27.5	$21.1	$20.8
EV/EBITDA	7.0x	6.6x	8.3x	8.3x

Quarterly EPS	Q1	Q2	Q3	Q4
2004A	$1.00	$0.01	-$0.31	$0.71
2005A	$1.08	$0.02	-$0.24	$0.89
2006E	$1.04↑	$0.03	-$0.25↓	$0.82↑

Dividend	$0.80	**Yield**	4.3%
Book Value	$21.48	**Price/Book**	0.9x
Shares O/S (mm)	3.6	**Mkt. Cap ($mm)**	$68
Float O/S (mm)	3.6	**Float Cap ($mm)**	$68
Wkly Vol (000s)	41	**Wkly $ Vol (mm)**	$0.8
Net Debt ($mm)	$96.3	**Next Rep. Date**	18-May (E)

Notes: Estimates are weather normal
Major Shareholders: Widely held
First Call Mean Estimates: PACIFIC NORTHERN GAS LTD 'A' (C$) 2006E: $1.56; 2007E: $1.51

Changes

Annual EPS	Quarterly EPS	Target
2006E $1.52 to $1.60	Q1/06E $0.99 to $1.04	$18.75 to $19.00
2007E $1.51 to $1.59	Q3/06E -$0.24 to -$0.25	
	Q4/06E $0.78 to $0.82	

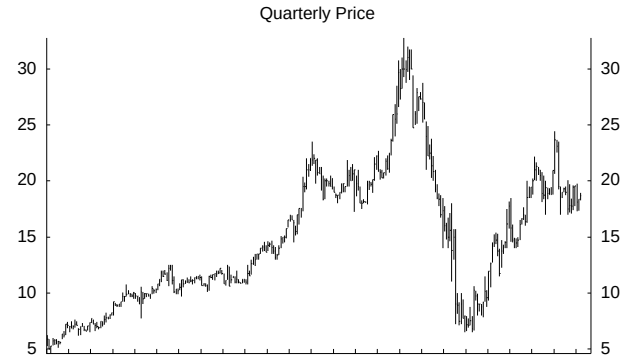
Please refer to pages 3 to 5 for Disclosure Statements, including the Analyst's Certification.

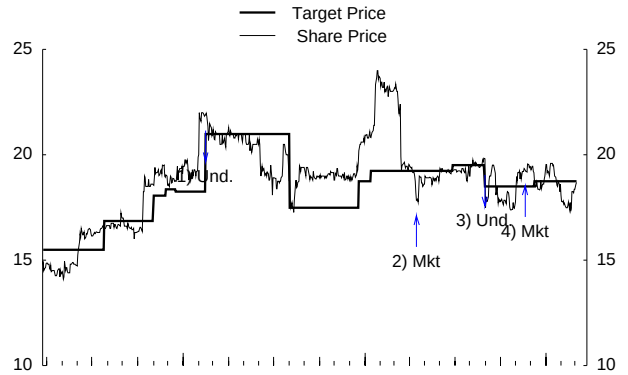
Table 1. Consolidated Summary Sheet

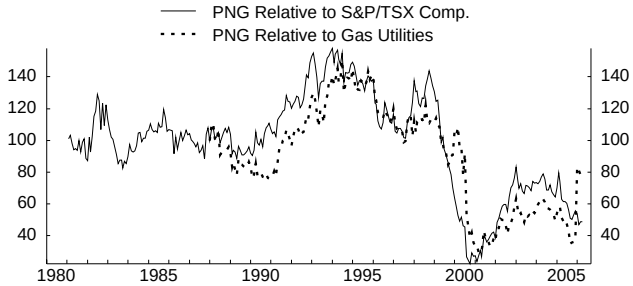
3-Mar-06									Karen J. Taylor
Current Price:	$19.08								BMO Nesbitt Burns Inc.
12-Month Target Price:	$19.00								
ROR:	3.8%						Recommendation:		Market Perform
				Year Ended December 31					
	1999	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006E**	**2007E**
Total Earnings Per Share	$1.92	$1.83	$1.52	$1.28	$1.49	$1.41	$1.75	$1.65	$1.63
Fully Diluted EPS	$1.67	$1.77	$1.47	$1.25	$1.46	$1.38	$1.72	$1.60	$1.59
Dividends	$1.12	$0.56	$0.00	$0.00	$0.80	$0.80	$0.80	$0.80	$0.80
Payout Ratio	58.3%	30.7%	0.0%	0.0%	53.8%	56.8%	45.8%	48.6%	49.0%
Average Shares (mm)	3.5	3.5	3.5	3.5	3.6	3.6	3.6	3.6	3.6
Net Book Value	17.62	18.84	20.36	21.62	19.25	20.52	21.44	22.30	23.14
Market Valuation									
Price: High	$28.70	$18.00	$11.95	$18.00	$19.50	$22.00	$24.00	-	-
Price: Low	$14.00	$6.80	$6.50	$9.35	$14.00	$17.28	$17.37	-	-
Price: Current	-	-	-	-	-	-	-	$19.08	
P/E Ratio: High	15.0	9.9	7.9	14.0	13.1	15.6	13.7	-	-
P/E Ratio: Low	7.3	3.7	4.3	7.3	9.4	12.3	9.9	-	-
P/E Ratio: Current	-	-	-	-	-	-	-	11.6	11.7
Price/Book Value: High	1.58	0.96	0.59	0.83	1.01	1.07	1.12	-	-
Price/Book Value: Low	0.77	0.36	0.32	0.43	0.73	0.84	0.81	-	-
Price/Book Value: Current	-	-	-	-	-	-	-	0.86	0.82
Yield: High Price	3.90%	3.11%	0.00%	0.00%	4.11%	3.64%	3.34%	-	-
Yield: Low Price	8.00%	8.24%	0.00%	0.00%	5.73%	4.63%	4.62%	-	-
Yield: Current	-	-	-	-	-	-	-	4.2%	4.2%
Balance Sheet ($mm)									
Debt (S-T)	38.3	27.7	12.1	4.4	7.3	10.4	14.7	15.3	15.8
Debt (L-T)	85.6	82.2	79.5	90.2	85.8	81.4	76.6	71.7	66.8
Deferred Items	15.7	22.2	17.3	17.0	17.9	15.8	15.7	15.7	15.7
Preferred Shares	6.7	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0
Shareholders' Equity	62.3	66.8	72.2	76.7	69.4	73.9	77.7	80.9	83.9
	208.5	203.9	186.2	193.3	185.4	186.7	189.7	188.5	187.2
Balance Sheet (%)									
Debt (S-T)	18.3%	13.6%	6.5%	2.3%	3.9%	5.6%	7.7%	8.1%	8.5%
Debt (L-T)	41.1%	40.3%	42.7%	46.7%	46.3%	43.6%	40.4%	38.0%	35.7%
Deferred Items	7.5%	10.9%	9.3%	8.8%	9.7%	8.5%	8.3%	8.3%	8.4%
Preferred Shares	3.2%	2.5%	2.7%	2.6%	2.7%	2.7%	2.6%	2.7%	2.7%
Shareholders' Equity	29.9%	32.8%	38.8%	39.7%	37.4%	39.6%	41.0%	42.9%	44.8%
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Income Statement ($mm)									
Total Revenue	77.7	115.7	138.6	109.1	133.7	137.8	160.0	144.6	142.5
EBIT	22.0	21.8	20.5	19.5	18.5	17.5	18.6	12.3	11.8
NPAT	7.1	6.8	5.7	4.9	5.7	5.4	6.7	6.3	6.3
Preferred Share Dividends	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Net Earnings to Common	6.8	6.5	5.4	4.6	5.3	5.1	6.3	6.0	5.9
Cash Flow from Operations	9.8	27.5	20.9	12.8	12.2	16.4	11.8	15.7	15.8
Key Statistics									
Average Utility Rate Base ($mm)	170.7	173.4	170.2	166.8	165.4	167.2	165.2	161.9	160.3
Growth Rate	1.05%	1.56%	-1.86%	-1.98%	-0.87%	1.10%	-1.19%	-2.00%	-1.00%
2004- 2007 CAGR									-1.40%
Allowed Return on Equity	10.00%	10.25%	10.00%	9.88%	10.17%	9.80%	9.68%	9.45%	9.45%
Deemed Equity	36.00%	36.00%	36.00%	36.00%	36.00%	36.00%	40.00%	40.00%	40.00%

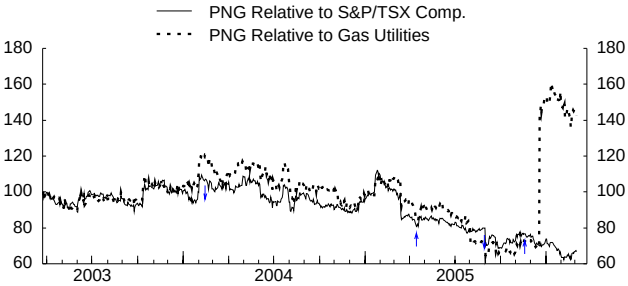
Source: BMO Nesbitt Burns

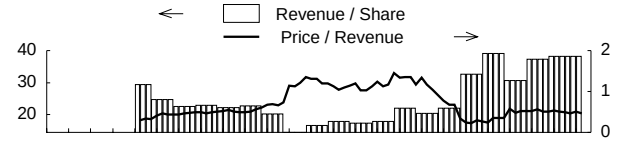
Pacific Nthn. Gas A (PNG)

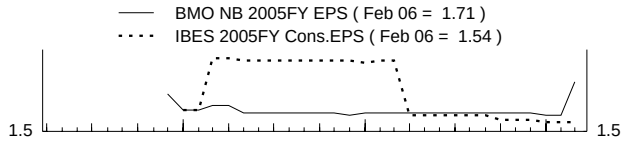


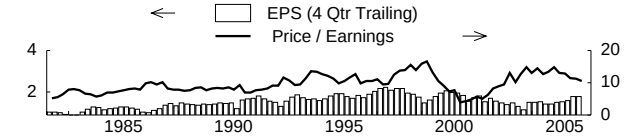


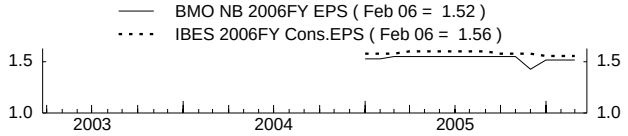












FYE (Dec.)	EPS $	P/E	DPS $	Yield %	Payout %	BV $	P/B	ROE %
1982	0.91	8	0.50	7.0	55	6.89	1.0	13
1983	1.16	6	0.50	6.8	43	7.69	1.0	16
1984	1.18	7	0.60	7.3	51	8.41	1.0	15
1985	1.22	8	0.70	7.0	57	8.03	1.2	15
1986	1.09	9	0.70	6.8	64	8.43	1.2	13
1987	1.31	8	0.75	7.4	57	8.97	1.1	15
1988	1.34	8	0.75	6.6	56	9.24	1.2	15
1989	1.45	8	0.75	6.4	52	9.92	1.2	15
1990	1.61	7	0.75	6.7	47	10.76	1.0	16
1991	1.66	8	0.80	5.9	48	11.62	1.2	15
1992	1.55	11	0.80	4.8	52	12.37	1.3	13
1993	1.63	13	0.88	4.0	54	12.37	1.8	13
1994	1.80	11	0.88	4.3	49	12.37	1.6	15
1995	1.67	13	0.96	4.6	57	14.57	1.4	12
1996	2.01	11	0.96	4.3	48	15.61	1.4	13
1997	2.16	14	1.04	3.5	48	16.42	1.8	13
1998	1.73	16	1.12	4.1	65	17.39	1.6	10
1999	1.92	9	1.12	6.5	58	18.19	1.0	11
2000	1.83	4	1.12	14.1	61	19.44	0.4	10
2001	ND	6	1.12	11.7	74	20.95	0.5	nm
2002	ND	13	1.12	6.3	82	19.27	0.9	nm
2003	ND	13	0.80	4.1	54	19.96	1.0	nm
2004	1.38	15	0.80	3.8	57	20.52	1.0	7
2005	1.71	11	0.80	4.1	46	20.52	1.0	8
Current*	1.75	10	0.80	4.4	46	21.48	0.9	8
Average:		10		6.1	56		1.2	13.0
Growth(%):								
5 Year:	-0.9		-6.5			2.0		
10 Year:	0.5		-1.8			4.0		
20 Year:	1.8		0.7			5.0		

* Current EPS is the 4 Quarter Trailing to Q4/2005.

PNG - Rating as of 24-Mar-03 = Mkt

	Date	Rating Change	Share Price
1	13-Feb-04	Mkt to Und.	$21.90
2	14-Apr-05	Und.to Mkt	$18.20
3	30-Aug-05	Mkt to Und.	$19.84
4	18-Nov-05	Und.to Mkt	$19.35

Last Daily Data Point: March 2, 2006

Company Risk Disclosure

In addition to the risks involved in investing in common stocks generally, we also highlight the following risks that pertain to this company. The company's natural gas transmission business is dependent upon the continued availability of natural gas. The BCUC approves PNG's customer rates and a fair return on the rate base. Changes in regulation may adversely affect performance. Natural gas and fuel oil compete with electricity for space heating in Pacific Northern Gas' service areas. Fluctuations in the price of natural gas could increase the working capital financing requirements and related costs for accounts receivable. In 2004, 75% of energy deliveries were made to four large industrial customers (67% to one customer, Methanex). Transportation service to Methanex was made pursuant to an agreement that expires in October 2009. On August 30, 2005, Methanex announced that it will close its Kitimat facilities in early 2006. PNG's DBRS credit BBB(L) rating is Under Review with Negative Implications. A one notch downgrade would result in a below investment grade bond rating.

Analyst's Certification

I, Karen Taylor, CFA, hereby certify that the views expressed in this report accurately reflect my personal views about the subject securities or issuers. I also certify that I have not, am not, and will not receive, directly or indirectly, compensation in exchange for expressing the specific recommendations or views in this report.

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Disclosure 10: This issuer is a client (or was a client) of BMO Nesbitt Burns, HNC or an affiliate within the past 12 months: Non Securities Related Services.

Distribution of Ratings

Rating Category	BMO NB Rating	BMO NB Universe	BMO NB I.B. Clients*	First Call Universe**
Buy	Outperform	41%	54%	47%
Hold	Market Perform	48%	39%	46%
Sell	Underperform	11%	7%	7%

* Reflects rating distribution of all companies where BMO NB has received compensation for Investment Banking services.

** Reflects rating distribution of all North American equity research analysts.

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^ Market performance as measured by a benchmark index such as the S&P/TSX Composite Index, S&P 500, Nasdaq Composite, as appropriate for each company.

Prior to September 1, 2003, a fourth rating tier—Top Pick—was used to designate those stocks we felt would be the best performers relative to the market. Our six Top 15 lists which guide investors to our best ideas according to six different objectives (large, small, growth, value, income and quantitative) have replaced the Top Pick rating.

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Additional Matters

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Pacific Northern Gas

(PNG-TSX)

August 22, 2006
Brief Research Note
Gas & Electrical

Stock Rating: **Market Perform**
Stock Price: **$17.29**
Target Price: **$19.00**

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BCUC Approves 2006 Revenue Requirements

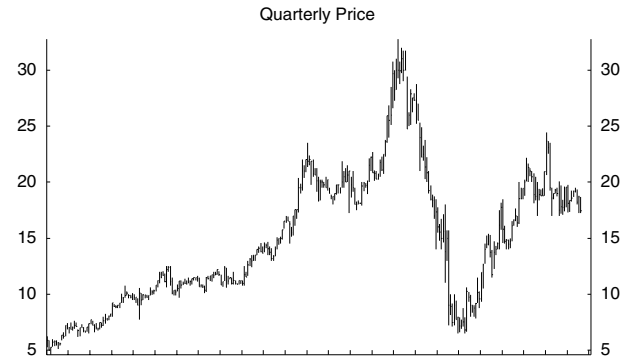
Impact

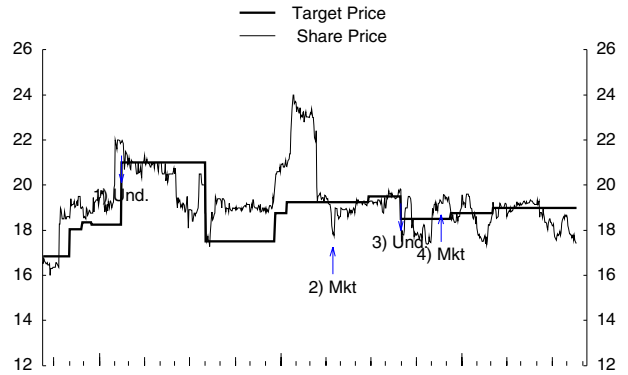
Positive

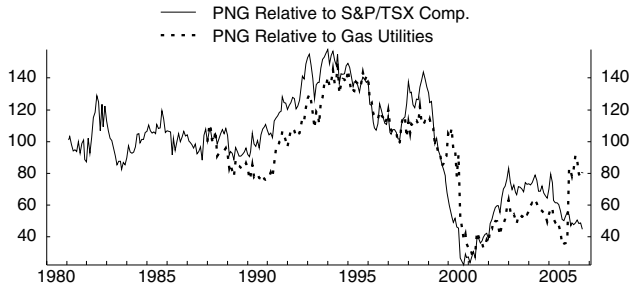
Details & Analysis

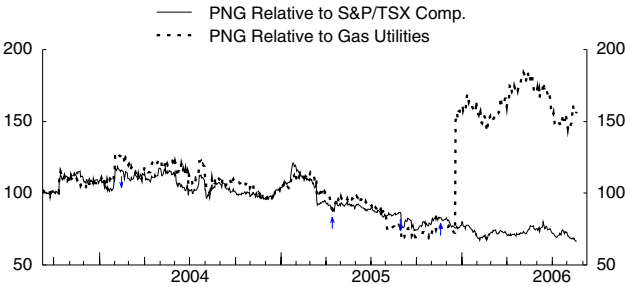
Pacific Northern Gas has announced that the British Columbia Utilities Commission (BCUC) has approved its 2006 Revenue Requirements applications for PNG-West, Pacific Northern Gas (N.E.) – Ft. St. John/Dawson Creek and Tumbler Ridge divisions. For PNG-West, the Commission approved the terms of a settlement agreement filed on March 28, 2006, which includes: 40% deemed equity; 9.45% ROE, and mid-year rate base of $131.2 million. These metrics are consistent with our financial model. In its reasons for decision, the Commission allowed the full recovery of the applied-for revenue deficiency from customers, a point that was severely tested during the regulatory process and a source of significant concern. In its decision, the Commission determined that to allocate any of the net revenue deficiency resulting from the termination of the Methanex Contract to PNG's shareholders would result in rates that do not permit PNG to recover its costs and would contravene the Utilities Commission Act. The Commission also found that given the statutory obligations imposed, there is no principled basis to allow it to deviate from the statutory requirement to allow the utility to recover its prudent and reasonable cost of providing service…and no evidence to support a specific allocation of the revenue deficiency, other than to the utility's customers. Our estimates, target price and rating assumed that the Commission would approve the allocation of the applied-for revenue deficiency to customers.

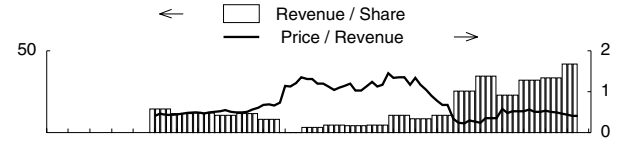
Pacific Nthn. Gas A (PNG)

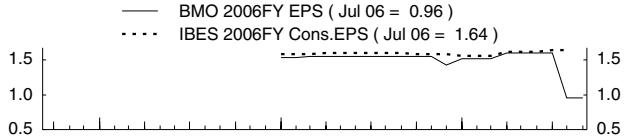


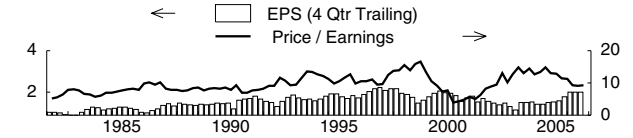


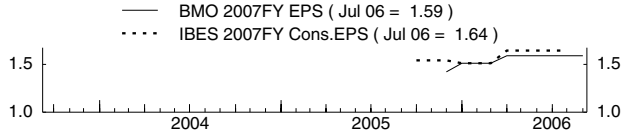












FYE (Dec.)	EPS $	P/E	DPS $	Yield %	Payout %	BV $	P/B	ROE %
1985	1.22	8	0.70	7.0	57	8.03	1.2	15
1986	1.09	9	0.70	6.8	64	8.43	1.2	13
1987	1.31	8	0.75	7.4	57	8.97	1.1	15
1988	1.34	8	0.75	6.6	56	9.24	1.2	15
1989	1.45	8	0.75	6.4	52	9.92	1.2	15
1990	1.61	7	0.75	6.7	47	10.76	1.0	16
1991	1.66	8	0.80	5.9	48	11.62	1.2	15
1992	1.55	11	0.80	4.8	52	12.37	1.3	13
1993	1.63	13	0.88	4.0	54	12.37	1.8	13
1994	1.80	11	0.88	4.3	49	12.37	1.6	15
1995	1.67	13	0.96	4.6	57	14.57	1.4	12
1996	2.01	11	0.96	4.3	48	15.61	1.4	13
1997	2.16	14	1.04	3.5	48	16.42	1.8	13
1998	1.73	16	1.12	4.1	65	17.39	1.6	10
1999	1.92	9	1.12	6.5	58	18.19	1.0	11
2000	1.83	4	1.12	14.1	61	19.44	0.4	10
2001	1.52	6	1.12	11.7	74	20.95	0.5	8
2002	1.25	13	1.12	6.3	82	19.27	0.9	6
2003	1.46	13	0.80	4.1	54	19.96	1.0	7
2004	1.38	15	0.80	3.8	57	20.52	1.0	7
2005	1.71	11	0.80	4.1	46	21.43	0.9	8
Current*	2.00	9	0.80	4.3	40	22.11	0.8	9
Average:		10		6.0	56		1.2	11.8
Growth(%):								
5 Year:	3.1		-6.5			2.6		
10 Year:	1.5		-1.8			4.3		
20 Year:	3.5		0.7			5.2		

* Current EPS is the 4 Quarter Trailing to Q2/2006.

PNG - Rating as of 9-Sep-03 = Mkt

	Date	Rating Change	Share Price
1	13-Feb-04	Mkt to Und.	$21.90
2	14-Apr-05	Und.to Mkt	$17.85
3	30-Aug-05	Mkt to Und.	$19.80
4	18-Nov-05	Und.to Mkt	$19.27

Last Daily Data Point: August 18, 2006

Company Risk Disclosure

In addition to the risks involved in investing in common stocks generally, we also highlight the following risks that pertain to this company. The company's natural gas transmission business is dependent upon the continued availability of natural gas. The BCUC approves PNG's customer rates and a fair return on the rate base. Changes in regulation may adversely affect performance. Natural gas and fuel oil compete with electricity for space heating in Pacific Northern Gas' service areas. Fluctuations in the price of natural gas could increase the working capital financing requirements and related costs for accounts receivable. In 2004, 75% of energy deliveries were made to four large industrial customers (67% to one customer, Methanex). Transportation service to Methanex was made pursuant to an agreement that expires in October 2009. On August 30, 2005, Methanex announced that it will close its Kitimat facilities in early 2006. PNG's DBRS credit BBB(L) rating is Under Review with Negative Implications. A one notch downgrade would result in a below investment grade bond rating.

Analyst's Certification

I, Karen Taylor, CFA, hereby certify that the views expressed in this report accurately reflect my personal views about the subject securities or issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report.

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Distribution of Ratings

Rating Category	BMO Rating	BMO Universe	BMO I.B. Clients*	First Call Universe**
Buy	Outperform	40%	49%	48%
Hold	Market Perform	50%	47%	45%
Sell	Underperform	10%	4%	7%

* Reflects rating distribution of all companies where BMO Capital Markets has received compensation for Investment Banking services.

** Reflects rating distribution of all North American equity research analysts.

Ratings Key

We use the following ratings system definitions:
OP = Outperform - Forecast to outperform the market;

Mkt = Market Perform - Forecast to perform roughly in line with the market;
Und = Underperform - Forecast to underperform the market;
(S) = speculative investment;
NR = No rating at this time;
R = Restricted – Dissemination of research is currently restricted.

Market performance is measured by a benchmark index such as the S&P/TSX Composite Index, S&P 500, Nasdaq Composite, as appropriate for each company. Prior to September 1, 2003, a fourth rating tier—Top Pick—was used to designate those stocks we felt would be the best performers relative to the market. Our six Top 15 lists which guide investors to our best ideas according to six different objectives (large, small, growth, value, income and quantitative) have replaced the Top Pick rating.

Dissemination of Research

Our research publications are available via our web site http://bmocapitalmarkets.com. Institutional clients may also receive our research via FIRST CALL Research Direct and Reuters. All of our research is made widely available at the same time to all BMO NB, BMO Capital Markets Corp. and BMO Nesbitt Burns Securities Ltd. client groups entitled to our research. Please contact your investment advisor or institutional salesperson for more information.

Additional Matters

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Pipelines/Gas & Electrical

September 25, 2006
Research Comment
Toronto, Ontario

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Industry Rating: **Pipelines – Market Perform**
Gas & Electrical – Market Perform

Ratings Changes: **Pacific Northern Gas** **Outperform ↑**
EPCOR Power, L.P. **Outperform ↑**

Lower Outlook for Bond Yields Drives Valuations Higher

We are updating our target prices and ratings for the common stocks and income trusts/limited partnerships in our coverage universe to reflect a new 10-year Government of Canada bond yield assumption of 4.00% versus our previous assumption of 4.25%. We have reduced our 10-year Government of Canada bond yield assumption based on BMO Nesbitt Burns Economics' view that yields will remain near current levels over the next year as the Bank of Canada and U.S. Federal Reserve remain "on hold" with respect to the overnight rate and Federal Funds Rate (at 4.25% and 5.25%, respectively). As at September 22, 2006 the 10-year government of Canada bond was trading at a yield of approximately 4.00% and BMO Capital Markets Economics was forecasting the 10-year Government of Canada bond yield to average approximately 4.07% during 2007.

We note the following in relation to the common stocks and income trusts/limited partnerships in our coverage universe:

- On September 21, 2006, we performed a simple regression analysis to establish the senstitivity of of the target prices of the common stock names in our coverage universe to the potential change (downward) in forecast 10-year Government of Canada Bond yields. Our analysis found that, in general, a 25 basis point change (downard) in the forecast or observed Government of Canada bond yield is likely to be accompanied by a 15 basis point change (reduction) in the trading yield of a pipeline and utility stocks. We have updated the valuation of the common stocks in our coverage universe to reflect our revised bond yield outlook. On average, our target prices increased by 2.4%. Our revised target prices and ratings appear in Table 1.
- Our change in bond yield assumption has the effect of lowering the effective yield used to value the trusts and limited partnerships in our coverage universe by 25 basis points. On average a 25 basis point decrease in our target yields resulted in a 2.5% increase in the target prices for the trusts/LPs in our coverage universe. Our revised ratings and target prices are set out in Table 2.

Summary

- We are reducing our 10-year bond yield assumption to 4.00% from 4.25% to reflect BMO Capital Markets Economics' view that yields will remain near current levels over the next year.
- In general, for a 25 basis point decline in 10-year bond yields, the trading yields of stocks in our coverage decline by an average of 15 basis points. We have increased the target prices of common stocks in our coverage universe by 2.4% on average to reflect our revised bond yield assumption.
- We have increased the target prices for the income trusts and limited partnerships in our coverage universe by 2.5% on average to reflect the 25 basis point reduction in our target yields.
- Our rating on the shares of Pacific Northern Gas increases to Outperform from Market Perform. There are no other changes to the ratings in our common stock universe.
- We are increasing our rating on EPCOR Power LP to Outperform from Market Perform due to recent weakness in unit price.

We note the following items related to specific issuers:

- We are increasing our rating on the shares of Pacific Northern Gas to Outperform from Market Perform. On August 16, the British Columbia Utilities Commission approved 2006 rates for Pacific Northern Gas (N.E.) Ltd. (Fort St John/Dawson Creek and Tumbler Ridge Divisions) as per the Negotiated Settlement Agreement dated March 15, 2006 and rates for PNG-West and Granisle. With respect to the latter approval, the financial metrics included therein, 40% deemed equity, return on equity and rate base of $131.2 million were consistent with the assumptions in our financial model. In its reasons for decision for PNG-West, the Commission allowed the full recovery of the applied-for revenue deficiency from customers, a point that was severely tested during the regulatory process and a source of significant concern.

  In its decision, the Commission determined that to allocate any of the net revenue deficiency resulting from the termination of the Methanex Contract to the company's shareholders would result in rates that do not permit Pacific Northern Gas to recover its costs and would contravene the Utilities Commission Act. The Commission also found that given the statutory obligations imposed, there is no principled basis to allow it to deviate from the statutory requirement to allow the utility to recover its prudent and reasonable cost of providing service…and no evidence to support a specific allocation of the revenue deficiency, other than to the utility's customers. While, these determinations substantially mitigate the regulatory risk that shaped our outlook for the stock, Pacific Northern Gas continues to have a business risk profile that is significantly higher than the low-risk benchmark utility used by the Commission.

  We also continue to track the company's efforts to develop the natural gas transmission pipeline system from Kitimat to Summit Lake, British Columbia to serve the planned Kitimat LNG facility. If this LNG facility proceeds, the PNG mainline would be expanded at a cost of $900 million to $1.2 billion (30" or 36" pipeline) to transport up to 1 bcf/d of LNG versus 115 mmcf/d currently. To date, Kitimat LNG has not been successful in its efforts to contract LNG for the facility. It is unclear whether the LNG facility is likely to proceed and the opportunity is not yet factored into our outlook for the company.

- We are increasing our rating on EPCOR Power LP to Outperform from Market Perform due to recent weakness in unit price. Our target price remains unchanged at $33.00 as we are increasing our credit spread for EPCOR Power L.P. to 375 basis points from 350 basis points to reflect the acquisition of Primary Energy Ventures ("PEV") that was announced on August 14, 2006. We believe that the lack of disclosure that characterized EPCOR's announcement complicates an assessment of the attractiveness of the PEV acquisition, and contributes to our view that the transaction increases the overall risk profile of the Partnership. Our estimates are currently exclusive of the PEV acquisition, and we will update our forecasts once we obtain the regulatory reports/filings that are necessary to revise our outlook for the Partnership's units pursuant to this transaction.

Table 1: Common Stocks – Revised Target Prices and Ratings

Company	New Valuation Metrics			New		Total Return
	P/E	P/BV	Yield	Target	Rating	
Canadian Hydro Developers	na	1.95	na	$5.60	Market Perform	8.53%
Canadian Utilities Limited	R	R	R	R	R	R
Caribbean Utilities Co. Ltd.	12.0	1.75	4.85%	$13.00	Outperform	14.41%
Duke Energy Corp.	15.0	1.65	4.00%	$32.50	Outperform	11.87%
Emera Inc.	15.0	1.40	4.35%	$20.00	Market Perform	1.65%
Enbridge Inc.	18.0	2.50	3.10%	$37.50	Market Perform	8.75%
Fortis Inc.	17.0	2.00	2.85%	$26.75	Outperform	11.34%
Pacific Northern Gas	10.0	1.00	4.10%	$19.50	Outperform	14.30%
TransAlta Corporation	16.5	na	na	$22.25	Underperform	-6.66%
TransCanada Corporation	18.0	2.00	3.60%	$35.65	Market Perform	4.19%

Company	Previous Valuation Metrics			Previous	
	P/E	P/BV	Yield	Target	Rating
Canadian Hydro Developers	na	1.95	na	$5.60	Market Perform
Canadian Utilities Limited	R	R	R	R	R
Caribbean Utilities Co. Ltd.	12.0	1.75	5.00%	$12.75	Outperform
Duke Energy Corp.	15.0	1.65	4.00%	$32.50	Outperform
Emera Inc.	15.0	1.40	4.50%	$19.25	Market Perform
Enbridge Inc.	18.0	2.50	3.25%	$36.00	Market Perform
Fortis Inc.	17.0	2.00	3.00%	$26.00	Outperform
Pacific Northern Gas	10.0	1.00	4.25%	$19.00	Market Perform
TransAlta Corporation	16.0	na	na	$21.50	Underperform
TransCanada Corporation	18.0	2.00	3.75%	$34.50	Market Perform

Source: BMO Capital Markets.

Table 2: Income Trusts/LPs – Target Prices and Target Spreads

			Target and Rating							
	BMO NB Bond Forecast	Target Spread	Target Yield	2007E Distribution	Valuation Yield Basis	Valuation DCF Basis	Target Price	Current Price	Implied Rate of Return	Rating
Atlantic Power Corporation	R	R	R	R	R	R	R	$10.63	R	R
Boralex Power Income Fund	4.00	4.25	8.25	$0.90	$10.91	$10.82	$11.00	$10.76	10.6%	Market Perform
Calpine Power Income Fund	R	R	R	R	R	R	R	$10.40	R	R
Creststreet Power & Income Fund L.P.	4.00	N/A	N/A	$0.65	N/A	$5.01	$5.00	$5.00	13.0%	Underperform
Enbridge Income Fund	4.00	3.50	7.50	$0.95	$12.62	$14.07	$13.25	$13.25	7.1%	Market Perform
EPCOR Power L.P.	4.00	3.75	7.75	$2.52	$32.52	$32.94	$33.00	$31.21	13.8%	Outperform
Fort Chicago Energy L.P.	4.00	3.60	7.60	$0.93	$12.18	$11.60	$12.00	$11.95	8.2%	Market Perform
Gaz Metro	4.00	2.75	6.75	$1.24	$18.37	N/A	$18.25	$17.04	14.4%	Outperform
Great Lakes Hydro Income Fund	4.00	3.00	7.00	$1.26	$18.00	$18.38	$18.25	$19.30	1.1%	Underperform
Innergex Power Income Fund	4.00	3.25	7.25	$0.97	$13.44	$13.67	$13.50	$13.96	3.7%	Market Perform
Inter Pipeline Fund	4.00	4.25	8.25	$0.84	$10.13	$10.32	$10.25	$10.38	6.8%	Market Perform
Pembina Pipeline Income Fund	4.00	4.00	8.00	$1.29	$16.12	$17.80	$17.00	$17.21	6.3%	Market Perform
TransAlta Power L.P.	4.00	5.50	9.50	$0.80	$8.37	$6.37	$7.25	$8.08	-0.4%	Underperform
Average		**3.73**	**7.73**							

			Old Target and Rating							
	BMO NB Bond Forecast	Target Spread	Target Yield	2007E Distribution	Valuation Yield Basis	Valuation DCF Basis	Target Price	Current Price	Implied Rate of Return	Rating
Atlantic Power Corporation	R	R	R	R	R	R	R	$10.63	R	R
Boralex Power Income Fund	4.25	4.25	8.50	$0.90	$10.59	$10.51	$10.50	$10.76	9.2%	Market Perform
Calpine Power Income Fund	R	R	R	R	R	R	R	$10.40	R	R
Creststreet Power & Income Fund L.P.	4.25	N/A	N/A	$0.65	N/A	$4.90	$5.00	$5.00	13.0%	Underperform
Enbridge Income Fund	4.25	3.50	7.75	$0.95	$12.22	$13.60	$13.00	$13.25	5.3%	Market Perform
EPCOR Power L.P.	4.25	3.50	7.75	$2.52	$32.52	$32.94	$33.00	$31.21	13.8%	Market Perform
Fort Chicago Energy L.P.	4.25	3.60	7.85	$0.93	$11.79	$11.35	$11.50	$11.95	4.0%	Market Perform
Gaz Metro	4.25	2.75	7.00	$1.24	$17.71	N/A	$17.75	$17.04	11.4%	Outperform
Great Lakes Hydro Income Fund	4.25	3.00	7.25	$1.26	$17.38	$17.78	$17.50	$19.30	-2.8%	Underperform
Innergex Power Income Fund	4.25	3.25	7.50	$0.97	$13.00	$13.28	$13.00	$13.96	0.1%	Market Perform
Inter Pipeline Fund	4.25	4.25	8.50	$0.84	$9.83	$10.00	$10.00	$10.38	4.4%	Market Perform
Pembina Pipeline Income Fund	4.25	4.00	8.25	$1.29	$15.63	$17.31	$16.50	$17.21	3.4%	Market Perform
TransAlta Power L.P.	4.25	5.50	9.75	$0.80	$8.15	$6.27	$7.25	$8.08	-0.4%	Underperform
Average		**3.71**	**7.96**							

Source: BMO Capital Markets

Table 3: Comparable Canadian Equities

Canadian Gas Utilities

Company	TSX Ticker	Price (C$) 22-Sep-06	Shares O/S (mm)	Market Cap. (mm)	Earnings per Share 2004A	2005A	2006E	2007E	P/E Ratios 2004A	2005A	2006E	2007E	Dividend Rate	Yield	12-Month Target	Total Return	Rating
Duke Energy Corp. [2]	DUK [5]	$30.07	1089.6	$32,763	$1.32	$1.73	$1.89	$1.97	16.8	16.1	16.0	15.3	$1.26	4.2%	$32.50	12.3%	Outperform
Enbridge Inc.	ENB	35.54	337.7	12,002	1.56	1.56	1.72	1.82	16.7	21.8	20.6	19.5	1.15	3.2%	37.50	8.8%	Market Perform
Enbridge Income Fund	ENF.UN	13.25	34.6	459	0.30	0.44	0.51	0.55	40.4	30.8	26.1	24.1	0.92	6.9%	13.25	6.9%	Market Perform
Fort Chicago Energy Partners L.P.	FCE.UN	11.95	133.7	1,597	0.74	0.59	0.60	0.46	14.1	20.9	19.9	25.8	0.93	7.8%	12.00	8.2%	Market Perform
Gaz Métro [4]	GZM.UN	17.04	117.5	2,002	1.40	1.30	1.24	1.26	15.4	16.7	13.8	13.5	1.30	7.6%	18.25	14.7%	Outperform
Inter Pipeline Fund	IPL.UN	10.38	199.5	2,071	0.46	0.48	0.63	0.48	17.6	20.1	16.5	21.7	0.80	7.7%	10.25	6.4%	Market Perform
Pacific Northern Gas Ltd.	PNG	17.76	3.6	64	1.38	1.72	0.96	1.59	14.3	11.4	18.5	11.1	0.80	4.5%	19.50	14.3%	Outperform
Pembina Pipeline Income Fund	PIF.UN	17.21	121.9	2,098	0.53	0.65	0.81	0.84	23.5	22.0	21.3	20.4	1.16	6.8%	17.00	5.5%	Market Perform
TransCanada Corp.	TRP	35.43	487.7	17,280	1.55	1.70	1.89	1.77	17.9	19.1	18.7	20.0	1.27	3.6%	35.65	4.2%	Market Perform
Group Average (Excl. ENF, FCE, GZM, IPL and PIF)									16.4	17.1	18.4	16.5		3.9%		9.9%	

Canadian Electric Utilities

Company	TSX Ticker	Price (C$) 22-Sep-06	Shares O/S (mm)	Market Cap. (mm)	Earnings per Share 2004A	2005A	2006E	2007E	P/E Ratios 2004A	2005A	2006E	2007E	Dividend Rate	Yield	12-Month Target	Total Return	Rating
Caribbean Utilities Co. Ltd. [2, 3]	CUP.U	$11.94	25.2	$301	$0.77	$0.13	$0.87	$0.86	16.1	NMF	13.7	13.8	$0.66	5.5%	$13.00	14.4%	Outperform
Emera Inc.	EMA	20.55	110.4	2,268	1.16	1.04	1.15	1.18	15.7	18.2	17.8	17.4	0.89	4.3%	20.00	1.7%	Market Perform
Fortis Inc.	FTS	24.60	103.4	2,545	0.99	1.10	1.25	1.40	15.6	18.6	19.7	17.5	0.64	2.6%	26.75	11.3%	Outperform
Maxim Power Corp.[1]	MXG	4.21	43.9	185	0.50	0.30	0.16	0.19	7.6	24.3	27.2	22.2	0.00	0.0%	NA	NA	NR
Group Average									13.7	20.4	19.6	17.7		4.2%		9.1%	

Canadian Multi-Utilities

Company	TSX Ticker	Price (C$) 22-Sep-06	Shares O/S (mm)	Market Cap. (mm)	Earnings per Share 2004A	2005A	2006E	2007E	P/E Ratios 2004A	2005A	2006E	2007E	Dividend Rate	Yield	12-Month Target	Total Return	Rating
ATCO Ltd. [1]	ACO/X	$43.97	52.5	$2,308	$2.17	$2.46	R	R	11.7	14.4	R	R	R	R	R	R	Restricted
Atlantic Power Corporation [6]	ATP.UN	10.63	49.7	528	(0.57)	(0.01)	R	R	NMF	13.2	R	R	R	R	R	R	Restricted
Boralex Power Income Fund	BPT.UN	10.76	59.1	636	0.50	0.50	0.52	0.51	21.1	21.5	20.7	21.0	$0.90	8.4%	$11.00	10.6%	Market Perform
Calpine Power Income Fund	CF.UN	10.40	61.7	642	0.81	0.76	R	R	13.5	13.3	R	R	R	R	R	R	Restricted
Cdn Hydro Developers, Inc.	KHD	5.16	120.5	622	0.06	0.00	0.07	0.08	44.4	NMF	76.5	67.0	NA	NA	5.60	8.5%	Market Perform
Canadian Utilities Ltd.	CU	43.29	127.0	5,496	1.98	2.03	R	R	14.4	17.4	R	R	R	R	R	R	Restricted
Creststreet Power & Income Fund LP	CRS.UN	5.00	11.5	58		(0.54)	(0.02)	(0.00)		NMF	NMF	NMF	0.65	13.0%	5.00	13.0%	Underperform
EPCOR Power, L.P.	EP.UN	31.21	48.4	1,512	2.25	1.83	1.86	1.30	15.1	19.2	16.8	24.0	2.52	8.1%	33.00	13.8%	Outperform
Great Lakes Hydro Income Fund	GLH.UN	19.30	48.3	932	1.03	0.75	1.18	1.03	16.5	25.0	16.4	18.7	1.24	6.4%	18.25	1.0%	Underperform
Innergex Power Income Fund	IEF.UN	13.96	24.7	345	0.46	0.46	0.50	0.47	25.5	28.5	27.8	29.9	0.97	6.9%	13.50	3.6%	Market Perform
TransAlta Corp.	TA	24.91	200.6	4,996	0.62	0.88	0.96	1.34	27.6	24.1	25.9	18.6	1.00	4.0%	22.25	-6.7%	Underperform
TransAlta Power L.P.	TPW.UN	8.08	75.1	607	0.48	(0.04)	0.46	0.37	19.8	NMF	17.7	21.6	0.80	9.8%	7.25	-0.4%	Underperform
Group Average (Excl. KHD, IPS, LPs and Income Trusts)									17.9	18.6	25.9	18.6		4.0%		-6.7%	

Notes:
NA = Not Applicable, NMF = Not Meaningful, NR = Not Rated
[1] Estimates from First Call
[2] All figures in US Dollars
[3] Caribbean Utilities' year end is April 30
[4] Gaz Metro's year end is Sept. 30
[5] Ticker on the New York Stock Exchange
[6] Represents Income Participating Securities (IPS). Share price, Market Cap and Dividend in C$; all else in US$.

Source: BMO Capital Markets

Analyst's Certification

I, Karen Taylor, CFA, hereby certify that the views expressed in this report accurately reflect my personal views about the subject securities or issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report.

I, Michael McGowan, CA, CFA, hereby certify that the views expressed in this report accurately reflect my personal views about the subject securities or issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report.

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Company Specific Disclosures

Atlantic Power Corp. (ATP.UN-TSX)	9, 10C	Fort Chicago Energy L.P. (FCE.UN-TSX)	9, 10C
Boralex Power Income Fund (BPT.UN-TSX)	11	Fortis Inc. (FTS-TSX)	9, 10C
Calpine Power Income Fund (CF.UN-TSX)	1, 3, 9, 10AC	Gaz Metro Limited Partnership (GZM.UN-TSX)	1, 2, 3, 9, 10AC
Canadian Hydro Developers Inc. (KHD-TSX)	2, 3, 10A	Great Lakes Hydro Income Fund (GLH.UN-TSX)	
Canadian Utilities (CU-TSX)	2, 3, 9, 10AC, 11, 12	Innergex Power Income Fund (IEF.UN-TSX)	2, 3, 9, 10AC
Caribbean Utilities Co. Ltd. (CUP.U-TSX)	5, 7, 9, 10AB	Inter Pipeline Fund (IPL.UN-TSX)	2, 3, 9, 10AC
Countryside Power Income Fund (COU.UN-TSX)	2, 3, 10A	Macquarie Power Income Fund (MPT.UN-TSX)	2, 3, 10A
Creststreet Power & Inc. Fund (CRS.UN-TSX)	2, 3, 9, 10AC	Northland Power Income Fund (NPI.UN-TSX)	2, 3, 9, 10AC
Duke Energy Corp. (DUK-NYSE)	2, 3, 9, 10AC	Pacific Northern Gas (PNG-TSX)	
Emera Inc. (EMA-TSX)	9, 10C	Pembina Pipeline Income Fund (PIF.UN-TSX)	9, 10C
Enbridge Inc. (ENB-TSX; ENB-NYSE)	2, 3, 4, 9, 10AC	TransAlta Corporation (TA-TSX; TAC-NYSE)	2, 3, 4, 5, 9, 10AC, 11, 12
Enbridge Income Fund (ENF.UN-TSX)		TransAlta Power L.P. (TPW.UN-TSX)	9, 10C
EPCOR Power, L.P. (EP.UN-TSX)	2, 3, 9, 10AC	TransCanada Corporation (TRP-TSX; TRP-NYSE)	1, 2, 3, 5, 9, 10AC, 12

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2 - BMO NB has undertaken an underwriting liability with respect to this issuer within the past 12 months.

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Rating Category	BMO Rating	BMO Universe	BMO I.B. Clients*	First Call Universe**
Buy	Outperform	38%	47%	49%
Hold	Market Perform	53%	47%	45%
Sell	Underperform	9%	6%	6%

* Reflects rating distribution of all companies where BMO Capital Markets has received compensation for Investment Banking services.
** Reflects rating distribution of all North American equity research analysts.

Ratings Key
We use the following ratings system definitions:
OP = Outperform - Forecast to outperform the market;
Mkt = Market Perform - Forecast to perform roughly in line with the market;
Und = Underperform - Forecast to underperform the market;
(S) = speculative investment;
NR = No rating at this time;
R = Restricted – Dissemination of research is currently restricted.

Market performance is measured by a benchmark index such as the S&P/TSX Composite Index, S&P 500, Nasdaq Composite, as appropriate for each company. Prior to September 1, 2003, a fourth rating tier—Top Pick—was used to designate those stocks we felt would be the best performers relative to the market. Our six Top 15 lists which guide investors to our best ideas according to six different objectives (large, small, growth, value, income and quantitative) have replaced the Top Pick rating.

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Additional Matters

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Pacific Northern Gas

(PNG-TSX)

Stock Rating: **Market Perform ↓**
Industry Rating: **Market Perform**

October 27, 2006
Research Comment
Toronto, Ontario

Karen Taylor, CFA
(416) 359-4304
Karen.Taylor@bmo.com
Assoc: Benjamin Pham

Lower Development Costs Increase Q3/06 EPS; Rating Lowered to Market Perform

Event

Pacific Northern Gas reported Q3/06 EPS of a loss of $0.42. We expected a loss of $0.83 per share. The variance between expected and actual results is attributable to: (i) $0.6 million of project development costs expensed during the quarter versus our expectation of $1.6 million in costs expensed (actual expense of $0.17 versus our expectation of $0.44 per share); and (ii) lower than expected operating costs that increased earnings by approximately $0.2 million or $0.05 per share. The change in the seasonal pattern of earnings arising from an increase in the portion of operating margin recovered from temperature sensitive residential and commercial customers in Q3/06 of $0.6 million was in line with expectations. Project development costs of $1.0 million are expected to be charged against earnings in Q4/06 versus our previous expectation of $0.3 million. Total project development costs (as discussed in our July 20, 2006 comment) are expected to be $2.1 million in 2006 versus previous guidance of $2.4 million after-tax.

Impact

Neutral.

Forecasts

Our diluted 2006 EPS estimate increases to $1.04 from $0.96 previously, due to lower anticipated project development costs. Our diluted 2007 EPS estimate is unchanged.

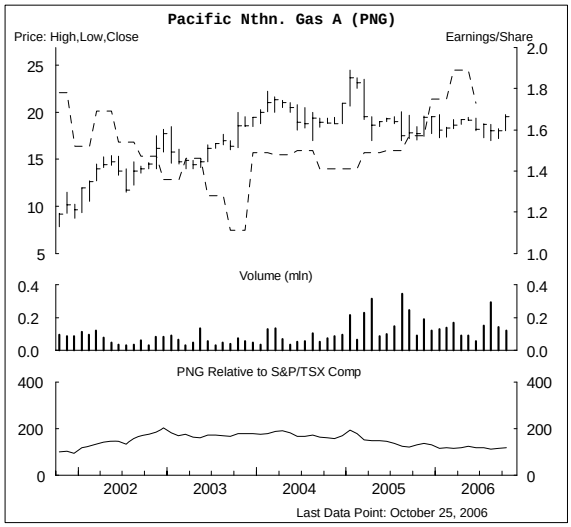
Valuation

Our target price of $20 reflects a weighted average approach: 12x diluted 2007E EPS of $1.59 (12.5%), 1.0x 2007E BV of $22.57 (12.5%), and a target yield of 4.10% (75%), assuming 2007 dividends per share of $0.80.

Recommendation

We believe that the shares are reasonably valued at current levels. We have downgraded the stock to Market Perform from Outperform.

Price (26-Oct)	$19.60	**52-Week High**	$19.75
Target Price	$20.00↑	**52-Week Low**	$16.96



(FY-Dec.)	2004A	2005A	2006E	2007E
EPS	$1.38	$1.71	$1.04↑	$1.59
P/E			18.8x	12.3x
CFPS	$4.55	$3.27	$3.69	$4.37
P/CFPS			5.3x	4.5x
Div.	$0.80	$0.80	$0.80	$0.80
EV ($mm)	$184	$183	$159	$155
EBITDA ($mm)	$26.3	$27.5	$18.0	$21.4
EV/EBITDA	7.0x	6.6x	8.9x	7.2x

Quarterly EPS	Q1	Q2	Q3	Q4
2004A	$1.00	$0.01	-$0.31	$0.71
2005A	$1.08	$0.02	-$0.24	$0.89
2006E	$1.22a	-$0.14a	-$0.42a	$0.42↑

Dividend	$0.80	**Yield**	4.1%
Book Value	$22.11	**Price/Book**	0.9x
Shares O/S (mm)	3.6	**Mkt. Cap ($mm)**	$71
Float O/S (mm)	3.6	**Float Cap ($mm)**	$71
Wkly Vol (000s)	33	**Wkly $ Vol (mm)**	$0.6
Net Debt ($mm)	$96.3	**Next Rep. Date**	Dec. (E)

Notes: Estimates are weather normal
Major Shareholders: Widely held
First Call Mean Estimates: PACIFIC NORTHERN GAS LTD 'A' (C$) 2006E: $0.97; 2007E: $1.64

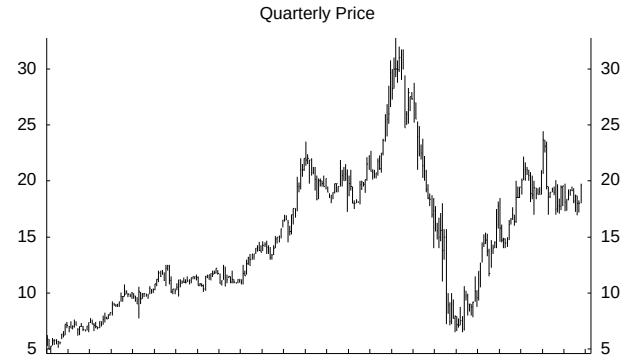
Changes	**Annual EPS**	**Quarterly EPS**	**Target**
	2006E $0.96 to $1.04	Q4/06E $0.34 to $0.42	$19.50 to $20.00
			Rating
			OP to Mkt

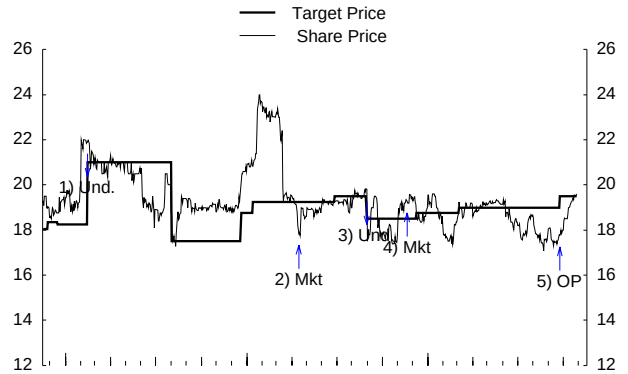
Table 1. Consolidated Summary Sheet

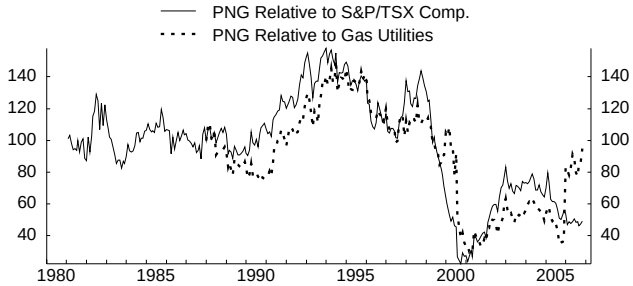
27-Oct-06									Karen J. Taylor
Current Price:	$19.60								BMO Capital Markets
12-Month Target Price:	$20.00								
ROR:	6.1%						Recommendation:		Market Perform
				Year Ended December 31					
	1999	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006E**	**2007E**
Total Earnings Per Share	$1.92	$1.83	$1.52	$1.28	$1.49	$1.41	$1.75	$1.07	$1.63
Fully Diluted EPS	$1.67	$1.77	$1.47	$1.25	$1.46	$1.38	$1.72	$1.04	$1.59
Dividends	$1.12	$0.56	$0.00	$0.00	$0.80	$0.80	$0.80	$0.80	$0.80
Payout Ratio	58.3%	30.7%	0.0%	0.0%	53.8%	56.8%	45.8%	74.5%	49.0%
Average Shares (mm)	3.5	3.5	3.5	3.5	3.6	3.6	3.6	3.626	3.6
Net Book Value	17.62	18.84	20.36	21.62	19.25	20.52	21.44	21.72	22.57
Market Valuation									
Price: High	$28.70	$18.00	$11.95	$18.00	$19.50	$22.00	$24.00	-	-
Price: Low	$14.00	$6.80	$6.50	$9.35	$14.00	$17.28	$17.37	-	-
Price: Current	-	-	-	-	-	-	-	$19.60	
P/E Ratio: High	15.0	9.9	7.9	14.0	13.1	15.6	13.7	-	-
P/E Ratio: Low	7.3	3.7	4.3	7.3	9.4	12.3	9.9	-	-
P/E Ratio: Current	-	-	-	-	-	-	-	18.2	12.0
Price/Book Value: High	1.58	0.96	0.59	0.83	1.01	1.07	1.12	-	-
Price/Book Value: Low	0.77	0.36	0.32	0.43	0.73	0.84	0.81	-	-
Price/Book Value: Current	-	-	-	-	-	-	-	0.90	0.87
Yield: High Price	3.90%	3.11%	0.00%	0.00%	4.11%	3.64%	3.34%	-	-
Yield: Low Price	8.00%	8.24%	0.00%	0.00%	5.73%	4.63%	4.62%	-	-
Yield: Current	-	-	-	-	-	-	-	4.1%	4.1%
Balance Sheet ($mm)									
Debt (S-T)	38.3	27.7	12.1	4.4	7.3	10.4	14.7	1.9	0.9
Debt (L-T)	85.6	82.2	79.5	90.2	85.8	81.4	76.6	71.7	66.8
Deferred Items	15.7	22.2	17.3	17.0	17.9	15.8	15.7	15.7	17.2
Preferred Shares	6.7	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0
Shareholders' Equity	62.3	66.8	72.2	76.7	69.4	73.9	77.7	78.8	81.8
	208.5	203.9	186.2	193.3	185.4	186.7	189.7	173.0	171.7
Balance Sheet (%)									
Debt (S-T)	18.3%	13.6%	6.5%	2.3%	3.9%	5.6%	7.7%	1.1%	0.5%
Debt (L-T)	41.1%	40.3%	42.7%	46.7%	46.3%	43.6%	40.4%	41.4%	38.9%
Deferred Items	7.5%	10.9%	9.3%	8.8%	9.7%	8.5%	8.3%	9.0%	10.0%
Preferred Shares	3.2%	2.5%	2.7%	2.6%	2.7%	2.7%	2.6%	2.9%	2.9%
Shareholders' Equity	29.9%	32.8%	38.8%	39.7%	37.4%	39.6%	41.0%	45.5%	47.7%
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Income Statement ($mm)									
Total Revenue	77.7	115.7	138.6	109.1	133.7	137.8	160.0	138.5	142.5
EBIT	22.0	21.8	20.5	19.5	18.5	17.5	18.6	7.8	11.8
NPAT	7.1	6.8	5.7	4.9	5.7	5.4	6.7	4.2	6.3
Preferred Share Dividends	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Net Earnings to Common	6.8	6.5	5.4	4.6	5.3	5.1	6.3	3.9	5.9
Cash Flow from Operations	9.8	27.5	20.9	12.8	12.2	16.4	11.8	13.7	17.3
Key Statistics									
Average Utility Rate Base ($mm)	170.7	173.4	170.2	166.8	165.4	167.2	165.2	162.4	160.4
Growth Rate	1.05%	1.56%	-1.86%	-1.98%	-0.87%	1.10%	-1.19%	-1.67%	-1.24%
2004- 2007 CAGR									-1.37%
Allowed Return on Equity	10.00%	10.25%	10.00%	9.88%	10.17%	9.80%	9.68%	9.45%	9.45%
Deemed Equity	36.00%	36.00%	36.00%	36.00%	36.00%	36.00%	40.00%	40.00%	40.00%

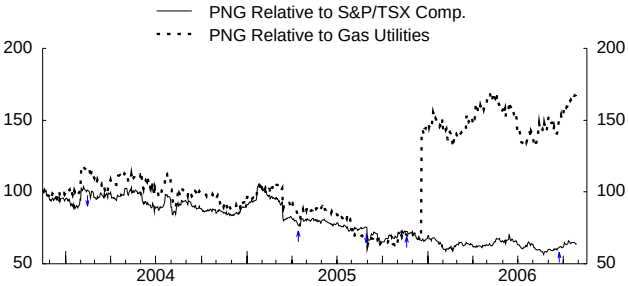
Source: BMO Capital Markets

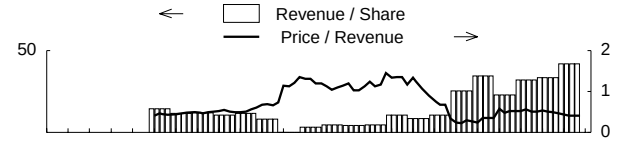
Pacific Nthn. Gas A (PNG)

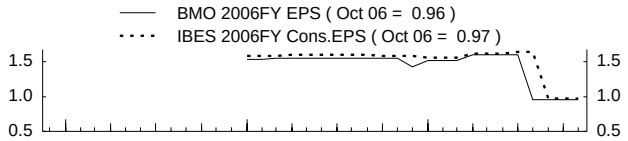


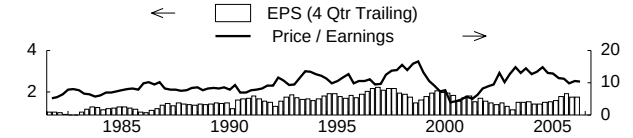


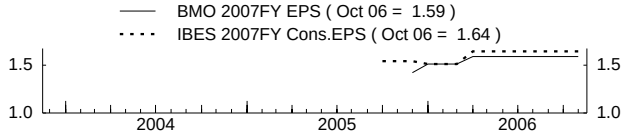












FYE (Dec.)	EPS $	P/E	DPS $	Yield %	Payout %	BV $	P/B	ROE %
1985	1.22	8	0.70	7.0	57	8.03	1.2	15
1986	1.09	9	0.70	6.8	64	8.43	1.2	13
1987	1.31	8	0.75	7.4	57	8.97	1.1	15
1988	1.34	8	0.75	6.6	56	9.24	1.2	15
1989	1.45	8	0.75	6.4	52	9.92	1.2	15
1990	1.61	7	0.75	6.7	47	10.76	1.0	16
1991	1.66	8	0.80	5.9	48	11.62	1.2	15
1992	1.55	11	0.80	4.8	52	12.37	1.3	13
1993	1.63	13	0.88	4.0	54	12.37	1.8	13
1994	1.80	11	0.88	4.3	49	12.37	1.6	15
1995	1.67	13	0.96	4.6	57	14.57	1.4	12
1996	2.01	11	0.96	4.3	48	15.61	1.4	13
1997	2.16	14	1.04	3.5	48	16.42	1.8	13
1998	1.73	16	1.12	4.1	65	17.39	1.6	10
1999	1.92	9	1.12	6.5	58	18.19	1.0	11
2000	1.83	4	1.12	14.1	61	19.44	0.4	10
2001	1.52	6	1.12	11.7	74	20.95	0.5	8
2002	1.25	13	1.12	6.3	82	19.27	0.9	6
2003	1.46	13	0.80	4.1	54	19.96	1.0	7
2004	1.38	15	0.80	3.8	57	20.52	1.0	7
2005	1.71	11	0.80	4.1	46	21.43	0.9	8
Current*	1.73	10	0.80	4.4	46	22.11	0.8	8
Average:		10		6.0	56		1.2	11.8
Growth(%):								
5 Year:	-0.6		-6.5			2.6		
10 Year:	-0.8		-1.8			4.3		
20 Year:	2.9		0.7			5.2		

* Current EPS is the 4 Quarter Trailing to Q2/2006.

PNG - Rating as of 17-Nov-03 = Mkt

	Date	Rating Change	Share Price
1	13-Feb-04	Mkt to Und.	$21.90
2	14-Apr-05	Und.to Mkt	$17.85
3	30-Aug-05	Mkt to Und.	$19.80
4	18-Nov-05	Und.to Mkt	$19.27
5	22-Sep-06	Mkt to OP	$17.76

Last Daily Data Point: October 26, 2006

Company Risk Disclosure

In addition to the risks involved in investing in common stocks generally, we also highlight the following risks that pertain to this company. The company's natural gas transmission business is dependent upon the continued availability of natural gas. The BCUC approves PNG's customer rates and a fair return on the rate base. Changes in regulation may adversely affect performance. Natural gas and fuel oil compete with electricity for space heating in Pacific Northern Gas' service areas. Fluctuations in the price of natural gas could increase the working capital financing requirements and related costs for accounts receivable. In 2004, 75% of energy deliveries were made to four large industrial customers (67% to one customer, Methanex). Transportation service to Methanex was made pursuant to an agreement that expires in October 2009. On August 30, 2005, Methanex announced that it will close its Kitimat facilities in early 2006. PNG's DBRS credit BBB(L) rating is Under Review with Negative Implications. A one notch downgrade would result in a below investment grade bond rating.

Analyst's Certification

I, Karen Taylor, CFA, hereby certify that the views expressed in this report accurately reflect my personal views about the subject securities or issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report.

General Disclosure

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Distribution of Ratings

Rating Category	BMO Rating	BMO Universe	BMO I.B. Clients*	First Call Universe**
Buy	Outperform	38%	47%	49%
Hold	Market Perform	53%	47%	45%
Sell	Underperform	9%	6%	6%

* Reflects rating distribution of all companies where BMO Capital Markets has received compensation for Investment Banking services.

** Reflects rating distribution of all North American equity research analysts.

Ratings Key

We use the following ratings system definitions:

OP = Outperform - Forecast to outperform the market;

Mkt = Market Perform - Forecast to perform roughly in line with the market;

Und = Underperform - Forecast to underperform the market;

(S) = speculative investment;

NR = No rating at this time;

R = Restricted – Dissemination of research is currently restricted.

Market performance is measured by a benchmark index such as the S&P/TSX Composite Index, S&P 500, Nasdaq Composite, as appropriate for each company. Prior to September 1, 2003, a fourth rating tier—Top Pick—was used to designate those stocks we felt would be the best performers relative to the market. Our six Top 15 lists which guide investors to our best ideas according to six different objectives (large, small, growth, value, income and quantitative) have replaced the Top Pick rating.

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Pacific Northern Gas

(PNG-TSX)

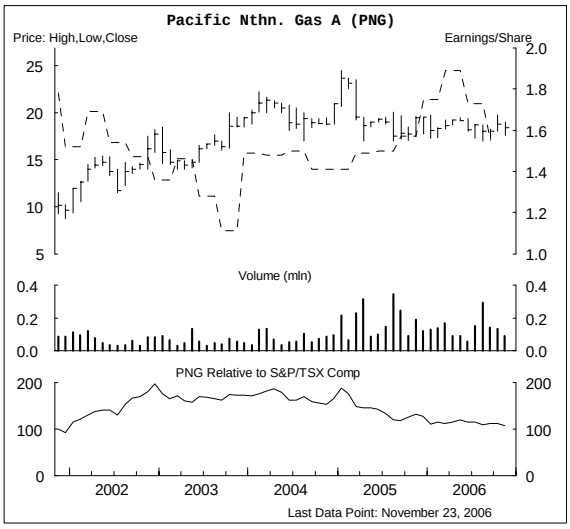
Stock Rating: **Outperform ↑**
Industry Rating: **Market Perform**

November 27, 2006
Research Comment
Toronto, Ontario

Karen Taylor, CFA
(416) 359-4304
Karen.Taylor@bmo.com
Assoc: Benjamin Pham

BCUC Release 2007 ROE; Rating Raised to Outperform

Price (23-Nov)	$18.42	**52-Week High**	$19.75
Target Price	$20.00	**52-Week Low**	$16.96



Event

On November 23, the British Columbia Utilities Commission (BCUC) released its return on common equity for a low-risk benchmark utility for the year 2007. The low-risk return is 8.37% for 2007 versus 8.80% in 2006. The operations of PNG West and Tumbler Ridge earn the benchmark return (8.37%) plus a 0.65% premium, or 9.02%. The Ft. St. John and Dawson Creek divisions of the company receive the benchmark return of 8.37% plus a premium of 0.40%, or 8.77%.

Impact

Neutral. While we believe that the return on equity determined by the automatic adjustment mechanism currently used by the BCUC likely violates the fair return standard and is confiscatory, it is in line with expectations and is therefore neutral to our outlook.

Forecasts

We have updated our financial model to reflect the new 2007 allowed return on equity, as determined by the Commission.

Valuation

Our target price reflects a weighted valuation approach: 12x 2008E diluted EPS of $1.50 (12.5%), 1x 2008E BV per share of $23.24 (12.5%), and a target yield of 4.10% (75%), assuming 2008 dividends per share of $0.80.

Recommendation

We have increased our rating on the shares of Pacific Northern Gas to Outperform from Market Perform, largely due to price weakness following the federal government's taxation initiatives announced on October 31, 2006.

(FY-Dec.)	2005A	2006E	2007E	2008E
EPS	$1.72	$1.04	$1.52↓	$1.50↓
P/E		17.7x	12.1x	12.3x
CFPS	$3.27	$3.77	$4.78	$4.82
P/CFPS		4.9x	3.8x	3.8x
Div.	$0.80	$0.80	$0.80	$0.80
EV ($mm)	$183	$161	$157	$153
EBITDA ($mm)	$27.5	$17.3	$21.4	$21.1
EV/EBITDA	6.6x	9.3x	7.3x	7.2x

Quarterly EPS	Q1	Q2	Q3	Q4
2005A	$1.08	$0.02	-$0.24	$0.89
2006E	$1.22a	-$0.14a	-$0.42a	$0.42
2007E	$1.14	$0.02	-$0.22	$0.69

Dividend	$0.80	**Yield**	4.3%
Book Value	$21.57	**Price/Book**	0.9x
Shares O/S (mm)	3.6	**Mkt. Cap ($mm)**	$67
Float O/S (mm)	3.6	**Float Cap ($mm)**	$67
Wkly Vol (000s)	32	**Wkly $ Vol (mm)**	$0.6
Net Debt ($mm)	$78.6	**Next Rep. Date**	19-Feb (E)

Notes: Estimates are weather normal
Major Shareholders: Widely held
First Call Mean Estimates: PACIFIC NORTHERN GAS LTD 'A' (C$) 2006E: $1.01; 2007E: $1.64

Changes

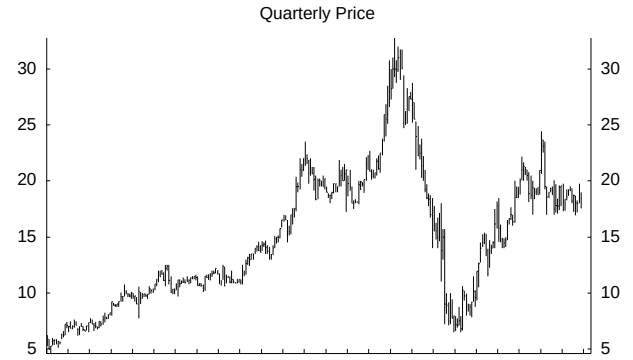
Annual EPS	**Rating**
2007E $1.59 to $1.52	Mkt to OP
2008E $1.57 to $1.50	

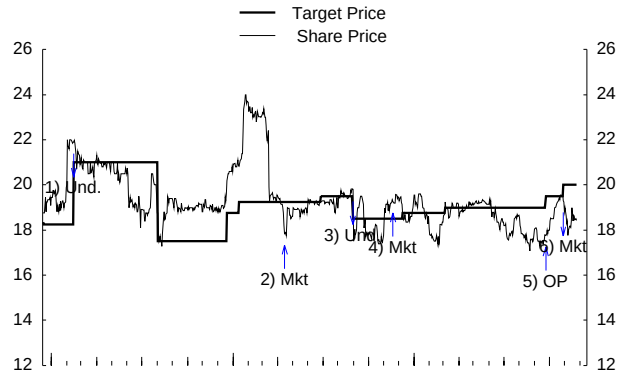
Table 1. Consolidated Summary Sheet

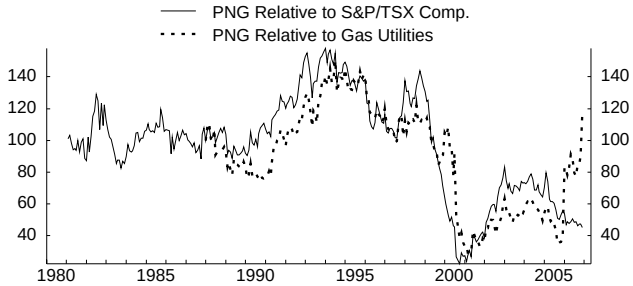
24-Nov-06								Karen J. Taylor
Current Price:	$18.50							BMO Capital Markets
12-Month Target Price:	$20.00							
ROR:	12.4%					Recommendation:		Outperform
				Year Ended December 31				
	2001	**2002**	**2003**	**2004**	**2005**	**2006E**	**2007E**	**2008E**
Total Earnings Per Share	$1.52	$1.28	$1.49	$1.41	$1.75	$1.07	$1.56	$1.54
Fully Diluted EPS	$1.47	$1.25	$1.46	$1.38	$1.72	$1.04	$1.52	$1.50
Dividends	$0.00	$0.00	$0.80	$0.80	$0.80	$0.80	$0.80	$0.80
Payout Ratio	0.0%	0.0%	53.8%	56.8%	45.8%	74.5%	51.3%	51.8%
Average Shares (mm)	3.5	3.5	3.6	3.6	3.6	3.626	3.6	3.6
Net Book Value	20.36	21.62	19.25	20.52	21.44	21.72	22.49	23.24
Market Valuation								
Price: High	$11.95	$18.00	$19.50	$22.00	$24.00	-	-	-
Price: Low	$6.50	$9.35	$14.00	$17.28	$17.37	-	-	-
Price: Current	-	-	-	-	-	$18.50		
P/E Ratio: High	7.9	14.0	13.1	15.6	13.7	-	-	-
P/E Ratio: Low	4.3	7.3	9.4	12.3	9.9	-	-	-
P/E Ratio: Current	-	-	-	-	-	17.2	11.9	12.0
Price/Book Value: High	0.59	0.83	1.01	1.07	1.12	-	-	-
Price/Book Value: Low	0.32	0.43	0.73	0.84	0.81	-	-	-
Price/Book Value: Current	-	-	-	-	-	0.85	0.82	0.80
Yield: High Price	0.00%	0.00%	4.11%	3.64%	3.34%	-	-	-
Yield: Low Price	0.00%	0.00%	5.73%	4.63%	4.62%	-	-	-
Yield: Current	-	-	-	-	-	4.3%	4.3%	4.3%
Balance Sheet ($mm)								
Debt (S-T)	12.1	4.4	7.3	10.4	14.7	1.9	1.1	0.4
Debt (L-T)	79.5	90.2	85.8	81.4	76.6	71.7	66.8	61.9
Deferred Items	17.3	17.0	17.9	15.8	15.7	15.7	17.2	18.7
Preferred Shares	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0
Shareholders' Equity	72.2	76.7	69.4	73.9	77.7	78.8	81.6	84.3
	186.2	193.3	185.4	186.7	189.7	173.0	171.7	170.3
Balance Sheet (%)								
Debt (S-T)	6.5%	2.3%	3.9%	5.6%	7.7%	1.1%	0.7%	0.2%
Debt (L-T)	42.7%	46.7%	46.3%	43.6%	40.4%	41.4%	38.9%	36.4%
Deferred Items	9.3%	8.8%	9.7%	8.5%	8.3%	9.0%	10.0%	11.0%
Preferred Shares	2.7%	2.6%	2.7%	2.7%	2.6%	2.9%	2.9%	2.9%
Shareholders' Equity	38.8%	39.7%	37.4%	39.6%	41.0%	45.5%	47.5%	49.5%
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Income Statement ($mm)								
Total Revenue	138.6	109.1	133.7	137.8	160.0	138.5	139.3	137.5
EBIT	20.5	19.5	18.5	17.5	18.6	7.8	11.3	10.8
NPAT	5.7	4.9	5.7	5.4	6.7	4.2	6.0	5.9
Preferred Share Dividends	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Net Earnings to Common	5.4	4.6	5.3	5.1	6.3	3.9	5.7	5.6
Cash Flow from Operations	20.9	12.8	12.2	16.4	11.8	13.7	17.1	17.2

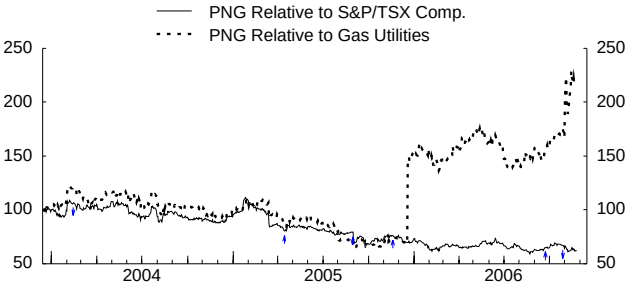
Source: BMO Capital Markets

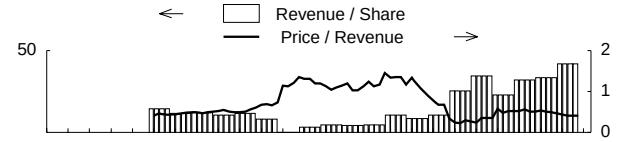
Pacific Nthn. Gas A (PNG)

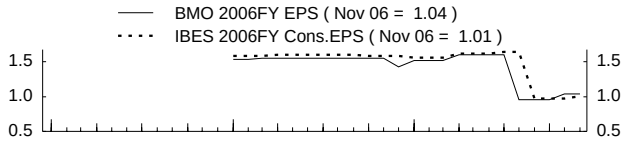


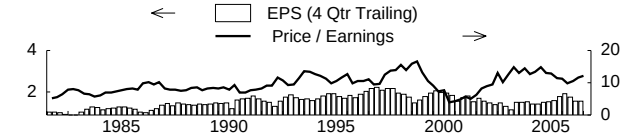


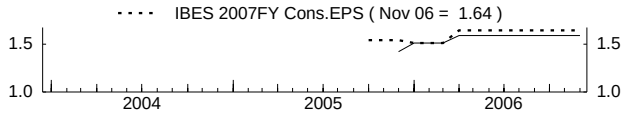












FYE (Dec.)	EPS $	P/E	DPS $	Yield %	Payout %	BV $	P/B	ROE %
1985	1.22	8	0.70	7.0	57	8.03	1.2	15
1986	1.09	9	0.70	6.8	64	8.43	1.2	13
1987	1.31	8	0.75	7.4	57	8.97	1.1	15
1988	1.34	8	0.75	6.6	56	9.24	1.2	15
1989	1.45	8	0.75	6.4	52	9.92	1.2	15
1990	1.61	7	0.75	6.7	47	10.76	1.0	16
1991	1.66	8	0.80	5.9	48	11.62	1.2	15
1992	1.55	11	0.80	4.8	52	12.37	1.3	13
1993	1.63	13	0.88	4.0	54	12.37	1.8	13
1994	1.80	11	0.88	4.3	49	12.37	1.6	15
1995	1.67	13	0.96	4.6	57	14.57	1.4	12
1996	2.01	11	0.96	4.3	48	15.61	1.4	13
1997	2.16	14	1.04	3.5	48	16.42	1.8	13
1998	1.73	16	1.12	4.1	65	17.39	1.6	10
1999	1.92	9	1.12	6.5	58	18.19	1.0	11
2000	1.83	4	1.12	14.1	61	19.44	0.4	10
2001	1.52	6	1.12	11.7	74	20.95	0.5	8
2002	1.25	13	1.12	6.3	82	19.27	0.9	6
2003	1.46	13	0.80	4.1	54	19.96	1.0	7
2004	1.38	15	0.80	3.8	57	20.52	1.0	7
2005	1.72	11	0.80	4.1	46	21.43	0.9	8
Current*	1.55	12	0.80	4.3	52	21.57	0.9	7
Average:		10		6.0	56		1.2	11.8
Growth(%):								
5 Year:	-2.7		-6.5			2.1		
10 Year:	-1.9		-1.8			4.0		
20 Year:	2.3		0.7			5.1		

* Current EPS is the 4 Quarter Trailing to Q3/2006.

PNG - Rating as of 15-Dec-03 = Mkt

	Date	Rating Change	Share Price
1	13-Feb-04	Mkt to Und.	$21.90
2	14-Apr-05	Und.to Mkt	$17.85
3	30-Aug-05	Mkt to Und.	$19.80
4	18-Nov-05	Und.to Mkt	$19.27
5	22-Sep-06	Mkt to OP	$17.76
6	27-Oct-06	OP to Mkt	$19.30

Last Daily Data Point: November 23, 2006

Company Risk Disclosure

In addition to the risks involved in investing in common stocks generally, we also highlight the following risks that pertain to this company. The company's natural gas transmission business is dependent upon the continued availability of natural gas. The BCUC approves PNG's customer rates and a fair return on the rate base. Changes in regulation may adversely affect performance. Natural gas and fuel oil compete with electricity for space heating in Pacific Northern Gas' service areas. Fluctuations in the price of natural gas could increase the working capital financing requirements and related costs for accounts receivable. In 2004, 75% of energy deliveries were made to four large industrial customers (67% to one customer, Methanex). Transportation service to Methanex was made pursuant to an agreement that expires in October 2009. On August 30, 2005, Methanex announced that it will close its Kitimat facilities in early 2006. PNG's DBRS credit BBB(L) rating is Under Review with Negative Implications. A one notch downgrade would result in a below investment grade bond rating.

Analyst's Certification

I, Karen Taylor, CFA, hereby certify that the views expressed in this report accurately reflect my personal views about the subject securities or issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report.

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Pacific Northern Gas

(PNG-TSX)

Stock Rating: **Outperform**
Industry Rating: **Market Perform**

December 13, 2006
Research Comment
Toronto, Ontario

Karen Taylor, CFA
(416) 359-4304
Karen.Taylor@bmo.com
Assoc: Benjamin Pham

2007 Rate Applications; Outperform Rating Unchanged

Event

On October 26, Pacific Northern Gas filed 2007 rate applications with the British Columbia Utilities Commission (BCUC) for each of its operating divisions: PNG-West, Fort St. John/Dawson Creek and Tumbler Ridge. We have updated our financial model to reflect the key metrics of the application: Average Mid-Year Rate Base: $132.851 million, $32.227 million and $1.525 million, respectively; Deemed Equity - 40% for each division; Allowed Return on Equity: 9.02%, 8.77% and 9.02%, respectively; and Capital Expenditures (net of dispositions): $5.708 million, $2.578 million and $0.184 million, respectively. Our ROE assumptions are consistent with the BCUC's November 23, 2006, announcement of the 2007 benchmark utility return on equity calculation, as highlighted in our comment dated November 27, 2006.

Impact

Slightly positive.

Forecasts

Our 2007 and 2008 diluted EPS estimates increase to $1.58 and $1.54, respectively, from $1.52 and $1.50.

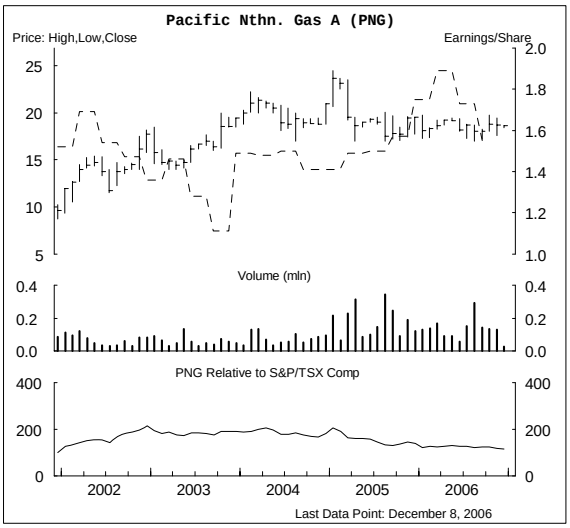
Valuation

Our target price reflects a weighted valuation approach: 12.0x 2008E diluted EPS of $1.54 (12.5%), 1.0x 2008E BV per share of $23.34 (12.5%), and a target yield of 4.10% (75%), assuming 2008 dividends per share of $0.80.

Recommendation

We believe that the shares are reasonably valued at current levels. Our rating is Outperform.

Price (12-Dec)	$18.55	**52-Week High**	$19.75
Target Price	$20.00	**52-Week Low**	$16.96



(FY-Dec.)	2005A	2006E	2007E	2008E
EPS	$1.72	$1.04	$1.58↑	$1.54↑
P/E		17.8x	11.7x	12.0x
CFPS	$3.27	$3.77	$4.78	$4.82
P/CFPS		4.9x	3.9x	3.8x
Div.	$0.80	$0.80	$0.80	$0.80
EV ($mm)	$183	$161	$157	$153
EBITDA ($mm)	$27.5	$17.3	$20.9	$20.6
EV/EBITDA	6.6x	9.3x	7.5x	7.4x

Quarterly EPS	Q1	Q2	Q3	Q4
2005A	$1.08	$0.02	-$0.24	$0.89
2006E	$1.22a	-$0.14a	-$0.42a	$0.42
2007E	$1.13↓	$0.02	-$0.22	$0.69

Dividend	$0.80	**Yield**	4.3%
Book Value	$21.57	**Price/Book**	0.9x
Shares O/S (mm)	3.6	**Mkt. Cap ($mm)**	$67
Float O/S (mm)	3.6	**Float Cap ($mm)**	$67
Wkly Vol (000s)	31	**Wkly $ Vol (mm)**	$0.6
Net Debt ($mm)	$78.6	**Next Rep. Date**	19-Feb (E)

Notes: Estimates are weather normal
Major Shareholders: Widely held
First Call Mean Estimates: PACIFIC NORTHERN GAS LTD 'A' (C$) 2006E: $1.04; 2008E: $1.57

Changes

Annual EPS
2007E $1.52 to $1.58
2008E $1.50 to $1.54

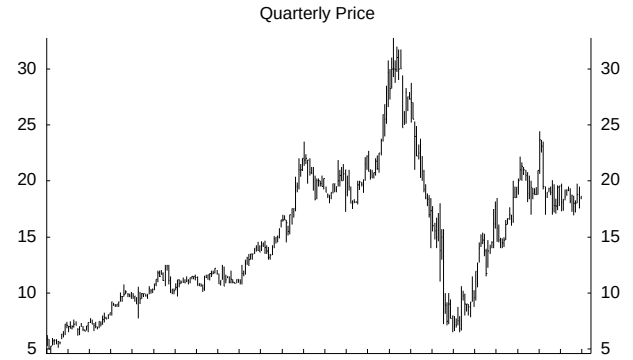
Quarterly EPS
Q1/07E $1.14 to $1.13

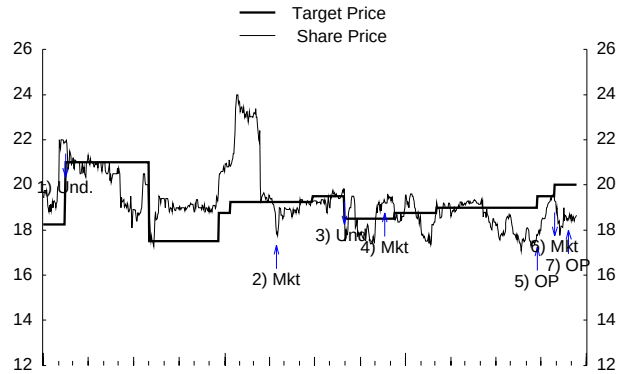
Table 1. Consolidated Summary Sheet

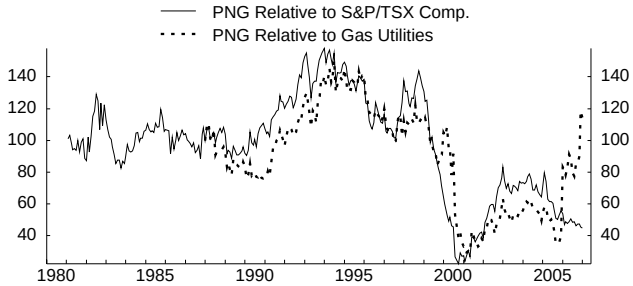
12-Dec-06								Karen J. Taylor
Current Price:	$18.55							BMO Capital Markets
12-Month Target Price:	$20.00							
ROR:	12.1%					Recommendation:		Outperform
				Year Ended December 31				
	2001	**2002**	**2003**	**2004**	**2005**	**2006E**	**2007E**	**2008E**
Total Earnings Per Share	$1.52	$1.28	$1.49	$1.41	$1.75	$1.07	$1.62	$1.58
Fully Diluted EPS	$1.47	$1.25	$1.46	$1.38	$1.72	$1.04	$1.58	$1.54
Dividends	$0.00	$0.00	$0.80	$0.80	$0.80	$0.80	$0.80	$0.80
Payout Ratio	0.0%	0.0%	53.8%	56.8%	45.8%	74.5%	49.5%	50.6%
Average Shares (mm)	3.5	3.5	3.6	3.6	3.6	3.626	3.6	3.6
Net Book Value	20.36	21.62	19.25	20.52	21.44	21.72	22.55	23.34
Market Valuation								
Price: High	$11.95	$18.00	$19.50	$22.00	$24.00	-	-	-
Price: Low	$6.50	$9.35	$14.00	$17.28	$17.37	-	-	-
Price: Current	-	-	-	-	-	$18.55		
P/E Ratio: High	7.9	14.0	13.1	15.6	13.7	-	-	-
P/E Ratio: Low	4.3	7.3	9.4	12.3	9.9	-	-	-
P/E Ratio: Current	-	-	-	-	-	17.3	11.5	11.7
Price/Book Value: High	0.59	0.83	1.01	1.07	1.12	-	-	-
Price/Book Value: Low	0.32	0.43	0.73	0.84	0.81	-	-	-
Price/Book Value: Current	-	-	-	-	-	0.85	0.82	0.79
Yield: High Price	0.00%	0.00%	4.11%	3.64%	3.34%	-	-	-
Yield: Low Price	0.00%	0.00%	5.73%	4.63%	4.62%	-	-	-
Yield: Current	-	-	-	-	-	4.3%	4.3%	4.3%
Balance Sheet ($mm)								
Debt (S-T)	12.1	4.4	7.3	10.4	14.7	1.9	4.1	3.8
Debt (L-T)	79.5	90.2	85.8	81.4	76.6	71.7	66.8	61.9
Deferred Items	17.3	17.0	17.9	15.8	15.7	15.7	15.0	16.5
Preferred Shares	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0
Shareholders' Equity	72.2	76.7	69.4	73.9	77.7	78.8	81.8	84.6
	186.2	193.3	185.4	186.7	189.7	173.0	172.6	171.9
Balance Sheet (%)								
Debt (S-T)	6.5%	2.3%	3.9%	5.6%	7.7%	1.1%	2.3%	2.2%
Debt (L-T)	42.7%	46.7%	46.3%	43.6%	40.4%	41.4%	38.7%	36.0%
Deferred Items	9.3%	8.8%	9.7%	8.5%	8.3%	9.0%	8.7%	9.6%
Preferred Shares	2.7%	2.6%	2.7%	2.7%	2.6%	2.9%	2.9%	2.9%
Shareholders' Equity	38.8%	39.7%	37.4%	39.6%	41.0%	45.5%	47.4%	49.2%
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Income Statement ($mm)								
Total Revenue	138.6	109.1	133.7	137.8	160.0	138.5	110.1	122.0
EBIT	20.5	19.5	18.5	17.5	18.6	7.8	8.6	9.1
NPAT	5.7	4.9	5.7	5.4	6.7	4.2	6.2	6.1
Preferred Share Dividends	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Net Earnings to Common	5.4	4.6	5.3	5.1	6.3	3.9	5.9	5.7
Cash Flow from Operations	20.9	12.8	12.2	16.4	11.8	13.7	14.4	16.8

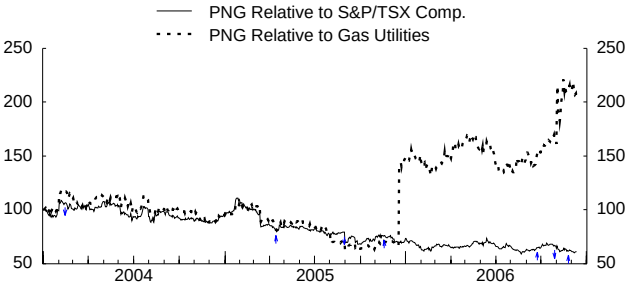
Source: BMO Capital Markets

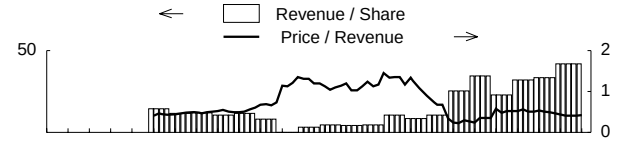
Pacific Nthn. Gas A (PNG)

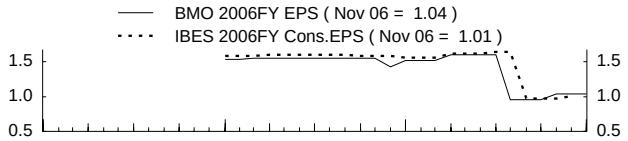


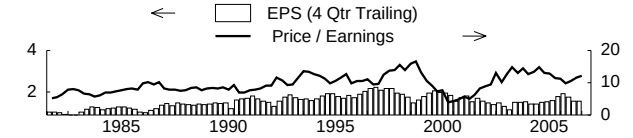


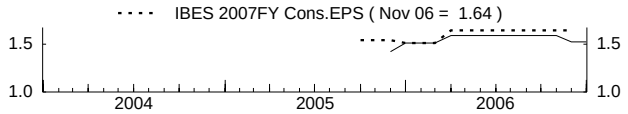












FYE (Dec.)	EPS $	P/E	DPS $	Yield %	Payout %	BV $	P/B	ROE %
1985	1.22	8	0.70	7.0	57	8.03	1.2	15
1986	1.09	9	0.70	6.8	64	8.43	1.2	13
1987	1.31	8	0.75	7.4	57	8.97	1.1	15
1988	1.34	8	0.75	6.6	56	9.24	1.2	15
1989	1.45	8	0.75	6.4	52	9.92	1.2	15
1990	1.61	7	0.75	6.7	47	10.76	1.0	16
1991	1.66	8	0.80	5.9	48	11.62	1.2	15
1992	1.55	11	0.80	4.8	52	12.37	1.3	13
1993	1.63	13	0.88	4.0	54	12.37	1.8	13
1994	1.80	11	0.88	4.3	49	12.37	1.6	15
1995	1.67	13	0.96	4.6	57	14.57	1.4	12
1996	2.01	11	0.96	4.3	48	15.61	1.4	13
1997	2.16	14	1.04	3.5	48	16.42	1.8	13
1998	1.73	16	1.12	4.1	65	17.39	1.6	10
1999	1.92	9	1.12	6.5	58	18.19	1.0	11
2000	1.83	4	1.12	14.1	61	19.44	0.4	10
2001	1.52	6	1.12	11.7	74	20.95	0.5	8
2002	1.25	13	1.12	6.3	82	19.27	0.9	6
2003	1.46	13	0.80	4.1	54	19.96	1.0	7
2004	1.38	15	0.80	3.8	57	20.52	1.0	7
2005	1.72	11	0.80	4.1	46	21.43	0.9	8
Current*	1.55	12	0.80	4.3	52	21.57	0.9	7
Average:		10		6.0	56		1.2	11.8
Growth(%):								
5 Year:	-2.7		-6.5			2.1		
10 Year:	-1.9		-1.8			4.0		
20 Year:	2.3		0.7			5.1		

* Current EPS is the 4 Quarter Trailing to Q3/2006.

PNG - Rating as of 31-Dec-03 = Mkt

	Date	Rating Change	Share Price
1	13-Feb-04	Mkt to Und.	$21.90
2	14-Apr-05	Und.to Mkt	$17.85
3	30-Aug-05	Mkt to Und.	$19.80
4	18-Nov-05	Und.to Mkt	$19.27
5	22-Sep-06	Mkt to OP	$17.76
6	27-Oct-06	OP to Mkt	$19.30
7	24-Nov-06	Mkt to OP	$18.50

Last Daily Data Point: December 11, 2006

Company Risk Disclosure

In addition to the risks involved in investing in common stocks generally, we also highlight the following risks that pertain to this company. The company's natural gas transmission business depends on the continued availability of natural gas. The BCUC approves PNG's customer rates and a fair return on the rate base. Changes in regulation may adversely affect performance. Natural gas and fuel oil compete with electricity for space heating in Pacific Northern Gas' service areas. Fluctuations in the price of natural gas could increase the working capital financing requirements and related costs for accounts receivable. In 2004, 75% of energy deliveries were made to four large industrial customers (67% to one customer, Methanex). Transportation service to Methanex was made pursuant to an agreement that expires in October 2009. On August 30, 2005, Methanex announced that it will close its Kitimat facilities in early 2006. PNG's DBRS credit BBB(L) rating is Under Review with Negative Implications. A one notch downgrade would result in a below investment grade bond rating.

Analyst's Certification

I, Karen Taylor, CFA, hereby certify that the views expressed in this report accurately reflect my personal views about the subject securities or issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report.

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Rating Category	BMO Rating	BMO Universe	BMO I.B. Clients*	First Call Universe**
Buy	Outperform	35%	45%	47%
Hold	Market Perform	55%	48%	46%
Sell	Underperform	10%	7%	7%

* Reflects rating distribution of all companies where BMO Capital Markets has received compensation for Investment Banking services.
** Reflects rating distribution of all North American equity research analysts.

Ratings Key

We use the following ratings system definitions:
OP = Outperform - Forecast to outperform the market;
Mkt = Market Perform - Forecast to perform roughly in line with the market;
Und = Underperform - Forecast to underperform the market;
(S) = speculative investment;
NR = No rating at this time;
R = Restricted – Dissemination of research is currently restricted.

Market performance is measured by a benchmark index such as the S&P/TSX Composite Index, S&P 500, Nasdaq Composite, as appropriate for each company. Prior to September 1, 2003, a fourth rating tier—Top Pick—was used to designate those stocks we felt would be the best performers relative to the market. Our six Top 15 lists which guide investors to our best ideas according to six different objectives (large, small, growth, value, income and quantitative) have replaced the Top Pick rating.

Dissemination of Research

Our research publications are available via our web site http://bmocapitalmarkets.com. Institutional clients may also receive our research via FIRST CALL Research Direct and Reuters. All of our research is made widely available at the same time to all BMO NB, BMO Capital Markets Corp. and BMO Nesbitt Burns Securities Ltd. client groups entitled to our research. Please contact your investment advisor or institutional salesperson for more information.

Additional Matters

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Pacific Northern Gas

(PNG-TSX)

Stock Rating: **Outperform**
Industry Rating: **Market Perform**

February 22, 2007
Research Comment
Toronto, Ontario

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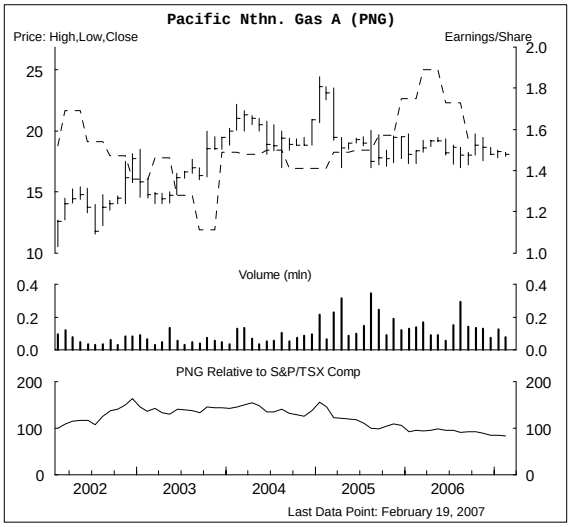
Karen.Taylor@bmo.com
Assoc: Benjamin Pham

Q4/06 and Fiscal 2006 Slightly Higher than Expected; Outperform Rating Maintained

Price (21-Feb)	$18.02	**52-Week High**	$19.74
Target Price	$20.00	**52-Week Low**	$16.96



Event

Pacific Northern Gas reported Q4/06 EPS of $0.61 versus our expectation of $0.42 and 2006 diluted EPS of $1.25 versus our expectation of diluted 2006 EPS of $1.04. The variance between expected and actual performance in the quarter and in 2006 is largely attributable to actual versus expected project development costs. In Q4/06, actual project development costs were $0.6 million versus our expectation of $1 million and in 2006, actual costs were $1.7 million after tax versus our expectation of $2.1 million after tax. Expenditures related to the preliminary study and investigation of a project to loop the company's main line transmission system from Kitimat to Summit Lake (the KSL project), as announced on July 17, 2006, and highlighted in our July 20, 2006, comment. Management indicated in its release that a further $1.5 million of after-tax development costs are likely in 2007 and may relate to the process to obtain environmental permits from the province of British Columbia. We do not expect additional costs beyond 2007; however, management is not precluded from initiating other certificate and approvals processes even if a firm service shipper(s) for the pipeline (and a use or pay contract for the related LNG regas facility) is not yet in hand. It is not yet clear that these projects are likely to proceed.

Impact

Mixed.

Forecasts

We have updated our financial model to reflect actual 2006 results and have reflected after-tax project development costs in our quarterly estimates as follows: $0.5 million in Q1/07 and $0.33 million in each of Q2, Q3 and Q4.

Valuation

Our target price reflects a weighted valuation approach: 12x diluted 2008E EPS of $1.56 (12.5%), 1.0x 2008E BV of $23.11 (12.5%), and a target yield of 4.10% (75%), assuming 2008 dividends of $0.80 per share.

Recommendation

We believe that the shares are attractively valued. Our rating is Outperform.

(FY-Dec.)	2005A	2006A	2007E	2008E
EPS	$1.72	$1.25	$1.18↓	$1.56↑
P/E			15.3x	11.6x
CFPS	$3.27	$3.77	$4.78	$4.82
P/CFPS			3.8x	3.7x
Div.	$0.80	$0.80	$0.80	$0.80
EV ($mm)	$167	$146	$142	$137
EBITDA ($mm)	$27.5	$17.3	$17.4	$18.3
EV/EBITDA	6.1x	8.4x	8.1x	7.5x

Quarterly EPS	Q1	Q2	Q3	Q4
2005A	$1.08	$0.02	-$0.24	$0.89
2006A	$1.22	-$0.14	-$0.42	$0.61
2007E	$1.12↓	-$0.22↓	-$0.33↓	$0.63↓

Dividend	$0.80	**Yield**	4.4%
Book Value	$21.92	**Price/Book**	0.8x
Shares O/S (mm)	3.6	**Mkt. Cap ($mm)**	$66
Float O/S (mm)	3.6	**Float Cap ($mm)**	$66
Wkly Vol (000s)	30	**Wkly $ Vol (mm)**	$0.6
Net Debt ($mm)	$75.9	**Next Rep. Date**	17-May (E)

Notes: Estimates are weather normal
Major Shareholders: Widely held
First Call Mean Estimates: PACIFIC NORTHERN GAS LTD 'A' (C$) 2006E: $1.04; 2008E: $1.54

Changes

Annual EPS
2007E $1.58 to $1.18
2008E $1.54 to $1.56

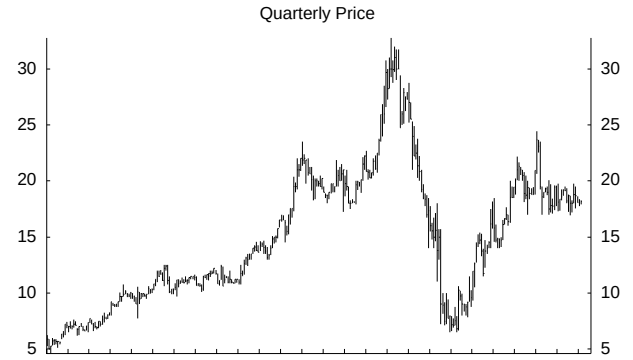
Quarterly EPS
Q1/07E $1.13 to $1.12
Q2/07E $0.02 to -$0.22
Q3/07E -$0.22 to -$0.33
Q4/07E $0.69 to $0.63

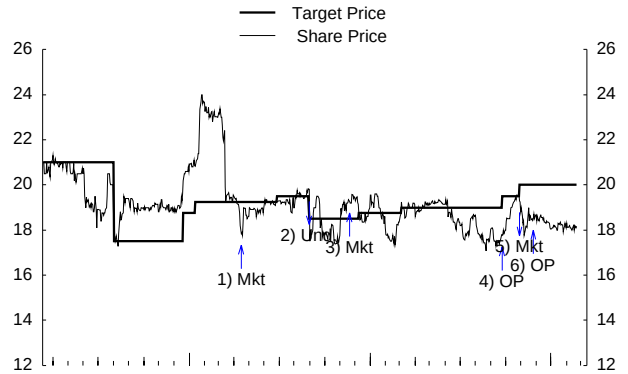
Table 1. Consolidated Summary Sheet

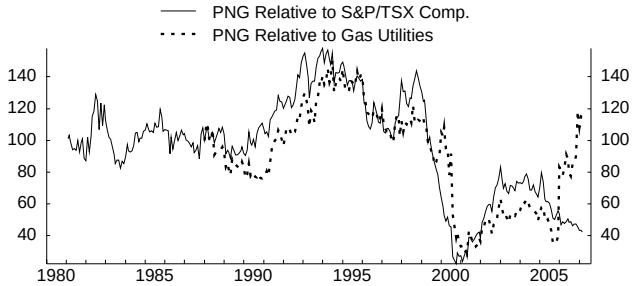
21-Feb-07								Karen J. Taylor
Current Price:	$18.10							BMO Capital Markets
12-Month Target Price:	$20.00							
ROR:	14.9%					Recommendation:		Outperform
				Year Ended December 31				
	2001	**2002**	**2003**	**2004**	**2005**	**2006**	**2007E**	**2008E**
Total Earnings Per Share	$1.52	$1.28	$1.49	$1.41	$1.75	$1.27	$1.20	$1.57
Fully Diluted EPS	$1.47	$1.25	$1.46	$1.38	$1.72	$1.25	$1.18	$1.56
Dividends	$0.00	$0.00	$0.80	$0.80	$0.80	$0.80	$0.80	$0.80
Payout Ratio	0.0%	0.0%	53.8%	56.8%	45.8%	63.0%	66.8%	50.8%
Average Shares (mm)	3.5	3.5	3.6	3.6	3.6	3.631	3.6	3.6
Net Book Value	20.36	21.62	19.25	20.52	21.44	21.92	22.33	23.11
Market Valuation								
Price: High	$11.95	$18.00	$19.50	$22.00	$24.00	$19.60	-	-
Price: Low	$6.50	$9.35	$14.00	$17.28	$17.37	$17.06	-	-
Price: Current	-	-	-	-	-	-	$18.10	
P/E Ratio: High	7.9	14.0	13.1	15.6	13.7	15.4	-	-
P/E Ratio: Low	4.3	7.3	9.4	12.3	9.9	13.4	-	-
P/E Ratio: Current	-	-	-	-	-	-	15.1	11.5
Price/Book Value: High	0.59	0.83	1.01	1.07	1.12	0.89	-	-
Price/Book Value: Low	0.32	0.43	0.73	0.84	0.81	0.78	-	-
Price/Book Value: Current	-	-	-	-	-	-	0.81	0.78
Yield: High Price	0.00%	0.00%	4.11%	3.64%	3.34%	4.08%	-	-
Yield: Low Price	0.00%	0.00%	5.73%	4.63%	4.61%	4.69%	-	-
Yield: Current	-	-	-	-	-	-	4.4%	4.4%
Balance Sheet ($mm)								
Debt (S-T)	12.1	4.4	7.3	10.4	14.7	10.0	13.7	13.5
Debt (L-T)	79.5	90.2	85.8	81.4	76.6	71.7	66.8	61.9
Deferred Items	17.3	17.0	17.9	15.8	15.7	24.0	23.3	24.8
Preferred Shares	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0
Shareholders' Equity	72.2	76.7	69.4	73.9	77.7	79.8	81.3	84.2
	186.2	193.3	185.4	186.7	189.7	190.5	190.1	189.4
Balance Sheet (%)								
Debt (S-T)	6.5%	2.3%	3.9%	5.6%	7.7%	5.2%	7.2%	7.1%
Debt (L-T)	42.7%	46.7%	46.3%	43.6%	40.4%	37.6%	35.1%	32.7%
Deferred Items	9.3%	8.8%	9.7%	8.5%	8.3%	12.6%	12.3%	13.1%
Preferred Shares	2.7%	2.6%	2.7%	2.7%	2.6%	2.6%	2.6%	2.6%
Shareholders' Equity	38.8%	39.7%	37.4%	39.6%	41.0%	41.9%	42.8%	44.4%
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Income Statement ($mm)								
Total Revenue	138.6	109.1	133.7	137.8	160.0	138.8	116.4	122.0
EBIT	20.5	19.5	18.5	17.5	18.6	17.6	7.5	9.1
NPAT	5.7	4.9	5.7	5.4	6.7	5.0	4.7	6.1
Preferred Share Dividends	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Net Earnings to Common	5.4	4.6	5.3	5.1	6.3	4.6	4.4	5.7
Cash Flow from Operations	20.9	12.8	12.2	16.4	11.8	17.6	12.9	16.8

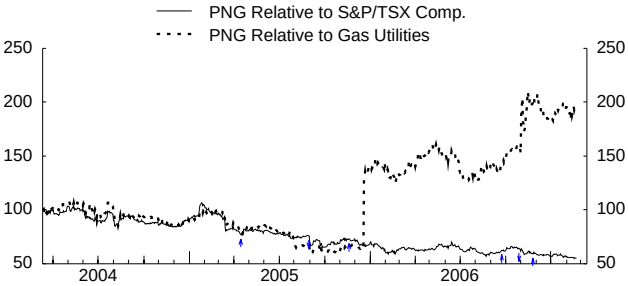
Source: BMO Capital Markets

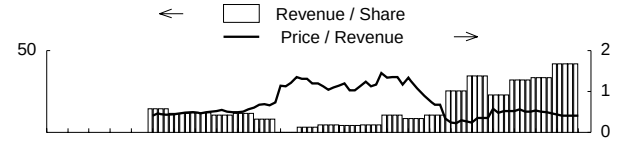
Pacific Nthn. Gas A (PNG)

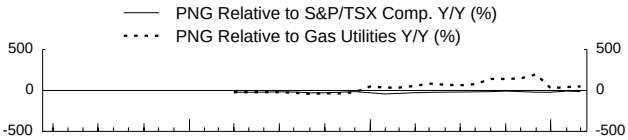


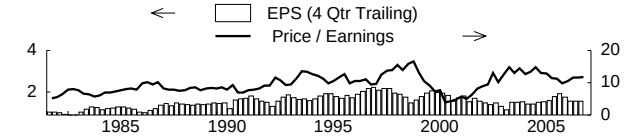












FYE (Dec.)	EPS $	P/E	DPS $	Yield %	Payout %	BV $	P/B	ROE %
1985	1.22	8	0.70	7.0	57	8.03	1.2	15
1986	1.09	9	0.70	6.8	64	8.43	1.2	13
1987	1.31	8	0.75	7.4	57	8.97	1.1	15
1988	1.34	8	0.75	6.6	56	9.24	1.2	15
1989	1.45	8	0.75	6.4	52	9.92	1.2	15
1990	1.61	7	0.75	6.7	47	10.76	1.0	16
1991	1.66	8	0.80	5.9	48	11.62	1.2	15
1992	1.55	11	0.80	4.8	52	12.37	1.3	13
1993	1.63	13	0.88	4.0	54	12.37	1.8	13
1994	1.80	11	0.88	4.3	49	12.37	1.6	15
1995	1.67	13	0.96	4.6	57	14.57	1.4	12
1996	2.01	11	0.96	4.3	48	15.61	1.4	13
1997	2.16	14	1.04	3.5	48	16.42	1.8	13
1998	1.73	16	1.12	4.1	65	17.39	1.6	10
1999	1.92	9	1.12	6.5	58	18.19	1.0	11
2000	1.83	4	1.12	14.1	61	19.44	0.4	10
2001	1.52	6	1.12	11.7	74	20.95	0.5	8
2002	1.25	13	1.12	6.3	82	19.27	0.9	6
2003	1.46	13	0.80	4.1	54	19.96	1.0	7
2004	1.38	15	0.80	3.8	57	20.52	1.0	7
2005	1.72	11	0.80	4.1	46	21.43	0.9	8
Current*	1.55	12	0.80	4.4	52	21.72	0.8	7
Average:		10		6.0	56		1.2	11.8
Growth(%):								
5 Year:	0.4		-6.5			0.7		
10 Year:	-2.6		-1.8			3.4		
20 Year:	1.8		0.7			4.8		

* Current EPS is the 4 Quarter Trailing to Q3/2006.

PNG - Rating as of 11-Mar-04 = Und.

	Date	Rating Change	Share Price
1	14-Apr-05	Und. to Mkt	$17.85
2	30-Aug-05	Mkt to Und.	$19.80
3	18-Nov-05	Und. to Mkt	$19.27
4	22-Sep-06	Mkt to OP	$17.76
5	27-Oct-06	OP to Mkt	$19.30
6	24-Nov-06	Mkt to OP	$18.50

Last Daily Data Point: February 20, 2007

Company Risk Disclosure

In addition to the risks involved in investing in common stocks generally, we also highlight the following risks that pertain to this company. The company's natural gas transmission business depends on the continued availability of natural gas. The BCUC approves PNG's customer rates and a fair return on the rate base. Changes in regulation may adversely affect performance. Natural gas and fuel oil compete with electricity for space heating in Pacific Northern Gas' service areas. Fluctuations in the price of natural gas could increase the working capital financing requirements and related costs for accounts receivable. In 2004, 75% of energy deliveries were made to four large industrial customers (67% to one customer, Methanex). Transportation service to Methanex was made pursuant to an agreement that expires in October 2009. On August 30, 2005, Methanex announced that it will close its Kitimat facilities in early 2006. PNG's DBRS credit BBB(L) rating is Under Review with Negative Implications. A one notch downgrade would result in a below investment grade bond rating.

Analyst's Certification

I, Karen Taylor, CFA, hereby certify that the views expressed in this report accurately reflect my personal views about the subject securities or issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report.

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Rating Category	BMO Rating	BMO Universe	BMO I.B. Clients*	First Call Universe**
Buy	Outperform	35%	45%	47%
Hold	Market Perform	55%	48%	46%
Sell	Underperform	10%	7%	7%

* Reflects rating distribution of all companies where BMO Capital Markets has received compensation for Investment Banking services.
** Reflects rating distribution of all North American equity research analysts.

Ratings Key

We use the following ratings system definitions:
OP = Outperform - Forecast to outperform the market;
Mkt = Market Perform - Forecast to perform roughly in line with the market;
Und = Underperform - Forecast to underperform the market;
(S) = speculative investment;
NR = No rating at this time;
R = Restricted – Dissemination of research is currently restricted.

Market performance is measured by a benchmark index such as the S&P/TSX Composite Index, S&P 500, Nasdaq Composite, as appropriate for each company. Prior to September 1, 2003, a fourth rating tier—Top Pick—was used to designate those stocks we felt would be the best performers relative to the market. Our six Top 15 lists which guide investors to our best ideas according to six different objectives (large, small, growth, value, income and quantitative) have replaced the Top Pick rating.

Dissemination of Research

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Additional Matters

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From: Karen Taylor [Karen.Taylor@bmo.com]
Sent: Friday, April 27, 2007 5:08 AM
To: Elizabeth Fletcher
Subject: PNG - "Pacific Northern Gas: Q1/07 Slightly Lower than Expected; Outperform Rating Unchanged" (Comment)

Utilities - Gas & Electric Utilities

BMO Capital Markets | Canada

Pacific Northern Gas

(PNG-TSX)

Stock Rating: Outperform
Industry Rating: Market Perform

April 27, 2007
Research Comment
Toronto, Ontario

Karen Taylor, CFA
(416) 359-4304
Karen.Taylor@bmo.com
Assoc: Benjamin Pham

Q1/07 Slightly Lower than Expected; Outperform Rating Unchanged

Event

Pacific Northern Gas reported Q1/07 EPS of $1.06 versus our expectation of $1.12. The variance between actual and expected performance is largely due to: (i) difference between actual and estimated project development expenses relating to Pacific Trail Pipelines Limited Partnership (PTP, Pacific Northern Gas 50%). Expenditures in Q1/07 were $0.3 million after-tax; and (ii) lower deliveries to large commercial and small industrial customers that reduced earnings by $0.1 million or approximately $0.03 per share. Total development expenditures for fiscal 2007 are expected to total $1.7 million after-tax: $0.8 million after-tax in Q2/07 and $0.6 million after-tax in each of Q3 and Q4/07. These expenditures are expected to be sufficient to complete the applications pursuant to the Canadian and British Columbia environmental assessment processes. We do not believe the company is likely to pursue a Certificate of Convenience and Necessity from the British Columbia Utilities Commission until the project has reached commercial certainty; i.e., the related LNG facility has a long term supply arrangement and the pipeline has long-term, ship or pay commercial contracts in place. Our outlook does not yet reflect PTP.

Impact

Neutral.

Forecasts

We have updated our estimates to reflect slightly higher project development expenses of $1.7 million in 2007 related in PTP versus our previous assumption of $1.5 million. Our diluted 2007 EPS estimate declines to $1.13 from $1.18. Our 2008 diluted EPS estimate of $1.56 is unchanged.

Valuation

Our target price reflects a weighted valuation approach: 12x 2008E diluted EPS of $1.56 (12.5%), 1x 2008E book value of $23.06 (12.5%), and a target yield of 4.10% (75%), assuming 2008E dividends of $0.80.

Recommendation

We believe the shares are attractively priced at current levels. Our rating is Outperform.

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Pacific Northern Gas

(PNG-TSX)

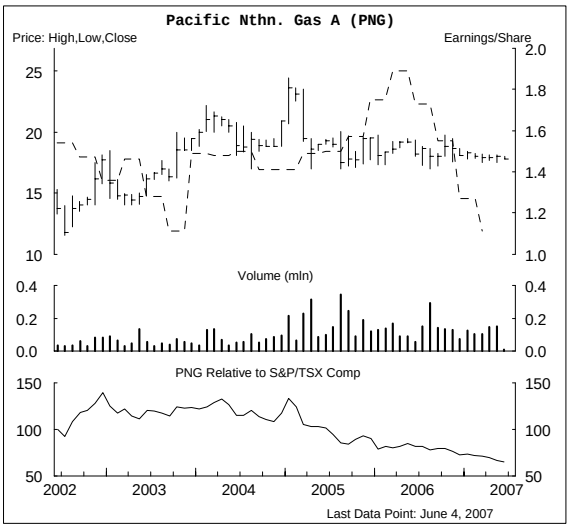
Stock Rating: **Outperform**
Industry Rating: **Market Perform**

June 6, 2007
Research Comment
Toronto, Ontario

Karen Taylor, CFA
(416) 359-4304
Karen.Taylor@bmo.com
Assoc: Benjamin Pham

BCUC Approves 2007 Revenue Requirements; Outperform Rating Unchanged

Price (5-Jun)	$17.85	**52-Week High**	$19.74
Target Price	$20.00	**52-Week Low**	$16.96



Event

On May 29, the British Columbia Utilities Commission (BCUC) approved 2007 Revenue Requirements Applications for each of the company's operating divisions: PNG-West, Fort St John/Dawson Creek and Tumbler Ridge. With respect to PNG-West, the Commission approved deemed equity of 40%, a return on equity of 9.02% (benchmark ROE of 8.37% plus a risk premium of 65 basis points) and capital expenditure of $5.878 million. The Commission disallowed the recovery of certain costs relating to the 2005 Income Trust Application Hearing and two-thirds of the costs arising from the inclusion of executive bonuses in pensionable earnings. PNG-West is encouraged by the Commission to continue to reduce its costs and improve its competitiveness in rates and services. PNG-West must also file in its 2008 rate application a five-year projection of revenue requirements and rate schedules for small commercial and residential customers without the proposed Pacific Trail Pipeline in service. The BCUC is concerned that the 2007 application did not sufficiently address its challenges, given the cessation in October 2009 of the amortization of the Methanex termination payment into the cost of service. The Commission approved an ROE of 8.77% and 9.02% for Fort St. John/Dawson Creek and Tumbler Ridge, respectively, and approved deemed equity of 36% for these divisions, consistent with the assumptions in our financial model.

Impact

Neutral. The decision is in line with expectations.

Forecasts

Unchanged.

Valuation

Our target price reflects a weighted valuation approach: 12.x 2008E diluted EPS of $1.56 (12.5%), 1.0x 2008E BVPS of $23.06 (12.5%), and a target yield of 4.10% (75%), assuming 2008 dividends per share of $0.80.

Recommendation

We believe that the shares are attractively valued at current levels. Our rating is Outperform.

(FY-Dec.)	2005A	2006A	2007E	2008E
EPS	$1.72	$1.25	$1.13	$1.56
P/E			15.8x	11.4x
CFPS	$3.26	$4.84	$3.53	$4.60
P/CFPS			5.1x	3.9x
Div.	$0.80	$0.80	$0.80	$0.80
EV ($mm)	$167	$154	$151	$146
EBITDA ($mm)	$27.5	$26.1	$16.1	$18.3
EV/EBITDA	6.1x	5.9x	9.4x	8.0x

Quarterly EPS	Q1	Q2	Q3	Q4
2005A	$1.08	$0.02	-$0.24	$0.89
2006A	$1.22	-$0.14	-$0.42	$0.61
2007E	$1.06a	-$0.17	-$0.34	$0.60

Dividend	$0.80	**Yield**	4.5%
Book Value	$21.92	**Price/Book**	0.8x
Shares O/S (mm)	3.6	**Mkt. Cap ($mm)**	$65
Float O/S (mm)	3.6	**Float Cap ($mm)**	$65
Wkly Vol (000s)	31	**Wkly $ Vol (mm)**	$0.6
Net Debt ($mm)	$85.7	**Next Rep. Date**	27-Jul (E)

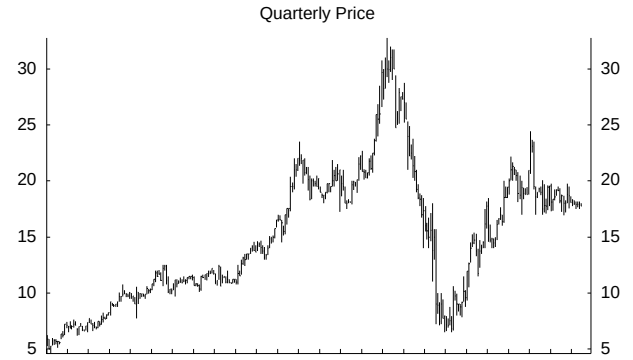
Notes: Estimates are weather normal
Major Shareholders: Widely held
First Call Mean Estimates: PACIFIC NORTHERN GAS LTD 'A' (C$) 2008E: $1.56

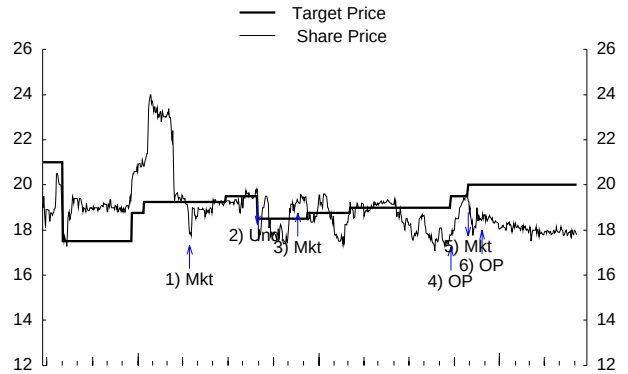
Table 1. Consolidated Summary Sheet

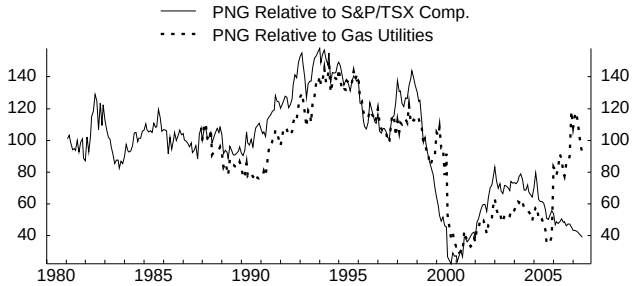
6-Jun-07								Karen J. Taylor
Current Price:	$17.85							BMO Capital Markets
12-Month Target Price:	$20.00							
ROR:	16.5%					Recommendation:		Outperform
				Year Ended December 31				
	2001	**2002**	**2003**	**2004**	**2005**	**2006**	**2007E**	**2008E**
Total Earnings Per Share	$1.52	$1.28	$1.49	$1.41	$1.75	$1.27	$1.14	$1.57
Fully Diluted EPS	$1.47	$1.25	$1.46	$1.38	$1.72	$1.25	$1.13	$1.56
Dividends	$0.00	$0.00	$0.80	$0.80	$0.80	$0.80	$0.80	$0.80
Payout Ratio	0.0%	0.0%	53.8%	56.8%	45.8%	63.0%	70.0%	50.8%
Average Shares (mm)	3.5	3.5	3.6	3.6	3.6	3.631	3.6	3.6
Net Book Value	20.36	21.62	19.25	20.52	21.44	21.92	22.27	23.06
Market Valuation								
Price: High	$11.95	$18.00	$19.50	$22.00	$24.00	$19.60	-	-
Price: Low	$6.50	$9.35	$14.00	$17.28	$17.37	$17.06	-	-
Price: Current	-	-	-	-	-	-	$17.85	
P/E Ratio: High	7.9	14.0	13.1	15.6	13.7	15.4	-	-
P/E Ratio: Low	4.3	7.3	9.4	12.3	9.9	13.4	-	-
P/E Ratio: Current	-	-	-	-	-	-	15.6	11.3
Price/Book Value: High	0.59	0.83	1.01	1.07	1.12	0.89	-	-
Price/Book Value: Low	0.32	0.43	0.73	0.84	0.81	0.78	-	-
Price/Book Value: Current	-	-	-	-	-	-	0.80	0.77
Yield: High Price	0.00%	0.00%	4.11%	3.64%	3.34%	4.08%	-	-
Yield: Low Price	0.00%	0.00%	5.73%	4.63%	4.61%	4.69%	-	-
Yield: Current	-	-	-	-	-	-	4.5%	4.5%
Balance Sheet ($mm)								
Debt (S-T)	12.1	4.4	7.3	10.4	14.7	10.0	13.9	13.7
Debt (L-T)	79.5	90.2	85.8	81.4	76.6	71.7	66.8	61.9
Deferred Items	17.3	17.0	17.9	15.8	15.7	24.0	23.3	24.8
Preferred Shares	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0
Shareholders' Equity	72.2	76.7	69.4	73.9	77.7	79.8	81.1	84.0
	186.2	193.3	185.4	186.7	189.7	190.5	190.1	189.4
Balance Sheet (%)								
Debt (S-T)	6.5%	2.3%	3.9%	5.6%	7.7%	5.2%	7.3%	7.2%
Debt (L-T)	42.7%	46.7%	46.3%	43.6%	40.4%	37.6%	35.1%	32.7%
Deferred Items	9.3%	8.8%	9.7%	8.5%	8.3%	12.6%	12.3%	13.1%
Preferred Shares	2.7%	2.6%	2.7%	2.7%	2.6%	2.6%	2.6%	2.6%
Shareholders' Equity	38.8%	39.7%	37.4%	39.6%	41.0%	41.9%	42.7%	44.3%
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Income Statement ($mm)								
Total Revenue	138.6	109.1	133.7	137.8	160.0	138.8	114.9	122.0
EBIT	20.5	19.5	18.5	17.5	18.6	17.6	7.2	9.1
NPAT	5.7	4.9	5.7	5.4	6.7	5.0	4.5	6.1
Preferred Share Dividends	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Net Earnings to Common	5.4	4.6	5.3	5.1	6.3	4.6	4.2	5.7
Cash Flow from Operations	20.9	12.8	12.2	16.4	11.8	17.6	12.7	16.8

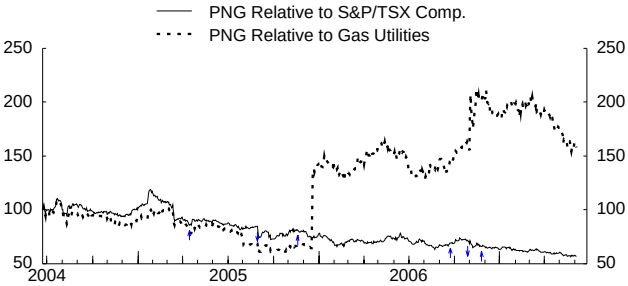
Source: BMO Capital Markets

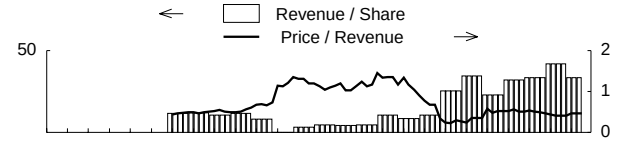
Pacific Nthn. Gas A (PNG)

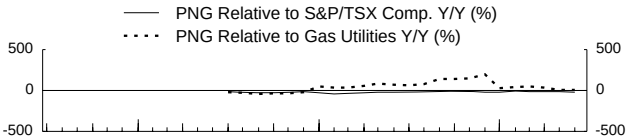


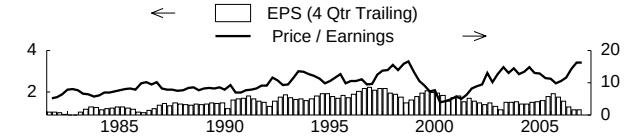












FYE (Dec.)	EPS $	P/E	DPS $	Yield %	Payout %	BV $	P/B	ROE %
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1989	1.45	8	0.75	6.4	52	9.92	1.2	15
1990	1.61	7	0.75	6.7	47	10.76	1.0	16
1991	1.66	8	0.80	5.9	48	11.62	1.2	15
1992	1.55	11	0.80	4.8	52	12.37	1.3	13
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2006	1.25	14	0.80	4.4	63	21.91	0.8	6
Current*	1.11	16	0.80	4.4	72	22.80	0.8	5
Average:		11		5.9	57		1.2	11.5
Growth(%):								
5 Year:	-8.1		-6.5			1.7		
10 Year:	-6.4		-1.8			3.9		
20 Year:	-0.2		0.7			5.1		

* Current EPS is the 4 Quarter Trailing to Q1/2007.

PNG - Rating as of 23-Jun-04 = Und.

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Last Daily Data Point: June 4, 2007

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Analyst's Certification

I, Karen Taylor, CFA, hereby certify that the views expressed in this report accurately reflect my personal views about the subject securities or issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report.

General Disclosure

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Distribution of Ratings

Rating Category	BMO Rating	BMO Universe	BMO I.B. Clients*	First Call Universe**
Buy	Outperform	39%	41%	45%
Hold	Market Perform	52%	52%	47%
Sell	Underperform	9%	7%	8%

* Reflects rating distribution of all companies where BMO Capital Markets has received compensation for Investment Banking services.
** Reflects rating distribution of all North American equity research analysts.

Ratings Key

We use the following ratings system definitions:
OP = Outperform - Forecast to outperform the market;
Mkt = Market Perform - Forecast to perform roughly in line with the market;
Und = Underperform - Forecast to underperform the market;
(S) = speculative investment;
NR = No rating at this time;
R = Restricted – Dissemination of research is currently restricted.

Market performance is measured by a benchmark index such as the S&P/TSX Composite Index, S&P 500, Nasdaq Composite, as appropriate for each company. Prior to September 1, 2003, a fourth rating tier—Top Pick—was used to designate those stocks we felt would be the best performers relative to the market. Our six Top 15 lists which guide investors to our best ideas according to six different objectives (large, small, growth, value, income and quantitative) have replaced the Top Pick rating.

Dissemination of Research

Our research publications are available via our web site http://bmocapitalmarkets.com. Institutional clients may also receive our research via FIRST CALL Research Direct and Reuters. All of our research is made widely available at the same time to all BMO NB, BMO Capital Markets Corp. and BMO Nesbitt Burns Securities Ltd. client groups entitled to our research. Please contact your investment advisor or institutional salesperson for more information.

Additional Matters

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Pacific Northern Gas

(PNG-TSX)

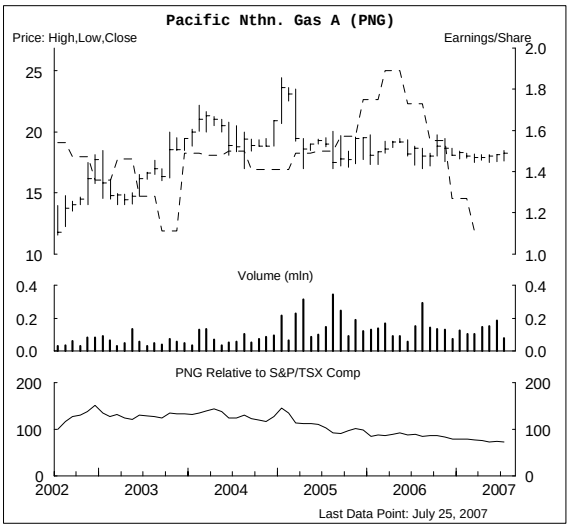
Stock Rating: **Outperform**
Industry Rating: **Market Perform**

July 27, 2007
Research Comment
Toronto, Ontario

Karen Taylor, CFA
(416) 359-4304
Karen.Taylor@bmo.com
Assoc: Benjamin Pham

Q2/07 Slightly Lower than Expected; Outperform Rating Unchanged

Price (25-Jul)	$18.25	**52-Week High**	$19.74
Target Price	$20.00	**52-Week Low**	$16.96



Event

Pacific Northern Gas reported Q2/07 EPS of a loss of $0.24 per share versus our expectation of a loss of $0.17 per share. Results were slightly lower than expected and the variance between expected and actual results is attributable to: (i) seasonality of earnings of approximately $0.5 million; (ii) lower than expected project development expenditures: $0.4 million after-tax versus our expectation of $0.8 million after-tax; (iii) lower sales to large commercial and small industrial customers not subject to deferral accounts reduced earnings by $0.1 million; (iv) disallowed trust conversion hearings costs of $0.2 million; and (v) $0.2 million draw down of deferred tax balances that increased reported earnings. Development expenditures related to the proposed Pacific Trail Pipeline (PTP) project totalled $0.7 million after-tax in 1H07 and are expected to be a further $0.8 million in 2H07, $0.6 million after-tax in Q3/07 and $0.2 million after-tax in Q4/07 (total $1.5 million after-tax in F2007 versus a previous estimate of $1.7 million after-tax).

Impact

Neutral.

Forecasts

We have updated our estimates to reflect lower PTP project development costs. Our diluted 2007 EPS estimate increases to $1.18 from $1.13, and our diluted 2008 EPS estimate of $1.56 is unchanged.

Valuation

Our target price of $20 reflects a weighted valuation approach: 12x 2008E diluted EPS of $1.56 (12.5%), 1.0x BVPS of $23.11 (12.5%), and a target yield of 4.10% (75%), assuming 2008 dividends per share of $0.80.

Recommendation

We believe the shares are attractively valued at current levels. Our rating is Outperform.

(FY-Dec.)	2005A	2006A	2007E	2008E
EPS	$1.72	$1.25	$1.18↑	$1.56
P/E			15.5x	11.7x
CFPS	$3.26	$4.84	$3.48	$4.60
P/CFPS			5.3x	4.0x
Div.	$0.80	$0.80	$0.80	$0.80
EV ($mm)	$167	$154	$151	$146
EBITDA ($mm)	$27.5	$26.1	$16.0	$18.2
EV/EBITDA	6.1x	5.9x	9.5x	8.0x

Quarterly EPS	Q1	Q2	Q3	Q4
2005A	$1.08	$0.02	-$0.24	$0.89
2006A	$1.22	-$0.14	-$0.42	$0.61
2007E	$1.06a	-$0.24a	-$0.36↓	$0.75↑

Dividend	$0.80	**Yield**	4.4%
Book Value	$22.34	**Price/Book**	0.8x
Shares O/S (mm)	3.6	**Mkt. Cap ($mm)**	$66
Float O/S (mm)	3.6	**Float Cap ($mm)**	$66
Wkly Vol (000s)	33	**Wkly $ Vol (mm)**	$0.6
Net Debt ($mm)	$85.7	**Next Rep. Date**	25-Oct (E)

Notes: Estimates are weather normal
Major Shareholders: Widely held
First Call Mean Estimates: PACIFIC NORTHERN GAS LTD 'A' (C$) 2008E: $1.56

Changes

Annual EPS
2007E $1.13 to $1.18

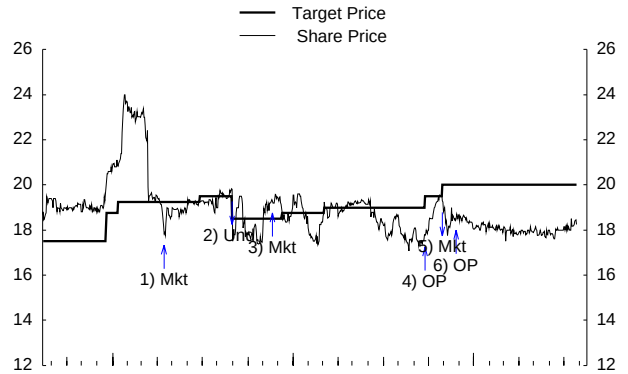
Quarterly EPS
Q3/07E -$0.34 to -$0.36
Q4/07E $0.60 to $0.75

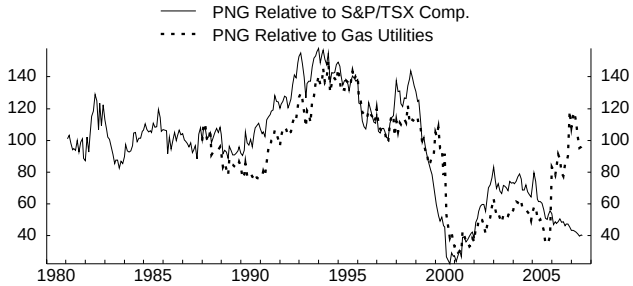
Table 1. Consolidated Summary Sheet

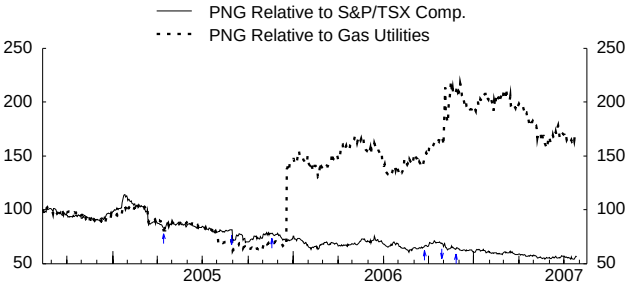
26-Jul-07								Karen J. Taylor
Current Price:	$18.00							BMO Capital Markets
12-Month Target Price:	$20.00							
ROR:	15.6%					Recommendation:		Outperform
				Year Ended December 31				
	2001	**2002**	**2003**	**2004**	**2005**	**2006**	**2007E**	**2008E**
Total Earnings Per Share	$1.52	$1.28	$1.49	$1.41	$1.75	$1.27	$1.20	$1.57
Fully Diluted EPS	$1.47	$1.25	$1.46	$1.38	$1.72	$1.25	$1.18	$1.56
Dividends	$0.00	$0.00	$0.80	$0.80	$0.80	$0.80	$0.80	$0.80
Payout Ratio	0.0%	0.0%	53.8%	56.8%	45.8%	63.0%	66.8%	50.8%
Average Shares (mm)	3.5	3.5	3.6	3.6	3.6	3.631	3.6	3.6
Net Book Value	20.36	21.62	19.25	20.52	21.44	21.92	22.33	23.11
Market Valuation								
Price: High	$11.95	$18.00	$19.50	$22.00	$24.00	$19.60	-	-
Price: Low	$6.50	$9.35	$14.00	$17.28	$17.37	$17.06	-	-
Price: Current	-	-	-	-	-	-	$18.00	
P/E Ratio: High	7.9	14.0	13.1	15.6	13.7	15.4	-	-
P/E Ratio: Low	4.3	7.3	9.4	12.3	9.9	13.4	-	-
P/E Ratio: Current	-	-	-	-	-	-	15.0	11.4
Price/Book Value: High	0.59	0.83	1.01	1.07	1.12	0.89	-	-
Price/Book Value: Low	0.32	0.43	0.73	0.84	0.81	0.78	-	-
Price/Book Value: Current	-	-	-	-	-	-	0.81	0.78
Yield: High Price	0.00%	0.00%	4.11%	3.64%	3.34%	4.08%	-	-
Yield: Low Price	0.00%	0.00%	5.73%	4.63%	4.61%	4.69%	-	-
Yield: Current	-	-	-	-	-	-	4.4%	4.4%
Balance Sheet ($mm)								
Debt (S-T)	12.1	4.4	7.3	10.4	14.7	10.0	13.7	13.5
Debt (L-T)	79.5	90.2	85.8	81.4	76.6	71.7	66.8	61.9
Deferred Items	17.3	17.0	17.9	15.8	15.7	24.0	23.3	24.8
Preferred Shares	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0
Shareholders' Equity	72.2	76.7	69.4	73.9	77.7	79.8	81.3	84.2
	186.2	193.3	185.4	186.7	189.7	190.5	190.1	189.4
Balance Sheet (%)								
Debt (S-T)	6.5%	2.3%	3.9%	5.6%	7.7%	5.2%	7.2%	7.1%
Debt (L-T)	42.7%	46.7%	46.3%	43.6%	40.4%	37.6%	35.1%	32.7%
Deferred Items	9.3%	8.8%	9.7%	8.5%	8.3%	12.6%	12.3%	13.1%
Preferred Shares	2.7%	2.6%	2.7%	2.7%	2.6%	2.6%	2.6%	2.6%
Shareholders' Equity	38.8%	39.7%	37.4%	39.6%	41.0%	41.9%	42.8%	44.4%
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Income Statement ($mm)								
Total Revenue	138.6	109.1	133.7	137.8	160.0	138.8	115.8	121.1
EBIT	20.5	19.5	18.5	17.5	18.6	17.6	7.4	9.0
NPAT	5.7	4.9	5.7	5.4	6.7	5.0	4.7	6.1
Preferred Share Dividends	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Net Earnings to Common	5.4	4.6	5.3	5.1	6.3	4.6	4.4	5.7
Cash Flow from Operations	20.9	12.8	12.2	16.4	11.8	17.6	12.9	16.8

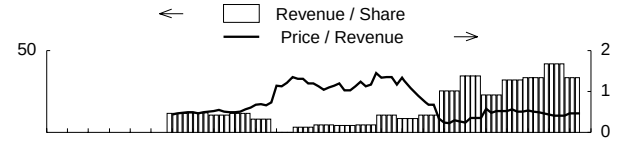
Source: BMO Capital Markets

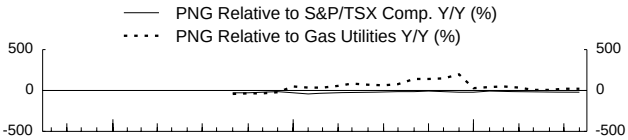
Pacific Nthn. Gas A (PNG)

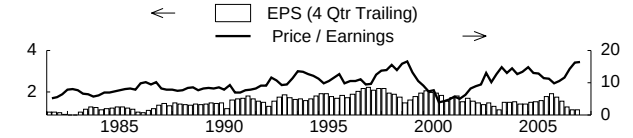












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I, Karen Taylor, CFA, hereby certify that the views expressed in this report accurately reflect my personal views about the subject securities or issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report.

General Disclosure

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Distribution of Ratings

Rating Category	BMO Rating	BMO Universe	BMO I.B. Clients*	First Call Universe**
Buy	Outperform	38%	47%	47%
Hold	Market Perform	52%	45%	46%
Sell	Underperform	10%	8%	7%

* Reflects rating distribution of all companies where BMO Capital Markets has received compensation for Investment Banking services.

** Reflects rating distribution of all North American equity research analysts.

Ratings Key

We use the following ratings system definitions:

OP = Outperform - Forecast to outperform the market;

Mkt = Market Perform - Forecast to perform roughly in line with the market;

Und = Underperform - Forecast to underperform the market;

(S) = speculative investment;

NR = No rating at this time;

R = Restricted – Dissemination of research is currently restricted.

Market performance is measured by a benchmark index such as the S&P/TSX Composite Index, S&P 500, Nasdaq Composite, as appropriate for each company. Prior to September 1, 2003, a fourth rating tier—Top Pick—was used to designate those stocks we felt would be the best performers relative to the market. Our six Top 15 lists which guide investors to our best ideas according to six different objectives (large, small, growth, value, income and quantitative) have replaced the Top Pick rating.

Dissemination of Research

Our research publications are available via our web site http://bmocapitalmarkets.com. Institutional clients may also receive our research via FIRST CALL Research Direct and Reuters. All of our research is made widely available at the same time to all BMO NB, BMO Capital Markets Corp. and BMO Nesbitt Burns Securities Ltd. client groups entitled to our research. Please contact your investment advisor or institutional salesperson for more information.

Additional Matters

TO U.S. RESIDENTS: BMO Capital Markets Corp. and/or BMO Nesbitt Burns Securities Ltd., affiliates of BMO NB, furnish this report to U.S. residents and accept responsibility for the contents herein, except to the extent that it refers to securities of Bank of Montreal. Any U.S. person wishing to effect transactions in any security discussed herein should do so through BMO Capital Markets Corp. and/or BMO Nesbitt Burns Securities Ltd.

TO U.K. RESIDENTS: The contents hereof are intended solely for the use of, and may only be issued or passed onto, persons described in part VI of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2001.

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Pacific Northern Gas

(PNG-TSX)

Stock Rating: **Outperform**
Industry Rating: **Market Perform**

October 26, 2007
Research Comment
Toronto, Ontario

Karen Taylor, CFA
(416) 359-4304
Karen.Taylor@bmo.com
Assoc: Benjamin Pham

2008 Rate Applications: Outperform Rating Unchanged

Event

On October 9, Pacific Northern Gas filed 2008 Revenue Requirements Applications with the British Columbia Utilities Commission (BCUC) for PNG-West and PNG-N.E. (Fort St. John/Dawson Creek and Tumbler Ridge). The key parameters of each application for the respective operating divisions are highlighted herein.

Impact

Neutral.

Forecasts

We have updated our estimates to reflect the information filed for 2008, as set out herein. Our diluted 2007 EPS estimate of $1.18 is unchanged and our diluted 2008 EPS estimate increases to $1.60 from $1.56.

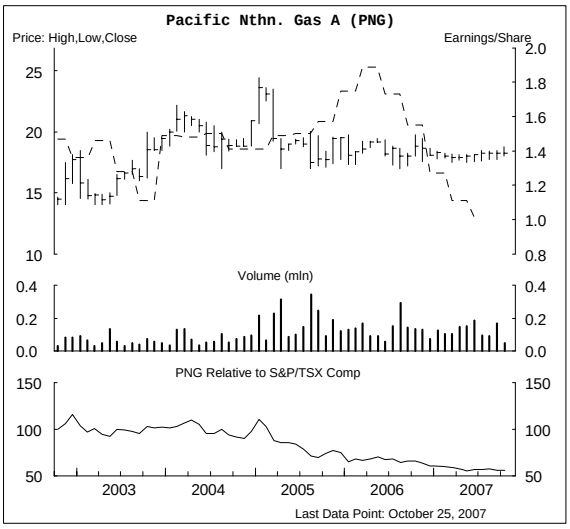
Valuation

Our target price of $20.00 reflects a weighted valuation approach: 12x 2008E diluted EPS of $1.60 (12.5%), 1.0x 2008E BVPS of $23.11 (12.5%), and a target yield of 4.10% (75%), assuming 2008 dividends per share of $0.80.

Recommendation

We believe that the shares are attractively valued at current levels. Our rating is Outperform.

Price (25-Oct)	$18.25	**52-Week High**	$19.48
Target Price	$20.00	**52-Week Low**	$17.50



(FY-Dec.)	2005A	2006A	2007E	2008E
EPS	$1.72	$1.25	$1.18	$1.60↑
P/E			15.5x	11.4x
CFPS	$3.26	$4.84	$3.53	$4.60
P/CFPS			5.2x	4.0x
Div.	$0.80	$0.80	$0.80	$0.80
EV ($mm)	$167	$154	$152	$147
EBITDA ($mm)	$27.5	$26.1	$16.2	$18.2
EV/EBITDA	6.1x	5.9x	9.3x	8.1x

Quarterly EPS	Q1	Q2	Q3	Q4
2005A	$1.08	$0.02	-$0.24	$0.89
2006A	$1.22	-$0.14	-$0.42	$0.61
2007E	$1.06a	-$0.24a	-$0.36	$0.75

Dividend	$0.80	**Yield**	4.4%
Book Value	$22.34	**Price/Book**	0.8x
Shares O/S (mm)	3.6	**Mkt. Cap ($mm)**	$66
Float O/S (mm)	3.6	**Float Cap ($mm)**	$66
Wkly Vol (000s)	28	**Wkly $ Vol (mm)**	$0.5
Net Debt ($mm)	$85.5	**Next Rep. Date**	1-Nov (E)

Notes: Estimates are weather normal
Major Shareholders: Widely held
First Call Mean Estimates: PACIFIC NORTHERN GAS LTD 'A' (C$) 2007E: $1.18; 2008E: $1.56

Changes

Annual EPS
2008E $1.56 to $1.60

Details & Analysis

On October 9, Pacific Northern Gas filed 2008 Revenue Requirements Applications with the British Columbia Utilities Commission (BCUC) for PNG-West and PNG-N.E. (Fort St. John/Dawson Creek and Tumbler Ridge). The key parameters of each application for the respective operating divisions are highlighted below:

PNG – West

- 2008 Rate base of $133.159 million versus $131.628 million approved in 2007.
- Capital additions of $7.030 million versus $5.888 million approved for 2007.
- Allowed return on equity equal to the Benchmark Return established by the Commission annually plus a risk premium of 65 basis points. The applied-for return on equity mechanism is consistent with the established methodology.
- Deemed equity of 40%. The utility has applied to the Commission to establish 2008 rates using 40% deemed equity and to create a new return on equity deferral account to capture the equity return foregone by setting rates based on a 40% common equity component rather than the 47.5% common equity it actually has on its balance sheet. The company's debt is currently rated BBB (low) by Dominion Bond Rating Service (DBRS), and the rating agency has indicated that if Pacific Northern Gas were to reduce its actual equity to the level authorized by the Commission, DBRS would reduce its credit rating. The deferral account would provide the company an opportunity to earn its approved return on common equity, and the balance in the account would earn a return equal to the utility's approved rate of return on common equity (calculated monthly). The ultimate recovery of the amounts recorded in the return on equity deferral account would be dependent on improvements in the competitiveness of the utility's rates and on market conditions.

PNG-N.E. - Fort St. John/Dawson Creek

- 2008 Rate base of $33.478 million versus $31.996 million approved in 2007.
- Capital additions of $2.545 million in 2008 versus $2.625 million in 2007.
- Allowed return on equity equal to the Benchmark Return established by the Commission annually plus a risk premium of 40 basis points. The applied-for return on equity mechanism is consistent with the established methodology.
- Deemed equity of 36%.

PNG-N.E. – Tumbler Ridge

- 2008 Rate base of $1.458 million versus $1.360 million approved in 2007.
- Capital additions of $0.184 million versus $0.181 million in 2007.
- Allowed return on equity equal to the Benchmark Return established by the Commission annually plus a risk premium of 65 basis points. The applied-for return on equity mechanism is consistent with the established methodology.

We believe that the following points are relevant about these applications:

- We have not reflected the new return on equity deferral account in our rate base calculation for PNG-West. Even if this deferral account were to be approved by the Commission, we believe that recovery of any balance is highly uncertain, given the overall business and

operating risks faced by the utility and the ongoing willingness of the Commission to meet the legal requirements of the Fair Return Standard.

- We do not expect the utility to accrue GAAP earnings on the basis of 47.5% deemed equity, largely due to the lack of certainty that deferred amounts are likely to be recovered in future rates.
- We continue to believe that it is prima facie evidence that if a utility cannot reach a Commission-imposed capital structure without a deterioration in its credit rating (in this case to below investment grade), then the capital structure imposed by the Commission (and the corresponding return on equity) violates the Fair Return Standard. We also highlight that the primary reason for not allowing 47.5% common equity is the adverse effect of a further 3% increase in customer rates. This is contrary to the determination of the Federal Court of Appeal, which found that the determination of a cost (rate of return on the equity component of deemed capital structure) is unaffected by the impact of tolls on customers or consumers.

Estimates

We have updated our estimates to reflect the information filed for 2008, as set out herein. Our diluted 2007 EPS estimate of $1.18 is unchanged and our diluted 2008 EPS estimate increases to $1.60 from $1.56.

Valuation

Our target price of $20.00 reflects a weighted valuation approach: 12x 2008E diluted EPS of $1.60 (12.5%), 1.0x 2008E BVPS of $23.11 (12.5%), and a target yield of 4.10% (75%), assuming 2008 dividends per share of $0.80.

Recommendation

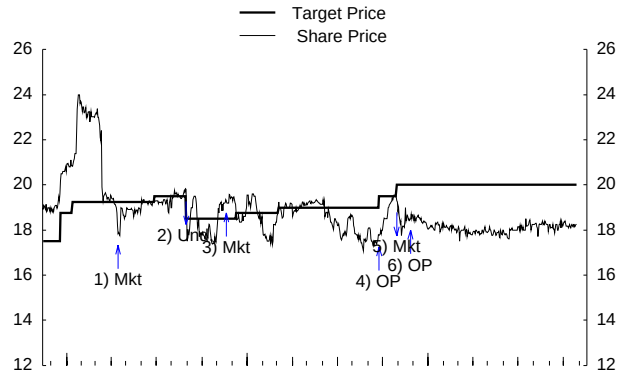
We believe that the shares are attractively valued at current levels. Our rating is Outperform.

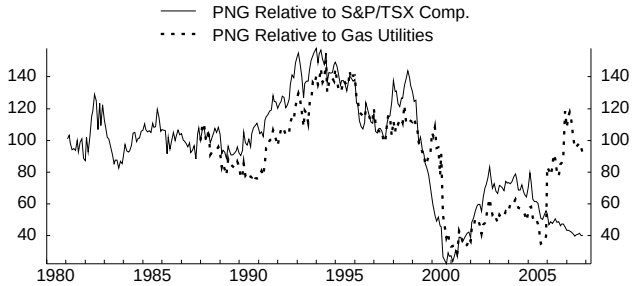
Table 1. Consolidated Summary Sheet

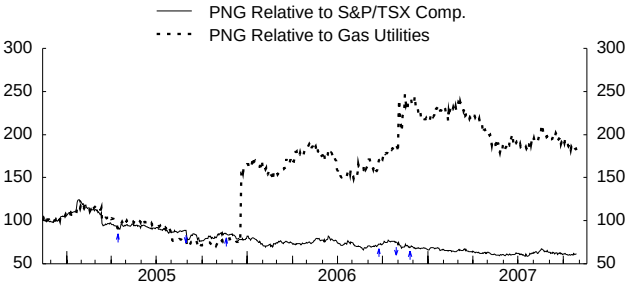
26-Oct-07								Karen J. Taylor
Current Price:	$18.25							BMO Capital Markets
12-Month Target Price:	$20.00							
ROR:	14.0%					Recommendation:		Outperform
				Year Ended December 31				
	2001	**2002**	**2003**	**2004**	**2005**	**2006**	**2007E**	**2008E**
Total Earnings Per Share	$1.52	$1.28	$1.49	$1.41	$1.75	$1.27	$1.20	$1.62
Fully Diluted EPS	$1.47	$1.25	$1.46	$1.38	$1.72	$1.25	$1.18	$1.60
Dividends	$0.00	$0.00	$0.80	$0.80	$0.80	$0.80	$0.80	$0.80
Payout Ratio	0.0%	0.0%	53.8%	56.8%	45.8%	63.0%	66.8%	49.3%
Average Shares (mm)	3.5	3.5	3.6	3.6	3.6	3.631	3.6	3.6
Net Book Value	20.36	21.62	19.25	20.52	21.44	21.92	22.33	23.16
Market Valuation								
Price: High	$11.95	$18.00	$19.50	$22.00	$24.00	$19.60	-	-
Price: Low	$6.50	$9.35	$14.00	$17.28	$17.37	$17.06	-	-
Price: Current	-	-	-	-	-	-	$18.25	
P/E Ratio: High	7.9	14.0	13.1	15.6	13.7	15.4	-	-
P/E Ratio: Low	4.3	7.3	9.4	12.3	9.9	13.4	-	-
P/E Ratio: Current	-	-	-	-	-	-	15.2	11.2
Price/Book Value: High	0.59	0.83	1.01	1.07	1.12	0.89	-	-
Price/Book Value: Low	0.32	0.43	0.73	0.84	0.81	0.78	-	-
Price/Book Value: Current	-	-	-	-	-	-	0.82	0.79
Yield: High Price	0.00%	0.00%	4.11%	3.64%	3.34%	4.08%	-	-
Yield: Low Price	0.00%	0.00%	5.73%	4.63%	4.61%	4.69%	-	-
Yield: Current	-	-	-	-	-	-	4.4%	4.4%
Balance Sheet ($mm)								
Debt (S-T)	12.1	4.4	7.3	10.4	14.7	10.0	13.7	14.1
Debt (L-T)	79.5	90.2	85.8	81.4	76.6	71.7	66.8	61.9
Deferred Items	17.3	17.0	17.9	15.8	15.7	24.0	23.3	24.8
Preferred Shares	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0
Shareholders' Equity	72.2	76.7	69.4	73.9	77.7	79.8	81.3	84.3
	186.2	193.3	185.4	186.7	189.7	190.5	190.1	190.1
Balance Sheet (%)								
Debt (S-T)	6.5%	2.3%	3.9%	5.6%	7.7%	5.2%	7.2%	7.4%
Debt (L-T)	42.7%	46.7%	46.3%	43.6%	40.4%	37.6%	35.1%	32.6%
Deferred Items	9.3%	8.8%	9.7%	8.5%	8.3%	12.6%	12.3%	13.0%
Preferred Shares	2.7%	2.6%	2.7%	2.7%	2.6%	2.6%	2.6%	2.6%
Shareholders' Equity	38.8%	39.7%	37.4%	39.6%	41.0%	41.9%	42.8%	44.4%
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Income Statement ($mm)								
Total Revenue	138.6	109.1	133.7	137.8	160.0	138.8	115.8	126.3
EBIT	20.5	19.5	18.5	17.5	18.6	17.6	7.4	9.2
NPAT	5.7	4.9	5.7	5.4	6.7	5.0	4.7	6.2
Preferred Share Dividends	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Net Earnings to Common	5.4	4.6	5.3	5.1	6.3	4.6	4.4	5.9
Cash Flow from Operations	20.9	12.8	12.2	16.4	11.8	17.6	12.9	17.5

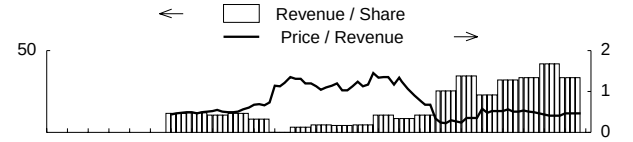
Source: BMO Capital Market

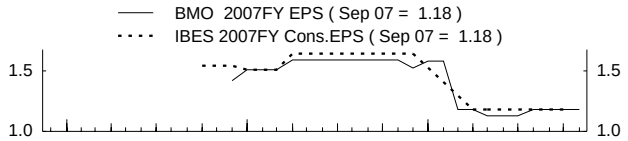
Pacific Nthn. Gas A (PNG)

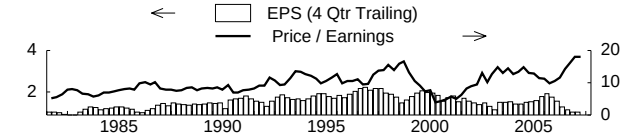


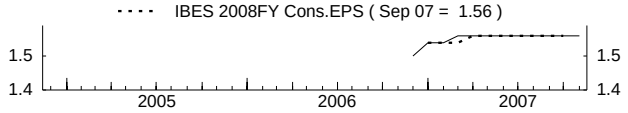












FYE (Dec.)	EPS $	P/E	DPS $	Yield %	Payout %	BV $	P/B	ROE %
1985	1.22	8	0.70	7.0	57	8.03	1.2	15
1986	1.09	9	0.70	6.8	64	8.43	1.2	13
1987	1.31	8	0.75	7.4	57	8.97	1.1	15
1988	1.34	8	0.75	6.6	56	9.24	1.2	15
1989	1.45	8	0.75	6.4	52	9.92	1.2	15
1990	1.61	7	0.75	6.7	47	10.76	1.0	16
1991	1.66	8	0.80	5.9	48	11.62	1.2	15
1992	1.55	11	0.80	4.8	52	12.37	1.3	13
1993	1.63	13	0.88	4.0	54	12.37	1.8	13
1994	1.80	11	0.88	4.3	49	12.37	1.6	15
1995	1.67	13	0.96	4.6	57	14.57	1.4	12
1996	2.01	11	0.96	4.3	48	15.61	1.4	13
1997	2.16	14	1.04	3.5	48	16.42	1.8	13
1998	1.73	16	1.12	4.1	65	17.39	1.6	10
1999	1.92	9	1.12	6.5	58	18.19	1.0	11
2000	1.83	4	1.12	14.1	61	19.44	0.4	10
2001	1.52	6	1.12	11.7	74	20.95	0.5	8
2002	1.25	13	1.12	6.3	82	19.27	0.9	6
2003	1.46	13	0.80	4.1	54	19.96	1.0	7
2004	1.38	15	0.80	3.8	57	20.52	1.0	7
2005	1.72	11	0.80	4.1	46	21.43	0.9	8
2006	1.25	14	0.80	4.4	63	21.91	0.8	6
Current*	1.01	18	0.80	4.4	79	22.34	0.8	5
Average:		11		5.9	57		1.2	11.5
Growth(%):								
5 Year:	-7.2		-6.5			1.3		
10 Year:	-7.0		-2.6			3.6		
20 Year:	-1.7		0.3			5.0		

* Current EPS is the 4 Quarter Trailing to Q2/2007.

PNG - Rating as of 15-Nov-04 = Und.

	Date	Rating Change	Share Price
1	14-Apr-05	Und.to Mkt	$17.85
2	30-Aug-05	Mkt to Und.	$19.80
3	18-Nov-05	Und.to Mkt	$19.27
4	22-Sep-06	Mkt to OP	$17.76
5	27-Oct-06	OP to Mkt	$19.30
6	24-Nov-06	Mkt to OP	$18.50

Last Daily Data Point: October 25, 2007

Company Risk Disclosure

In addition to the risks involved in investing in common stocks generally, we also highlight the following risks that pertain to this company. The company's natural gas transmission business depends on the continued availability of natural gas. The BCUC approves PNG's customer rates and a fair return on the rate base. Changes in regulation may adversely affect performance. Natural gas and fuel oil compete with electricity for space heating in Pacific Northern Gas' service areas. Fluctuations in the price of natural gas could increase the working capital financing requirements and related costs for accounts receivable. In 2004, 75% of energy deliveries were made to four large industrial customers (67% to one customer, Methanex). Transportation service to Methanex was made pursuant to an agreement that expires in October 2009. On August 30, 2005, Methanex announced that it will close its Kitimat facilities in early 2006.

Analyst's Certification

I, Karen Taylor, CFA, hereby certify that the views expressed in this report accurately reflect my personal views about the subject securities or issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report.

General Disclosure

The information and opinions in this report were prepared by BMO Nesbitt Burns Inc. and BMO Nesbitt Burns Ltée./Ltd., collectively ("BMO NB"). BMO NB is not subject to U.S. rules with regard to the preparation of research reports and the independence of analysts. "BMO Capital Markets" is a trade name used by the BMO Investment Banking Group, which includes the wholesale/institutional arms of Bank of Montreal and BMO NB in Canada, and BMO Capital Markets Corp. in the U.S. BMO Capital Markets Corp. is an affiliate of BMO NB. BMO NB and BMO Capital Markets Corp. are subsidiaries of Bank of Montreal. Bank of Montreal or its affiliates ("BMO Financial Group") has lending arrangements with, or provide other remunerated services to, many issuers covered by BMO NB research. A significant lending relationship may exist between BMO Financial Group and certain of the issuers mentioned herein. The reader should assume that BMO NB, BMO Capital Markets Corp., Bank of Montreal or their affiliates may have a conflict of interest and should not rely solely on this report in evaluating whether or not to buy or sell securities of issuers discussed herein. The opinions, estimates and projections contained in this report are those of BMO NB as of the date of this report and are subject to change without notice. BMO NB endeavours to ensure that the contents have been compiled or derived from sources that we believe are reliable and contain information and opinions that are accurate and complete. However, BMO NB makes no representation or warranty, express or implied, in respect thereof, takes no responsibility for any errors and omissions contained herein and accepts no liability whatsoever for any loss arising from any use of, or reliance on, this report or its contents. Information may be available to BMO NB or its affiliates that is not reflected in this report. The information in this report is not intended to be used as the primary basis of investment decisions, and because of individual client objectives, should not be construed as advice designed to meet the particular investment needs of any investor. This material is for information purposes only and is not an offer to sell or the solicitation of an offer to buy any security. The research analyst and/or associates who prepared this report are compensated based upon (among other factors) the overall profitability of BMO NB and its affiliates, which includes the overall profitability of investment banking services. BMO NB, or its affiliates expect to receive or will seek compensation for investment banking services within the next 3 months from all issuers covered by BMO NB. BMO NB or its affiliates will buy from or sell to customers the securities of issuers mentioned in this report on a principal basis. BMO NB or its affiliates, officers, directors or employees may have a long or short position in the securities discussed herein, related securities or in options, futures or other derivative instruments based thereon.

Distribution of Ratings

Rating Category	BMO Rating	BMO Universe	BMO I.B. Clients*	First Call Universe**
Buy	Outperform	42%	49%	49%
Hold	Market Perform	50%	46%	45%
Sell	Underperform	8%	5%	6%

* Reflects rating distribution of all companies where BMO Capital Markets has received compensation for Investment Banking services.
** Reflects rating distribution of all North American equity research analysts.

Ratings Key

We use the following ratings system definitions:
OP = Outperform - Forecast to outperform the market;
Mkt = Market Perform - Forecast to perform roughly in line with the market;
Und = Underperform - Forecast to underperform the market;
(S) = speculative investment;
NR = No rating at this time;
R = Restricted – Dissemination of research is currently restricted.

Market performance is measured by a benchmark index such as the S&P/TSX Composite Index, S&P 500, Nasdaq Composite, as appropriate for each company. Prior to September 1, 2003, a fourth rating tier—Top Pick—was used to designate those stocks we felt would be the best performers relative to the market. Our six Top 15 lists which guide investors to our best ideas according to six different objectives (large, small, growth, value, income and quantitative) have replaced the Top Pick rating.

Dissemination of Research

Our research publications are available via our web site http://bmocapitalmarkets.com. Institutional clients may also receive our research via FIRST CALL Research Direct and Reuters. All of our research is made widely available at the same time to all BMO NB, BMO Capital Markets Corp. and BMO Nesbitt Burns Securities Ltd. client groups entitled to our research. Please contact your investment advisor or institutional salesperson for more information.

Additional Matters

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Pacific Northern Gas

(PNG-TSX)

Stock Rating: **Outperform**
Industry Rating: **Market Perform**

November 2, 2007
Research Comment
Toronto, Ontario

Karen Taylor, CFA
(416) 359-4304
Karen.Taylor@bmo.com
Assoc: Benjamin Pham

Q3/07 Slightly Lower Than Expected; Outperform Rating Unchanged

Event

Q3/07 EPS were ($0.40) versus our expectation of ($0.36). The variance is largely attributable to: (i) lower operating margins arising from lower deliveries to large commercial and small industrial customers reduced Q3/07 net income by $0.2 million (there is no deferral account for variances attributable to these customers); (ii) the effect of the rate stabilization mechanism for residential and small commercial customers increased net income by $0.1 million; (iii) after-tax project development expenses incurred by Pacific Trail Pipelines LP (PTP) were $0.4 million after tax versus our expectation of $0.6 million after tax in the quarter; and (iv) earnings seasonality.

Impact

Neutral. Further development expenses of $0.4 million after tax are expected in Q4/07, brining the total for 2007 to about $1.5 million after tax, in line with expectations. The PTP pipeline is not reflected in our outlook, as permitting and construction are contingent upon a number of conditions precedent, including the receipt of all regulatory approvals and the execution of long-term, use or pay firm shipping contracts on the proposed pipeline. It is unlikely that project proponents can file an application of a Certificate of Public Convenience and Necessity with the British Columbia Utilities Commission for pipeline facilities, without the presence of these shipping contracts, which generally establish the need for facility. Development expenditures in 2007 related to the B.C. environmental process, and we expect a favorable decision in H1/08.

Forecasts

Our diluted 2007 and 2008 EPS estimates of $1.18 and $1.60 are unchanged. We are introducing our 2009 diluted EPS estimate of $1.59.

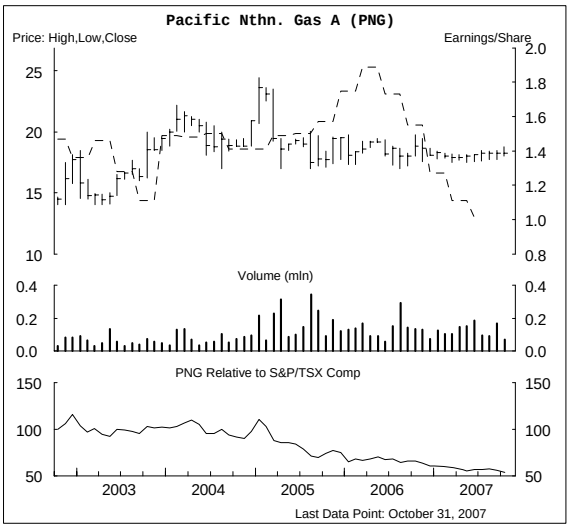
Valuation

Our target price of $20.00 reflects a weighted valuation approach: 12x 2009E diluted EPS of $1.59 (12.5%), 1.0x 2009 BVPS of $23.98 (12.5%), and a target yield of 4.10% (75%), assuming 2009 dividends per share of $0.80.

Recommendation

We believe that the shares are attractively valued. Our rating is Outperform.

Price (1-Nov)	$18.25	**52-Week High**	$19.48
Target Price	$20.00	**52-Week Low**	$17.50



(FY-Dec.)	2006A	2007E	2008E	2009E
EPS	$1.25	$1.18	$1.60	$1.59
P/E		15.5x	11.4x	11.5x
CFPS	$4.84	$3.53	$4.79	$4.69
P/CFPS		5.2x	3.8x	3.9x
Div.	$0.80	$0.80	$0.80	$0.80
EV ($mm)	$154	$152	$147	$142
EBITDA ($mm)	$26.1	$16.2	$18.9	$18.6
EV/EBITDA	5.9x	9.4x	7.8x	7.6x

Quarterly EPS	Q1	Q2	Q3	Q4
2006A	$1.22	-$0.14	-$0.42	$0.61
2007E	$1.06a	-$0.24a	-$0.40a	$0.79↑
2008E	$1.12	$0.03	-$0.32	$0.80

Dividend	$0.80	**Yield**	4.4%
Book Value	$21.82	**Price/Book**	0.8x
Shares O/S (mm)	3.6	**Mkt. Cap ($mm)**	$66
Float O/S (mm)	3.6	**Float Cap ($mm)**	$66
Wkly Vol (000s)	28	**Wkly $ Vol (mm)**	$0.5
Net Debt ($mm)	$85.5	**Next Rep. Date**	31-Jan (E)

Notes: Estimates are weather normal
Major Shareholders: Widely held
First Call Mean Estimates: PACIFIC NORTHERN GAS LTD 'A' (C$) 2007E: $1.18; 2008E: $1.60

Changes

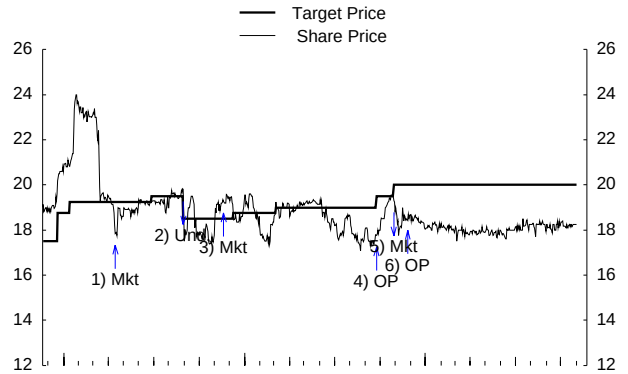
Quarterly EPS
Q4/07E $0.75 to $0.79

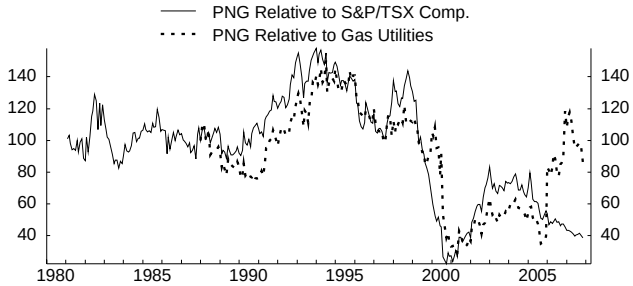
Table 1. Consolidated Summary Sheet

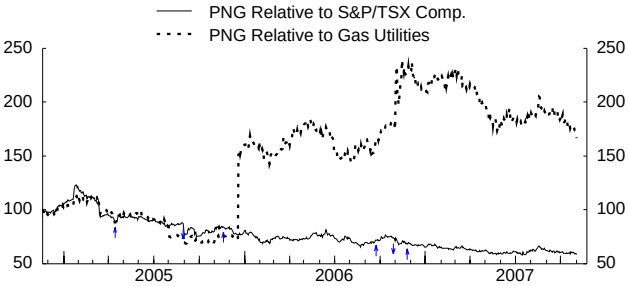
2-Nov-07								Karen J. Taylor
Current Price:	$18.25							BMO Capital Markets
12-Month Target Price:	$20.00							
ROR:	14.0%					Recommendation:		Outperform
				Year Ended December 31				
	2002	**2003**	**2004**	**2005**	**2006**	**2007E**	**2008E**	**2009E**
Total Earnings Per Share	$1.28	$1.49	$1.41	$1.75	$1.27	$1.20	$1.62	$1.61
Fully Diluted EPS	$1.25	$1.46	$1.38	$1.72	$1.25	$1.18	$1.60	$1.59
Dividends	$0.00	$0.80	$0.80	$0.80	$0.80	$0.80	$0.80	$0.80
Payout Ratio	0.0%	53.8%	56.8%	45.8%	63.0%	66.8%	49.3%	49.8%
Average Shares (mm)	3.5	3.6	3.6	3.6	3.631	3.6	3.6	3.6
Net Book Value	21.62	19.25	20.52	21.44	21.92	22.33	23.16	23.98
Market Valuation								
Price: High	$18.00	$19.50	$22.00	$24.00	$19.60	-	-	-
Price: Low	$9.35	$14.00	$17.28	$17.37	$17.06	-	-	-
Price: Current	-	-	-	-	-	$18.25		
P/E Ratio: High	14.0	13.1	15.6	13.7	15.4	-	-	-
P/E Ratio: Low	7.3	9.4	12.3	9.9	13.4	-	-	-
P/E Ratio: Current	-	-	-	-	-	15.2	11.2	11.4
Price/Book Value: High	0.83	1.01	1.07	1.12	0.89	-	-	-
Price/Book Value: Low	0.43	0.73	0.84	0.81	0.78	-	-	-
Price/Book Value: Current	-	-	-	-	-	0.82	0.79	0.76
Yield: High Price	0.00%	4.11%	3.64%	3.34%	4.08%	-	-	-
Yield: Low Price	0.00%	5.73%	4.63%	4.61%	4.69%	-	-	-
Yield: Current	-	-	-	-	-	4.4%	4.4%	4.4%
Balance Sheet ($mm)								
Debt (S-T)	4.4	7.3	10.4	14.7	10.0	13.7	14.1	13.8
Debt (L-T)	90.2	85.8	81.4	76.6	71.7	66.8	61.9	56.8
Deferred Items	17.0	17.9	15.8	15.7	24.0	23.3	24.8	26.3
Preferred Shares	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0
Shareholders' Equity	76.7	69.4	73.9	77.7	79.8	81.3	84.3	87.3
	193.3	185.4	186.7	189.7	190.5	190.1	190.1	189.3
Balance Sheet (%)								
Debt (S-T)	2.3%	3.9%	5.6%	7.7%	5.2%	7.2%	7.4%	7.3%
Debt (L-T)	46.7%	46.3%	43.6%	40.4%	37.6%	35.1%	32.6%	30.0%
Deferred Items	8.8%	9.7%	8.5%	8.3%	12.6%	12.3%	13.0%	13.9%
Preferred Shares	2.6%	2.7%	2.7%	2.6%	2.6%	2.6%	2.6%	2.6%
Shareholders' Equity	39.7%	37.4%	39.6%	41.0%	41.9%	42.8%	44.4%	46.1%
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Income Statement ($mm)								
Total Revenue	109.1	133.7	137.8	160.0	138.8	115.8	126.3	124.3
EBIT	19.5	18.5	17.5	18.6	17.6	7.4	9.2	9.2
NPAT	4.9	5.7	5.4	6.7	5.0	4.7	6.2	6.2
Preferred Share Dividends	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Net Earnings to Common	4.6	5.3	5.1	6.3	4.6	4.4	5.9	5.8
Cash Flow from Operations	12.8	12.2	16.4	11.8	17.6	12.9	17.5	17.1

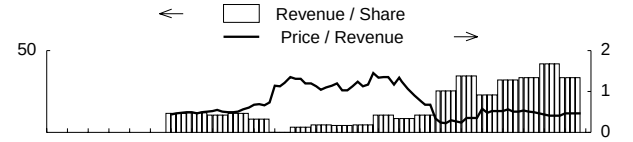
Source: BMO Capital Markets

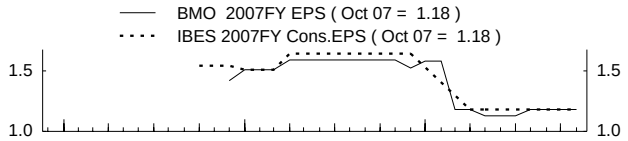
Pacific Nthn. Gas A (PNG)

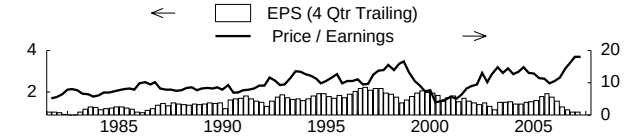


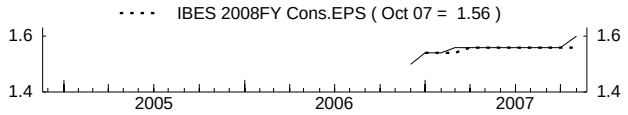












FYE (Dec.)	EPS $	P/E	DPS $	Yield %	Payout %	BV $	P/B	ROE %
1985	1.22	8	0.70	7.0	57	8.03	1.2	15
1986	1.09	9	0.70	6.8	64	8.43	1.2	13
1987	1.31	8	0.75	7.4	57	8.97	1.1	15
1988	1.34	8	0.75	6.6	56	9.24	1.2	15
1989	1.45	8	0.75	6.4	52	9.92	1.2	15
1990	1.61	7	0.75	6.7	47	10.76	1.0	16
1991	1.66	8	0.80	5.9	48	11.62	1.2	15
1992	1.55	11	0.80	4.8	52	12.37	1.3	13
1993	1.63	13	0.88	4.0	54	12.37	1.8	13
1994	1.80	11	0.88	4.3	49	12.37	1.6	15
1995	1.67	13	0.96	4.6	57	14.57	1.4	12
1996	2.01	11	0.96	4.3	48	15.61	1.4	13
1997	2.16	14	1.04	3.5	48	16.42	1.8	13
1998	1.73	16	1.12	4.1	65	17.39	1.6	10
1999	1.92	9	1.12	6.5	58	18.19	1.0	11
2000	1.83	4	1.12	14.1	61	19.44	0.4	10
2001	1.52	6	1.12	11.7	74	20.95	0.5	8
2002	1.25	13	1.12	6.3	82	19.27	0.9	6
2003	1.46	13	0.80	4.1	54	19.96	1.0	7
2004	1.38	15	0.80	3.8	57	20.52	1.0	7
2005	1.72	11	0.80	4.1	46	21.43	0.9	8
2006	1.25	14	0.80	4.4	63	21.91	0.8	6
Current*	1.01	18	0.80	4.4	79	22.34	0.8	5
Average:		11		5.9	57		1.2	11.5
Growth(%):								
5 Year:	-7.2		-6.5			1.3		
10 Year:	-7.0		-2.6			3.6		
20 Year:	-1.7		0.3			5.0		

* Current EPS is the 4 Quarter Trailing to Q2/2007.

PNG - Rating as of 19-Nov-04 = Und.

	Date	Rating Change	Share Price
1	14-Apr-05	Und.to Mkt	$17.85
2	30-Aug-05	Mkt to Und.	$19.80
3	18-Nov-05	Und.to Mkt	$19.27
4	22-Sep-06	Mkt to OP	$17.76
5	27-Oct-06	OP to Mkt	$19.30
6	24-Nov-06	Mkt to OP	$18.50

Last Daily Data Point: October 31, 2007

Company Risk Disclosure

In addition to the risks involved in investing in common stocks generally, we also highlight the following risks that pertain to this company. The company's natural gas transmission business depends on the continued availability of natural gas. The BCUC approves PNG's customer rates and a fair return on the rate base. Changes in regulation may adversely affect performance. Natural gas and fuel oil compete with electricity for space heating in Pacific Northern Gas' service areas. Fluctuations in the price of natural gas could increase the working capital financing requirements and related costs for accounts receivable. In 2004, 75% of energy deliveries were made to four large industrial customers (67% to one customer, Methanex). Transportation service to Methanex was made pursuant to an agreement that expires in October 2009. On August 30, 2005, Methanex announced that it will close its Kitimat facilities in early 2006.

Analyst's Certification

I, Karen Taylor, CFA, hereby certify that the views expressed in this report accurately reflect my personal views about the subject securities or issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report.

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Rating Category	BMO Rating	BMO Universe	BMO I.B. Clients*	First Call Universe**
Buy	Outperform	42%	49%	49%
Hold	Market Perform	50%	46%	45%
Sell	Underperform	8%	5%	6%

* Reflects rating distribution of all companies where BMO Capital Markets has received compensation for Investment Banking services.
** Reflects rating distribution of all North American equity research analysts.

Ratings Key

We use the following ratings system definitions:
OP = Outperform - Forecast to outperform the market;
Mkt = Market Perform - Forecast to perform roughly in line with the market;
Und = Underperform - Forecast to underperform the market;
(S) = speculative investment;
NR = No rating at this time;
R = Restricted – Dissemination of research is currently restricted.

Market performance is measured by a benchmark index such as the S&P/TSX Composite Index, S&P 500, Nasdaq Composite, as appropriate for each company. Prior to September 1, 2003, a fourth rating tier—Top Pick—was used to designate those stocks we felt would be the best performers relative to the market. Our six Top 15 lists which guide investors to our best ideas according to six different objectives (large, small, growth, value, income and quantitative) have replaced the Top Pick rating.

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Pacific Northern Gas

(PNG-TSX)

Stock Rating: **Outperform**
Industry Rating: **Market Perform**

January 22, 2008
Research Comment
Toronto, Ontario

Karen Taylor, CFA
(416) 359-4304
Karen.Taylor@bmo.com
Assoc: Benjamin Pham

Recapitalization Upside; Maintaining Outperform Rating

Event

On January 17 and 18, senior management of Pacific Northern Gas met with institutional investors to update the company's regulatory agenda, further delineate its future prospects and gather feedback from investors regarding various alternatives to "surface additional shareholder value".

Impact

Positive.

Forecasts

Our diluted 2007, 2008 and 2009 EPS estimates of $1.18, $1.65 and $1.63 are unchanged. Our estimates are exclusive of the planned KSL Pipeline (50% - Pacific Northern Gas).

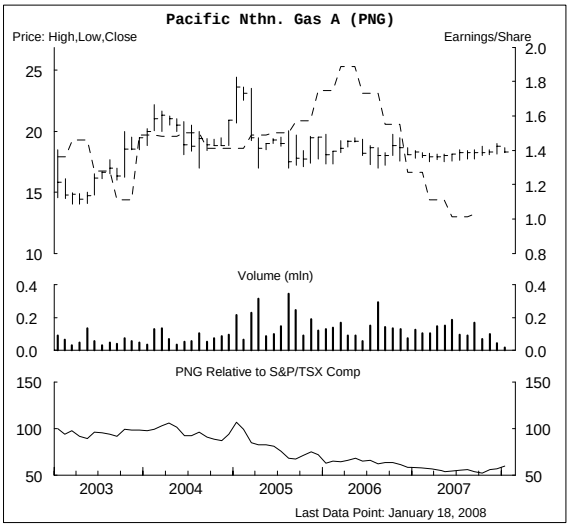
Valuation

Our target price of $20.50 reflects a weighted valuation approach: 12x 2009E diluted EPS of $1.63 (12.5%), 1.0x 2009E BVPS of $23.99 (12.5%), and a target yield of 4.25% (75%), assuming 2009 dividends per share of $0.86. As discussed herein, in the event that the company is acquired, we believe the acquisition price per share could be approximately $27, representing a 31.7% premium to our target price and a 50% premium to last night's closing price.

Recommendation

We continue to believe the shares are attractively valued at current levels. Our rating is Outperform.

Price (21-Jan)	$18.00	**52-Week High**	$19.00
Target Price	$20.50↑	**52-Week Low**	$17.50



(FY-Dec.)	2006A	2007E	2008E	2009E
EPS	$1.25	$1.18	$1.65	$1.63
P/E		15.3x	10.9x	11.0x
CFPS	$4.84	$3.53	$4.79	$4.69
P/CFPS		5.1x	3.8x	3.8x
Div.	$0.80	$0.80	$0.82	$0.86
EV ($mm)	$154	$152	$149	$143
EBITDA ($mm)	$26.1	$16.3	$19.0	$18.7
EV/EBITDA	5.9x	9.3x	7.8x	7.7x

Quarterly EPS	Q1	Q2	Q3	Q4
2006A	$1.22	-$0.14	-$0.42	$0.61
2007E	$1.06a	-$0.24a	-$0.40a	$0.79
2008E	$1.15	$0.03	-$0.33	$0.82

Dividend	$0.80	**Yield**	4.4%
Book Value	$21.82	**Price/Book**	0.8x
Shares O/S (mm)	3.6	**Mkt. Cap ($mm)**	$66
Float O/S (mm)	3.6	**Float Cap ($mm)**	$66
Wkly Vol (000s)	25	**Wkly $ Vol (mm)**	$0.5
Net Debt ($mm)	$85.8	**Next Rep. Date**	21-Feb (E)

Notes: Estimates are weather normal
Major Shareholders: Widely held
First Call Mean Estimates: PACIFIC NORTHERN GAS LTD 'A' (C$) 2007E: $1.18; 2008E: $1.65; 2009E: $1.63

Changes

Target
$20.00 to $20.50

Details & Analysis

On January 17 and 18, senior management of Pacific Northern Gas met with institutional investors to update the company's regulatory agenda, further delineate its future prospects and gather feedback from investors regarding various alternatives to "surface additional shareholder value". The highlights from our meetings include:

The Tool-Kit to Address Shareholder Value

There have been three key events over the last 24 months that have arguably provided the company with the "tool-kit" to address shareholder value:

1. The August 16, 2006, Decision and Order of the British Columbia Utilities Commission (BCUC) clearly establishes that a utility regulated on a cost of service basis pursuant to the Utilities Commission Act is permitted under the Act to recover the reasonable and prudent costs of providing its services in exchange for the obligation to provide safe and reliable service. In the decision, the Commission also states that it has a statutory obligation to approve rates that will afford a fair compensation for the services rendered and provide the utility with a fair and reasonable return. This decision strongly implies that, short of a change in the Act, the remaining revenue deficiency arising from the termination of the Methanex contract effective March 1, 2006, is likely to be recoverable in rates. We expect the company to file an application for fiscal 2009 rates in Q3/08, with a decision likely by late Q4/08. The amortization of the termination payment received by Methanex ceases November 1, 2009.

2. On July 24, 2007, the company announced that it had arranged $55 million in new and refinanced debt, comprised of a $20 million, 364-day operating credit facility, a $20 million, 5-year revolving term loan, and a $15 million, 10-year term loan. The existing term lender Roynat committed at that time to refinance $14 million in PNG debentures that would be scheduled to mature in 2011 and 2012, with a new $15 million debenture issue maturing in 2017. The new debenture did not have any required principal payments. The new financing arrangements allowed the company to: (i) extend the term of its debt; (ii) reduce the annual "sinking fund" or amortization requirements; (iii) materially reduce the number and scope of the governing covenant package; and (iv) increase its financial flexibility.

3. On April 23, 2007, British Columbia Hydro released its 2007/2008 to 2009/10 Service Plan. Among other things, the plan complies with the provincial Energy Plan released in 2002 and the February 14, 2006, Speech from the Throne that announced the government's intention for British Columbia to become self sufficient (regarding electricity) within the decade ahead. BC Hydro's rates increased by 1.54% for the period from July 1, 2006 to January 31, 2007, a further 2% increase took effect on February 1, 2007, and additional rate increases of 5.86% and 3.74% are contemplated in F2009 and F2010, under the plan. BC Hydro has also implemented a 2% per annum increase in rates for the purpose of recovering the current balances in its deferral accounts. At the end of fiscal 2006, the total balance in its four deferral accounts was $257 million. Rate increases by BC Hydro increase the competitiveness of natural gas, and help mitigate the risk that Pacific Northern Gas' potential revenue deficiencies arising from the loss of customers or higher natural gas commodity costs can in fact be recovered in customer rates without changing the relative competitiveness of the provided service.

Releasing Trapped Value

The weighted average capital structure allowed by the BCUC is 39.25%, whereas the actual equity capitalization of the company is approximately 53.5%. The company has, in essence, approximately $6.40 per share of notional cash on its balance sheet that could be paid to shareholders and funded with debt. This notional cash could be returned to shareholders via: (i) special dividend; (ii) share repurchase; (iii) increase in the ordinary, quarterly dividend; or (iv) corporate acquisition (with a total enterprise value of approximately $40 million and funding it entirely with debt). The company's outstanding debt instruments are presently rated by Dominion Bond Rating Service, which rates its secured debentures BBB(low) with a negative trend. We believe the company's debt securities would likely be reduced to non-investment grade if either a special dividend or share repurchase plan is executed. It is not clear to us whether management would be willing to reduce the company's credit ratings to below investment grade; as such, an action may increase certain natural gas supply procurement costs and result in higher customer rates.

We believe there a number of options to release the $6.40 of surplus equity on the balance sheet:

- Increase the Regular Quarterly Dividend: The company has not increased its $0.20 per share quarterly dividend since 2003 and its effective payout, after normalizing for project development expenses in 2007 arising from the KSL Pipeline Project, is approximately 50%. As set out in Table 1, the common equity component of the company's capital structure is increasing in the normal course, and we believe there is sufficient stability in the company's business that a measured program of dividend increases could be implemented. We have assumed the quarterly dividend is increased by $0.01 per share to $0.21 commencing with the third dividend payment in 2008. The total dividend paid in 2008 is expected to be $0.82 per share and $0.86 per share in 2009. The expected dividend payout in 2008 and 2009 is 49.2% and 52%, respectively. We do not believe a special dividend or a share repurchase program is likely to result in a sustained increase in share price.

- Make a Strategic Acquisition: as discussed above, the company could effectively recapitalize its balance sheet by making an acquisition with an enterprise value of approximately $40 million, and fund the purchase entirely with debt without necessarily adversely affecting its credit rating. An acquisition of a comparable, utility operation could actually enhance its corporate credit rating, as the increase in leverage would be associated with incremental earnings and cash flow from the acquired business.

- Conduct an Auction: management could put itself up for sale and the potential acquirer could use the existing balance sheet capability of the company to partially fund the transaction, such that the actual capital structure of the company is "equal" to that allowed on its regulated utility assets or a weighted average of 39.25%. We believe an acquirer would likely have to pay the full value of the effective cash on hand of $6.40 per share, such that a takeout price would likely be in the range of $27. An acquirer could release additional value on Pacific Northern Gas' balance sheet by "rolling" the existing utility assets into a larger utility rate base with lower deemed equity capital. For example, the utility operations of Terasen Gas (100% - Fortis Inc.) have deemed equity of 35%, suggesting that by averaging the two rate bases together, an additional $1.89 per share of notional cash is available on Pacific Northern Gas' balance sheet. We note that by lowering Pacific Northern Gas' regulated deemed equity from 40% to 35% would reduce estimated earnings by approximately $1 million or approximately $0.20 per share and the acquirer would likely adjust the purchase price per share by some multiple of this amount.

- Continue to develop the KSL Pipeline: we expect management to continue to advance the development of the proposed Kitimat to Summit Lake Pipeline (KSL). The project is expected to receive its final environmental certificates in H1/08; however, activities related to the process to obtain authorization from the BCUC to build, own and operate the pipeline via a Certificate of Convenience and Necessity (CPCN) are not likely to proceed until the related liquefied natural gas terminal is able to secure a commodity supply, on a take or pay basis and either the supplier or customer contracts for the pipeline's capacity, also on a use or pay basis. The commodity supplier and/or customer must have an investment grade credit rating and be able to sign a long-term shipping agreement (at least 20 years) before the pipeline project can proceed. We do not believe the project is likely to proceed over our 2008 and 2009 forecast period and we have assumed that no additional material project development costs are incurred post 2007.

We believe management is likely to consider these options over the forecast period and note that Mr. Jerry Zucker disclosed on November 20, 2007 that he owns approximately 10.244% of the issued and outstanding common shares of the company, for investment purposes.

Estimates

Our diluted 2007, 2008 and 2009 EPS estimates of $1.18, $1.65 and $1.63 are unchanged. Our estimates are exclusive of the planned KSL Pipeline (50% - Pacific Northern Gas).

Valuation

Our target price of $20.50 reflects a weighted valuation approach: 12x 2009E diluted EPS of $1.63 (12.5%), 1.0x 2009E BVPS of $23.99 (12.5%), and a target yield of 4.25% (75%), assuming 2009 dividends per share of $0.86. As discussed herein, in the event that the company is acquired, we believe the acquisition price per share could be approximately $27, representing a 31.7% premium to our target price and a 50% premium to last night's closing price.

Recommendation

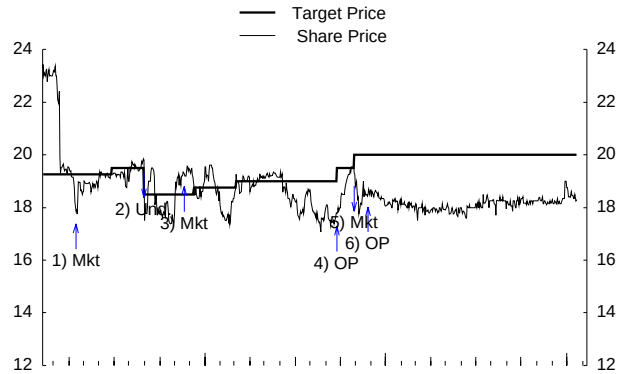
We continue to believe the shares are attractively valued at current levels. Our rating is Outperform.

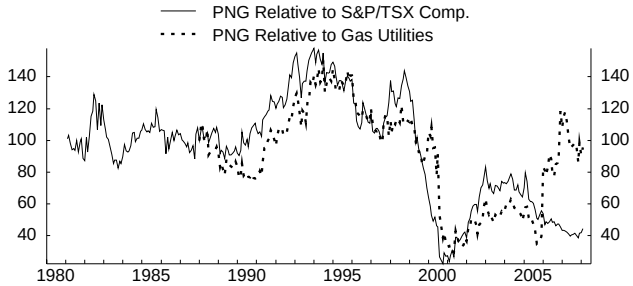
Table 1. Consolidated Summary Sheet

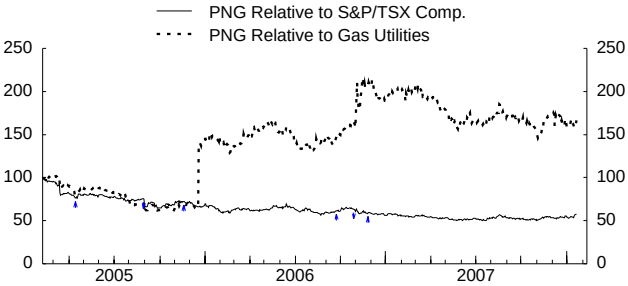
22-Jan-08								Karen J. Taylor
Current Price:	$18.00							BMO Capital Markets
12-Month Target Price:	$20.50							
ROR:	18.4%					Recommendation:		Outperform
				Year Ended December 31				
	2002	**2003**	**2004**	**2005**	**2006**	**2007E**	**2008E**	**2009E**
Total Earnings Per Share	$1.28	$1.49	$1.41	$1.75	$1.27	$1.20	$1.67	$1.65
Fully Diluted EPS	$1.25	$1.46	$1.38	$1.72	$1.25	$1.18	$1.65	$1.63
Dividends	$0.00	$0.80	$0.80	$0.80	$0.80	$0.80	$0.82	$0.86
Payout Ratio	0.0%	53.8%	56.8%	45.8%	63.0%	66.7%	49.2%	52.0%
Average Shares (mm)	3.5	3.6	3.6	3.6	3.631	3.6	3.6	3.6
Net Book Value	21.62	19.25	20.52	21.44	21.92	22.33	23.19	23.99
Market Valuation								
Price: High	$18.00	$19.50	$22.00	$24.00	$19.60	-	-	-
Price: Low	$9.35	$14.00	$17.28	$17.37	$17.06	-	-	-
Price: Current	-	-	-	-	-	$18.00		
P/E Ratio: High	14.0	13.1	15.6	13.7	15.4	-	-	-
P/E Ratio: Low	7.3	9.4	12.3	9.9	13.4	-	-	-
P/E Ratio: Current	-	-	-	-	-	15.0	10.8	10.9
Price/Book Value: High	0.83	1.01	1.07	1.12	0.89	-	-	-
Price/Book Value: Low	0.43	0.73	0.84	0.81	0.78	-	-	-
Price/Book Value: Current	-	-	-	-	-	0.81	0.78	0.75
Yield: High Price	0.00%	4.11%	3.64%	3.34%	4.08%	-	-	-
Yield: Low Price	0.00%	5.73%	4.63%	4.61%	4.69%	-	-	-
Yield: Current	-	-	-	-	-	4.4%	4.6%	4.8%
Balance Sheet ($mm)								
Debt (S-T)	4.4	7.3	10.4	14.7	10.0	14.0	14.3	14.1
Debt (L-T)	90.2	85.8	81.4	76.6	71.7	66.8	61.9	56.8
Deferred Items	17.0	17.9	15.8	15.7	24.0	23.3	24.8	26.3
Preferred Shares	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0
Shareholders' Equity	76.7	69.4	73.9	77.7	79.8	81.3	84.4	87.3
	193.3	185.4	186.7	189.7	190.5	190.4	190.4	189.6
Balance Sheet (%)								
Debt (S-T)	2.3%	3.9%	5.6%	7.7%	5.2%	7.4%	7.5%	7.4%
Debt (L-T)	46.7%	46.3%	43.6%	40.4%	37.6%	35.1%	32.5%	30.0%
Deferred Items	8.8%	9.7%	8.5%	8.3%	12.6%	12.2%	13.0%	13.9%
Preferred Shares	2.6%	2.7%	2.7%	2.6%	2.6%	2.6%	2.6%	2.6%
Shareholders' Equity	39.7%	37.4%	39.6%	41.0%	41.9%	42.7%	44.3%	46.1%
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Income Statement ($mm)								
Total Revenue	109.1	133.7	137.8	160.0	138.8	115.8	126.8	124.6
EBIT	19.5	18.5	17.5	18.6	17.6	7.4	9.3	9.3
NPAT	4.9	5.7	5.4	6.7	5.0	4.7	6.4	6.4
Preferred Share Dividends	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Net Earnings to Common	4.6	5.3	5.1	6.3	4.6	4.4	6.1	6.0
Cash Flow from Operations	12.8	12.2	16.4	11.8	17.6	12.9	17.7	17.3
Key Statistics								
Average Utility Rate Base ($mm)	166.8	165.4	167.2	165.2	162.4	165.6	168.0	166.4
Growth Rate	-1.98%	-0.87%	1.10%	-1.19%	-1.67%	1.95%	1.43%	-0.93%
2006 - 2009 CAGR								0.81%
Allowed Return on Equity	9.88%	10.17%	9.80%	9.68%	9.45%	9.02%	9.27%	9.27%
Deemed Equity	36.00%	36.00%	36.00%	40.00%	40.00%	40.00%	40.00%	40.00%
Sensitivity								
100 bp Change ROE								
Change Total Income	0.6	0.6	0.6	0.7	0.6	0.7	0.7	0.7
Change Per Share	0.17	0.17	0.17	0.18	0.18	0.18	0.18	0.18
100 bp Change in Deemed Equity								
Change Total Income	0.2	0.2	0.2	0.2	0.2	0.1	0.2	0.2
Change Per Share	0.05	0.05	0.05	0.04	0.04	0.04	0.04	0.04
1.00% Change in Average Rate Base								
Change Total Income	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Change Per Share	0.02	0.02	0.02	0.02	0.02	0.02	0.02	0.02

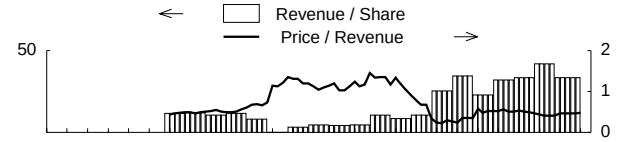
Source: BMO Capital Markets

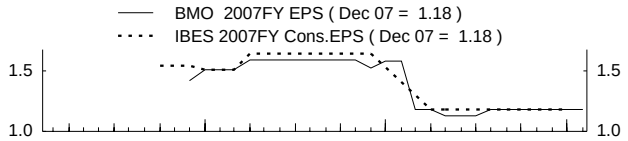
Pacific Nthn. Gas A (PNG)

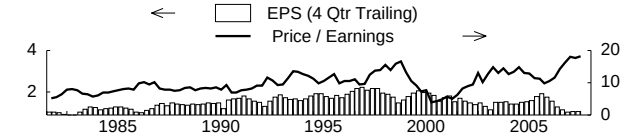


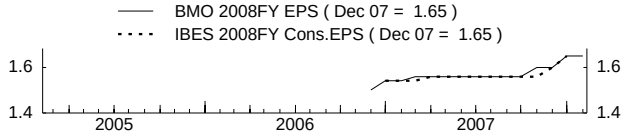












FYE (Dec.)	EPS $	P/E	DPS $	Yield %	Payout %	BV $	P/B	ROE %
1985	1.22	8	0.70	7.0	57	8.03	1.2	15
1986	1.09	9	0.70	6.8	64	8.43	1.2	13
1987	1.31	8	0.75	7.4	57	8.97	1.1	15
1988	1.34	8	0.75	6.6	56	9.24	1.2	15
1989	1.45	8	0.75	6.4	52	9.92	1.2	15
1990	1.61	7	0.75	6.7	47	10.76	1.0	16
1991	1.66	8	0.80	5.9	48	11.62	1.2	15
1992	1.55	11	0.80	4.8	52	12.37	1.3	13
1993	1.63	13	0.88	4.0	54	12.37	1.8	13
1994	1.80	11	0.88	4.3	49	12.37	1.6	15
1995	1.67	13	0.96	4.6	57	14.57	1.4	12
1996	2.01	11	0.96	4.3	48	15.61	1.4	13
1997	2.16	14	1.04	3.5	48	16.42	1.8	13
1998	1.73	16	1.12	4.1	65	17.39	1.6	10
1999	1.92	9	1.12	6.5	58	18.19	1.0	11
2000	1.83	4	1.12	14.1	61	19.44	0.4	10
2001	1.52	6	1.12	11.7	74	20.95	0.5	8
2002	1.25	13	1.12	6.3	82	19.27	0.9	6
2003	1.46	13	0.80	4.1	54	19.96	1.0	7
2004	1.38	15	0.80	3.8	57	20.52	1.0	7
2005	1.72	11	0.80	4.1	46	21.43	0.9	8
2006	1.25	14	0.80	4.4	63	21.91	0.8	6
Current*	1.03	18	0.80	4.3	78	21.82	0.9	5
Average:		11		5.9	57		1.2	11.5
Growth(%):								
5 Year:	-5.4		-6.5			2.5		
10 Year:	-7.1		-2.6			2.9		
20 Year:	-1.2		0.3			4.5		

* Current EPS is the 4 Quarter Trailing to Q3/2007.

PNG - Rating as of 8-Feb-05 = Und.

	Date	Rating Change	Share Price
1	14-Apr-05	Und.to Mkt	$17.85
2	30-Aug-05	Mkt to Und.	$19.80
3	18-Nov-05	Und.to Mkt	$19.27
4	22-Sep-06	Mkt to OP	$17.76
5	27-Oct-06	OP to Mkt	$19.30
6	24-Nov-06	Mkt to OP	$18.50

Last Daily Data Point: January 18, 2008

Company Risk Disclosure

In addition to the risks involved in investing in common stocks generally, we also highlight the following risks that pertain to this company. The company's natural gas transmission business depends on the continued availability of natural gas. The BCUC approves PNG's customer rates and a fair return on the rate base. Changes in regulation may adversely affect performance. Natural gas and fuel oil compete with electricity for space heating in Pacific Northern Gas' service areas. Fluctuations in the price of natural gas could increase the working capital financing requirements and related costs for accounts receivable. In 2004, 75% of energy deliveries were made to four large industrial customers (67% to one customer, Methanex). Transportation service to Methanex was made pursuant to an agreement that expires in October 2009. On August 30, 2005, Methanex announced that it will close its Kitimat facilities in early 2006.

Analyst's Certification

I, Karen Taylor, CFA, hereby certify that the views expressed in this report accurately reflect my personal views about the subject securities or issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report.

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Distribution of Ratings

Rating Category	BMO Rating	BMO Universe	BMO I.B. Clients*	First Call Universe**
Buy	Outperform	38%	42%	49%
Hold	Market Perform	53%	52%	46%
Sell	Underperform	9%	6%	5%

* Reflects rating distribution of all companies where BMO Capital Markets has received compensation for Investment Banking services.

** Reflects rating distribution of all North American equity research analysts.

Ratings Key

We use the following ratings system definitions:

OP = Outperform - Forecast to outperform the market;

Mkt = Market Perform - Forecast to perform roughly in line with the market;

Und = Underperform - Forecast to underperform the market;

(S) = speculative investment;

NR = No rating at this time;

R = Restricted – Dissemination of research is currently restricted.

Market performance is measured by a benchmark index such as the S&P/TSX Composite Index, S&P 500, Nasdaq Composite, as appropriate for each company. Prior to September 1, 2003, a fourth rating tier—Top Pick—was used to designate those stocks we felt would be the best performers relative to the market. Our six Top 15 lists which guide investors to our best ideas according to six different objectives (large, small, growth, value, income and quantitative) have replaced the Top Pick rating.

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Additional Matters

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From: Karen Taylor <Karen.Taylor@bmo.com>
Sent: Friday, February 22, 2008 5:31 AM
To: Kevin Teitge
Subject: Pacific Northern Gas: Q4/07 EPS Lower Than Expected (Flash)
Attachments: ATT3350071.txt

Utilities - Gas & Electric Utilities

BMO Capital Markets | Canada

Pacific Northern Gas

(PNG-TSX)

Stock Rating: Outperform
Stock Price: $18.25
Target Price: $20.50

February 22, 2008
Brief Research Note
Gas & Electric

Karen Taylor, CFA
(416) 359-4304
Karen.Taylor@bmo.com
Assoc: Benjamin Pham

Q4/07 EPS Lower Than Expected

Impact

Slightly Positive

Details & Analysis

Pacific Northern Gas reported Q4/07 EPS of $0.70, lower than our expectation of $0.79 per share and 2007 diluted EPS of $1.10, lower than our expectation of $1.18 per share. The variance between expected and actual performance is largely attributable to lower deliveries to large commercial and small industrial customers, primarily in the forestry sector, that are not subject to deferral accounts. In Q4/07, actual project development costs relating to Pacific Trail Pipelines LP (PNG - 50%) were $0.3 million, versus our expectation of $0.4 million, and in 2007, actual costs were $1.4 million versus our expectation of $1.5 million. Management indicated in its release that a further $0.4 million of after-tax development costs are likely in 2008 and that costs will be minimized until suitable commercial arrangements for firm gas transportation services are in place. The companys board of directors also approved an increase in the quarterly dividend to $0.22 per share from the current payment of $0.20 per share. The higher dividend is payable on March 20, 2008 to shareholders of record on the close of business on March 1, 2008. The increase in dividend is two quarters earlier than expected and $0.01 higher than our estimate of the increased dividend of $0.21 per share. We rate the shares Outperform.

CLICK HERE for more details and research disclosures.

CLICK HERE to access our research website.

CLICK HERE to apply for a web account.

From: Michael McGowan <Michael.McGowan@bmo.com>
Sent: Wednesday, April 30, 2008 6:25 AM
To: Kevin Teitge
Subject: Pacific Northern Gas: Q1/08 EPS Slightly Higher Than Expected (Flash)
Attachments: ATT173888.txt

Utilities - Gas & Electric Utilities

BMO Capital Markets | Canada

Pacific Northern Gas

(PNG-TSX)

April 30, 2008
Brief Research Note
Gas & Electric

Stock Rating: Outperform
Stock Price: $18.25
Target Price: $22.00

Michael McGowan, CA, CFA
(416) 359-5807
Michael.McGowan@bmo.com
Assoc: Benjamin Pham

Q1/08 EPS Slightly Higher Than Expected

Impact

Neutral

Details & Analysis

Pacific Northern Gas reported Q1/08 EPS of $1.21 (basic) versus our EPS estimate of $1.07. The $0.5 million variance between expected and actual performance appears to be largely due to: (i) lower-than-expected administrative and general and income tax expense; and (ii) a slight change in seasonality of earnings due to weather that was 5 percent colder in Q1/08 versus Q1/07. Development expenditures relating to the proposed Pacific Trail Pipeline project (50% - Pacific Northern Gas) totalled $0.2 million after tax in Q1/08 and are expected to be a further $0.2 million after tax for the remainder of 2008, which is in line with our expectations.

From: Michael McGowan <Michael.McGowan@bmo.com>
Sent: Thursday, May 01, 2008 4:42 AM
To: Kevin Teitge
Subject: Pacific Northern Gas: Q1/08 Results: EPS Reflect Seasonality; Outperform Rating Unchanged (Comment)
Attachments: ATT203459.txt

Utilities - Gas & Electric Utilities

BMO Capital Markets | Canada

Pacific Northern Gas

(PNG-TSX)

May 1, 2008
Research Comment
Toronto, Ontario

Stock Rating: Outperform
Industry Rating: Market Perform

Michael McGowan, CA, CFA
(416) 359-5807
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Assoc: Benjamin Pham

Q1/08 Results: EPS Reflect Seasonality; Outperform Rating Unchanged

Event

Pacific Northern Gas reported Q1/08 EPS of $1.21 (basic) versus our EPS estimate of $1.07. The $0.5 million variance between expected and actual performance appears to be largely due to: (i) lower-than-expected administrative and general and income tax expense; and (ii) a slight change in the seasonality of earnings due to weather that was 5 percent colder in Q1/08 versus Q1/07. Development expenditures relating to the proposed Pacific Trail Pipeline project (50% - Pacific Northern Gas) totalled $0.2 million after-tax in Q1/08 and are expected to be a further $0.2 million after-tax for the remainder of 2008, which is in line with our expectations.

Impact

Neutral.

Forecasts

Our diluted 2008 and 2009 EPS estimates of $1.53 and $1.63, respectively, are unchanged; however, we have adjusted our quarterly estimates to reflect revised seasonality.

Valuation

Our target price of $22 reflects a weighted valuation approach: 12x 2009E diluted EPS of $1.63 (12.5%), 1.0x 2009E BVPS of $23.55 (12.5%), and a target yield of 4.25% (75%), assuming 2009 dividends of $0.94.

Recommendation

We believe the shares are attractively valued at current levels. Our rating is Outperform.

CLICK HERE for full report including research disclosures.

CLICK HERE to access our research website.

CLICK HERE to apply for a web account.

From: Michael McGowan <Michael.McGowan@bmo.com>
Sent: Friday, August 01, 2008 6:45 AM
To: Kevin Teitge
Subject: Pacific Northern Gas: Q2/08 Results Lower Than Expected (Flash)
Attachments: ATT2179486.txt

Utilities - Gas & Electric Utilities

BMO Capital Markets | Canada

Pacific Northern Gas

(PNG-TSX)

Stock Rating: Market Perform
Stock Price: $17.00
Target Price: $19.00

July 31, 2008
Brief Research Note
Gas & Electric

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Assoc: Benjamin Pham

Q2/08 Results Lower Than Expected

Impact

Neutral

Details & Analysis

Pacific Northern Gas reported a net loss of $0.08 (basic) per share in Q2/08 versus our estimate of a loss of $0.02 per share. The variance between actual and expected net income was approximately $0.2 million. Development expenditures relating to the proposed Pacific Trail Pipeline project (50% - Pacific Northern Gas) totaled $0.1 million after tax in Q2/08, in line with our estimates. However, total project development costs in the last six months of 2008 are expected to be $0.3 million after tax ($0.2 million after tax in Q3/08 and $0.1 million after tax in Q4/08) versus previous guidance of $0.2 million after tax, due to expected increases in expenditures relating to the environmental review process.

From: Michael McGowan <Michael.McGowan@bmo.com>
Sent: Tuesday, August 05, 2008 4:51 AM
To: Kevin Teitge
Subject: Pacific Northern Gas: Q2/08 Results Lower Than Expected; Market Perform Rating Maintained (Comment)
Attachments: ATT2895720.txt

Utilities - Gas & Electric Utilities

BMO Capital Markets | Canada

Pacific Northern Gas

(PNG-TSX)

August 5, 2008
Research Comment
Toronto, Ontario

Stock Rating: Market Perform
Industry Rating: Market Perform

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Q2/08 Results Lower Than Expected; Market Perform Rating Maintained

Event

Pacific Northern Gas reported a net loss of $0.08 (basic) per share in Q2/08 versus our estimate of a loss of $0.02 per share. The variance between actual and expected net income was approximately $0.2 million. Development expenditures relating to the proposed Pacific Trail Pipeline project (PTP; 50% - Pacific Northern Gas) totalled $0.1 million after tax in Q2/08. We understand that project development costs in the last six months of 2008 are expected to be $0.3 million after tax ($0.2 million after tax in Q3/08 and $0.1 million after tax in Q4/08) versus previous guidance of $0.2 million after tax, due to expected increases in expenditures relating to the environmental review process.

Impact

Neutral.

Forecasts

We have updated our estimates to reflect higher PTP project development costs. Our diluted 2008 EPS estimate decreases to $1.51 from $1.53, and our diluted 2009 EPS estimate of $1.63 is unchanged.

Valuation

Our target price reflects a weighted valuation approach: 12x 2009E EPS of $1.63 (12.5%), 1.0x 2009E BVPS of $23.53 (12.5%), and a target yield of 5.25% (75%), assuming 2009 dividends per share of $0.94.

Recommendation

We believe the shares are reasonably valued at current levels. Our rating is Market Perform.

CLICK HERE for full report including research disclosures.

CLICK HERE to access our research website.

CLICK HERE to apply for a web account.

From: Michael McGowan <Michael.McGowan@bmo.com>
Sent: Tuesday, November 04, 2008 6:37 AM
To: Kevin Teitge
Subject: Pacific Northern Gas: Q3/08 Results Lower Than Expected (Flash)

Utilities - Gas & Electric Utilities

BMO Capital Markets | Canada

Pacific Northern Gas

(PNG-TSX)

Stock Rating: **Market Perform**
Stock Price: **$15.90**
Target Price: **$19.00**

November 4, 2008
Brief Research Note
Gas & Electric Utilities

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Q3/08 Results Lower Than Expected

Impact

Neutral

Details & Analysis

Pacific Northern Gas reported a Q3/08 net loss of $0.44 per share versus our estimate of a loss of $0.35 per share. The variance between expected and actual results was approximately $0.25 million. Project development expenditures relating to the proposed Pacific Trail Pipeline project (50% - Pacific Northern Gas) totaled $84,000 after tax. Project development costs for Q4/08 are expected to be $0.3 million after tax versus previous company guidance of $0.1 million after tax, due to a combination of timing and incremental expenses to complete the Canadian Environmental Assessment Agency environmental approval process.

From: Michael McGowan <Michael.McGowan@bmo.com>
Sent: Wednesday, November 05, 2008 5:03 AM
To: Kevin Teitge
Subject: Pacific Northern Gas: Q3/08 Results Lower Than Expected; Market Perform Rating Maintained (Comment)

Utilities - Gas & Electric Utilities

BMO Capital Markets | Canada

Pacific Northern Gas

(PNG-TSX)

November 5, 2008
Research Comment
Toronto, Ontario

Stock Rating: **Market Perform**
Industry Rating: **Market Perform**

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Q3/08 Results Lower Than Expected; Market Perform Rating Maintained

Event

Pacific Northern Gas reported a net loss of $0.44 per share in Q3/08 versus our estimate of a loss of $0.35 per share. The variance between expected and actual results was approximately $0.25 million and appears to reflect seasonality. Project development expenditures relating to the proposed Pacific Trail Pipeline project (PTP; 50% - Pacific Northern Gas) totaled $84,000 after-tax in Q3/08.

Impact

Neutral.

Forecasts

We have updated our estimates to reflect Q4/08 PTP project development costs of $0.3 million (after-tax) versus our previous estimate of $0.1 million (after-tax) and development costs of $0.2 million in 2009. The increase in fourth-quarter PTP expenses are due to a combination of timing (some expenses originally scheduled for Q3/08 will be incurred in Q4/08) and incremental expenses to complete the Canadian Environmental Assessment Agency environmental approval process. Our diluted EPS estimates decline to $1.48 from $1.51 in 2008 and to $1.57 from $1.63 in 2009. We are introducing our 2010 diluted EPS estimate of $1.60.

Valuation

Our revised target price of $18 reflects a weighted valuation approach: 12x 2009E EPS of $1.57 (12.5%), 1.0x BVPS of $23.44 (12.5%), and a target yield of 5.50% (75%), assuming 2009 dividends per share of $0.94. We have

increased our target yield by 25 bps to reflect higher observed risk premiums.

Recommendation

We believe the shares are reasonably valued at current levels. Our rating is Market Perform.

CLICK HERE for full report including research disclosures.

CLICK HERE to access our research website.

CLICK HERE to apply for a web account.

From: Michael McGowan <Michael.McGowan@bmo.com>
Sent: Thursday, December 04, 2008 5:12 AM
To: Kevin Teitge
Subject: Pacific Northern Gas: BCUC Approves Term Sheet for Transportation Service Between PNG and LNG Partners (Comment)

Utilities - Gas & Electric Utilities

BMO Capital Markets | Canada

Pacific Northern Gas

(PNG-TSX)

December 4, 2008
Research Comment
Toronto, Ontario

Stock Rating: **Market Perform**
Industry Rating: **Market Perform**

Michael McGowan, CA, CFA
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Assoc: Benjamin Pham

BCUC Approves Term Sheet for Transportation Service Between PNG and LNG Partners

Event

On November 27, the British Columbia Utilities Commission (BCUC) issued an order approving the term sheet filed by Pacific Northern Gas (PNG) on September 25 relating to a proposed natural gas transportation agreement between PNG and LNG Partner LLC. Pursuant to the term sheet, LNG Partners will pay PNG a non-refundable fee of $1.5 million in return for a six-month option to contract for at least 75 mmcf/d of firm gas transportation capacity on the PNG-West pipeline system for a three- to five-year period. The option may be extended for a further six-month period for payment of an additional fee of $1.5 million. It is our understanding that the initial option fee will be recorded in an interest-bearing deferral account.

Impact

Slightly Negative. Although a cash payment of $1.5 million is expected to be received in December 2008, it is unlikely that PNG will recognize revenue associated with the option fee in its 2008 financial statements. These proceeds will be determined by the BCUC during adjudication of PNG's 2009 rate application. PNG had requested that 1/3 of the initial option fee be recorded as income with the remaining 2/3 used to reduce customer rates in 2009.

Forecasts

Our financial estimates are unchanged.

Valuation

Our revised target price of $17 reflects a weighted valuation approach: 12x 2009E EPS of $1.57 (12.5%), 1.0x BVPS of $23.44 (12.5%), and a target yield

of 6.00% (75%), assuming 2009 dividends per share of $0.94.

Recommendation

We believe the shares are reasonably valued at current levels. Our rating is Market Perform.

CLICK HERE for full report including research disclosures.

CLICK HERE to access our research website.

CLICK HERE to apply for a web account.

From: Michael McGowan <Michael.McGowan@bmo.com>
Sent: Monday, December 08, 2008 4:45 AM
To: Kevin Teitge
Subject: Pacific Northern Gas: 2009 Rate Applications Filed; Market Perform Rating Maintained (Comment)

Utilities - Gas & Electric Utilities

BMO Capital Markets | Canada

Pacific Northern Gas

(PNG-TSX)

December 8, 2008
Research Comment
Toronto, Ontario

Stock Rating: **Market Perform**
Industry Rating: **Market Perform**

Michael McGowan, CA, CFA
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Assoc: Benjamin Pham

2009 Rate Applications Filed; Market Perform Rating Maintained

Event

On November 27, 2008, Pacific Northern Gas (PNG) filed 2009 Revenue Requirement Applications with the British Columbia Utilities Commission (BCUC) for PNG West and PNG (N.E.) Ltd., which owns the Fort St. John/ Dawson's Creek and Tumbler Ridge operating divisions. Key details of each application are set out herein.

Impact

Neutral.

Forecasts

We have updated our estimates to reflect the rate applications. Our diluted EPS estimate is unchanged in 2008, decreases to $1.53 from $1.57 in 2009 and is unchanged at $1.60 in 2010.

Valuation

Our target price of $17.00 reflects a weighted valuation approach: 12x 2009E diluted EPS of $1.53 (12.5%), 1.0x 2009E BVPS of $23.40 (12.5%) and a target yield of 6.00% (75%), assuming 2009 dividends per share of $0.94.

Recommendation

We believe the shares are reasonably valued. Our rating is Market Perform.

From: Michael McGowan <Michael.McGowan@bmo.com>
Sent: Wednesday, December 17, 2008 5:35 AM
To: Kevin Teitge
Subject: Pacific Northern Gas: Option Fee Not Received (Flash)

Utilities - Gas & Electric Utilities

BMO Capital Markets | Canada

Pacific Northern Gas

(PNG-TSX)

Stock Rating: **Market Perform**
Stock Price: **$13.50**
Target Price: **$17.00**

December 17, 2008
Brief Research Note
Gas & Electric Utilities

Michael McGowan, CA, CFA
(416) 359-5807
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Assoc: Benjamin Pham

Option Fee Not Received

Impact

Slightly Negative

Details & Analysis

Pacific Northern Gas ("PNG") has disclosed that it has not received a payment of $1.5 million from LNG Partners that was due on December 15, 2008. The $1.5 million fee is consideration for an option that PNG had sold LNG Partners for the right to contract at least 75 MMcf/d of firm gas transportation capacity on the PNG West pipeline system for a three- to five-year term. Reasons for the late payment were not included in the press release. As we did not believe that PNG would recognize revenue associated with the option fee until the BCUC ruled on the disposition of this amount, the $1.5 million receivable has not been included in our estimates.

Pacific Northern Gas

(PNG-TSX)

Stock Rating: **Market Perform**
Industry Rating: **Market Perform**

January 9, 2009
Research Comment
Toronto, Ontario

Michael McGowan, CA, CFA
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Target Price Reduced to $16 on Conservative Dividend Outlook

Event

We are adopting a more conservative dividend outlook, pending the outcome of the 2010 rate application for the PNG-West operating division, which will likely be filed sometime in H2/09. On August 30, 2005, Methanex terminated a long-term firm transportation agreement with PNG in connection with its decision to close facilities located in Kitimat, BC. As compensation for the contract termination, Methanex made a settlement payment of $23.33 million to PNG on March 1, 2006. After-tax proceeds of $15 million were recorded in a deferral account, and PNG has been amortizing the settlement against its annual revenue requirement. Upon the completion of regulatory amortization on October 31, 2009, it is likely that PNG's 2010 revenue requirement will increase. While we believe that the British Columbia Utilities Commission should allow PNG to pass through prudently incurred costs to its ratepayers, the potential for rate shock associated with the cessation of regulatory amortization will likely increase the regulatory risk associated with the 2010 rate application.

Impact

Slightly Negative.

Forecasts

We are reducing our 2010E DPS estimate to $0.94 from $1.00.

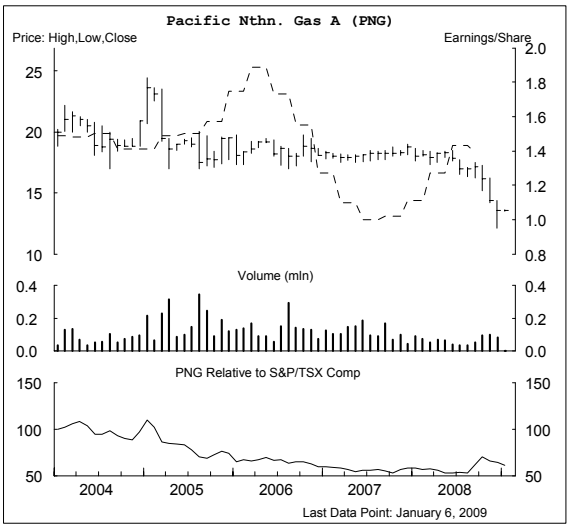
Valuation

Our revised target price of $16 reflects a weighted valuation approach: 12x 2010E EPS of $1.60 (12.5%), 1.0x BVPS of $24.09 (12.5%) and a target yield of 6.50% (75%), assuming 2010 dividends per share of $0.94. We have increased our target yield by 50 basis points to reflect the potential for increased regulatory risk in 2009.

Recommendation

We believe the shares are reasonably valued. Our rating is Market Perform.

Price (8-Jan)	$13.50	**52-Week High**	$18.55
Target Price	$16.00↓	**52-Week Low**	$12.11



(FY-Dec.)	2007A	2008E	2009E	2010E
EPS	$1.10	$1.48	$1.57	$1.60
P/E		9.1x	8.6x	8.4x
CFPS	-$0.72	$4.08	$4.66	$4.74
P/CFPS		3.3x	2.9x	2.8x
Div.	$0.80	$0.88	$0.94	$0.94
EV ($mm)	$155	$139	$134	$129
EBITDA ($mm)	$22.5	$15.6	$18.7	$23.3
EV/EBITDA	6.9x	8.9x	7.2x	5.5x

Quarterly EPS	Q1	Q2	Q3	Q4
2007A	$1.05	-$0.24	-$0.40	$0.70
2008E	$1.21a	-$0.08a	-$0.44a	$0.80
2009E	$1.10	$0.03	-$0.32	$0.78

Dividend	$0.88	**Yield**	6.5%
Book Value	$24.56	**Price/Book**	0.5x
Shares O/S (mm)	3.7	**Mkt. Cap ($mm)**	$49
Float O/S (mm)	3.7	**Float Cap ($mm)**	$49
Wkly Vol (000s)	15	**Wkly $ Vol (mm)**	$0.3
Net Debt ($mm)	$81.4	**Next Rep. Date**	23-Feb (E)

Notes: Estimates are weather normal
Major Shareholders: Widely held
First Call Mean Estimates: PACIFIC NORTHERN GAS LTD 'A' (C$) 2008E: $1.48; 2009E: $1.57; 2010E: $1.60

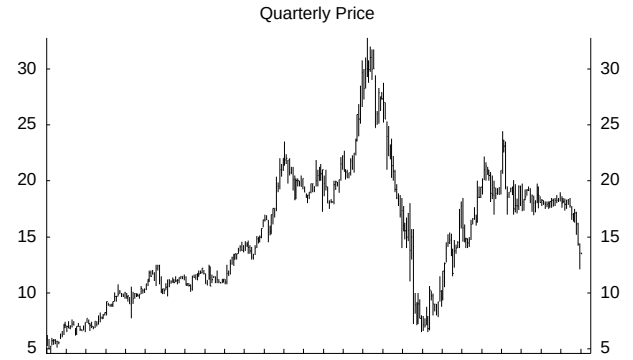
Changes

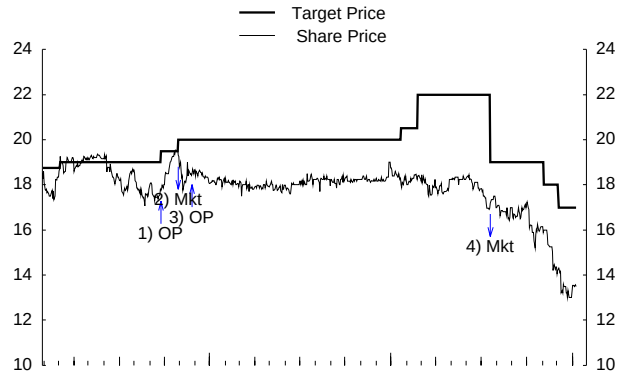
Target
$17.00 to $16.00

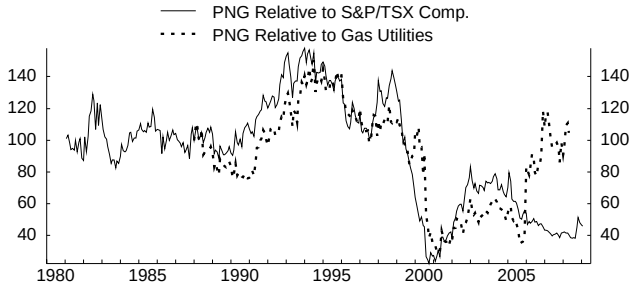
Table 1: Consolidated Summary

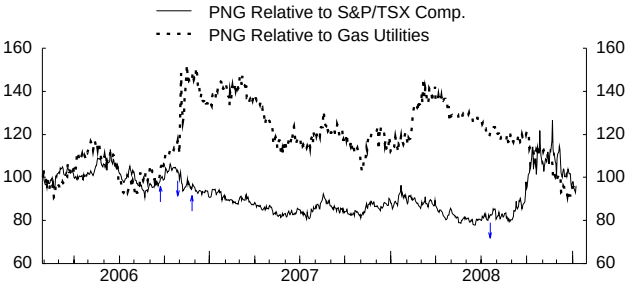
08-Jan-09									Michael McGowan
Current Price:	$13.50								BMO Capital Markets
12-Month Target Price:	$16.00								
ROR:	25.0%						Recommendation:		Market Perform
				Year Ended December 31					
	2002	**2003**	**2004**	**2005**	**2006**	**2007**	**2008E**	**2009E**	**2010E**
Total Earnings Per Share	$1.28	$1.49	$1.41	$1.75	$1.27	$1.11	$1.49	$1.55	$1.62
Fully Diluted EPS	$1.25	$1.46	$1.38	$1.72	$1.25	$1.10	$1.48	$1.53	$1.60
Dividends	$0.00	$0.80	$0.80	$0.80	$0.80	$0.80	$0.88	$0.94	$0.94
Payout Ratio	0.0%	53.8%	56.8%	45.8%	63.0%	72.4%	59.0%	60.7%	58.2%
Average Shares (mm)	3.5	3.6	3.6	3.6	3.6	3.6	3.7	3.7	3.7
Net Book Value	$21.62	$19.25	$20.52	$21.44	$21.91	$22.17	$22.79	$23.40	$24.09
Market Valuation									
Price: High	$18.00	$19.50	$22.00	$24.00	$19.60	$19.00	$18.65	-	-
Price: Low	$9.35	$14.00	$17.28	$17.37	$17.06	$17.50	$13.00	-	-
Price: Current	-	-	-	-	-	-	-	$13.50	
P/E Ratio: High	14.0	13.1	15.6	13.7	15.4	17.2	12.5	-	-
P/E Ratio: Low	7.3	9.4	12.3	9.9	13.4	15.8	8.7	-	-
P/E Ratio: Current	-	-	-	-	-	-	-	8.7	8.4
Price/Book Value: High	0.83	1.01	1.07	1.12	0.89	0.86	0.82	-	-
Price/Book Value: Low	0.43	0.73	0.84	0.81	0.78	0.79	0.57	-	-
Price/Book Value: Current	-	-	-	-	-	-	-	0.58	0.56
Yield: High Price	0.00%	4.11%	3.64%	3.34%	4.08%	4.21%	4.72%	-	-
Yield: Low Price	0.00%	5.73%	4.63%	4.61%	4.69%	4.58%	6.77%	-	-
Yield: Current	-	-	-	-	-	-	-	7.0%	7.0%
Balance Sheet ($mm)									
Debt (S-T)	4.4	7.3	10.4	14.7	10.0	11.1	22.3	24.8	28.6
Debt (L-T)	90.2	85.8	81.4	76.6	71.7	72.8	62.6	54.7	45.7
Deferred Items	17.0	17.9	15.8	15.7	24.0	18.5	20.0	21.5	23.0
Preferred Shares	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0
Shareholders' Equity	76.7	69.4	73.9	77.7	79.8	81.2	83.5	85.8	88.3
	193.3	185.4	186.7	189.7	190.5	188.7	193.4	191.8	190.6
Balance Sheet (%)									
Debt (S-T)	2.3%	3.9%	5.6%	7.7%	5.2%	5.9%	11.5%	12.9%	15.0%
Debt (L-T)	46.7%	46.3%	43.6%	40.4%	37.6%	38.6%	32.3%	28.5%	23.9%
Deferred Items	8.8%	9.7%	8.5%	8.3%	12.6%	9.8%	10.4%	11.2%	12.1%
Preferred Shares	2.6%	2.7%	2.7%	2.6%	2.6%	2.7%	2.6%	2.6%	2.6%
Shareholders' Equity	39.7%	37.4%	39.6%	41.0%	41.9%	43.1%	43.2%	44.7%	46.3%
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Income Statement ($mm)									
Total Revenue	109.1	133.7	137.8	160.0	138.8	129.5	104.1	124.4	155.3
EBIT	19.5	18.5	17.5	18.6	17.6	14.3	8.0	9.3	13.7
NPAT	4.9	5.7	5.4	6.7	5.0	4.4	5.8	6.0	6.3
Preferred Share Dividends	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Net Earnings to Common	4.6	5.3	5.1	6.3	4.6	4.0	5.5	5.7	5.9
Cash Flow from Operations	12.8	12.2	16.4	11.8	17.6	(2.6)	14.9	16.9	17.4
Key Statistics									
Average Utility Rate Base ($mm)	166.8	165.4	167.2	165.2	162.4	165.6	167.9	167.6	166.8
Growth Rate	-1.98%	-0.87%	1.10%	-1.19%	-1.67%	1.95%	1.38%	-0.15%	-0.52%
2007 - 2010 CAGR									0.23%
Allowed Return on Equity	9.88%	10.17%	9.80%	9.68%	9.45%	9.02%	9.27%	9.12%	9.12%
Deemed Equity	36.00%	36.00%	36.00%	40.00%	40.00%	40.00%	40.00%	40.00%	40.00%
Sensitivity									
100 bp Change ROE									
Change Total Income	0.6	0.6	0.6	0.7	0.6	0.7	0.7	0.7	0.7
Change Per Share	0.17	0.17	0.17	0.18	0.18	0.18	0.18	0.18	0.18
100 bp Change in Deemed Equity									
Change Total Income	0.2	0.2	0.2	0.2	0.2	0.1	0.2	0.2	0.2
Change Per Share	0.05	0.05	0.05	0.04	0.04	0.04	0.04	0.04	0.04
1.00% Change in Average Rate Base									
Change Total Income	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Change Per Share	0.02	0.02	0.02	0.02	0.02	0.02	0.02	0.02	0.02

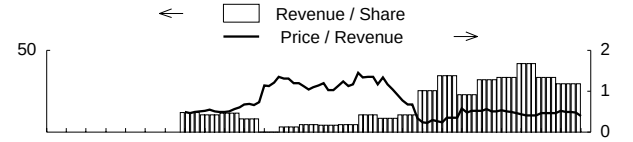
Pacific Nthn. Gas A (PNG)

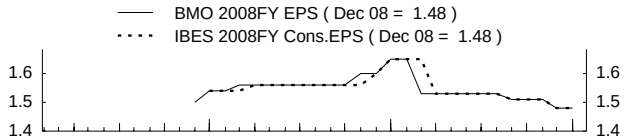


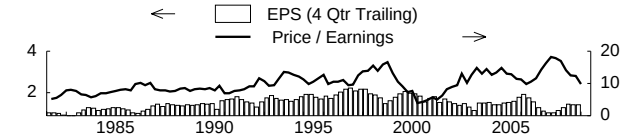


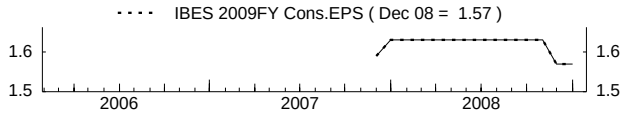












FYE (Dec.)	EPS $	P/E	DPS $	Yield %	Payout %	BV $	P/B	ROE %
1987	1.31	8	0.75	7.4	57	8.97	1.1	15
1988	1.34	8	0.75	6.6	56	9.24	1.2	15
1989	1.45	8	0.75	6.4	52	9.92	1.2	15
1990	1.61	7	0.75	6.7	47	10.76	1.0	16
1991	1.66	8	0.80	5.9	48	11.62	1.2	15
1992	1.55	11	0.80	4.8	52	12.37	1.3	13
1993	1.63	13	0.88	4.0	54	12.37	1.8	13
1994	1.80	11	0.88	4.3	49	12.37	1.6	15
1995	1.67	13	0.96	4.6	57	14.57	1.4	12
1996	2.01	11	0.96	4.3	48	15.61	1.4	13
1997	2.16	14	1.04	3.5	48	16.42	1.8	13
1998	1.73	16	1.12	4.1	65	17.39	1.6	10
1999	1.92	9	1.12	6.5	58	18.19	1.0	11
2000	1.83	4	1.12	14.1	61	19.44	0.4	10
2001	1.52	6	1.12	11.7	74	20.95	0.5	8
2002	1.25	13	1.12	6.3	82	19.27	0.9	6
2003	1.46	13	0.80	4.1	54	19.96	1.0	7
2004	1.38	15	0.80	3.8	57	20.52	1.0	7
2005	1.72	11	0.80	4.1	46	21.43	0.9	8
2006	1.25	14	0.80	4.4	63	21.91	0.8	6
2007	1.10	17	0.80	4.3	72	22.16	0.8	5
Current*	1.39	10	0.88	6.5	63	24.56	0.6	6
Average:		11		5.7	57		1.1	10.9
Growth(%):								
5 Year:	-1.4		1.9			4.2		
10 Year:	-2.2		-2.4			3.5		
20 Year:	0.2		0.8			5.0		

* Current EPS is the 4 Quarter Trailing to Q3/2008.

PNG - Rating as of 27-Jan-06 = Mkt

	Date	Rating Change	Share Price
1	22-Sep-06	Mkt to OP	$17.76
2	27-Oct-06	OP to Mkt	$19.30
3	24-Nov-06	Mkt to OP	$18.50
4	18-Jul-08	OP to Mkt	$17.20

Last Daily Data Point: January 7, 2009

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Analyst's Certification
I, Michael McGowan, CA, CFA, hereby certify that the views expressed in this report accurately reflect my personal views about the subject securities or issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report.

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Distribution of Ratings

Rating Category	BMO Rating	BMO Universe	BMO I.B. Clients*	Starmine Universe**
Buy	Outperform	37%	40%	50%
Hold	Market Perform	54%	55%	43%
Sell	Underperform	9%	5%	7%

* Reflects rating distribution of all companies where BMO Capital Markets has received compensation for Investment Banking services.
** Reflects rating distribution of all North American equity research analysts.

Ratings Key
We use the following ratings system definitions:
OP = Outperform - Forecast to outperform the market;
Mkt = Market Perform - Forecast to perform roughly in line with the market;
Und = Underperform - Forecast to underperform the market;
(S) = speculative investment;
NR = No rating at this time;
R = Restricted – Dissemination of research is currently restricted.

Market performance is measured by a benchmark index such as the S&P/TSX Composite Index, S&P 500, Nasdaq Composite, as appropriate for each company. Prior to September 1, 2003, a fourth rating tier—Top Pick—was used to designate those stocks we felt would be the best performers relative to the market. Our six Top 15 lists which guide investors to our best ideas according to six different objectives (large, small, growth, value, income and quantitative) have replaced the Top Pick rating.

Dissemination of Research

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Additional Matters

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Pacific Northern Gas

(PNG-TSX)

March 5, 2009
Brief Research Note
Gas & Electric Utilities

Stock Rating: **Market Perform**
Stock Price: **$11.50**
Target Price: **$16.00**

Michael McGowan, CA, CFA
(416) 359-5807
Michael.McGowan@bmo.com
Assoc: Benjamin Pham

Q4/08 Operating Results in Line

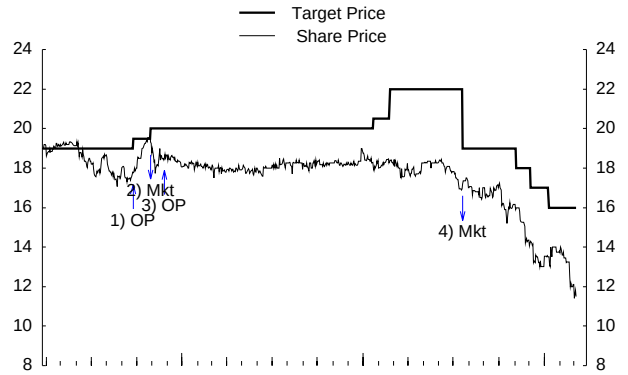
Impact

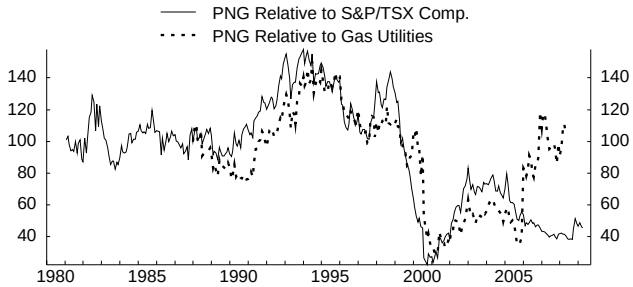
Neutral

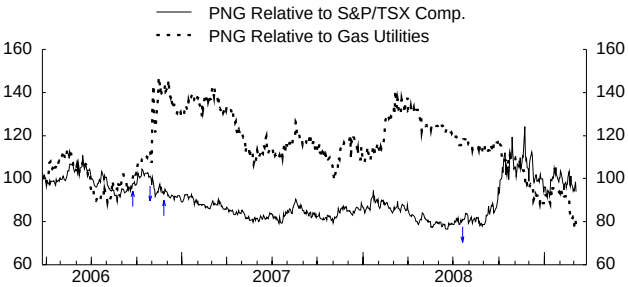
Details & Analysis

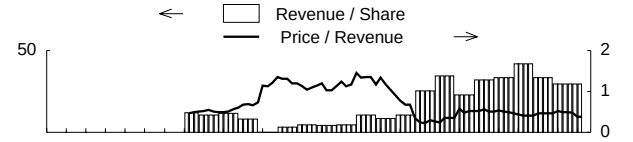
Pacific Northern Gas reported Q4/08 EPS of $0.84 vs. our estimate of $0.80. The difference between actual and expected results appears to be due to spending on the company's KSL project that was $0.1 million ($0.03/share) less than expected. We believe the following points from the earnings release are relevant: (1) The company has increased its quarterly dividend to $0.23 from $0.22. The increase was slightly less than our estimated quarterly dividend of $0.235; (2) The company has instituted a normal course issuer bid (NCIB). Under the terms of the NCIB, the company is authorized to acquire 300,000 common shares during the period from March 9, 2009 to March 8, 2010. The maximum number of common shares that may be acquired pursuant to the NCIB are 1,627/day up to and including March 31, 2009, and 1,000 shares/day thereafter; (3) The receipt of a $1.5 million option fee from LNG Partners is still outstanding. The fee was meant to be consideration for an option that PNG had negotiated with LNG Partners, which provided LNG Partners with the right to contract at least 75 MMcf/d of firm gas transportation capacity on the PNG West pipeline system for a three-to-five-year term. The option fee was due on December 15, 2008.

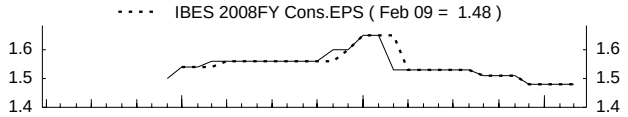
Pacific Nthn. Gas A (PNG)

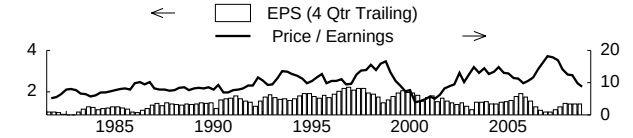


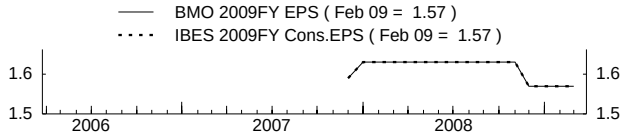












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1987	1.31	8	0.75	7.4	57	8.97	1.1	15
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1990	1.61	7	0.75	6.7	47	10.76	1.0	16
1991	1.66	8	0.80	5.9	48	11.62	1.2	15
1992	1.55	11	0.80	4.8	52	12.37	1.3	13
1993	1.63	13	0.88	4.0	54	12.37	1.8	13
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2000	1.83	4	1.12	14.1	61	19.44	0.4	10
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2003	1.46	13	0.80	4.1	54	19.96	1.0	7
2004	1.38	15	0.80	3.8	57	20.52	1.0	7
2005	1.72	11	0.80	4.1	46	21.43	0.9	8
2006	1.25	14	0.80	4.4	63	21.91	0.8	6
2007	1.10	17	0.80	4.3	72	22.16	0.8	5
Current*	1.39	9	0.88	7.3	63	24.56	0.5	6
Average:		11		5.7	57		1.1	10.9
Growth(%):								
5 Year:	-1.4		1.9			4.2		
10 Year:	-2.2		-2.4			3.5		
20 Year:	0.2		0.8			5.0		

* Current EPS is the 4 Quarter Trailing to Q3/2008.

PNG - Rating as of 24-Mar-06 = Mkt

	Date	Rating Change	Share Price
1	22-Sep-06	Mkt to OP	$17.76
2	27-Oct-06	OP to Mkt	$19.30
3	24-Nov-06	Mkt to OP	$18.50
4	18-Jul-08	OP to Mkt	$17.20

Last Daily Data Point: March 4, 2009

Company Risk Disclosure

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Analyst's Certification

I, Michael McGowan, CA, CFA, hereby certify that the views expressed in this report accurately reflect my personal views about the subject securities or issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report.

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Company Specific Disclosure

Disclosure 1: BMO NB has provided advice for a fee with respect to this issuer within the past 12 months.

Disclosure 3: BMO NB has provided investment banking services with respect to this issuer within the past 12 months.

Disclosure 7: BMO Capital Markets Corp. or an affiliate has received compensation for investment banking services from this issuer within the past 12 months.

Disclosure 10: This issuer is a client (or was a client) of BMO NB, BMO Capital Markets Corp., BMO CM Ltd. or an affiliate within the past 12 months: Investment Banking Services.

Distribution of Ratings (Dec. 5, 2008)

Rating Category	BMO Rating	BMO Universe	BMO I.B. Clients*	Starmine Universe**
Buy	Outperform	37%	40%	50%
Hold	Market Perform	54%	55%	43%

Sell	Underperform	9%	5%	7%

* Reflects rating distribution of all companies where BMO Capital Markets has received compensation for Investment Banking services.
** Reflects rating distribution of all North American equity research analysts.

Ratings Key

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Conflict Statement

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Pacific Northern Gas

(PNG-TSX)

Stock Rating: **Market Perform**
Industry Rating: **Market Perform**

March 6, 2009
Research Comment
Toronto, Ontario

Michael McGowan, CA, CFA
(416) 359-5807
Michael.McGowan@bmo.com
Assoc: Benjamin Pham

Q4/08 Operating Results in Line; Market Perform Rating Maintained

Event

Pacific Northern Gas reported Q4/08 EPS of $0.84 versus our estimate of $0.80. The difference between actual and expected results appears to be due to spending on the company's KSL project that was $0.1 million ($0.03/share) less than expected. In addition, the company increased its quarterly dividend to $0.23/share from $0.22/share and initiated a normal course issuer bid.

Impact

Neutral.

Forecasts

We have updated our forecasts to reflect: (1) the revised annual dividend rate of $0.92/share; and (2) spending of $140,000 (after tax) on the KSL project in 2009 versus $200,000 previously assumed. Our 2009E EPS estimate increases to $1.55 from $1.53. Our 2010E EPS estimate of $1.60 is unchanged.

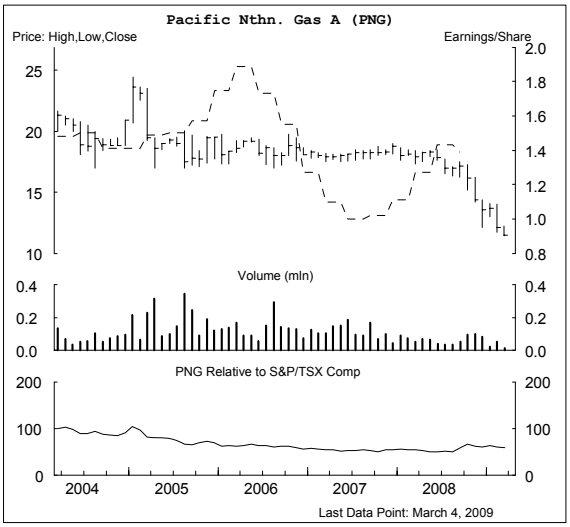
Valuation

Our revised target price of $15 reflects a weighted valuation approach: 10x 2010E EPS of $1.60 (12.5%), 1.0x BVPS of $24.09 (12.5%) and a target yield of 7.00% (75%), assuming 2010 dividends per share of $0.92.

Recommendation

Although the earnings release contained a number of positive elements (dividends were increased and the company has initiated a normal course issuer bid), as discussed herein, we believe that it is too early to recommend an investment in the company's common shares. Accordingly, we are maintaining our Market Perform rating.

Price (5-Mar)	$11.95	**52-Week High**	$18.50
Target Price	$15.00↓	**52-Week Low**	$11.40



(FY-Dec.)	2007A	2008A	2009E	2010E
EPS	$1.10	$1.48	$1.55↑	$1.60
P/E			7.7x	7.5x
CFPS	-$0.72	$4.59	$4.63	$4.74
P/CFPS			2.6x	2.5x
Div.	$0.80	$0.88	$0.92	$0.92
EV ($mm)	$155	$152	$129	$124
EBITDA ($mm)	$22.5	$15.6	$18.7	$23.3
EV/EBITDA	6.9x	9.8x	6.9x	5.3x

Quarterly EPS	Q1	Q2	Q3	Q4
2007A	$1.05	-$0.24	-$0.40	$0.70
2008A	$1.21	-$0.08	-$0.44	$0.84
2009E	$1.09↑	$0.03	-$0.31	$0.76

Dividend	$0.92	**Yield**	7.7%
Book Value	$22.85	**Price/Book**	0.5x
Shares O/S (mm)	3.7	**Mkt. Cap ($mm)**	$44
Float O/S (mm)	3.7	**Float Cap ($mm)**	$44
Wkly Vol (000s)	13	**Wkly $ Vol (mm)**	$0.2
Net Debt ($mm)	$79.9	**Next Rep. Date**	30-Apr (E)

Notes: Estimates are weather normal
Major Shareholders: Widely held
First Call Mean Estimates: PACIFIC NORTHERN GAS LTD 'A' (C$) 2008E: $1.48; 2009E: $1.57; 2010E: $1.60

Changes	Annual EPS	Quarterly EPS	Target
	2009E $1.53 to $1.55	Q1/09E $1.07 to $1.09	$16.00 to $15.00

Q4/08 Operating Results in Line

Pacific Northern Gas reported Q4/08 EPS of $0.84 versus our estimate of $0.80. The difference between actual and expected results appears to be due to spending on the company's KSL project that was $0.1 million ($0.03/share) less than expected.

We believe the following points from the earnings release are relevant:

- The company's board of directs approved an increase in the quarterly dividend to $0.23/share versus $0.22 previously. The increase was slightly lower than our 2009E quarterly dividend forecast of $0.235/share.
- The company has instituted a normal course issuer bid (NCIB). Under the terms of the NCIB, the company is authorized to acquire 300,000 common shares during the period from March 9, 2009, to March 8, 2010. The maximum number of common shares that may be acquired pursuant to the NCIB are 1,627/day up to and including March 31, 2009, and 1,000 shares/day thereafter.
- On November 27, 2008, the company filed 2009 revenue requirement applications for its PNG West and Fort St. John/Dawson's Creek/Tumbler Ridge operating divisions. Our estimates were updated to reflect these rate applications on December 8, 2008. Disclosure in the earnings release suggested that a negotiated settlement process regarding the 2009 revenue requirement applications is scheduled to begin on March 23, 2009.
- The receipt of a $1.5 million option fee from LNG Partners remains outstanding. The fee was meant to be consideration for an option that PNG had negotiated with LNG Partners that provided LNG Partners with the right to contract at least 75 MMcf/d of firm gas transportation capacity on the PNG West pipeline system for a three- to five-year term. The option fee was due on December 15, 2008.

Valuation and Recommendation

Our revised target price of $15 reflects a weighted valuation approach: 10x 2010E EPS of $1.60 (12.5%), 1.0x BVPS of $24.09 (12.5%) and a target yield of 7.00% (75%), assuming 2010 dividends per share of $0.92. We have increased our target yield to 7.00% from 6.50% and reduced our target P/E to 10x 2010E earnings from 12x to better reflect market risk premiums.

Although the earnings release contained a number of positive elements (dividends were increased and the company has initiated a normal course issuer bid), we believe that it is too early to recommend an investment in PNG's common shares. Accordingly, we are maintaining our Market Perform rating. Factors that are likely to affect the company's valuation in 2009 include:

- The BCUC's decision regarding the company's 2009 revenue requirement applications, which will likely address the cessation of regulatory amortization associated with a $15 million (after-tax) termination payment received from Methanex on March 1, 2006. Although we believe that the BCUC will allow PNG to recover prudently incurred costs from its customers, the cessation of regulatory amortization will likely lead to an increase

in the company's 2010 revenue requirement. The company's industrial customers, many of whom operate in sectors of the economy that have been negatively affected by the economic downturn (such as forestry), may intervene against a future rate increase, even if it is justified.

- PNG's capital structure, as the company's actual return on equity continues to be below the rate of return allowed by its regulator. Concerns regarding credit rating downgrades have caused the company to maintain an actual capital structure that is inconsistent with that deemed by the provincial regulator. For example, as at December 31, 2008, PNG's actual equity/total capitalization ratio (excluding deferred liabilities) was 49.6% versus a deemed common equity thickness of 36–40% for its operating divisions. We understand that PNG intends to file a request with the BCUC to modify its deemed capital structure in H1/09. We estimate that PNG's actual ROE (after adjusting for $0.6 million in development expenses related to the KSL project) was 7.8% vs. an allowed ROE of 9.02–9.27% for the company's operating divisions.

Estimates

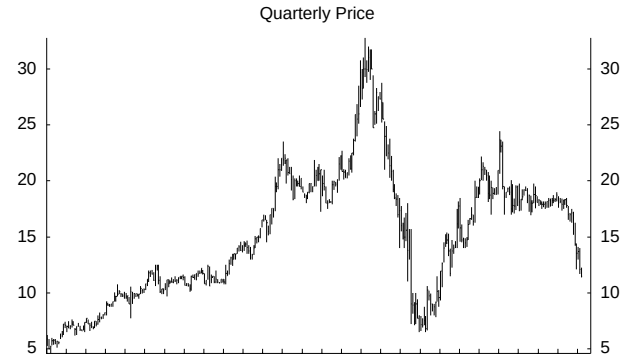
We have updated our forecasts to reflect: (1) the revised annual dividend rate of $0.92/share; and (2) spending of $140,000 (after tax) on the KSL project in 2009 versus $200,000 previously assumed. Our 2009E EPS estimate increases to $1.55 from $1.53. Our 2010E EPS estimate of $1.60 is unchanged.

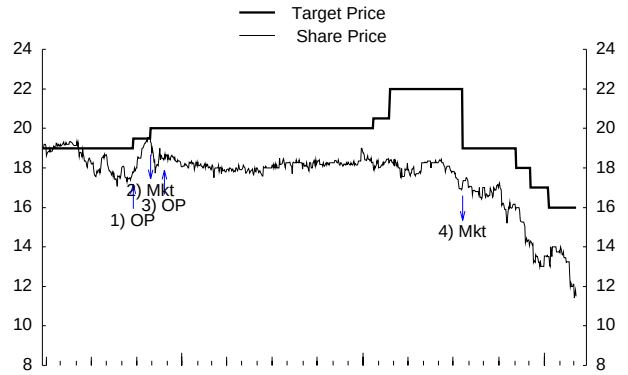
We will update our forecasts to reflect purchases under the NCIB after initial share repurchases are disclosed in the company's Q1/09 earnings release.

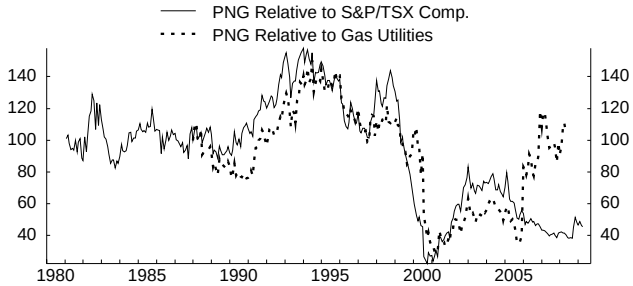
Table 1: Consolidated Summary

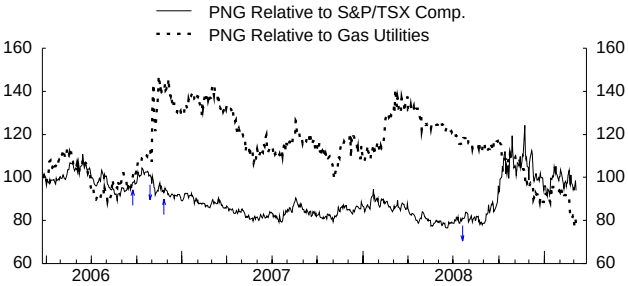
05-Mar-09									Michael McGowan
Current Price:	$11.95								BMO Capital Markets
12-Month Target Price:	$15.00								
ROR:	32.9%						Recommendation:		Market Perform
				Year Ended December 31					
	2002	2003	2004	2005	2006	2007	2008	2009E	2010E
Total Earnings Per Share	$1.28	$1.49	$1.41	$1.75	$1.27	$1.11	$1.53	$1.56	$1.62
Fully Diluted EPS	$1.25	$1.46	$1.38	$1.72	$1.25	$1.10	$1.52	$1.55	$1.60
Dividends	$0.00	$0.80	$0.80	$0.80	$0.80	$0.80	$0.88	$0.92	$0.92
Payout Ratio	0.0%	53.8%	56.8%	45.8%	63.0%	72.4%	57.6%	58.8%	56.9%
Average Shares (mm)	3.5	3.6	3.6	3.6	3.6	3.6	3.7	3.7	3.7
Net Book Value	$21.62	$19.25	$20.52	$21.44	$21.91	$22.17	$22.85	$23.50	$24.21
Market Valuation									
Price: High	$18.00	$19.50	$22.00	$24.00	$19.60	$19.00	$18.65	-	-
Price: Low	$9.35	$14.00	$17.28	$17.37	$17.06	$17.50	$13.00	-	-
Price: Current	-	-	-	-	-	-	-	$11.95	
P/E Ratio: High	14.0	13.1	15.6	13.7	15.4	17.2	12.2	-	-
P/E Ratio: Low	7.3	9.4	12.3	9.9	13.4	15.8	8.5	-	-
P/E Ratio: Current	-	-	-	-	-	-	-	7.6	7.4
Price/Book Value: High	0.8	1.0	1.1	1.1	0.9	0.9	0.8	-	-
Price/Book Value: Low	0.4	0.7	0.8	0.8	0.8	0.8	0.6	-	-
Price/Book Value: Current	-	-	-	-	-	-	-	0.5	0.5
Yield: High Price	0.0%	4.1%	3.6%	3.3%	4.1%	4.2%	4.7%	-	-
Yield: Low Price	0.0%	5.7%	4.6%	4.6%	4.7%	4.6%	6.8%	-	-
Yield: Current	-	-	-	-	-	-	-	7.7%	7.7%
Balance Sheet ($mm)									
Debt (S-T)	4.4	7.3	10.4	14.7	10.0	11.2	5.4	2.5	10.9
Debt (L-T)	90.2	85.8	81.4	76.6	71.7	72.8	74.5	72.4	63.8
Deferred Items	17.0	17.9	15.8	15.7	24.0	18.5	13.8	15.3	16.8
Preferred Shares	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0
Shareholders' Equity	76.7	69.4	73.9	77.7	79.8	81.2	83.7	86.1	88.7
	193.3	185.4	186.7	189.7	190.5	188.9	182.5	181.4	185.2
Balance Sheet (%)									
Debt (S-T)	2.3%	3.9%	5.6%	7.7%	5.2%	6.0%	3.0%	1.4%	5.9%
Debt (L-T)	46.7%	46.3%	43.6%	40.4%	37.6%	38.6%	40.8%	39.9%	34.4%
Deferred Items	8.8%	9.7%	8.5%	8.3%	12.6%	9.8%	7.6%	8.5%	9.1%
Preferred Shares	2.6%	2.7%	2.7%	2.6%	2.6%	2.7%	2.7%	2.8%	2.7%
Shareholders' Equity	39.7%	37.4%	39.6%	41.0%	41.9%	43.0%	45.9%	47.5%	47.9%
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Income Statement ($mm)									
Total Revenue	109.1	133.7	137.8	160.0	138.8	129.5	132.8	122.5	144.7
EBIT	19.5	18.5	17.5	18.6	17.6	14.3	14.9	10.8	14.3
NPAT	4.9	5.7	5.4	6.7	5.0	4.4	5.9	6.1	6.3
Preferred Share Dividends	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Net Earnings to Common	4.6	5.3	5.1	6.3	4.6	4.0	5.6	5.7	5.9
Cash Flow from Operations	12.8	12.2	16.4	11.8	17.6	(2.6)	16.8	17.0	17.4
Key Statistics									
Average Utility Rate Base ($mm)	166.8	165.4	167.2	165.2	162.4	165.6	167.9	167.6	166.8
Growth Rate	-1.98%	-0.87%	1.10%	-1.19%	-1.67%	1.95%	1.38%	-0.15%	-0.52%
2007 - 2010 CAGR									0.23%
Allowed Return on Equity	9.88%	10.17%	9.80%	9.68%	9.45%	9.02%	9.27%	9.12%	9.12%
Deemed Equity	36.00%	36.00%	36.00%	40.00%	40.00%	40.00%	40.00%	40.00%	40.00%
Sensitivity									
100 bp Change ROE									
Change Total Income	0.6	0.6	0.6	0.7	0.6	0.7	0.7	0.7	0.7
Change Per Share	0.17	0.17	0.17	0.18	0.18	0.18	0.18	0.18	0.18
100 bp Change in Deemed Equity									
Change Total Income	0.2	0.2	0.2	0.2	0.2	0.1	0.2	0.2	0.2
Change Per Share	0.05	0.05	0.05	0.04	0.04	0.04	0.04	0.04	0.04
1.00% Change in Average Rate Base									
Change Total Income	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Change Per Share	0.02	0.02	0.02	0.02	0.02	0.02	0.02	0.02	0.02

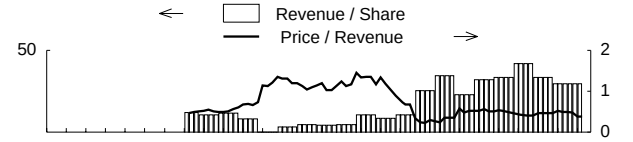
Pacific Nthn. Gas A (PNG)

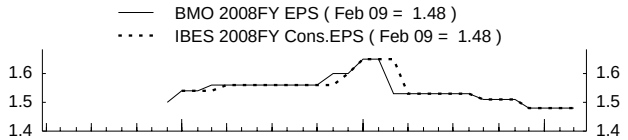


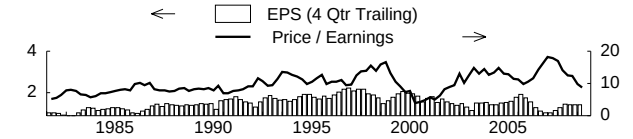


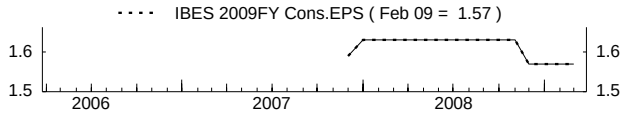












FYE (Dec.)	EPS $	P/E	DPS $	Yield %	Payout %	BV $	P/B	ROE %
1987	1.31	8	0.75	7.4	57	8.97	1.1	15
1988	1.34	8	0.75	6.6	56	9.24	1.2	15
1989	1.45	8	0.75	6.4	52	9.92	1.2	15
1990	1.61	7	0.75	6.7	47	10.76	1.0	16
1991	1.66	8	0.80	5.9	48	11.62	1.2	15
1992	1.55	11	0.80	4.8	52	12.37	1.3	13
1993	1.63	13	0.88	4.0	54	12.37	1.8	13
1994	1.80	11	0.88	4.3	49	12.37	1.6	15
1995	1.67	13	0.96	4.6	57	14.57	1.4	12
1996	2.01	11	0.96	4.3	48	15.61	1.4	13
1997	2.16	14	1.04	3.5	48	16.42	1.8	13
1998	1.73	16	1.12	4.1	65	17.39	1.6	10
1999	1.92	9	1.12	6.5	58	18.19	1.0	11
2000	1.83	4	1.12	14.1	61	19.44	0.4	10
2001	1.52	6	1.12	11.7	74	20.95	0.5	8
2002	1.25	13	1.12	6.3	82	19.27	0.9	6
2003	1.46	13	0.80	4.1	54	19.96	1.0	7
2004	1.38	15	0.80	3.8	57	20.52	1.0	7
2005	1.72	11	0.80	4.1	46	21.43	0.9	8
2006	1.25	14	0.80	4.4	63	21.91	0.8	6
2007	1.10	17	0.80	4.3	72	22.16	0.8	5
Current*	1.39	9	0.88	7.3	63	24.56	0.5	6
Average:		11		5.7	57		1.1	10.9
Growth(%):								
5 Year:	-1.4		1.9			4.2		
10 Year:	-2.2		-2.4			3.5		
20 Year:	0.2		0.8			5.0		

* Current EPS is the 4 Quarter Trailing to Q3/2008.

PNG - Rating as of 24-Mar-06 = Mkt

	Date	Rating Change	Share Price
1	22-Sep-06	Mkt to OP	$17.76
2	27-Oct-06	OP to Mkt	$19.30
3	24-Nov-06	Mkt to OP	$18.50
4	18-Jul-08	OP to Mkt	$17.20

Last Daily Data Point: March 4, 2009

Company Risk Disclosure

In addition to the risks involved in investing in common stocks generally, we also highlight the following risks that pertain to this company. The company's natural gas transmission business depends on the continued availability of natural gas. The BCUC approves PNG's customer rates and a fair return on the rate base. Changes in regulation may adversely affect performance. Natural gas and fuel oil compete with electricity for space heating in Pacific Northern Gas' service areas. Fluctuations in the price of natural gas could increase the working capital financing requirements and related costs for accounts receivable. In 2004, 75% of energy deliveries were made to four large industrial customers (67% to one customer, Methanex). Transportation service to Methanex was made pursuant to an agreement that expires in October 2009. On August 30, 2005, Methanex announced that it will close its Kitimat facilities in early 2006.

Analyst's Certification

I, Michael McGowan, CA, CFA, hereby certify that the views expressed in this report accurately reflect my personal views about the subject securities or issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report.

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Disclosure 3: BMO NB has provided investment banking services with respect to this issuer within the past 12 months.

Disclosure 7: BMO Capital Markets Corp. or an affiliate has received compensation for investment banking services from this issuer within the past 12 months.

Disclosure 10: This issuer is a client (or was a client) of BMO NB, BMO Capital Markets Corp., BMO CM Ltd. or an affiliate within the past 12 months: Investment Banking Services.

Distribution of Ratings (Dec. 5, 2008)

Rating Category	BMO Rating	BMO Universe	BMO I.B. Clients*	Starmine Universe**
Buy	Outperform	37%	40%	50%
Hold	Market Perform	54%	55%	43%
Sell	Underperform	9%	5%	7%

* Reflects rating distribution of all companies where BMO Capital Markets has received compensation for Investment Banking services.
** Reflects rating distribution of all North American equity research analysts.

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OP = Outperform - Forecast to outperform the market;
Mkt = Market Perform - Forecast to perform roughly in line with the market;
Und = Underperform - Forecast to underperform the market;
(S) = speculative investment;
NR = No rating at this time;
R = Restricted – Dissemination of research is currently restricted.

Market performance is measured by a benchmark index such as the S&P/TSX Composite Index, S&P 500, Nasdaq Composite, as appropriate for each company. Prior to September 1, 2003, a fourth rating tier—Top Pick—was used to designate those stocks we felt would be the best performers relative to the market. Our six Top 15 lists which guide investors to our best ideas according to six different objectives (large, small, growth, value, income and quantitative) have replaced the Top Pick rating.

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Additional Matters
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Pacific Northern Gas

(PNG-TSX)

March 9, 2009
Brief Research Note
Gas & Electric Utilities

Stock Rating: **Market Perform**
Stock Price: **$12.05**
Target Price: **$15.00**

Michael McGowan, CA, CFA
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Michael.McGowan@bmo.com
Assoc: Benjamin Pham

New Option for Excess Firm Capacity Granted

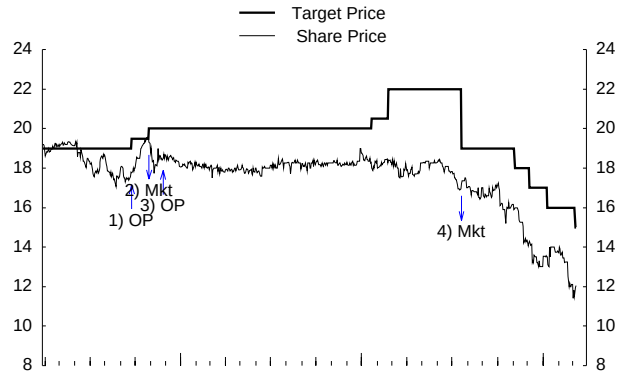
Impact

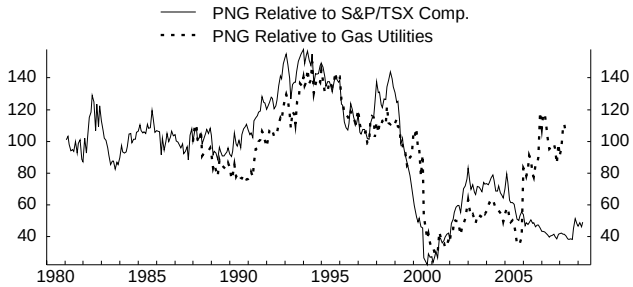
Potentially Positive

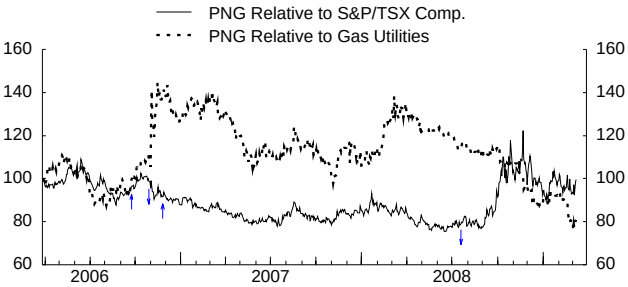
Details & Analysis

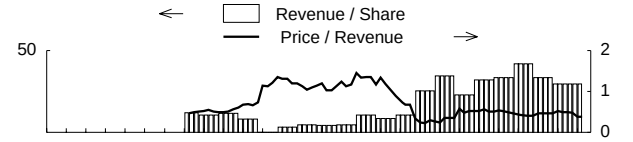
Pacific Northern Gas has announced that it has entered into an agreement with Merrill Lynch Commodities, Inc. (MLCI) to provide MLCI an extendible option to contract for 75 MMcf/d of firm natural gas transportation service on the PNG-West pipeline system for a non-refundable fee of $1.5 million, which has already been deposited in an escrow account. Pursuant to the agreement, MLCI will have an exclusive option until December 31, 2009, to contract firm transportation capacity for a two- to five-year term, with a right to renew for an additional two- to five-year term. The option period may be extended by up to four six-month periods, with payment of $1 million for each extension. If MLCI exercises the option, PNG estimates that additional volumes on the PNG-West system would generate approximately $15 million of incremental revenue per annum, with firm transportation service beginning between January 1, 2012 and January 1, 2013. The agreement must be approved by the British Columbia Utilities Commission and release of funds from escrow is contingent upon regulatory approval. PNG has terminated its previously approved arrangement with LNG Partners, LLC due to LNG Partners' non-payment of the original option fee, which was due on December 15, 2008.

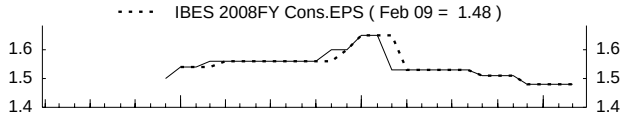
Pacific Nthn. Gas A (PNG)

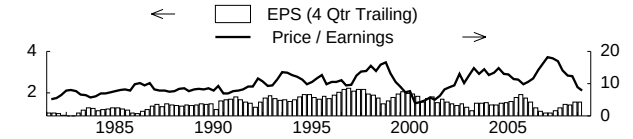


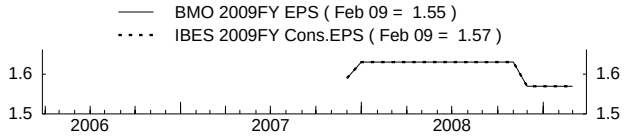












FYE (Dec.)	EPS $	P/E	DPS $	Yield %	Payout %	BV $	P/B	ROE %
1987	1.31	8	0.75	7.4	57	8.97	1.1	15
1988	1.34	8	0.75	6.6	56	9.24	1.2	15
1989	1.45	8	0.75	6.4	52	9.92	1.2	15
1990	1.61	7	0.75	6.7	47	10.76	1.0	16
1991	1.66	8	0.80	5.9	48	11.62	1.2	15
1992	1.55	11	0.80	4.8	52	12.37	1.3	13
1993	1.63	13	0.88	4.0	54	12.37	1.8	13
1994	1.80	11	0.88	4.3	49	12.37	1.6	15
1995	1.67	13	0.96	4.6	57	14.57	1.4	12
1996	2.01	11	0.96	4.3	48	15.61	1.4	13
1997	2.16	14	1.04	3.5	48	16.42	1.8	13
1998	1.73	16	1.12	4.1	65	17.39	1.6	10
1999	1.92	9	1.12	6.5	58	18.19	1.0	11
2000	1.83	4	1.12	14.1	61	19.44	0.4	10
2001	1.52	6	1.12	11.7	74	20.95	0.5	8
2002	1.25	13	1.12	6.3	82	19.27	0.9	6
2003	1.46	13	0.80	4.1	54	19.96	1.0	7
2004	1.38	15	0.80	3.8	57	20.52	1.0	7
2005	1.72	11	0.80	4.1	46	21.43	0.9	8
2006	1.25	14	0.80	4.4	63	21.91	0.8	6
2007	1.10	17	0.80	4.3	72	22.16	0.8	5
2008	1.52	9	0.88	6.5	58	22.16	0.6	7
Current*	1.53	8	0.88	7.3	58	22.85	0.5	7
Average:		11		5.8	57		1.1	10.7
Growth(%):								
5 Year:	0.5		1.9			2.7		
10 Year:	-1.2		-2.4			2.8		
20 Year:	0.7		0.8			4.6		

* Current EPS is the 4 Quarter Trailing to Q4/2008.

PNG - Rating as of 28-Mar-06 = Mkt

	Date	Rating Change	Share Price
1	22-Sep-06	Mkt to OP	$17.76
2	27-Oct-06	OP to Mkt	$19.30
3	24-Nov-06	Mkt to OP	$18.50
4	18-Jul-08	OP to Mkt	$17.20

Last Daily Data Point: March 6, 2009

Company Risk Disclosure

In addition to the risks involved in investing in common stocks generally, we also highlight the following risks that pertain to this company. The company's natural gas transmission business depends on the continued availability of natural gas. The BCUC approves PNG's customer rates and a fair return on the rate base. Changes in regulation may adversely affect performance. Natural gas and fuel oil compete with electricity for space heating in Pacific Northern Gas' service areas. Fluctuations in the price of natural gas could increase the working capital financing requirements and related costs for accounts receivable. In 2004, 75% of energy deliveries were made to four large industrial customers (67% to one customer, Methanex). Transportation service to Methanex was made pursuant to an agreement that expires in October 2009. On August 30, 2005, Methanex announced that it will close its Kitimat facilities in early 2006.

Analyst's Certification

I, Michael McGowan, CA, CFA, hereby certify that the views expressed in this report accurately reflect my personal views about the subject securities or issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report.

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Company Specific Disclosure

Disclosure 1: BMO NB has provided advice for a fee with respect to this issuer within the past 12 months.

Disclosure 3: BMO NB has provided investment banking services with respect to this issuer within the past 12 months.

Disclosure 7: BMO Capital Markets Corp. or an affiliate has received compensation for investment banking services from this issuer within the past 12 months.

Disclosure 10: This issuer is a client (or was a client) of BMO NB, BMO Capital Markets Corp., BMO CM Ltd. or an affiliate within the past 12 months: Investment Banking Services.

Distribution of Ratings (Dec. 5, 2008)

Rating Category	BMO Rating	BMO Universe	BMO I.B. Clients*	Starmine Universe**
Buy	Outperform	37%	40%	50%
Hold	Market Perform	54%	55%	43%
Sell	Underperform	9%	5%	7%

* Reflects rating distribution of all companies where BMO Capital Markets has received compensation for Investment Banking services.

** Reflects rating distribution of all North American equity research analysts.

Ratings Key

We use the following ratings system definitions:
OP = Outperform - Forecast to outperform the market;
Mkt = Market Perform - Forecast to perform roughly in line with the market;
Und = Underperform - Forecast to underperform the market;
(S) = speculative investment;
NR = No rating at this time;
R = Restricted – Dissemination of research is currently restricted.

Market performance is measured by a benchmark index such as the S&P/TSX Composite Index, S&P 500, Nasdaq Composite, as appropriate for each company. Prior to September 1, 2003, a fourth rating tier—Top Pick—was used to designate those stocks we felt would be the best performers relative to the market. Our six Top 15 lists which guide investors to our best ideas according to six different objectives (large, small, growth, value, income and quantitative) have replaced the Top Pick rating.

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Additional Matters

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Pacific Northern Gas

(PNG-TSX)

Stock Rating: **Market Perform**
Industry Rating: **Market Perform**

May 4, 2009
Research Comment
Toronto, Ontario

Michael McGowan, CA, CFA
(416) 359-5807
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Assoc: Benjamin Pham

Q1/09 Results Exceed Expectations; Market Perform Maintained

Event

Pacific Northern Gas (PNG) reported Q1/09 EPS of $1.39 vs. our estimate of $1.09. The difference between actual and expected results was approximately $1 million and was due to a combination of: (1) a change in the timing of revenue, which increased operating margin by $0.4 million in Q1 and is expected to be offset by lower revenue in Q4; (2) higher-than-expected net residential customer additions; and (3) deliveries to commercial and small industrial customers in excess of forecast volumes used for ratemaking purposes.

Impact

Neutral. Although quarterly results were better than expected, we attribute the results to seasonality.

Forecasts

Our 2009E and 2010E estimates are unchanged. We have adjusted the quarterly profile of our 2009E EPS estimates to better reflect the expected seasonality of earnings.

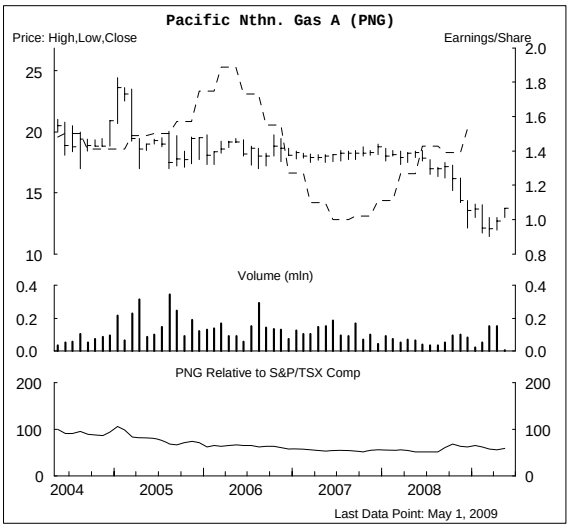
Valuation

Our target price of $15 reflects a weighted valuation approach: 10x 2010E EPS of $1.60 (12.5%), 1.0x BVPS of $24.09 (12.5%) and a target yield of 7.00% (75%), assuming 2010 dividends per share of $0.92.

Recommendation

We believe the units are reasonably valued. Our rating is Market Perform.

Price (1-May)	$13.75	**52-Week High**	$18.50
Target Price	$15.00	**52-Week Low**	$11.40



(FY-Dec.)	2007A	2008A	2009E	2010E
EPS	$1.10	$1.52	$1.55	$1.60
P/E			8.9x	8.6x
CFPS	-$0.72	$4.59	$4.63	$4.74
P/CFPS			3.0x	2.9x
Div.	$0.80	$0.88	$0.92	$0.92
EV ($mm)	$155	$147	$125	$125
EBITDA ($mm)	$22.5	$23.6	$20.2	$23.9
EV/EBITDA	6.9x	6.2x	6.2x	5.2x

Quarterly EPS	Q1	Q2	Q3	Q4
2007A	$1.05	-$0.24	-$0.40	$0.70
2008A	$1.21	-$0.08	-$0.44	$0.84
2009E	$1.39a	-$0.10↓	-$0.45↓	$0.72↓

Dividend	$0.92	**Yield**	6.7%
Book Value	$22.85	**Price/Book**	0.6x
Shares O/S (mm)	3.7	**Mkt. Cap ($mm)**	$50
Float O/S (mm)	3.7	**Float Cap ($mm)**	$50
Wkly Vol (000s)	17	**Wkly $ Vol (mm)**	$0.2
Net Debt ($mm)	$79.9	**Next Rep. Date**	31-Jul (E)

Notes: Estimates are weather normal
Major Shareholders: Widely held
First Call Mean Estimates: PACIFIC NORTHERN GAS LTD 'A' (C$) 2009E: $1.55; 2010E: $1.60

Changes

Quarterly EPS
Q2/09E $0.03 to -$0.10
Q3/09E -$0.31 to -$0.45
Q4/09E $0.76 to $0.72

Q1/09 Results Exceed Expectations, Seasonality Likely Played a Role

Pacific Northern Gas (PNG) reported Q1/09 EPS of $1.39 vs. our estimate of $1.09. The difference between actual and expected results was approximately $1 million and was due to a combination of: (1) a change in the timing of revenue, which increased operating margin by $0.4 million in Q1 and is expected to be offset by lower revenue in Q4; (2) higher-than-expected net residential customer additions; and (3) deliveries to commercial and small industrial customers in excess of forecast volumes used for ratemaking purposes.

We believe the following points from the earnings release are relevant:

- On April 23, the British Columbia Utilities Commission (BCUC) approved negotiated settlement agreements relating to the 2009 revenue requirements applications of PNG-West and PNG-NE (Tumbler Ridge/Fort St. John/Dawson Creek). The settlement agreements reflect updated revenue requirement applications filed by each division on March 13 and are reflected in our outlook. Notable components from the settlement agreement include:

    1. A $25,000 reduction in cost of service, resulting from the BCUC's decision to allow only 1/3 of executive bonuses and pensionable earnings in rates;

    2. A $120,000 reduction in revenue requirement, which we understand is meant to reflect a reduction in audit fees, travel, expenses and directors' fees.

    3. A $900,000 draw-down of the deferred income tax liability, which had a balance of $13.6 million per the Q4/08 financial statements. The draw-down of deferred income taxes will be used to partially offset income taxes payable as set out in the company's 2009 revenue requirement application. PNG also drew down its deferred income tax account by $900,000 in each of 2007 and 2008.

- Also on April 23, the BCUC approved an agreement negotiated with Merrill Lynch Commodities Inc. (MLCI) to provide MLCI with an extendable option to contract up to 75 MMcf/d of firm natural gas transportation service on the PNG-West pipeline system for a non-refundable fee of $1.5 million. We understand that the fee is being held in an interest bearing account; however, the allocation of the fee between ratepayers and customers is unclear. Details of the agreement between PNG and MLCI can be found in our research comment dated, March 9, 2009.

Although quarterly results were better than expected, we attribute the results to seasonality and are maintaining our Market Perform rating and target price of $15. Our target price reflects a weighted valuation approach: 10x 2010E EPS of $1.60 (12.5%), 1.0x BVPS of $24.09 (12.5%) and a target yield of 7.00% (75%), assuming 2010 dividends per share of $0.92.

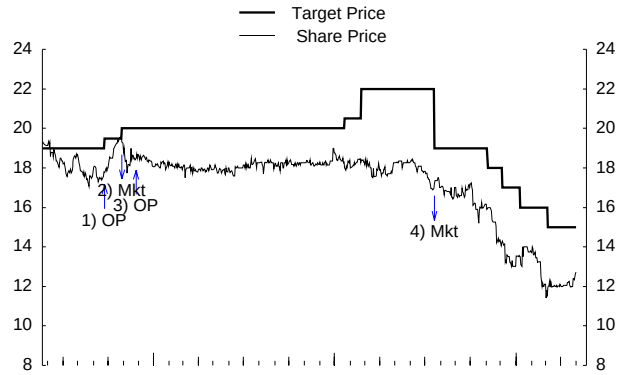
Estimates

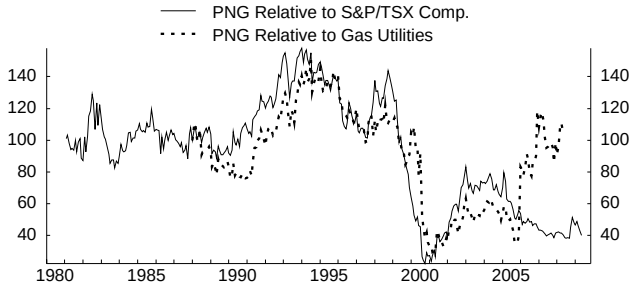
Our 2009E and 2010E estimates are unchanged. We have adjusted the quarterly profile of our 2009E EPS estimates to better reflect the expected seasonality of earnings.

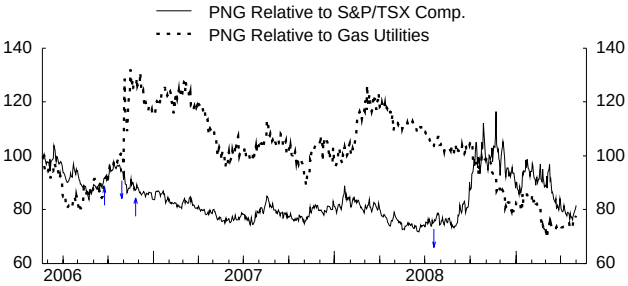
Table 1: Consolidated Summary

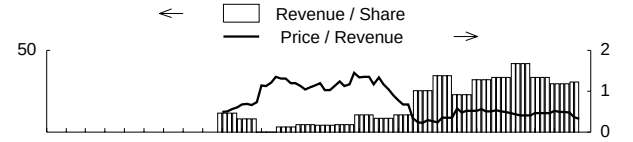
3-May-09									Michael McGowan
Current Price:	$13.75								BMO Capital Markets
12-Month Target Price:	$15.00								
ROR:	15.5%						Recommendation:		Market Perform
				Year Ended December 31					
	2002	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009E**	**2010E**
Total Earnings Per Share	$1.28	$1.49	$1.41	$1.75	$1.27	$1.11	$1.53	$1.56	$1.62
Fully Diluted EPS	$1.25	$1.46	$1.38	$1.72	$1.25	$1.10	$1.52	$1.55	$1.60
Dividends	$0.00	$0.80	$0.80	$0.80	$0.80	$0.80	$0.88	$0.92	$0.92
Payout Ratio	0.0%	53.8%	56.8%	45.8%	63.0%	72.4%	57.6%	58.9%	57.0%
Average Shares (mm)	3.5	3.6	3.6	3.6	3.6	3.6	3.7	3.7	3.7
Net Book Value	$21.62	$19.25	$20.52	$21.44	$21.91	$22.17	$22.85	$23.50	$24.20
Market Valuation									
Price: High	$18.00	$19.50	$22.00	$24.00	$19.75	$19.00	$18.65	-	-
Price: Low	$9.35	$14.00	$17.28	$17.37	$16.96	$17.50	$12.11	-	-
Price: Current	-	-	-	-	-	-	-	$13.75	
P/E Ratio: High	14.0	13.1	15.6	13.7	15.5	17.2	12.2	-	-
P/E Ratio: Low	7.3	9.4	12.3	9.9	13.3	15.8	7.9	-	-
P/E Ratio: Current	-	-	-	-	-	-	-	8.8	8.5
Price/Book Value: High	0.8	1.0	1.1	1.1	0.9	0.9	0.8	-	-
Price/Book Value: Low	0.4	0.7	0.8	0.8	0.8	0.8	0.5	-	-
Price/Book Value: Current	-	-	-	-	-	-	-	0.6	0.6
Yield: High Price	0.0%	4.1%	3.6%	3.3%	4.1%	4.2%	4.7%	-	-
Yield: Low Price	0.0%	5.7%	4.6%	4.6%	4.7%	4.6%	7.3%	-	-
Yield: Current	-	-	-	-	-	-	-	6.7%	6.7%
Balance Sheet ($mm)									
Debt (S-T)	4.4	7.3	10.4	14.7	10.0	11.2	5.4	5.1	13.5
Debt (L-T)	90.2	85.8	81.4	76.6	71.7	72.8	74.5	72.4	63.8
Deferred Items	17.0	17.9	15.8	15.7	24.0	18.5	13.8	13.1	14.6
Preferred Shares	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0
Shareholders' Equity	76.7	69.4	73.9	77.7	79.8	81.2	83.7	86.1	88.7
	193.3	185.4	186.7	189.7	190.5	188.9	182.5	181.8	185.6
Balance Sheet (%)									
Debt (S-T)	2.3%	3.9%	5.6%	7.7%	5.2%	6.0%	3.0%	2.8%	7.3%
Debt (L-T)	46.7%	46.3%	43.6%	40.4%	37.6%	38.6%	40.8%	39.8%	34.4%
Deferred Items	8.8%	9.7%	8.5%	8.3%	12.6%	9.8%	7.6%	7.2%	7.9%
Preferred Shares	2.6%	2.7%	2.7%	2.6%	2.6%	2.7%	2.7%	2.8%	2.7%
Shareholders' Equity	39.7%	37.4%	39.6%	41.0%	41.9%	43.0%	45.9%	47.4%	47.8%
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Income Statement ($mm)									
Total Revenue	109.1	133.7	137.8	160.0	138.8	129.5	132.8	123.9	144.7
EBIT	19.5	18.5	17.5	18.6	17.6	14.3	14.9	14.4	14.0
NPAT	4.9	5.7	5.4	6.7	5.0	4.4	5.9	6.1	6.3
Preferred Share Dividends	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Net Earnings to Common	4.6	5.3	5.1	6.3	4.6	4.0	5.6	5.7	5.9
Cash Flow from Operations	12.8	12.2	16.4	11.8	17.6	(2.6)	16.8	14.4	17.4
Key Statistics									
Average Utility Rate Base ($mm)	166.8	165.4	167.2	165.2	162.4	165.6	167.9	167.6	166.8
Growth Rate	-1.98%	-0.87%	1.10%	-1.19%	-1.67%	1.95%	1.38%	-0.15%	-0.52%
2007 - 2010 CAGR									0.23%
Allowed Return on Equity	9.88%	10.17%	9.80%	9.68%	9.45%	9.02%	9.27%	9.12%	9.12%
Deemed Equity	36.00%	36.00%	36.00%	40.00%	40.00%	40.00%	40.00%	40.00%	40.00%
Sensitivity									
100 bp Change ROE									
Change Total Income	0.6	0.6	0.6	0.7	0.6	0.7	0.7	0.7	0.7
Change Per Share	0.17	0.17	0.17	0.18	0.18	0.18	0.18	0.18	0.18
100 bp Change in Deemed Equity									
Change Total Income	0.2	0.2	0.2	0.2	0.2	0.1	0.2	0.2	0.2
Change Per Share	0.05	0.05	0.05	0.04	0.04	0.04	0.04	0.04	0.04
1.00% Change in Average Rate Base									
Change Total Income	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Change Per Share	0.02	0.02	0.02	0.02	0.02	0.02	0.02	0.02	0.02

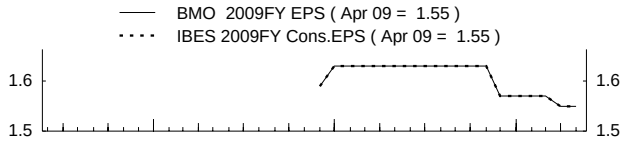
Pacific Nthn. Gas A (PNG)

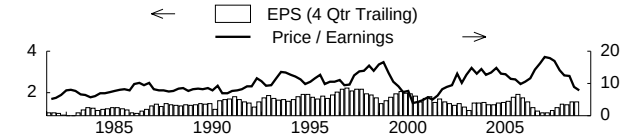


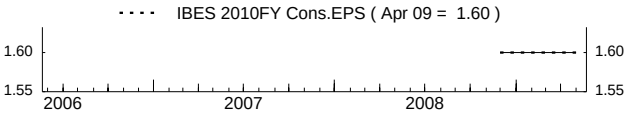












FYE (Dec.)	EPS $	P/E	DPS $	Yield %	Payout %	BV $	P/B	ROE %
1987	1.31	8	0.75	7.4	57	8.97	1.1	15
1988	1.34	8	0.75	6.6	56	9.24	1.2	15
1989	1.45	8	0.75	6.4	52	9.92	1.2	15
1990	1.61	7	0.75	6.7	47	10.76	1.0	16
1991	1.66	8	0.80	5.9	48	11.62	1.2	15
1992	1.55	11	0.80	4.8	52	12.37	1.3	13
1993	1.63	13	0.88	4.0	54	12.37	1.8	13
1994	1.80	11	0.88	4.3	49	12.37	1.6	15
1995	1.67	13	0.96	4.6	57	14.57	1.4	12
1996	2.01	11	0.96	4.3	48	15.61	1.4	13
1997	2.16	14	1.04	3.5	48	16.42	1.8	13
1998	1.73	16	1.12	4.1	65	17.39	1.6	10
1999	1.92	9	1.12	6.5	58	18.19	1.0	11
2000	1.83	4	1.12	14.1	61	19.44	0.4	10
2001	1.52	6	1.12	11.7	74	20.95	0.5	8
2002	1.25	13	1.12	6.3	82	19.27	0.9	6
2003	1.46	13	0.80	4.1	54	19.96	1.0	7
2004	1.38	15	0.80	3.8	57	20.52	1.0	7
2005	1.72	11	0.80	4.1	46	21.43	0.9	8
2006	1.25	14	0.80	4.4	63	21.91	0.8	6
2007	1.10	17	0.80	4.3	72	22.16	0.8	5
2008	1.52	9	0.88	6.5	58	24.21	0.6	7
Current*	1.53	8	0.92	7.6	60	22.85	0.5	7
Average:		11		5.8	57		1.1	10.7
Growth(%):								
5 Year:	0.6		2.8			2.7		
10 Year:	0.5		-1.9			2.8		
20 Year:	0.5		1.0			4.6		

* Current EPS is the 4 Quarter Trailing to Q4/2008.

PNG - Rating as of 22-May-06 = Mkt

	Date	Rating Change	Share Price
1	22-Sep-06	Mkt to OP	$17.76
2	27-Oct-06	OP to Mkt	$19.30
3	24-Nov-06	Mkt to OP	$18.50
4	18-Jul-08	OP to Mkt	$17.20

Last Daily Data Point: April 30, 2009

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Analyst's Certification

I, Michael McGowan, CA, CFA, hereby certify that the views expressed in this report accurately reflect my personal views about the subject securities or issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report.

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Distribution of Ratings (Mar. 5, 2009)

Rating Category	BMO Rating	BMO Universe	BMO I.B. Clients*	Starmine Universe**
Buy	Outperform	29%	44%	47%
Hold	Market Perform	59%	51%	45%
Sell	Underperform	12%	5%	8%

* Reflects rating distribution of all companies where BMO Capital Markets has received compensation for Investment Banking services.
** Reflects rating distribution of all North American equity research analysts.

Ratings Key
We use the following ratings system definitions:
OP = Outperform - Forecast to outperform the market;
Mkt = Market Perform - Forecast to perform roughly in line with the market;
Und = Underperform - Forecast to underperform the market;
(S) = speculative investment;
NR = No rating at this time;
R = Restricted – Dissemination of research is currently restricted.

Market performance is measured by a benchmark index such as the S&P/TSX Composite Index, S&P 500, Nasdaq Composite, as appropriate for each company. Prior to September 1, 2003, a fourth rating tier—Top Pick—was used to designate those stocks we felt would be the best performers relative to the market. Our six Top 15 lists which guide investors to our best ideas according to six different objectives (large, small, growth, value, income and quantitative) have replaced the Top Pick rating.

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Our research publications are available via our web site http://bmocapitalmarkets.com. Institutional clients may also receive our research via FIRST CALL Research Direct and Reuters. All of our research is made widely available at the same time to all BMO NB, BMO Capital Markets Ltd., BMO Capital Markets Corp. and BMO Nesbitt Burns Securities Ltd. client groups entitled to our research. Please contact your investment advisor or institutional salesperson for more information.

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http://research-ca.bmocapitalmarkets.com/conflict_statement_public.asp

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Pacific Northern Gas

(PNG-TSX)

July 31, 2009
Brief Research Note
Gas & Electric Utilities

Stock Rating: **Market Perform**
Stock Price: **$16.86**
Target Price: **$15.00**

Michael McGowan, CA, CFA
(416) 359-5807
Michael.McGowan@bmo.com
Assoc: Mark Laing, CA

Q2/09 Results Generally in Line; Dividend Increased by 8.7%

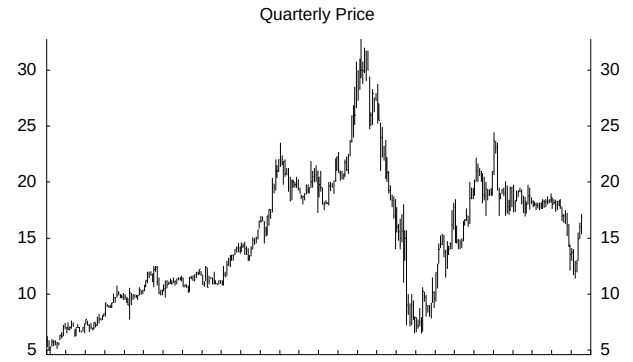
Impact

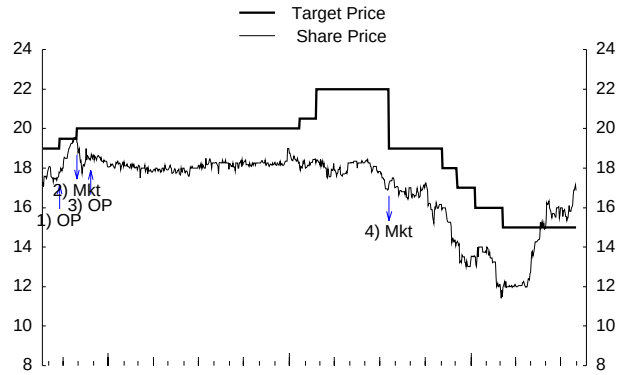
Slightly Positive

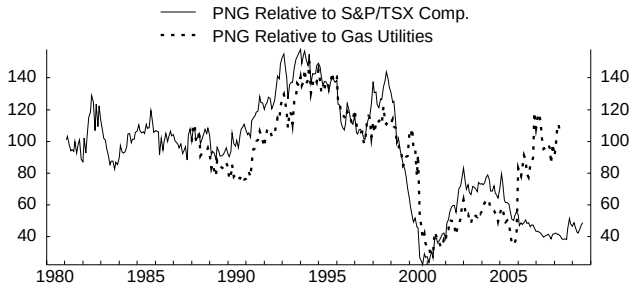
Details & Analysis

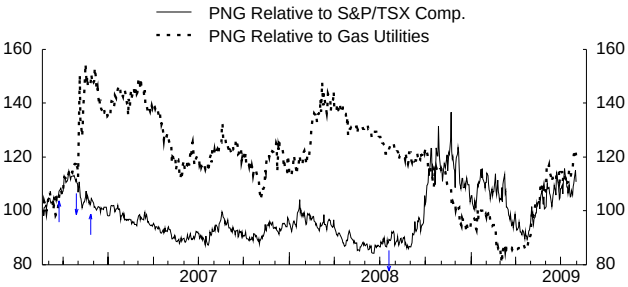
Pacific Northern Gas reported a Q2/09 loss per share of $0.13, which was generally in line with our estimate of a $0.10 loss per share. In addition, the company increased its quarterly dividend by 8.7% to $0.25/share from $0.23/share and has filed its 2010 rate application with the British Columbia Utilities Commission. Key aspects of the rate filing include: (1) A request to increase the deemed equity thickness at the PNG West division to 47.5% from 40% and an increase in the relative risk premium to 75 basis points over the benchmark utility return in B.C., up from the current 65 basis point risk premium; (2) A request to increase the deemed equity thickness at the Fort St. John/Dawson Creek and Tumbler Ridge divisions to 42.5% from 36%. The company has also requested that the equity risk premium at the Fort St. John/Dawson's Creek division be increased 75 basis points from 40 basis points and that the risk premium at the Tumbler Ridge division be increased to 75 basis points from 65 basis points; and (3) Allocation of $0.7 million from the $1.5 million option fee received from Merrill Lynch Commodities to shareholders.

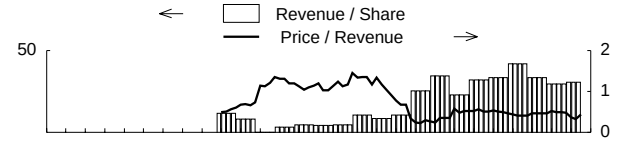
Pacific Nthn. Gas A (PNG)

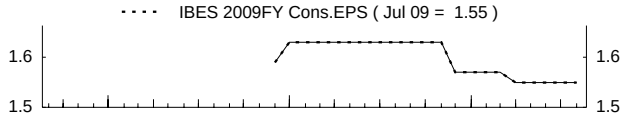


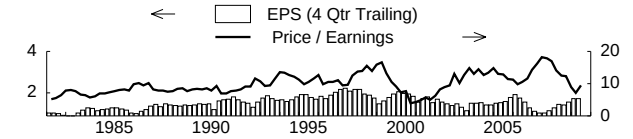


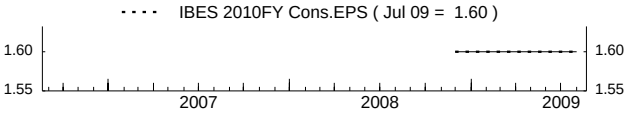












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1990	1.61	7	0.75	6.7	47	10.76	1.0	16
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1995	1.67	13	0.96	4.6	57	14.57	1.4	12
1996	2.01	11	0.96	4.3	48	15.61	1.4	13
1997	2.16	14	1.04	3.5	48	16.42	1.8	13
1998	1.73	16	1.12	4.1	65	17.39	1.6	10
1999	1.92	9	1.12	6.5	58	18.19	1.0	11
2000	1.83	4	1.12	14.1	61	19.44	0.4	10
2001	1.52	6	1.12	11.7	74	20.95	0.5	8
2002	1.25	13	1.12	6.3	82	19.27	0.9	6
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2004	1.38	15	0.80	3.8	57	20.52	1.0	7
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2006	1.25	14	0.80	4.4	63	21.91	0.8	6
2007	1.10	17	0.80	4.3	72	22.16	0.8	5
2008	1.52	9	0.88	6.5	58	24.21	0.6	7
Current*	1.70	9	0.92	5.8	54	22.85	0.7	7
Average:		11		5.8	57		1.1	10.7
Growth(%):								
5 Year:	2.5		2.8			2.7		
10 Year:	0.5		-1.9			2.8		
20 Year:	1.1		1.0			4.6		

* Current EPS is the 4 Quarter Trailing to Q1/2009.

PNG - Rating as of 21-Aug-06 = Mkt

	Date	Rating Change	Share Price
1	22-Sep-06	Mkt to OP	$17.76
2	27-Oct-06	OP to Mkt	$19.30
3	24-Nov-06	Mkt to OP	$18.50
4	18-Jul-08	OP to Mkt	$17.20

Last Daily Data Point: July 30, 2009

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Distribution of Ratings (June 11, 2009)

Rating Category	BMO Rating	BMO Universe	BMO I.B. Clients*	Starmine Universe**
Buy	Outperform	31%	46%	46%
Hold	Market Perform	57%	47%	46%
Sell	Underperform	12%	7%	8%

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** Reflects rating distribution of all North American equity research analysts.

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Pacific Northern Gas

(PNG-TSX)

Stock Rating: **Market Perform**
Industry Rating: **Market Perform**

August 4, 2009
Research Comment
Toronto, Ontario

Michael McGowan, CA, CFA
(416) 359-5807
Michael.McGowan@bmo.com
Assoc: Mark Laing, CA

Q2/09 Results in Line; Dividend Increased by 8.7%

Event

Pacific Northern Gas reported a Q2/09 loss per share of $0.13, which was generally in line with our estimate of a $0.10 loss per share. In addition, the company increased its quarterly dividend by 8.7% to $0.25/share from $0.23/share, and filed a capital structure and equity risk premium application with the British Columbia Utilities Commission.

Impact

Slightly Positive.

Forecasts

We have updated our forecasts to reflect Q2/09 results and the dividend increase, effective for the dividend payable on September 22, 2009. Our DPS estimates increase to $0.96 in 2009E and to $1.00 in 2010E. Our EPS estimates for 2009 and 2010 are unchanged.

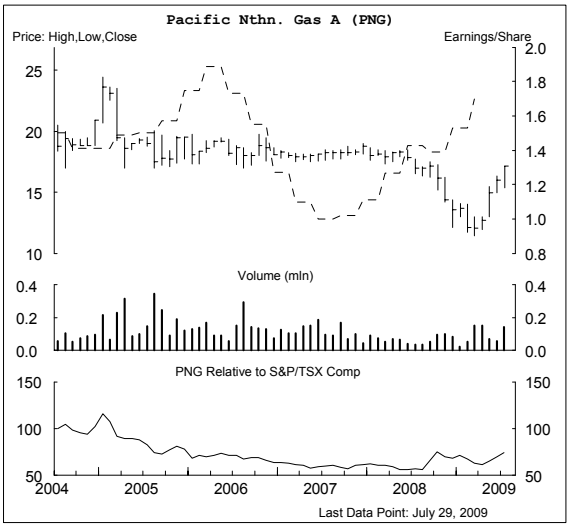
Valuation

As a result of the dividend increase, we are increasing our target price to $16 from $15. Our target price is based on a weighted valuation approach: 10x 2010E EPS of $1.60 (12.5%), 1.0x BVPS of $24.08 (12.5%) and a 7% dividend yield applied to 2010E DPS of $1.00 (75%).

Recommendation

We believe the shares are reasonably valued at current levels. Our rating is Market Perform.

Price (30-Jul)	$16.86	**52-Week High**	$17.49
Target Price	$16.00↑	**52-Week Low**	$11.40



(FY-Dec.)	2007A	2008A	2009E	2010E
EPS	$1.10	$1.52	$1.55	$1.60
P/E			10.9x	10.5x
CFPS	-$0.72	$4.59	$3.93	$4.74
P/CFPS			4.3x	3.6x
Div.	$0.80	$0.88	$0.96	$1.00
EV ($mm)	$155	$147	$144	$144
EBITDA ($mm)	$22.5	$23.6	$23.4	$23.6
EV/EBITDA	6.9x	6.2x	6.2x	6.1x

Quarterly EPS	Q1	Q2	Q3	Q4
2007A	$1.05	-$0.24	-$0.40	$0.70
2008A	$1.21	-$0.08	-$0.44	$0.84
2009E	$1.38a	-$0.13a	-$0.43↑	$0.73↑

Dividend	$0.92	**Yield**	5.5%
Book Value	$22.85	**Price/Book**	0.7x
Shares O/S (mm)	3.7	**Mkt. Cap ($mm)**	$62
Float O/S (mm)	3.7	**Float Cap ($mm)**	$62
Wkly Vol (000s)	19	**Wkly $ Vol (mm)**	$0.3
Net Debt ($mm)	$79.9	**Next Rep. Date**	31-Jul (E)

Notes: Estimates are weather normal
Major Shareholders: Widely held
First Call Mean Estimates: PACIFIC NORTHERN GAS LTD 'A' (C$) 2009E: $1.55; 2010E: $1.60

Changes

	Quarterly EPS	Target
	Q3/09E -$0.45 to -$0.43	$15.00 to $16.00
	Q4/09E $0.72 to $0.73	

Q2/09 Results in Line

Pacific Northern Gas reported a Q2/09 loss per share of $0.13, which was generally in line with our estimate of a $0.10 loss per share. In addition, the company increased its quarterly dividend by 8.7% to $0.25/share from $0.23/share, and filed a capital structure and equity risk premium application with the British Columbia Utilities Commission.

As a result of the dividend increase, we are increasing our target price to $16 from $15. Our target price is based on a weighted valuation approach: 10x 2010E EPS of $1.60 (12.5%), 1.0x BVPS of $24.08 (12.5%) and a 7% dividend yield applied to 2010E DPS of $1.00 (75%).

We believe the shares are reasonably valued at current levels. Our rating is Market Perform.

Capital Structure and Equity Risk Premium Application Filed

On July 16, 2009, PNG filed a Capital Structure and Equity Risk Premium Application with the British Columbia Utilities Commission. Key aspects of the application include:

- A request to increase the deemed equity thickness at the PNG West division to 47.5% from 40% and an increase in the relative risk premium to 75 basis points over the benchmark utility return in B.C., up from the current 65 basis point risk premium.
- A request to increase the deemed equity thickness at the Fort St. John/Dawson Creek and Tumbler Ridge divisions to 42.5% from 36%. The company has also requested that the equity risk premium at the Fort St. John/Dawson's Creek division be increased 75 basis points from 40 basis points and that the risk premium at the Tumbler Ridge division be increased to 75 basis points from 65 basis points.
- Recover in a return on equity deferral account the difference between the approved 2009 cost of service for the company and the cost of service determined for 2009 on the basis of the increases in capital structure and risk premia applied for in the 2009 Capital Structure and Risk Premium Application.
- Allocation of $0.7 million from the $1.5 million option fee received from Merrill Lynch Commodities to shareholders on the basis that the company is entitled to compensation for a foregone return on investment in gas transmission facilities that were deactivated in 2006 as a result in lost load following the closure of Methanex's methanol/ammonia plant.

We believe that this will be an important application for PNG since the company has maintained a more conservative capital structure than that allowed by the regulator, due to concerns regarding credit rating downgrades. At the end of Q2/09, PNG's actual common equity/total capitalization ratio was 50.8% versus a deemed common equity thickness of 36–40% for its operating divisions. Consequently, the actual return on equity realized by the company is lower than that allowed by its regulator.

In our flash research note dated July 31, 2009, we incorrectly referred to the 2009 Capital Structure and Equity Risk Premium Application as the 2010 Rate Application. PNG expects to file its 2010 rate application in H2/09.

Pacific Trail Pipeline Update

Since Q1/09 financial results were released, the following updates have occurred with respect to the LNG gasification terminal that is being proposed by Kitimat LNG:

- During Q2/09, Kitimat LNG announced that it had signed a memorandum of understanding ("MOU") with Korea Gas Corporation for the purchase of up to 40% of the annual LNG, which would be produced at the proposed re-gasification terminal;
- In early July, Kitimat LNG announced that it had signed an MOU with Gas Natural SDG, SA, of Spain, under which Gas Natural would purchase up to 32 percent of the annual LNG produced by the proposed re-gasification terminal;
- Also in early July, Kitimat LNG announced that it had signed a MOU with EOG Resources Canada to supply an undisclosed amount of natural gas that would be used by the terminal to produce LNG.

We believe that these developments are slightly positive for PNG as they relate to the company's investment in the Pacific Trail Pipeline Limited Partnership (50% PNG), the entity proposing to construct a 463-km pipeline that would transport natural gas from Spectra Energy's Westcoast System to Kitimat LNG's proposed gasification terminal; however we consider completion of the overall project (LNG Terminal plus Pacific Trail Pipeline) to be highly uncertain.

Accordingly, construction of the Pacific Trail Pipeline is not reflected in our outlook for Pacific Northern Gas. Before the LNG gasification terminal or the Pacific Trail Pipeline can proceed, the projects would need to obtain all necessary regulatory approvals, negotiate further commercial arrangements (binding natural gas supply and purchase commitments, in particular) and obtain the financing commitments necessary to support the construction of the project.

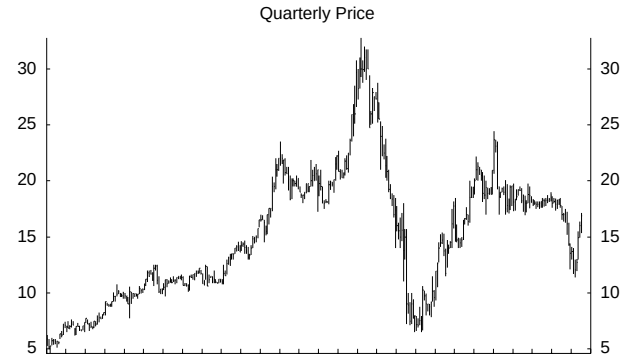
Estimates

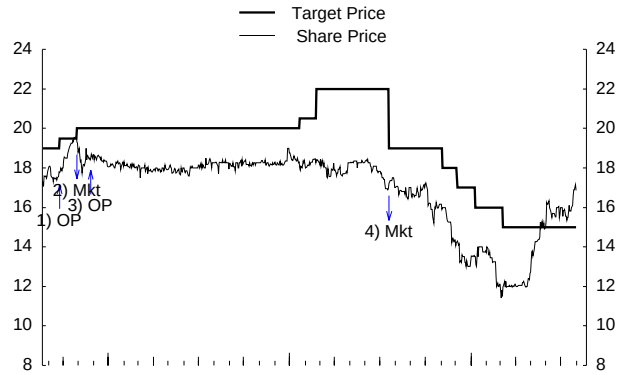
We have updated our forecasts to reflect Q2/09 results and the dividend increase, effective for the dividend payable on September 22, 2009. Our DPS estimates increase to $0.96 in 2009E and to $1.00 in 2010E. Our EPS estimates for 2009 and 2010 are unchanged.

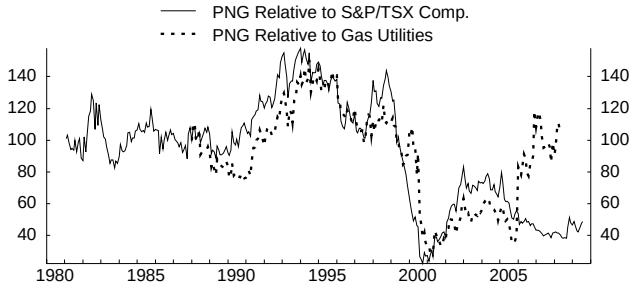
Table 1: Consolidated Summary

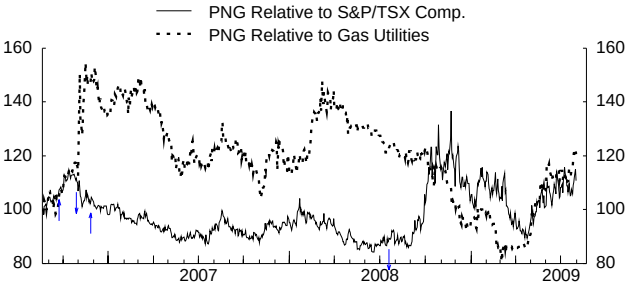
3-Aug-09									Michael McGowan
Current Price:	$17.00								BMO Capital Markets
12-Month Target Price:	$16.00								
ROR:	-0.7%						Recommendation:		Market Perform
				Year Ended December 31					
	2002	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009E**	**2010E**
Total Earnings Per Share	$1.28	$1.49	$1.41	$1.75	$1.27	$1.11	$1.53	$1.56	$1.62
Fully Diluted EPS	$1.25	$1.46	$1.38	$1.72	$1.25	$1.10	$1.52	$1.55	$1.60
Dividends	$0.00	$0.80	$0.80	$0.80	$0.80	$0.80	$0.88	$0.96	$1.00
Payout Ratio	0.0%	53.8%	56.8%	45.8%	63.0%	72.4%	57.6%	61.5%	61.9%
Average Shares (mm)	3.5	3.6	3.6	3.6	3.6	3.6	3.7	3.7	3.7
Net Book Value	$21.62	$19.25	$20.52	$21.44	$21.91	$22.17	$22.85	$23.46	$24.08
Market Valuation									
Price: High	$18.00	$19.50	$22.00	$24.00	$19.75	$19.00	$18.65	-	-
Price: Low	$9.35	$14.00	$17.28	$17.37	$16.96	$17.50	$12.11	-	-
Price: Current	-	-	-	-	-	-	-	$17.00	
P/E Ratio: High	14.0	13.1	15.6	13.7	15.5	17.2	12.2	-	-
P/E Ratio: Low	7.3	9.4	12.3	9.9	13.3	15.8	7.9	-	-
P/E Ratio: Current	-	-	-	-	-	-	-	10.9	10.5
Price/Book Value: High	0.8	1.0	1.1	1.1	0.9	0.9	0.8	-	-
Price/Book Value: Low	0.4	0.7	0.8	0.8	0.8	0.8	0.5	-	-
Price/Book Value: Current	-	-	-	-	-	-	-	0.7	0.7
Yield: High Price	0.0%	4.1%	3.6%	3.3%	4.1%	4.2%	4.7%	-	-
Yield: Low Price	0.0%	5.7%	4.6%	4.6%	4.7%	4.6%	7.3%	-	-
Yield: Current	-	-	-	-	-	-	-	5.6%	5.9%
Balance Sheet ($mm)									
Debt (S-T)	4.4	7.3	10.4	14.7	10.0	11.2	5.4	5.3	13.9
Debt (L-T)	90.2	85.8	81.4	76.6	71.7	72.8	74.5	72.4	63.8
Deferred Items	17.0	17.9	15.8	15.7	24.0	18.5	13.8	13.1	14.6
Preferred Shares	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0
Shareholders' Equity	76.7	69.4	73.9	77.7	79.8	81.2	83.7	86.0	88.2
	193.3	185.4	186.7	189.7	190.5	188.9	182.5	181.8	185.6
Balance Sheet (%)									
Debt (S-T)	2.3%	3.9%	5.6%	7.7%	5.2%	6.0%	3.0%	2.9%	7.5%
Debt (L-T)	46.7%	46.3%	43.6%	40.4%	37.6%	38.6%	40.8%	39.8%	34.4%
Deferred Items	8.8%	9.7%	8.5%	8.3%	12.6%	9.8%	7.6%	7.2%	7.9%
Preferred Shares	2.6%	2.7%	2.7%	2.6%	2.6%	2.7%	2.7%	2.8%	2.7%
Shareholders' Equity	39.7%	37.4%	39.6%	41.0%	41.9%	43.0%	45.9%	47.3%	47.5%
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Income Statement ($mm)									
Total Revenue	109.1	133.7	137.8	160.0	138.8	129.5	132.8	123.9	144.7
EBIT	19.5	18.5	17.5	18.6	17.6	14.3	14.9	14.4	14.0
NPAT	4.9	5.7	5.4	6.7	5.0	4.4	5.9	6.1	6.3
Preferred Share Dividends	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Net Earnings to Common	4.6	5.3	5.1	6.3	4.6	4.0	5.6	5.7	5.9
Cash Flow from Operations	12.8	12.2	16.4	11.8	17.6	(2.6)	16.8	14.4	17.4
Key Statistics									
Average Utility Rate Base ($mm)	166.8	165.4	167.2	165.2	162.4	165.6	167.9	167.6	166.8
Growth Rate	-1.98%	-0.87%	1.10%	-1.19%	-1.67%	1.95%	1.38%	-0.15%	-0.52%
2007 - 2010 CAGR									0.23%
Allowed Return on Equity	9.88%	10.17%	9.80%	9.68%	9.45%	9.02%	9.27%	9.12%	9.12%
Deemed Equity	36.00%	36.00%	36.00%	40.00%	40.00%	40.00%	40.00%	40.00%	40.00%
Sensitivity									
100 bp Change ROE									
Change Total Income	0.6	0.6	0.6	0.7	0.6	0.7	0.7	0.7	0.7
Change Per Share	0.17	0.17	0.17	0.18	0.18	0.18	0.18	0.18	0.18
100 bp Change in Deemed Equity									
Change Total Income	0.2	0.2	0.2	0.2	0.2	0.1	0.2	0.2	0.2
Change Per Share	0.05	0.05	0.05	0.04	0.04	0.04	0.04	0.04	0.04
1.00% Change in Average Rate Base									
Change Total Income	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Change Per Share	0.02	0.02	0.02	0.02	0.02	0.02	0.02	0.02	0.02

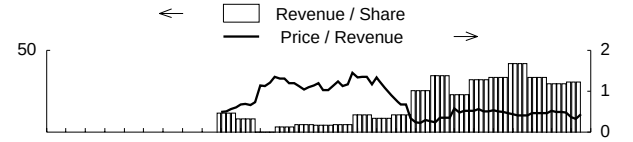
Pacific Nthn. Gas A (PNG)

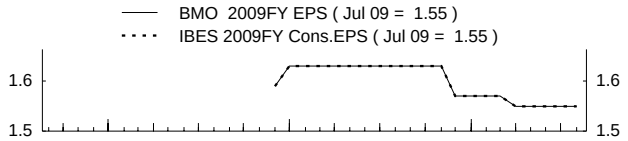


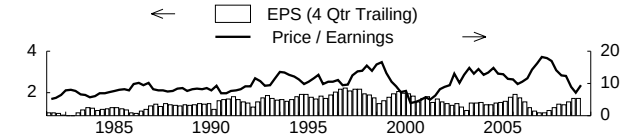


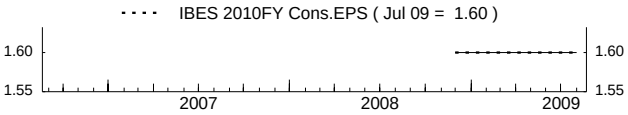












FYE (Dec.)	EPS $	P/E	DPS $	Yield %	Payout %	BV $	P/B	ROE %
1987	1.31	8	0.75	7.4	57	8.97	1.1	15
1988	1.34	8	0.75	6.6	56	9.24	1.2	15
1989	1.45	8	0.75	6.4	52	9.92	1.2	15
1990	1.61	7	0.75	6.7	47	10.76	1.0	16
1991	1.66	8	0.80	5.9	48	11.62	1.2	15
1992	1.55	11	0.80	4.8	52	12.37	1.3	13
1993	1.63	13	0.88	4.0	54	12.37	1.8	13
1994	1.80	11	0.88	4.3	49	12.37	1.6	15
1995	1.67	13	0.96	4.6	57	14.57	1.4	12
1996	2.01	11	0.96	4.3	48	15.61	1.4	13
1997	2.16	14	1.04	3.5	48	16.42	1.8	13
1998	1.73	16	1.12	4.1	65	17.39	1.6	10
1999	1.92	9	1.12	6.5	58	18.19	1.0	11
2000	1.83	4	1.12	14.1	61	19.44	0.4	10
2001	1.52	6	1.12	11.7	74	20.95	0.5	8
2002	1.25	13	1.12	6.3	82	19.27	0.9	6
2003	1.46	13	0.80	4.1	54	19.96	1.0	7
2004	1.38	15	0.80	3.8	57	20.52	1.0	7
2005	1.72	11	0.80	4.1	46	21.43	0.9	8
2006	1.25	14	0.80	4.4	63	21.91	0.8	6
2007	1.10	17	0.80	4.3	72	22.16	0.8	5
2008	1.52	9	0.88	6.5	58	24.21	0.6	7
Current*	1.70	9	0.92	5.8	54	22.85	0.7	7
Average:		11		5.8	57		1.1	10.7
Growth(%):								
5 Year:	2.5		2.8			2.7		
10 Year:	0.5		-1.9			2.8		
20 Year:	1.1		1.0			4.6		

* Current EPS is the 4 Quarter Trailing to Q1/2009.

PNG - Rating as of 21-Aug-06 = Mkt

	Date	Rating Change	Share Price
1	22-Sep-06	Mkt to OP	$17.76
2	27-Oct-06	OP to Mkt	$19.30
3	24-Nov-06	Mkt to OP	$18.50
4	18-Jul-08	OP to Mkt	$17.20

Last Daily Data Point: July 30, 2009

Company Risk Disclosure

In addition to the risks involved in investing in common stocks generally, we also highlight the following risks that pertain to this company. The company's natural gas transmission business depends on the continued availability of natural gas. The BCUC approves PNG's customer rates and a fair return on the rate base. Changes in regulation may adversely affect performance. Natural gas and fuel oil compete with electricity for space heating in Pacific Northern Gas' service areas. Fluctuations in the price of natural gas could increase the working capital financing requirements and related costs for accounts receivable. In 2004, 75% of energy deliveries were made to four large industrial customers (67% to one customer, Methanex). Transportation service to Methanex was made pursuant to an agreement that expires in October 2009. On August 30, 2005, Methanex announced that it will close its Kitimat facilities in early 2006.

Analyst's Certification

I, Michael McGowan, CA, CFA, hereby certify that the views expressed in this report accurately reflect my personal views about the subject securities or issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report.

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Company Specific Disclosure

Disclosure 1: BMO NB has provided advice for a fee with respect to this issuer within the past 12 months.

Disclosure 3: BMO NB has provided investment banking services with respect to this issuer within the past 12 months.

Disclosure 7: BMO Capital Markets Corp. or an affiliate has received compensation for investment banking services from this issuer within the past 12 months.

Disclosure 9: BMO Capital Markets Corp. or an affiliate received compensation for products or services other than investment banking services within the past 12 months.

Disclosure 10: This issuer is a client (or was a client) of BMO NB, BMO Capital Markets Corp., BMO CM Ltd. or an affiliate within the past 12 months: Investment Banking Services & Non-Investment Banking Securities Related Services.

Distribution of Ratings (June 11, 2009)

Rating Category	BMO Rating	BMO Universe	BMO I.B. Clients*	Starmine Universe**
Buy	Outperform	31%	46%	46%
Hold	Market Perform	57%	47%	46%
Sell	Underperform	12%	7%	8%

* Reflects rating distribution of all companies where BMO Capital Markets has received compensation for Investment Banking services.
** Reflects rating distribution of all North American equity research analysts.

Ratings Key
We use the following ratings system definitions:
OP = Outperform - Forecast to outperform the market;
Mkt = Market Perform - Forecast to perform roughly in line with the market;
Und = Underperform - Forecast to underperform the market;
(S) = speculative investment;
NR = No rating at this time;
R = Restricted – Dissemination of research is currently restricted.

Market performance is measured by a benchmark index such as the S&P/TSX Composite Index, S&P 500, Nasdaq Composite, as appropriate for each company. Prior to September 1, 2003, a fourth rating tier—Top Pick—was used to designate those stocks we felt would be the best performers relative to the market. Our six Top 15 lists which guide investors to our best ideas according to six different objectives (large, small, growth, value, income and quantitative) have replaced the Top Pick rating.

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A general description of how BMO Financial Group identifies and manages conflicts of interest is contained in our public facing policy for managing conflicts of interest in connection with investment research which is available at:
http://research-ca.bmocapitalmarkets.com/conflict_statement_public.asp

Additional Matters
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Pacific Northern Gas

(PNG-TSX)

February 9, 2010
Brief Research Note
Gas & Electric Utilities

Stock Rating: **Market Perform**
Stock Price: **$21.40**
Target Price: **$19.50**

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Q4/09 Results Exceed Expectations; Dividend Increased by 12%

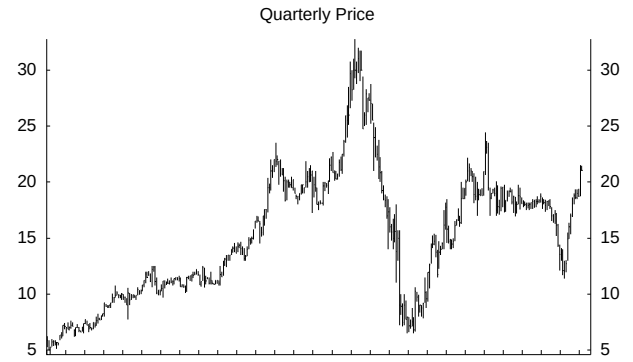
Impact

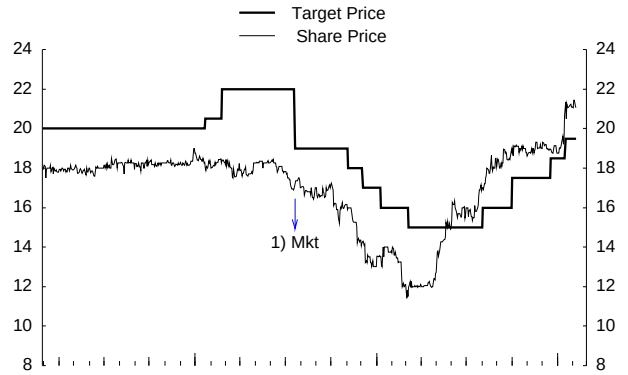
Slightly Positive

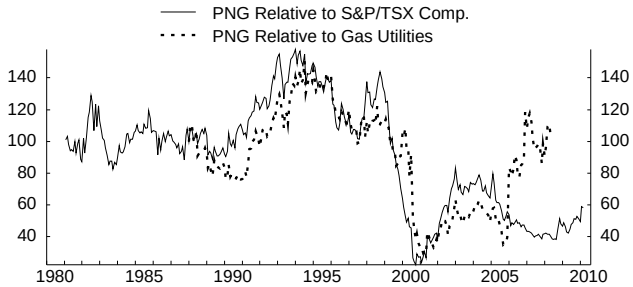
Details & Analysis

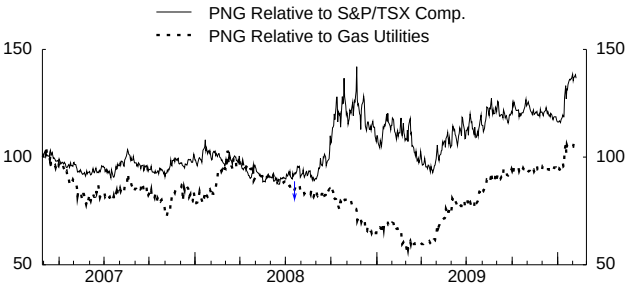
Pacific Northern Gas reported Q4/09 EPS of $0.95 (basic), which was greater than our estimate of $0.82 and Q4/08 EPS of $0.84. Complete financial statements were not included in the press release; however, reasons cited for the increased earnings included an accrual for higher regulated rates of return on equity and lower capital expenditures related to the Kitimat to Summit Lake project. In addition, PNG announced that it is increasing its annual dividend by 12% to $1.12/share vs. the current annualized rate of $1.00/share. The revised quarterly dividend of $0.28/share is payable on March 22, 2010, to shareholders of record as of March 8, 2010. Although we generally view dividend increases favourably, we were surprised by the timing of this announcement considering that: (1) one of the company's largest remaining shippers, West Fraser, completed the closure of its Eurocan paper mill in January 2010; and (2) PNG may face increased development costs associated with the Kitimat to Summit Lake initiative over the next two years.

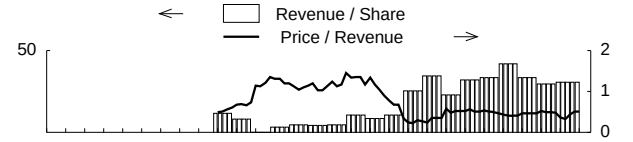
Pacific Nthn. Gas A (PNG)

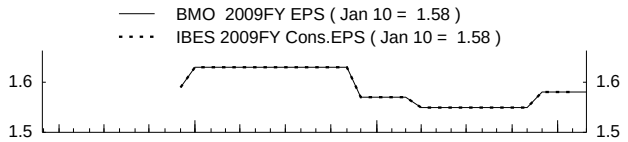


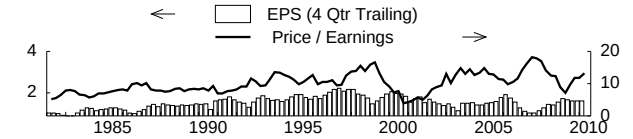


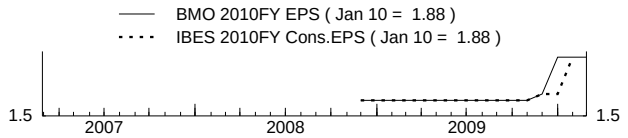












FYE (Dec.)	EPS $	P/E	DPS $	Yield %	Payout %	BV $	P/B	ROE %
1987	1.31	8	0.75	7.4	57	8.97	1.1	15
1988	1.34	8	0.75	6.6	56	9.24	1.2	15
1989	1.45	8	0.75	6.4	52	9.92	1.2	15
1990	1.61	7	0.75	6.7	47	10.76	1.0	16
1991	1.66	8	0.80	5.9	48	11.62	1.2	15
1992	1.55	11	0.80	4.8	52	12.37	1.3	13
1993	1.63	13	0.88	4.0	54	12.37	1.8	13
1994	1.80	11	0.88	4.3	49	12.37	1.6	15
1995	1.67	13	0.96	4.6	57	14.57	1.4	12
1996	2.01	11	0.96	4.3	48	15.61	1.4	13
1997	2.16	14	1.04	3.5	48	16.42	1.8	13
1998	1.73	16	1.12	4.1	65	17.39	1.6	10
1999	1.92	9	1.12	6.5	58	18.19	1.0	11
2000	1.83	4	1.12	14.1	61	19.44	0.4	10
2001	1.52	6	1.12	11.7	74	20.95	0.5	8
2002	1.25	13	1.12	6.3	82	19.27	0.9	6
2003	1.46	13	0.80	4.1	54	19.96	1.0	7
2004	1.38	15	0.80	3.8	57	20.52	1.0	7
2005	1.72	11	0.80	4.1	46	21.43	0.9	8
2006	1.25	14	0.80	4.4	63	21.91	0.8	6
2007	1.10	17	0.80	4.3	72	22.16	0.8	5
2008	1.52	9	0.88	6.5	58	24.21	0.6	7
Current*	1.60	13	1.00	4.7	63	23.25	0.9	7
Average:		11		5.8	57		1.1	10.7
Growth(%):								
5 Year:	2.5		4.6			2.5		
10 Year:	-1.8		-1.1			2.5		
20 Year:	0.5		1.4			4.4		

* Current EPS is the 4 Quarter Trailing to Q3/2009.

PNG - Rating as of 27-Feb-07 = OP

	Date	Rating Change	Share Price
1	18-Jul-08	OP to Mkt	$17.20

Last Daily Data Point: February 5, 2010

IMPORTANT DISCLOSURES

Analyst's Certification

I, Michael McGowan, CA, CFA, hereby certify that the views expressed in this report accurately reflect my personal views about the subject securities or issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report.

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Disclosure 6: This issuer is a client (or was a client) of BMO NB, BMO Capital Markets Corp., BMO CM Ltd. or an affiliate within the past 12 months: Non-Investment Banking Securities Related Services.

Methodology and Risks to Price Target/Valuation

Methodology: Our target price is based on a weighted valuation approach: 13x 2011E diluted EPS (12.5%); 1.0x 2011E BVPS (12.5%) and a target yield of 5.75% based on 2011E dividends per share (75%).

Risks: The company's natural gas transmission business depends on the continued availability of natural gas. The BCUC approves PNG's customer rates and a fair return on the rate base. Changes in regulation may adversely affect performance. Natural gas and fuel oil compete with electricity for space heating in Pacific Northern Gas' service areas. Fluctuations in the price of natural gas could increase the working capital financing requirements and related costs for accounts receivable. In 2004, 75% of energy deliveries were made to four large industrial customers (67% to one customer, Methanex). Transportation service to Methanex was made pursuant to an agreement that expires in October 2009. On August 30, 2005, Methanex announced that it will close its Kitimat facilities in early 2006. On October 28, 2009 another large industrial customer (West Fraser Timber Co. Ltd. announced that it was permanently closing its mill on January 31, 2010.

Distribution of Ratings (Dec. 31, 2009)

Rating Category	BMO Rating	BMOCM US Universe*	BMOCM US IB Clients**	BMOCM US IB Clients***	BMOCM Universe****	BMOCM IB Clients*****	First Call Universe
Buy	Outperform	32.2%	12.3%	38.3%	36.1%	47.9%	50%
Hold	Market Perform	62.6%	10.2%	61.7%	56.9%	48.9%	43%
Sell	Underperform	5.3%	0%	0%	6.9%	3.2%	7%

* Reflects rating distribution of all companies covered by BMO Capital Markets Corp. equity research analysts.

** Reflects rating distribution of all companies from which BMO Capital Markets Corp. has received compensation for Investment Banking services as percentage within ratings category.

*** Reflects rating distribution of all companies from which BMO Capital Markets Corp. has received compensation for Investment Banking services as percentage of Investment Banking clients.

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Ratings and Sector Key
We use the following ratings system definitions:
OP = Outperform - Forecast to outperform the market;
Mkt = Market Perform - Forecast to perform roughly in line with the market;
Und = Underperform - Forecast to underperform the market;
(S) = speculative investment;
NR = No rating at this time;
R = Restricted – Dissemination of research is currently restricted.

Market performance is measured by a benchmark index such as the S&P/TSX Composite Index, S&P 500, Nasdaq Composite, as appropriate for each company. BMO Capital Markets eight Top 15 lists guide investors to our best ideas according to different objectives (Canadian large, small, growth, value, income, quantitative; and US large, US small) have replaced the Top Pick rating.

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Pacific Northern Gas

(PNG-TSX)

Stock Rating: **Market Perform**
Industry Rating: **Market Perform**

April 7, 2010
Research Comment
Toronto, Ontario

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Assoc: Mark Laing, CA

Hydro Acquisition Announced; Market Perform Rating Maintained

Event

Pacific Northern Gas announced that it has acquired a 97% interest in the 9.8 MW McNair Creek run of river hydro facility for $17 million ($1,735/kW). The acquisition will be financed through the assumption of existing debt (approximately $9.4 million) and utilization of the company's existing credit facility. After the acquisition is complete, PNG's debt-to-capitalization ratio is expected to increase to approximately 51%, up from approximately 46.5% at the end of Q4/09. The McNair Creek project was awarded a 20-year PPA with BC Hydro in 2001 and the facility was commissioned on November 3, 2004. Expected annual electricity production from the plant is 30–32 GWh.

Impact

Mixed. We believe this project is a first step in an attempt to diversify PNG's earnings away from its core regulated natural gas distribution system, which has experienced declining volumes. Although McNair Creek is expected to be accretive to earnings and cash flow, we believe it could reduce the company's attractiveness as a pure-play pipeline company, should the KSL project proceed.

Forecasts

We have updated our model to reflect the acquisition. Our diluted EPS estimates increase to $1.89 from $1.88 in 2010E and to $1.90 from $1.86 in 2011E.

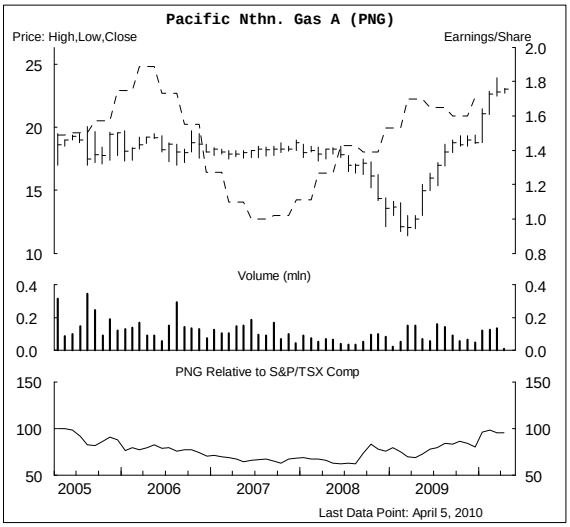
Valuation

We are increasing our target price slightly to $20 from $19.50. Our $20 price target is based on a weighted valuation approach: 13x 2011E diluted EPS of $1.90 (12.5%); 1.0x 2011E BVPS of $25.62 (12.5%); and a 6.25% dividend yield applied to 2011E DPS of $1.12 (75%).

Recommendation

At current levels, we believe shares are reasonably valued. Our rating is Market Perform.

Price (7-Apr)	$22.70	**52-Week High**	$23.96
Target Price	$20.00↑	**52-Week Low**	$11.93



(FY-Dec.)	2008A	2009A	2010E	2011E
EPS	$1.52	$1.71	$1.89↑	$1.90↑
P/E			12.0x	11.9x
CFPS	$4.59	$5.25	$4.99↑	$5.05↑
P/CFPS			4.5x	4.5x
Div.	$0.88	$0.96	$1.12	$1.12
EV ($mm)	$147	$141	$164	$160
EBITDA ($mm)	$23.6	$22.8	$24.9	$24.7
EV/EBITDA	6.2x	6.2x	6.6x	6.5x

Quarterly EPS	Q1	Q2	Q3	Q4
2008A	$1.21	-$0.08	-$0.44	$0.84
2009A	$1.38	-$0.13	-$0.49	$0.95
2010E	$1.48	-$0.03↑	-$0.51↓	$0.96

Dividend	$1.12	**Yield**	4.9%
Book Value	$24.03	**Price/Book**	0.9x
Shares O/S (mm)	3.5	**Mkt. Cap ($mm)**	$80
Float O/S (mm)	3.5	**Float Cap ($mm)**	$80
Wkly Vol (000s)	23	**Wkly $ Vol (mm)**	$0.4
Net Debt ($mm)	$74.6	**Next Rep. Date**	30-Apr (E)

Notes: All values in C$; Estimates are weather normal
Major Shareholders: Widely held
First Call Mean Estimates: PACIFIC NORTHERN GAS LTD 'A' (C$) 2010E: $1.88; 2011E: $1.86

Changes	Annual EPS	Annual CFPS	Quarterly EPS	Target
	2010E $1.88 to $1.89	2010E $4.90 to $4.99	Q2/10E -$0.07 to -$0.03	$19.50 to $20.00
	2011E $1.86 to $1.90	2011E $4.89 to $5.05	Q3/10E -$0.47 to -$0.51	

Table 1: McNair Creek Assumptions

Assumptions	2010E	2011E
Purchase Price ($mm)	$17.0	$17.0
Net Capacity (MW)	9.8	9.8
Potential Energy Production (GWh)	63.0	85.8
Utilization Rate	32.0%	36.1%
Actual Energy Production (GWh)	20.2	31.0
Realized Power Price	$59.00	$59.00
Operating Expenses ($/MWh)	$11.00	$11.00
Useful Life (Years)	40.0	40.0
Tax Rate	32%	32%
Shares o/s	3.6	3.6
Cost of Debt - non-recourse	7.4%	7.4%
Cost of Debt - bank facility	2.0%	2.0%
% of Project Financed with Debt - non-recourse	55.0%	55.0%
% of Project Financed with Debt - bank facility	45.0%	45.0%

Financial Estimates		
Realized Power Price ($/MWh)	$59.00	$59.00
Energy Production (GWh)	20.2	31.0
Power Revenue ($mm)	**$1.2**	**$1.8**
Operating Expenses	0.2	0.3
Amortization	0.3	0.4
Interest Expense - non-recourse	0.5	0.7
Interest Expense - bank facility	0.1	0.2
Total Expenses	**$1.2**	**$1.6**
Net Income Before Taxes	**$0.0**	**$0.2**
Income Tax Expense	0.0	0.1
Net Income	**$0.0**	**$0.2**
EPS Accretion	**$0.01**	**$0.04**
Add/(Deduct):		
Amortization	0.3	0.4
Operating Cash Flow	**$ 0.3**	**$ 0.6**
CPS Accretion	**$ 0.09**	**$ 0.17**

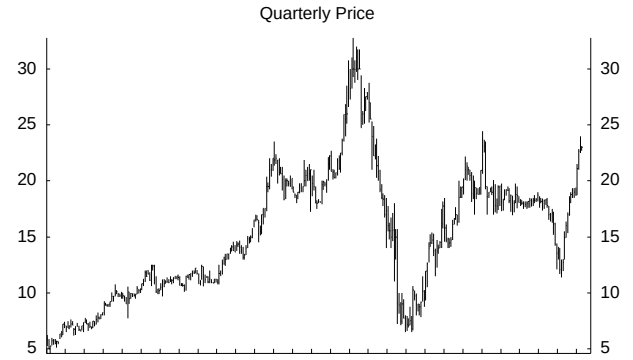
Source BMO Capital Markets

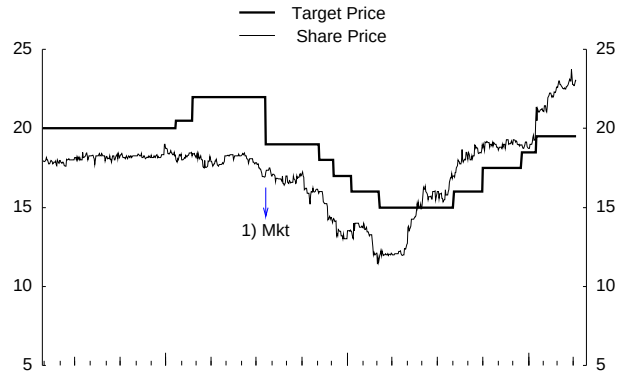
Table 2: Consolidated Summary

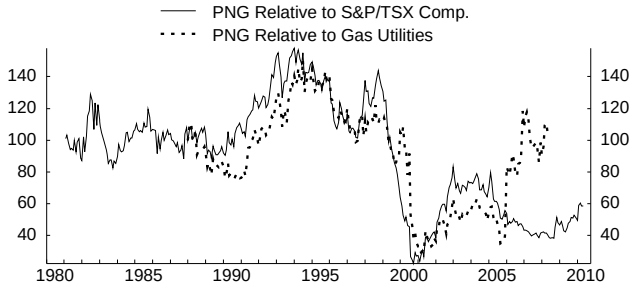
07-Apr-10										Michael McGowan
Current Price:	$22.70									BMO Capital Markets
12-Month Target Price:	$20.00									
ROR:	-7.0%							Recommendation:		Market Perform
				Year Ended December 31						
	2002	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010E**	**2011E**
Total Earnings Per Share	$1.28	$1.49	$1.41	$1.75	$1.27	$1.11	$1.53	$1.72	$1.91	$1.92
Fully Diluted EPS	$1.25	$1.46	$1.38	$1.72	$1.25	$1.10	$1.52	$1.71	$1.89	$1.90
Dividends	$0.00	$0.80	$0.80	$0.80	$0.80	$0.80	$0.88	$0.96	$1.12	$1.12
Payout Ratio	0.0%	53.8%	56.8%	45.8%	63.0%	72.4%	57.6%	55.7%	58.6%	58.5%
Average Shares (mm)	3.5	3.6	3.6	3.6	3.6	3.6	3.7	3.6	3.6	3.6
Net Book Value	$21.62	$19.25	$20.52	$21.44	$21.91	$22.17	$22.85	$24.03	$24.82	$25.62
Market Valuation										
Price: High	$18.00	$19.50	$22.00	$24.00	$19.75	$19.00	$18.65	$19.30	-	-
Price: Low	$9.35	$14.00	$17.28	$17.37	$16.96	$17.50	$12.11	$11.40	-	-
Price: Current	-	-	-	-	-	-	-	-	$22.70	-
P/E Ratio: High	14.0	13.1	15.6	13.7	15.5	17.2	12.2	11.2	-	-
P/E Ratio: Low	7.3	9.4	12.3	9.9	13.3	15.8	7.9	6.6	-	-
P/E Ratio: Current	-	-	-	-	-	-	-	-	11.9	11.8
Price/Book Value: High	0.8	1.0	1.1	1.1	0.9	0.9	0.8	0.8	-	-
Price/Book Value: Low	0.4	0.7	0.8	0.8	0.8	0.8	0.5	0.5	-	-
Price/Book Value: Current	-	-	-	-	-	-	-	-	0.9	0.9
Yield: High Price	0.0%	4.1%	3.6%	3.3%	4.1%	4.2%	4.7%	5.0%	-	-
Yield: Low Price	0.0%	5.7%	4.6%	4.6%	4.7%	4.6%	7.3%	8.4%	-	-
Yield: Current	-	-	-	-	-	-	-	-	4.9%	4.9%
Balance Sheet ($mm)										
Debt (S-T)	4.4	7.3	10.4	14.7	10.0	11.2	5.4	6.1	20.4	25.0
Debt (L-T)	90.2	85.8	81.4	76.6	71.7	72.8	74.5	72.4	73.4	64.6
Deferred Items	17.0	17.9	15.8	15.7	24.0	18.5	13.8	14.0	15.5	17.0
Preferred Shares	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0
Shareholders' Equity	76.7	69.4	73.9	77.7	79.8	81.2	83.7	85.4	88.2	91.1
	193.3	185.4	186.7	189.7	190.5	188.9	182.5	182.9	202.6	202.7
Balance Sheet (%)										
Debt (S-T)	2.3%	3.9%	5.6%	7.7%	5.2%	6.0%	3.0%	3.4%	10.1%	12.3%
Debt (L-T)	46.7%	46.3%	43.6%	40.4%	37.6%	38.6%	40.8%	39.6%	36.2%	31.9%
Deferred Items	8.8%	9.7%	8.5%	8.3%	12.6%	9.8%	7.6%	7.6%	7.6%	8.4%
Preferred Shares	2.6%	2.7%	2.7%	2.6%	2.6%	2.7%	2.7%	2.7%	2.5%	2.5%
Shareholders' Equity	39.7%	37.4%	39.6%	41.0%	41.9%	43.0%	45.9%	46.7%	43.6%	45.0%
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Income Statement ($mm)										
Total Revenue	109.1	133.7	137.8	160.0	138.8	129.5	132.8	104.1	93.9	94.7
EBIT	19.5	18.5	17.5	18.6	17.6	14.3	14.9	14.6	16.7	16.6
NPAT	4.9	5.7	5.4	6.7	5.0	4.4	5.9	6.5	7.1	7.2
Preferred Share Dividends	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Net Earnings to Common	4.6	5.3	5.1	6.3	4.6	4.0	5.6	6.2	6.8	6.8
Cash Flow from Operations	12.8	12.2	16.4	11.8	17.6	(2.6)	16.8	18.9	17.7	18.0
Key Statistics										
Average Utility Rate Base ($mm)	166.8	165.4	167.2	165.2	162.4	165.6	167.9	171.3	168.8	165.9
Growth Rate	-1.98%	-0.87%	1.10%	-1.19%	-1.67%	1.95%	1.38%	2.02%	-1.45%	-1.71%
2007 - 2010 CAGR									0.64%	-0.39%
Allowed Return on Equity	9.88%	10.17%	9.80%	9.68%	9.45%	9.02%	9.27%	9.12%	10.15%	10.15%
Deemed Equity	36.00%	36.00%	36.00%	40.00%	40.00%	40.00%	40.00%	40.00%	40.00%	40.00%
Sensitivity										
100 bp Change ROE										
Change Total Income	0.6	0.6	0.6	0.7	0.6	0.7	0.7	0.7	0.7	0.7
Change Per Share	0.17	0.17	0.17	0.18	0.18	0.18	0.18	0.19	0.19	0.19
100 bp Change in Deemed Equity										
Change Total Income	0.2	0.2	0.2	0.2	0.2	0.1	0.2	0.2	0.2	0.2
Change Per Share	0.05	0.05	0.05	0.04	0.04	0.04	0.04	0.04	0.05	0.05
1.00% Change in Average Rate Base										
Change Total Income	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Change Per Share	0.02	0.02	0.02	0.02	0.02	0.02	0.02	0.02	0.02	0.02

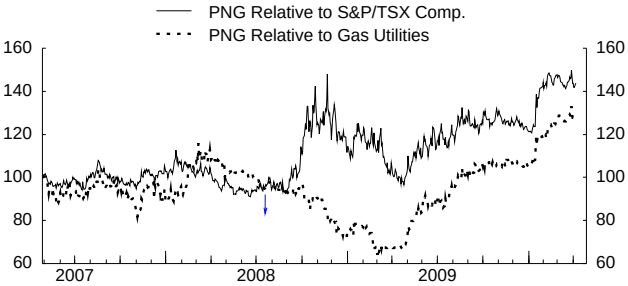
Source: BMO Capital Markets

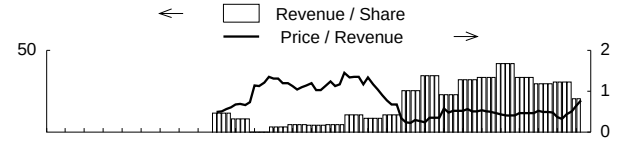
Pacific Nthn. Gas A (PNG)

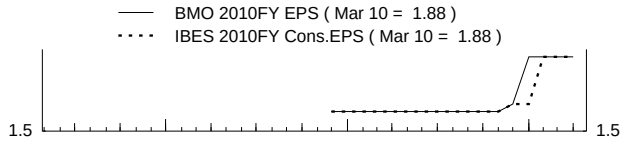


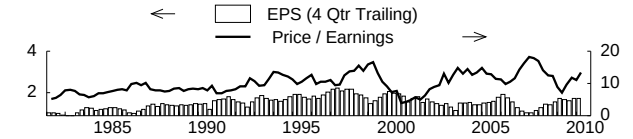


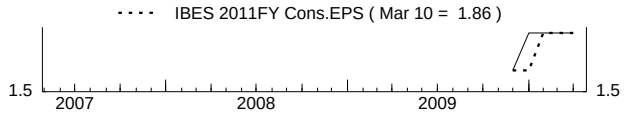












FYE (Dec.)	EPS $	P/E	DPS $	Yield %	Payout %	BV $	P/B	ROE %
1987	1.31	8	0.75	7.4	57	8.97	1.1	15
1988	1.34	8	0.75	6.6	56	9.24	1.2	15
1989	1.45	8	0.75	6.4	52	9.92	1.2	15
1990	1.61	7	0.75	6.7	47	10.76	1.0	16
1991	1.66	8	0.80	5.9	48	11.62	1.2	15
1992	1.55	11	0.80	4.8	52	12.37	1.3	13
1993	1.63	13	0.88	4.0	54	12.37	1.8	13
1994	1.80	11	0.88	4.3	49	12.37	1.6	15
1995	1.67	13	0.96	4.6	57	14.57	1.4	12
1996	2.01	11	0.96	4.3	48	15.61	1.4	13
1997	2.16	14	1.04	3.5	48	16.42	1.8	13
1998	1.73	16	1.12	4.1	65	17.39	1.6	10
1999	1.92	9	1.12	6.5	58	18.19	1.0	11
2000	1.83	4	1.12	14.1	61	19.44	0.4	10
2001	1.52	6	1.12	11.7	74	20.95	0.5	8
2002	1.25	13	1.12	6.3	82	19.27	0.9	6
2003	1.46	13	0.80	4.1	54	19.96	1.0	7
2004	1.38	15	0.80	3.8	57	20.52	1.0	7
2005	1.72	11	0.80	4.1	46	21.43	0.9	8
2006	1.25	14	0.80	4.4	63	21.91	0.8	6
2007	1.10	17	0.80	4.3	72	22.16	0.8	5
2008	1.52	9	0.88	6.5	58	24.21	0.6	7
2009	1.71	11	1.00	5.3	58	24.03	0.8	7
Current*	1.71	13	1.12	4.9	65	24.03	0.9	7
Average:		11		5.7	57		1.1	10.5
Growth(%):								
5 Year:	2.8		7.0			3.2		
10 Year:	-1.8		0.0			2.8		
20 Year:	0.9		2.0			4.5		

* Current EPS is the 4 Quarter Trailing to Q4/2009.

PNG - Rating as of 26-Apr-07 = OP

	Date	Rating Change	Share Price
1	18-Jul-08	OP to Mkt	$17.20

Last Daily Data Point: April 6, 2010

IMPORTANT DISCLOSURES

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Methodology and Risks to Price Target/Valuation
Methodology: Our target price is based on a weighted valuation approach: 13x 2011E diluted EPS (12.5%); 1.0x 2011E BVPS (12.5%) and a target yield of 6.25% based on 2011E dividends per share (75%).
Risks: The company's natural gas transmission business depends on the continued availability of natural gas. The BCUC approves PNG's customer rates and a fair return on the rate base. Changes in regulation may adversely affect performance. Natural gas and fuel oil compete with electricity for space heating in Pacific Northern Gas' service areas. Fluctuations in the price of natural gas could increase the working capital financing requirements and related costs for accounts receivable. In 2004, 75% of energy deliveries were made to four large industrial customers (67% to one customer, Methanex). Transportation service to Methanex was made pursuant to an agreement that expires in October 2009. On August 30, 2005, Methanex announced that it will close its Kitimat facilities in early 2006. On October 28, 2009 another large industrial customer (West Fraser Timber Co. Ltd. announced that it was permanently closing its mill on January 31, 2010.

Distribution of Ratings (Dec. 31, 2009)

Rating Category	BMO Rating	BMOCM US Universe*	BMOCM US IB Clients**	BMOCM US IB Clients***	BMOCM Universe****	BMOCM IB Clients*****	First Call Universe
Buy	Outperform	32.2%	12.3%	38.3%	36.1%	47.9%	50%
Hold	Market Perform	62.6%	10.2%	61.7%	56.9%	48.9%	43%
Sell	Underperform	5.3%	0%	0%	6.9%	3.2%	7%

* Reflects rating distribution of all companies covered by BMO Capital Markets Corp. equity research analysts.
** Reflects rating distribution of all companies from which BMO Capital Markets Corp. has received compensation for Investment Banking services as percentage within ratings category.
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**** Reflects rating distribution of all companies covered by BMO Capital Markets equity research analysts.
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OP = Outperform - Forecast to outperform the market;
Mkt = Market Perform - Forecast to perform roughly in line with the market;
Und = Underperform - Forecast to underperform the market;
(S) = speculative investment;
NR = No rating at this time;
R = Restricted – Dissemination of research is currently restricted.

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A member of **BMO** **Financial Group**

Pacific Northern Gas

(PNG-TSX)

Stock Rating: **Market Perform**
Industry Rating: **Market Perform**

April 29, 2010
Research Comment
Toronto, Ontario

Michael McGowan, CA, CFA
BMO Nesbitt Burns Inc.
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Assoc: Mark Laing, CA

Q1/10 Results in Line; Market Perform Rating Maintained

Event

Pacific Northern Gas reported Q1/10 EPS of $1.51, which was consistent with our estimate of $1.48 and greater than Q1/09 EPS of $1.39. The increase in earnings from Q1/10 vs. Q1/09 is largely due to increases in the benchmark ROE for regulated utilities in British Columbia. Benchmark ROEs increased to 9.50% in Q1/10 vs. 8.47% in Q1/09; however, PNG's divisions earn regulated rates of return that include premiums ranging 40–65 basis points over the benchmark return on equity.

Impact

Neutral. Results were generally consistent with our expectations and no new material developments associated with the Kitimat to Summit Lake (KSL) were disclosed in the release.

Forecasts

We have updated our estimates to reflect Q1 results. There are no changes to our annual forecasts; however, we have modified the profile of our quarterly EPS estimates.

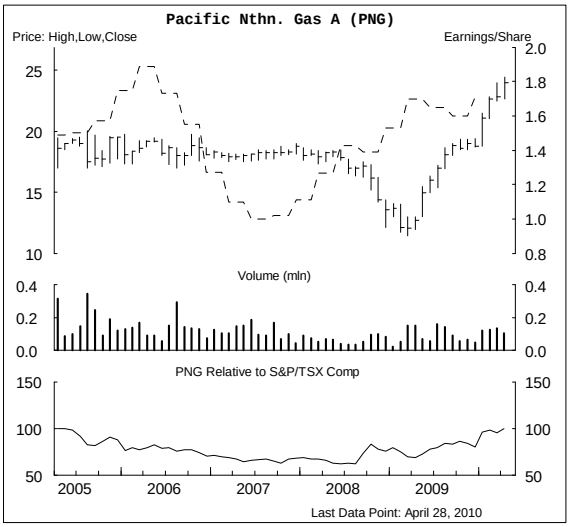
Valuation

We are increasing our target price to $21.50 from $20.00 to reflect lower market risk premiums. Our $21 price target is based on a weighted valuation approach: 13x 2011E diluted EPS of $1.90 (12.5%); 1.0x 2011E BVPS of $25.62 (12.5%); and a 5.5% dividend yield (previously 6.25%) applied to 2011E DPS of $1.12 (75%).

Recommendation

At current levels, we believe the shares are reasonably valued. Our rating is Market Perform.

Price (29-Apr)	$24.10	**52-Week High**	$24.44
Target Price	$21.50↑	**52-Week Low**	$12.71



(FY-Dec.)	2008A	2009A	2010E	2011E
EPS	$1.52	$1.71	$1.89	$1.90
P/E			12.8x	12.7x
CFPS	$4.59	$5.25	$4.99	$5.05
P/CFPS			4.8x	4.8x
Div.	$0.88	$0.96	$1.12	$1.12
EV ($mm)	$147	$141	$184	$180
EBITDA ($mm)	$23.6	$22.8	$25.8	$25.8
EV/EBITDA	6.2x	6.2x	7.1x	7.0x

Quarterly EPS	Q1	Q2	Q3	Q4
2008A	$1.21	-$0.08	-$0.44	$0.84
2009A	$1.38	-$0.13	-$0.49	$0.95
2010E	$1.51a	-$0.03↓	-$0.53↓	$0.95↓

Dividend	$1.12	**Yield**	4.6%
Book Value	$25.19	**Price/Book**	1.0x
Shares O/S (mm)	3.6	**Mkt. Cap ($mm)**	$86
Float O/S (mm)	3.6	**Float Cap ($mm)**	$86
Wkly Vol (000s)	23	**Wkly $ Vol (mm)**	$0.4
Net Debt ($mm)	$77.0	**Next Rep. Date**	31-Jul (E)

Notes: All values in C$; Estimates are weather normal
Major Shareholders: Widely held
First Call Mean Estimates: PACIFIC NORTHERN GAS LTD 'A' (C$) 2010E: $1.89; 2011E: $1.90

Changes

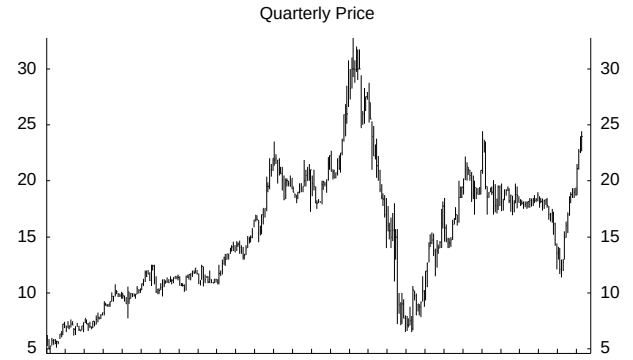
Quarterly EPS	Target
Q2/10E -$0.03 to -$0.03	$20.00 to $21.50
Q3/10E -$0.51 to -$0.53	
Q4/10E $0.96 to $0.95	

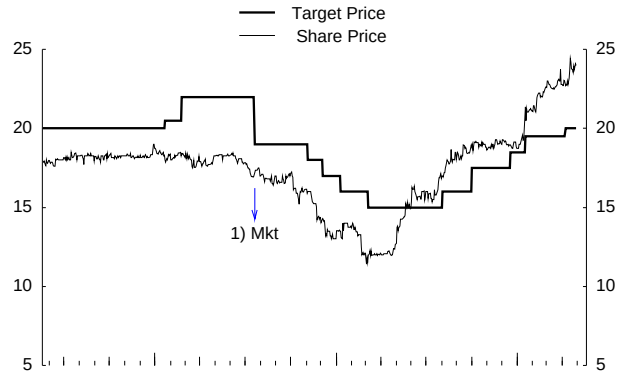
Table 1: Consolidated Summary

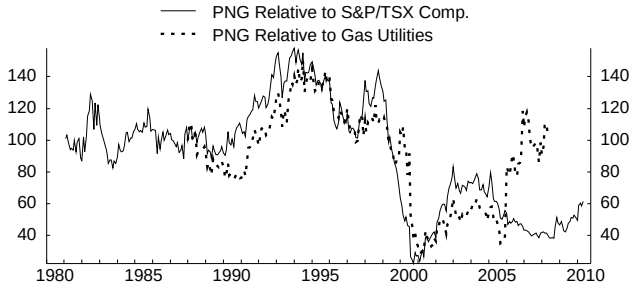
29-Apr-10										Michael McGowan
Current Price:	$24.10									BMO Capital Markets
12-Month Target Price:	$21.50									
ROR:	-6.1%							Recommendation:		Market Perform
				Year Ended December 31						
	2002	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010E**	**2011E**
Total Earnings Per Share	$1.28	$1.49	$1.41	$1.75	$1.27	$1.11	$1.53	$1.72	$1.91	$1.92
Fully Diluted EPS	$1.25	$1.46	$1.38	$1.72	$1.25	$1.10	$1.52	$1.71	$1.89	$1.90
Dividends	$0.00	$0.80	$0.80	$0.80	$0.80	$0.80	$0.88	$0.96	$1.12	$1.12
Payout Ratio	0.0%	53.8%	56.8%	45.8%	63.0%	72.4%	57.6%	55.7%	58.7%	58.4%
Average Shares (mm)	3.5	3.6	3.6	3.6	3.6	3.6	3.7	3.6	3.6	3.6
Net Book Value	$21.62	$19.25	$20.52	$21.44	$21.91	$22.17	$22.85	$24.03	$24.82	$25.62
Market Valuation										
Price: High	$18.00	$19.50	$22.00	$24.00	$19.75	$19.00	$18.65	$19.30	-	-
Price: Low	$9.35	$14.00	$17.28	$17.37	$16.96	$17.50	$12.11	$11.40	-	-
Price: Current	-	-	-	-	-	-	-	-	$24.10	-
P/E Ratio: High	14.0	13.1	15.6	13.7	15.5	17.2	12.2	11.2	-	-
P/E Ratio: Low	7.3	9.4	12.3	9.9	13.3	15.8	7.9	6.6	-	-
P/E Ratio: Current	-	-	-	-	-	-	-	-	12.6	12.6
Price/Book Value: High	0.8	1.0	1.1	1.1	0.9	0.9	0.8	0.8	-	-
Price/Book Value: Low	0.4	0.7	0.8	0.8	0.8	0.8	0.5	0.5	-	-
Price/Book Value: Current	-	-	-	-	-	-	-	-	1.0	0.9
Yield: High Price	0.0%	4.1%	3.6%	3.3%	4.1%	4.2%	4.7%	5.0%	-	-
Yield: Low Price	0.0%	5.7%	4.6%	4.6%	4.7%	4.6%	7.3%	8.4%	-	-
Yield: Current	-	-	-	-	-	-	-	-	4.6%	4.6%
Balance Sheet ($mm)										
Debt (S-T)	4.1	7.0	10.1	14.4	10.0	11.2	5.4	6.1	20.4	25.0
Debt (L-T)	90.2	85.8	81.4	76.6	71.7	72.8	74.5	72.4	73.4	64.6
Deferred Items	17.0	17.9	15.8	15.7	24.0	18.5	13.8	14.0	15.5	17.0
Preferred Shares	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0
Shareholders' Equity	76.7	69.4	73.9	77.7	79.8	81.2	83.7	85.4	88.2	91.1
	193.0	185.1	186.4	189.4	190.5	188.9	182.5	182.9	202.6	202.7
Balance Sheet (%)										
Debt (S-T)	2.1%	3.8%	5.4%	7.6%	5.2%	6.0%	3.0%	3.4%	10.1%	12.3%
Debt (L-T)	46.7%	46.4%	43.7%	40.4%	37.6%	38.6%	40.8%	39.6%	36.2%	31.9%
Deferred Items	8.8%	9.7%	8.5%	8.3%	12.6%	9.8%	7.6%	7.6%	7.6%	8.4%
Preferred Shares	2.6%	2.7%	2.7%	2.6%	2.6%	2.7%	2.7%	2.7%	2.5%	2.5%
Shareholders' Equity	39.7%	37.5%	39.7%	41.1%	41.9%	43.0%	45.9%	46.7%	43.6%	45.0%
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Income Statement ($mm)										
Total Revenue	109.1	133.7	137.8	160.0	138.8	129.5	132.8	104.1	93.9	94.7
EBIT	19.5	18.5	17.5	18.6	17.6	14.3	14.9	14.6	16.7	16.6
NPAT	4.9	5.7	5.4	6.7	5.0	4.4	5.9	6.5	7.1	7.2
Preferred Share Dividends	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Net Earnings to Common	4.6	5.3	5.1	6.3	4.6	4.0	5.6	6.2	6.8	6.8
Cash Flow from Operations	13.1	12.2	16.4	11.8	17.6	(2.6)	16.8	18.9	17.7	18.0
Key Statistics										
Average Utility Rate Base ($mm)	166.8	165.4	167.2	165.2	162.4	165.6	167.9	171.3	168.8	165.9
Growth Rate	-1.98%	-0.87%	1.10%	-1.19%	-1.67%	1.95%	1.38%	2.02%	-1.45%	-1.71%
2007 - 2010 CAGR									0.64%	-0.39%
Allowed Return on Equity	9.88%	10.17%	9.80%	9.68%	9.45%	9.02%	9.27%	9.12%	10.15%	10.15%
Deemed Equity	36.00%	36.00%	36.00%	40.00%	40.00%	40.00%	40.00%	40.00%	40.00%	40.00%

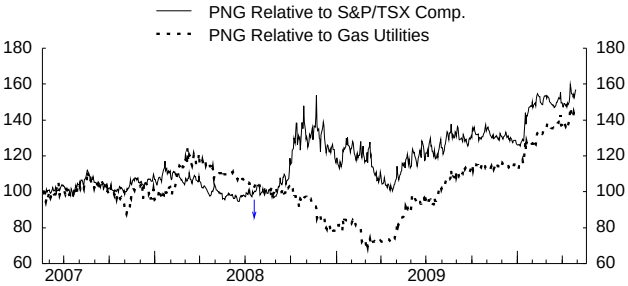
Source: BMO Capital Markets

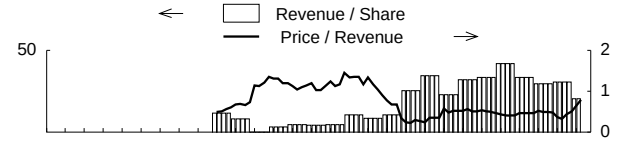
Pacific Nthn. Gas A (PNG)

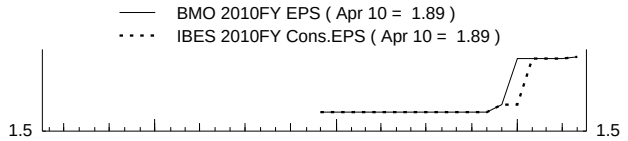


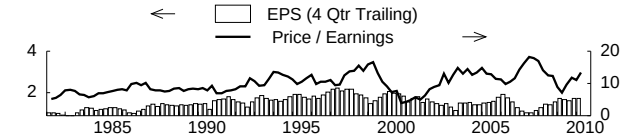


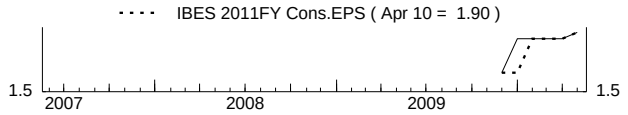












FYE (Dec.)	EPS $	P/E	DPS $	Yield %	Payout %	BV $	P/B	ROE %
1987	1.31	8	0.75	7.4	57	8.97	1.1	15
1988	1.34	8	0.75	6.6	56	9.24	1.2	15
1989	1.45	8	0.75	6.4	52	9.92	1.2	15
1990	1.61	7	0.75	6.7	47	10.76	1.0	16
1991	1.66	8	0.80	5.9	48	11.62	1.2	15
1992	1.55	11	0.80	4.8	52	12.37	1.3	13
1993	1.63	13	0.88	4.0	54	12.37	1.8	13
1994	1.80	11	0.88	4.3	49	12.37	1.6	15
1995	1.67	13	0.96	4.6	57	14.57	1.4	12
1996	2.01	11	0.96	4.3	48	15.61	1.4	13
1997	2.16	14	1.04	3.5	48	16.42	1.8	13
1998	1.73	16	1.12	4.1	65	17.39	1.6	10
1999	1.92	9	1.12	6.5	58	18.19	1.0	11
2000	1.83	4	1.12	14.1	61	19.44	0.4	10
2001	1.52	6	1.12	11.7	74	20.95	0.5	8
2002	1.25	13	1.12	6.3	82	19.27	0.9	6
2003	1.46	13	0.80	4.1	54	19.96	1.0	7
2004	1.38	15	0.80	3.8	57	20.52	1.0	7
2005	1.72	11	0.80	4.1	46	21.43	0.9	8
2006	1.25	14	0.80	4.4	63	21.91	0.8	6
2007	1.10	17	0.80	4.3	72	22.16	0.8	5
2008	1.52	9	0.88	6.5	58	24.21	0.6	7
2009	1.71	11	1.00	5.3	58	24.03	0.8	7
Current*	1.71	13	1.12	4.9	65	24.03	0.9	7
Average:		11		5.7	57		1.1	10.5
Growth(%):								
5 Year:	2.8		7.0			3.2		
10 Year:	-1.8		0.0			2.8		
20 Year:	0.9		2.0			4.5		

* Current EPS is the 4 Quarter Trailing to Q4/2009.

PNG - Rating as of 18-May-07 = OP

	Date	Rating Change	Share Price
1	18-Jul-08	OP to Mkt	$17.20

Last Daily Data Point: April 28, 2010

IMPORTANT DISCLOSURES

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Methodology and Risks to Price Target/Valuation
Methodology: Our target price is based on a weighted valuation approach: 13x 2011E diluted EPS (12.5%); 1.0x 2011E BVPS (12.5%) and a target yield of 6.25% based on 2011E dividends per share (75%).
Risks: The company's natural gas transmission business depends on the continued availability of natural gas. The BCUC approves PNG's customer rates and a fair return on the rate base. Changes in regulation may adversely affect performance. Natural gas and fuel oil compete with electricity for space heating in Pacific Northern Gas' service areas. Fluctuations in the price of natural gas could increase the working capital financing requirements and related costs for accounts receivable. In 2004, 75% of energy deliveries were made to four large industrial customers (67% to one customer, Methanex). Transportation service to Methanex was made pursuant to an agreement that expires in October 2009. On August 30, 2005, Methanex announced that it will close its Kitimat facilities in early 2006. On October 28, 2009 another large industrial customer (West Fraser Timber Co. Ltd. announced that it was permanently closing its mill on January 31, 2010.

Distribution of Ratings (Mar. 31, 2010)

Rating Category	BMO Rating	BMOCM US Universe*	BMOCM US IB Clients**	BMOCM US IB Clients***	BMOCM Universe****	BMOCM IB Clients*****	Starmine Universe
Buy	Outperform	32.9%	13.1%	36.4%	39.4%	47.9%	53%
Hold	Market Perform	63.2%	11.9%	63.6%	55.3%	48.5%	41%
Sell	Underperform	3.9%	0%	0%	5.2%	3.6%	6%

* Reflects rating distribution of all companies covered by BMO Capital Markets Corp. equity research analysts.
** Reflects rating distribution of all companies from which BMO Capital Markets Corp. has received compensation for Investment Banking services as percentage within ratings category.
*** Reflects rating distribution of all companies from which BMO Capital Markets Corp. has received compensation for Investment Banking services as percentage of Investment Banking clients.
**** Reflects rating distribution of all companies covered by BMO Capital Markets equity research analysts.
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OP = Outperform - Forecast to outperform the market;
Mkt = Market Perform - Forecast to perform roughly in line with the market;
Und = Underperform - Forecast to underperform the market;
(S) = speculative investment;
NR = No rating at this time;
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A member of **BMO** **Financial Group**

Pacific Northern Gas

(PNG-TSX)

Stock Rating: **Market Perform**
Industry Rating: **Market Perform**

May 12, 2010
Research Comment
Toronto, Ontario

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Assoc: Mark Laing, CA

Negotiated Settlement on Capital Structure and Equity Risk Premium Settlement Reached

Event

PNG has announced that it has reached a negotiated settlement regarding the capital structure and risk premium application that was filed with the BC Utilities Commission (BCUC) on July 16, 2009. Per the settlement, the equity thickness of the PNG West division will be increased to 45% from 40% and the equity thickness at the Fort St. John/Dawson Creek and Tumbler Ridge divisions will be increased to 40% from 36%. There will be no changes to equity risk premiums for any of the divisions. The negotiated settlement must be approved by the BCUC and parties that did not participate in the process have until May 19, 2010 to file comments. Changes to PNG West's equity thickness will be retroactive to January 1, 2009, while changes to the other divisions will be effective as of January 1, 2010.

Impact

Slightly positive. Although actual changes to equity thickness and risk premiums are lower than requested (see Table 1), the settlement will bring PNG's regulated capital structure closer to its actual capital structure.

Forecasts

We have updated our forecasts to reflect the settlement. Our diluted EPS estimates increase to $2.07 from $1.89 in 2010E and to $2.08 from $1.90 in 2011E.

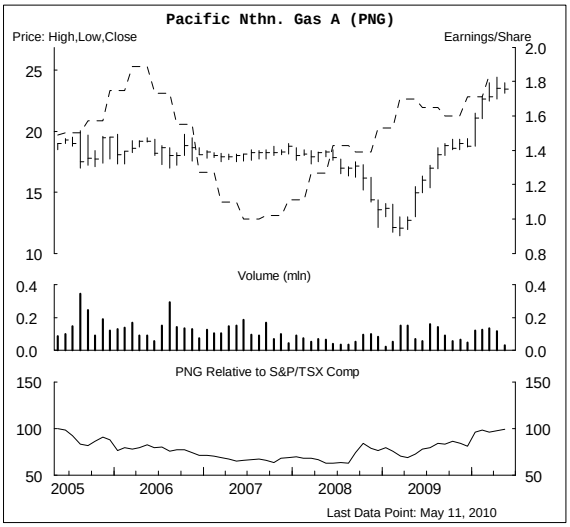
Valuation

Our $22 price target ($21.50 prior) is based on a weighted valuation approach: 13x 2011E diluted EPS of $2.08 (12.5%); 1.0x 2011E BVPS of $25.99 (12.5%); and a 5.5% dividend yield applied to 2011E DPS of $1.12 (75%).

Recommendation

At current levels we believe the shares are reasonably valued. Our rating is Market Perform.

Price (12-May)	$23.47	**52-Week High**	$24.44
Target Price	$22.00↑	**52-Week Low**	$14.26



(FY-Dec.)	2008A	2009A	2010E	2011E
EPS	$1.52	$1.71	$2.07↑	$2.08↑
P/E			11.3x	11.3x
CFPS	$4.59	$5.25	$5.17↑	$5.24↑
P/CFPS			4.5x	4.5x
Div.	$0.88	$0.96	$1.12	$1.12
EV ($mm)	$147	$141	$182	$178
EBITDA ($mm)	$23.6	$22.8	$25.8	$25.8
EV/EBITDA	6.2x	6.2x	7.1x	6.9x

Quarterly EPS	Q1	Q2	Q3	Q4
2008A	$1.21	-$0.08	-$0.44	$0.84
2009A	$1.38	-$0.13	-$0.49	$0.95
2010E	$1.51a	$0.07↑	-$0.50↑	$1.00↑

Dividend	$1.12	**Yield**	4.8%
Book Value	$25.19	**Price/Book**	0.9x
Shares O/S (mm)	3.6	**Mkt. Cap ($mm)**	$84
Float O/S (mm)	3.6	**Float Cap ($mm)**	$84
Wkly Vol (000s)	23	**Wkly $ Vol (mm)**	$0.4
Net Debt ($mm)	$77.0	**Next Rep. Date**	31-Jul (E)

Notes: All values in C$; Estimates are weather normal
Major Shareholders: Widely held
First Call Mean Estimates: PACIFIC NORTHERN GAS LTD 'A' (C$) 2010E: $1.89; 2011E: $1.90

Changes	**Annual EPS**	**Annual CFPS**	**Quarterly EPS**	**Target**
	2010E $1.89 to $2.07	2010E $4.99 to $5.17	Q2/10E -$0.03 to $0.07	$21.50 to $22.00
	2011E $1.90 to $2.08	2011E $5.05 to $5.24	Q3/10E -$0.53 to -$0.50	
			O4/10E $0.95 to $1.00	

Table 1: Actual vs. Requested Settlement

	As Requested		Per Settlement	
	Equity Thickness	Equity Risk Premium	Equity Thickness	Equity Risk Premium
PNG West	47.50%	0.75%	45.00%	0.65%
Fort St. John/Dawson Creek	42.50%	0.75%	40.00%	0.40%
Tumbler Ridge	42.50%	0.75%	40.00%	0.40%

Source: BMO Capital Markets, Company Reports

Table 2: Consolidated Summary

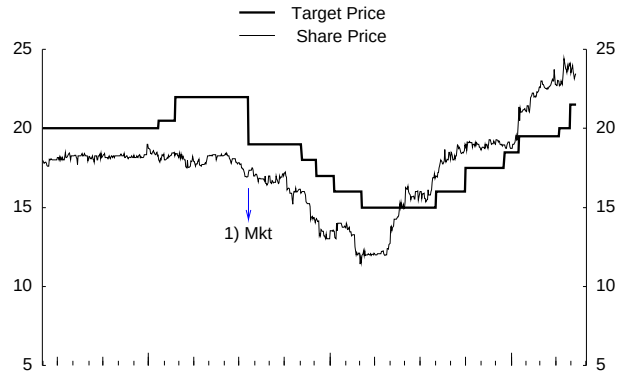
12-May-10 — Michael McGowan, BMO Capital Markets

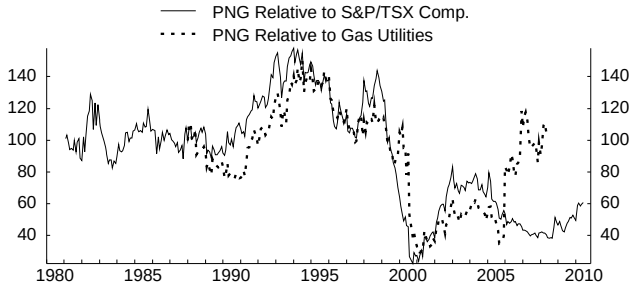
Current Price: $23.47
12-Month Target Price: $22.00
ROR: -1.5%
Recommendation: Market Perform

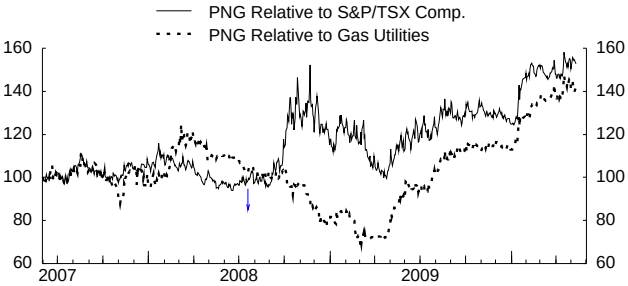
	Year Ended December 31									
	2002	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010E**	**2011E**
Total Earnings Per Share	$1.28	$1.49	$1.41	$1.75	$1.27	$1.11	$1.53	$1.72	$2.09	$2.10
Fully Diluted EPS	$1.25	$1.46	$1.38	$1.72	$1.25	$1.10	$1.52	$1.71	$2.07	$2.08
Dividends	$0.00	$0.80	$0.80	$0.80	$0.80	$0.80	$0.88	$0.96	$1.12	$1.12
Payout Ratio	0.0%	53.8%	56.8%	45.8%	63.0%	72.4%	57.6%	55.7%	53.5%	53.3%
Average Shares (mm)	3.5	3.6	3.6	3.6	3.6	3.6	3.7	3.6	3.6	3.6
Net Book Value	$21.62	$19.25	$20.52	$21.44	$21.91	$22.17	$22.85	$24.03	$25.00	$25.99
Market Valuation										
Price: High	$18.00	$19.50	$22.00	$24.00	$19.75	$19.00	$18.65	$19.30	-	-
Price: Low	$9.35	$14.00	$17.28	$17.37	$16.96	$17.50	$12.11	$11.40	-	-
Price: Current	-	-	-	-	-	-	-	-	$23.47	-
P/E Ratio: High	14.0	13.1	15.6	13.7	15.5	17.2	12.2	11.2	-	-
P/E Ratio: Low	7.3	9.4	12.3	9.9	13.3	15.8	7.9	6.6	-	-
P/E Ratio: Current	-	-	-	-	-	-	-	-	11.2	11.2
Price/Book Value: High	0.8	1.0	1.1	1.1	0.9	0.9	0.8	0.8	-	-
Price/Book Value: Low	0.4	0.7	0.8	0.8	0.8	0.8	0.5	0.5	-	-
Price/Book Value: Current	-	-	-	-	-	-	-	-	0.9	0.9
Yield: High Price	0.0%	4.1%	3.6%	3.3%	4.1%	4.2%	4.7%	5.0%	-	-
Yield: Low Price	0.0%	5.7%	4.6%	4.6%	4.7%	4.6%	7.3%	8.4%	-	-
Yield: Current	-	-	-	-	-	-	-	-	4.8%	4.8%
Balance Sheet ($mm)										
Debt (S-T)	4.1	7.0	10.1	14.4	10.0	11.2	5.4	6.1	19.8	23.7
Debt (L-T)	90.2	85.8	81.4	76.6	71.7	72.8	74.5	72.4	73.4	64.6
Deferred Items	17.0	17.9	15.8	15.7	24.0	18.5	13.8	14.0	15.5	17.0
Preferred Shares	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0
Shareholders' Equity	76.7	69.4	73.9	77.7	79.8	81.2	83.7	85.4	88.9	92.4
	193.0	185.1	186.4	189.4	190.5	188.9	182.5	182.9	202.6	202.7
Balance Sheet (%)										
Debt (S-T)	2.1%	3.8%	5.4%	7.6%	5.2%	6.0%	3.0%	3.4%	9.8%	11.7%
Debt (L-T)	46.7%	46.4%	43.7%	40.4%	37.6%	38.6%	40.8%	39.6%	36.2%	31.9%
Deferred Items	8.8%	9.7%	8.5%	8.3%	12.6%	9.8%	7.6%	7.6%	7.6%	8.4%
Preferred Shares	2.6%	2.7%	2.7%	2.6%	2.6%	2.7%	2.7%	2.7%	2.5%	2.5%
Shareholders' Equity	39.7%	37.5%	39.7%	41.1%	41.9%	43.0%	45.9%	46.7%	43.9%	45.6%
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Income Statement ($mm)										
Total Revenue	109.1	133.7	137.8	160.0	138.8	129.5	132.8	104.1	95.8	97.8
EBIT	19.5	18.5	17.5	18.6	17.6	14.3	14.9	14.6	17.6	17.6
NPAT	4.9	5.7	5.4	6.7	5.0	4.4	5.9	6.5	7.8	7.8
Preferred Share Dividends	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Net Earnings to Common	4.6	5.3	5.1	6.3	4.6	4.0	5.6	6.2	7.4	7.5
Cash Flow from Operations	13.1	12.2	16.4	11.8	17.6	(2.6)	16.8	18.9	18.4	18.6
Key Statistics										
Average Utility Rate Base ($mm)	166.8	165.4	167.2	165.2	162.4	165.6	167.9	171.3	168.8	165.9
Growth Rate	-1.98%	-0.87%	1.10%	-1.19%	-1.67%	1.95%	1.38%	2.02%	-1.45%	-1.71%
2007 - 2010 CAGR									0.64%	-0.39%
Allowed Return on Equity	9.88%	10.17%	9.80%	9.68%	9.45%	9.02%	9.27%	9.12%	10.15%	10.15%
Deemed Equity	36.00%	36.00%	36.00%	40.00%	40.00%	40.00%	40.00%	40.00%	45.00%	45.00%
Sensitivity										
100 bp Change ROE										
Change Total Income	0.6	0.6	0.6	0.7	0.6	0.7	0.7	0.7	0.8	0.7
Change Per Share	0.17	0.17	0.17	0.18	0.18	0.18	0.18	0.19	0.21	0.21
100 bp Change in Deemed Equity										
Change Total Income	0.2	0.2	0.2	0.2	0.2	0.1	0.2	0.2	0.2	0.2
Change Per Share	0.05	0.05	0.05	0.04	0.04	0.04	0.04	0.04	0.05	0.05
1.00% Change in Average Rate Base										
Change Total Income	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Change Per Share	0.02	0.02	0.02	0.02	0.02	0.02	0.02	0.02	0.02	0.02

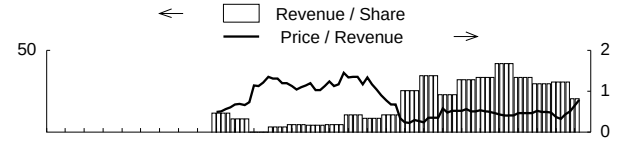
Source: BMO Capital Markets

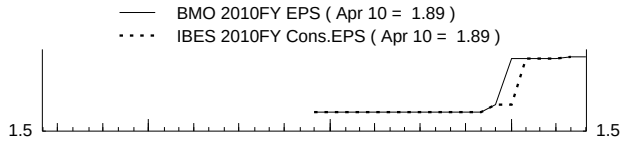
Pacific Nthn. Gas A (PNG)

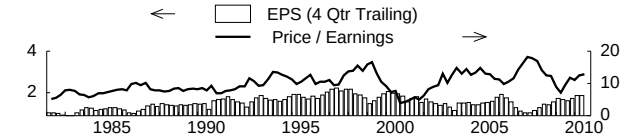


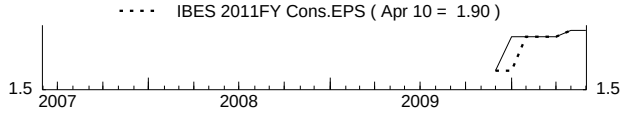












FYE (Dec.)	EPS $	P/E	DPS $	Yield %	Payout %	BV $	P/B	ROE %
1987	1.31	8	0.75	7.4	57	8.97	1.1	15
1988	1.34	8	0.75	6.6	56	9.24	1.2	15
1989	1.45	8	0.75	6.4	52	9.92	1.2	15
1990	1.61	7	0.75	6.7	47	10.76	1.0	16
1991	1.66	8	0.80	5.9	48	11.62	1.2	15
1992	1.55	11	0.80	4.8	52	12.37	1.3	13
1993	1.63	13	0.88	4.0	54	12.37	1.8	13
1994	1.80	11	0.88	4.3	49	12.37	1.6	15
1995	1.67	13	0.96	4.6	57	14.57	1.4	12
1996	2.01	11	0.96	4.3	48	15.61	1.4	13
1997	2.16	14	1.04	3.5	48	16.42	1.8	13
1998	1.73	16	1.12	4.1	65	17.39	1.6	10
1999	1.92	9	1.12	6.5	58	18.19	1.0	11
2000	1.83	4	1.12	14.1	61	19.44	0.4	10
2001	1.52	6	1.12	11.7	74	20.95	0.5	8
2002	1.25	13	1.12	6.3	82	19.27	0.9	6
2003	1.46	13	0.80	4.1	54	19.96	1.0	7
2004	1.38	15	0.80	3.8	57	20.52	1.0	7
2005	1.72	11	0.80	4.1	46	21.43	0.9	8
2006	1.25	14	0.80	4.4	63	21.91	0.8	6
2007	1.10	17	0.80	4.3	72	22.16	0.8	5
2008	1.52	9	0.88	6.5	58	24.21	0.6	7
2009	1.71	11	1.00	5.3	58	24.03	0.8	7
Current*	1.84	13	1.12	4.8	61	25.19	0.9	7
Average:		11		5.7	57		1.1	10.5
Growth(%):								
5 Year:	4.3		7.0			4.2		
10 Year:	-1.1		0.0			3.3		
20 Year:	1.3		2.0			4.8		

* Current EPS is the 4 Quarter Trailing to Q1/2010.

PNG - Rating as of 31-May-07 = OP

	Date	Rating Change	Share Price
1	18-Jul-08	OP to Mkt	$17.20

Last Daily Data Point: May 11, 2010

IMPORTANT DISCLOSURES

Analyst's Certification
I, Michael McGowan, CA, CFA, hereby certify that the views expressed in this report accurately reflect my personal views about the subject securities or issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report.
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Methodology and Risks to Price Target/Valuation
Methodology: Our target price is based on a weighted valuation approach: 13x 2011E diluted EPS (12.5%); 1.0x 2011E BVPS (12.5%) and a target yield of 5.5% based on 2011E dividends per share (75%).
Risks: The company's natural gas transmission business depends on the continued availability of natural gas. The BCUC approves PNG's customer rates and a fair return on the rate base. Changes in regulation may adversely affect performance. Natural gas and fuel oil compete with electricity for space heating in Pacific Northern Gas' service areas. Fluctuations in the price of natural gas could increase the working capital financing requirements and related costs for accounts receivable. In 2004, 75% of energy deliveries were made to four large industrial customers (67% to one customer, Methanex). Transportation service to Methanex was made pursuant to an agreement that expires in October 2009. On August 30, 2005, Methanex announced that it will close its Kitimat facilities in early 2006. On October 28, 2009 another large industrial customer (West Fraser Timber Co. Ltd. announced that it was permanently closing its mill on January 31, 2010.

Distribution of Ratings (Mar. 31, 2010)

Rating Category	BMO Rating	BMOCM US Universe*	BMOCM US IB Clients**	BMOCM US IB Clients***	BMOCM Universe****	BMOCM IB Clients*****	Starmine Universe
Buy	Outperform	32.9%	13.1%	36.4%	39.4%	47.9%	53%
Hold	Market Perform	63.2%	11.9%	63.6%	55.3%	48.5%	41%
Sell	Underperform	3.9%	0%	0%	5.2%	3.6%	6%

* Reflects rating distribution of all companies covered by BMO Capital Markets Corp. equity research analysts.
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Mkt = Market Perform - Forecast to perform roughly in line with the market;
Und = Underperform - Forecast to underperform the market;
(S) = speculative investment;
NR = No rating at this time;
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Pacific Northern Gas

(PNG-TSX)

May 19, 2010
Brief Research Note
Gas & Electric Utilities

Stock Rating: **Market Perform**
Stock Price: **$23.30**
Target Price: **$22.00**

Michael McGowan, CA, CFA
(416) 359-5807
Michael.McGowan@bmo.com
Assoc: Mark Laing, CA

EOG Resources Acquires Interest in Kitimat LNG Project

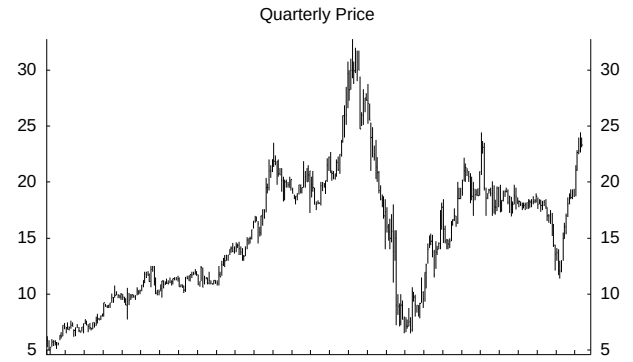
Impact

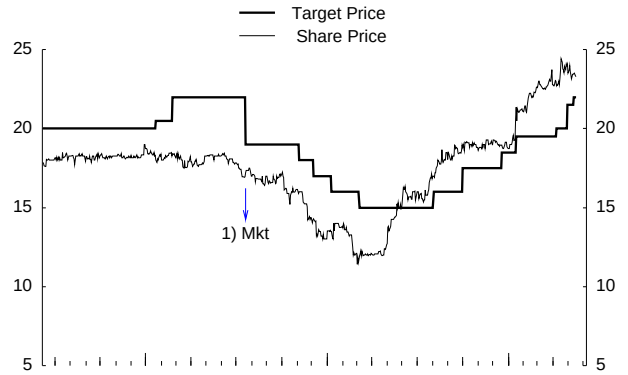
Potentially Positive

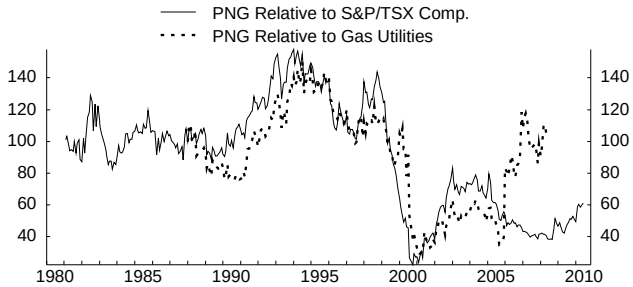
Details & Analysis

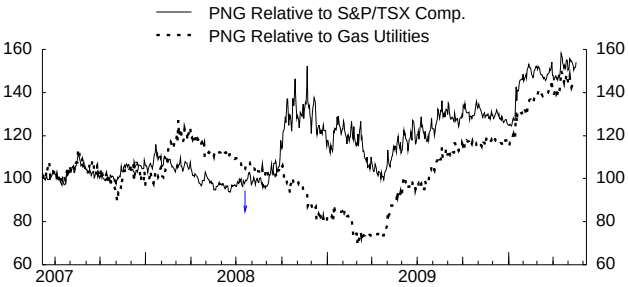
EOG Resources (rated Market Perform by Jim Byrne) has announced that it has acquired Galveston LNG's interests in the Kitimat LNG project and the Pacific Trail Pipelines Limited Partnership ("PTP"). EOG now holds a 49% interest in the proposed Kitimat LNG project and a 24.5% interest in PTP, the entity that is planning to construct a 463-km pipeline that would transmit natural gas from Spectra Energy's Westcoast Pipeline to the proposed gasification terminal. Pacific Northern Gas (PNG) continues to hold a 50% interest in PTP. Although we believe EOG's involvement in the Kitimat LNG and PTP projects is positive for PNG, a number of conditions must be satisfied before the pipeline can proceed. These conditions include securing firm committments for the proposed LNG facility's output; the receipt of financing commitments for the PTP project; and the receipt of regulatory approvals for the PTP, including a Certificate of Public Convenience and Necessity from the British Columbia Utilities Commission and other permits from the British Columbia Oil and Gas Commission. Accordingly, we have not included the PTP project in our valuation for PNG at this time.

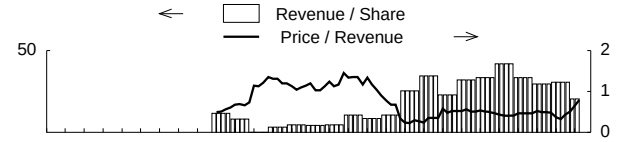
Pacific Nthn. Gas A (PNG)

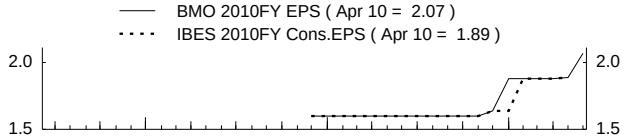


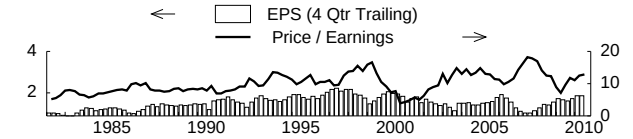


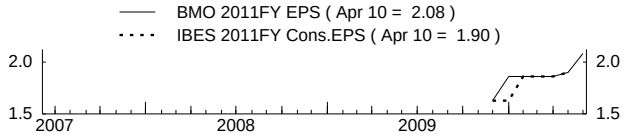












FYE (Dec.)	EPS $	P/E	DPS $	Yield %	Payout %	BV $	P/B	ROE %
1987	1.31	8	0.75	7.4	57	8.97	1.1	15
1988	1.34	8	0.75	6.6	56	9.24	1.2	15
1989	1.45	8	0.75	6.4	52	9.92	1.2	15
1990	1.61	7	0.75	6.7	47	10.76	1.0	16
1991	1.66	8	0.80	5.9	48	11.62	1.2	15
1992	1.55	11	0.80	4.8	52	12.37	1.3	13
1993	1.63	13	0.88	4.0	54	12.37	1.8	13
1994	1.80	11	0.88	4.3	49	12.37	1.6	15
1995	1.67	13	0.96	4.6	57	14.57	1.4	12
1996	2.01	11	0.96	4.3	48	15.61	1.4	13
1997	2.16	14	1.04	3.5	48	16.42	1.8	13
1998	1.73	16	1.12	4.1	65	17.39	1.6	10
1999	1.92	9	1.12	6.5	58	18.19	1.0	11
2000	1.83	4	1.12	14.1	61	19.44	0.4	10
2001	1.52	6	1.12	11.7	74	20.95	0.5	8
2002	1.25	13	1.12	6.3	82	19.27	0.9	6
2003	1.46	13	0.80	4.1	54	19.96	1.0	7
2004	1.38	15	0.80	3.8	57	20.52	1.0	7
2005	1.72	11	0.80	4.1	46	21.43	0.9	8
2006	1.25	14	0.80	4.4	63	21.91	0.8	6
2007	1.10	17	0.80	4.3	72	22.16	0.8	5
2008	1.52	9	0.88	6.5	58	24.21	0.6	7
2009	1.71	11	1.00	5.3	58	24.03	0.8	7
Current*	1.84	13	1.12	4.8	61	25.19	0.9	7
Average:		11		5.7	57		1.1	10.5
Growth(%):								
5 Year:	4.3		7.0			4.2		
10 Year:	-1.1		0.0			3.3		
20 Year:	1.3		2.0			4.8		

* Current EPS is the 4 Quarter Trailing to Q1/2010.

PNG - Rating as of 6-Jun-07 = OP

	Date	Rating Change	Share Price
1	18-Jul-08	OP to Mkt	$17.20

Last Daily Data Point: May 17, 2010

IMPORTANT DISCLOSURES

Analyst's Certification

I, Michael McGowan, CA, CFA, hereby certify that the views expressed in this report accurately reflect my personal views about the subject securities or issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report.

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Methodology and Risks to Price Target/Valuation

Methodology: Our target price is based on a weighted valuation approach: 13x 2011E diluted EPS (12.5%); 1.0x 2011E BVPS (12.5%) and a target yield of 5.5% based on 2011E dividends per share (75%).

Risks: The company's natural gas transmission business depends on the continued availability of natural gas. The BCUC approves PNG's customer rates and a fair return on the rate base. Changes in regulation may adversely affect performance. Natural gas and fuel oil compete with electricity for space heating in Pacific Northern Gas' service areas. Fluctuations in the price of natural gas could increase the working capital financing requirements and related costs for accounts receivable. In 2004, 75% of energy deliveries were made to four large industrial customers (67% to one customer, Methanex). Transportation service to Methanex was made pursuant to an agreement that expires in October 2009. On August 30, 2005, Methanex announced that it will close its Kitimat facilities in early 2006. On October 28, 2009 another large industrial customer (West Fraser Timber Co. Ltd. announced that it was permanently closing its mill on January 31, 2010.

Distribution of Ratings (Mar. 31, 2010)

Rating Category	BMO Rating	BMOCM US Universe*	BMOCM US IB Clients**	BMOCM US IB Clients***	BMOCM Universe****	BMOCM IB Clients*****	Starmine Universe
Buy	Outperform	32.9%	13.1%	36.4%	39.4%	47.9%	53%
Hold	Market Perform	63.2%	11.9%	63.6%	55.3%	48.5%	41%
Sell	Underperform	3.9%	0%	0%	5.2%	3.6%	6%

* Reflects rating distribution of all companies covered by BMO Capital Markets Corp. equity research analysts.

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We use the following ratings system definitions:
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Mkt = Market Perform - Forecast to perform roughly in line with the market;
Und = Underperform - Forecast to underperform the market;
(S) = speculative investment;
NR = No rating at this time;
R = Restricted – Dissemination of research is currently restricted.

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Pacific Northern Gas

(PNG-TSX)

Stock Rating: **Market Perform**
Industry Rating: **Market Perform**

June 2, 2010
Research Comment
Toronto, Ontario

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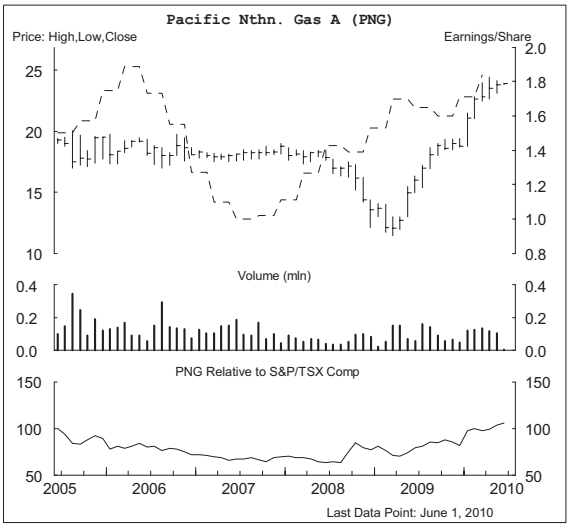
The KSL Project: Updating Our 'What If' Analysis, We Believe PNG Could be Worth $31–33 if Acquired

Price (1-Jun)	$23.90	**52-Week High**	$24.44
Target Price	$26.00↑	**52-Week Low**	$15.15



(FY-Dec.)	2008A	2009A	2010E	2011E
EPS	$1.52	$1.71	$2.07	$2.08
P/E			11.5x	11.5x
CFPS	$4.59	$5.25	$5.17	$5.24
P/CFPS			4.6x	4.6x
Div.	$0.88	$0.96	$1.12	$1.12
EV ($mm)	$147	$141	$184	$179
EBITDA ($mm)	$23.6	$22.8	$26.7	$26.8
EV/EBITDA	6.2x	6.2x	6.9x	6.7x

Quarterly EPS	Q1	Q2	Q3	Q4
2008A	$1.21	-$0.08	-$0.44	$0.84
2009A	$1.38	-$0.13	-$0.49	$0.95
2010E	$1.51a	$0.07	-$0.50	$1.00

Dividend	$1.12	**Yield**	4.7%
Book Value	$25.19	**Price/Book**	0.9x
Shares O/S (mm)	3.6	**Mkt. Cap ($mm)**	$86
Float O/S (mm)	3.6	**Float Cap ($mm)**	$86
Wkly Vol (000s)	23	**Wkly $ Vol (mm)**	$0.5
Net Debt ($mm)	$77.0	**Next Rep. Date**	31-Jul (E)

Notes: All values in C$; Estimates are weather normal
Major Shareholders: Widely held
First Call Mean Estimates: PACIFIC NORTHERN GAS LTD 'A' (C$) 2010E: $2.07; 2011E: $2.08

Event

We are updating the "what if" analysis we published on January 18, 2010 following EOG Resources' announcement (EOG is rated Market Perform by Jim Byrne) that it had acquired Galveston LNG's 49% interest in the Kitimat LNG project and its 24.5% interest in Pacific Trail Pipelines LP (50% PNG), the entity that is planning to construct a 463 km pipeline that would transmit natural gas from Spectra Energy's Westcoast Pipeline to the proposed gasification terminal. Since the time when performed our original "what if" analysis, market valuations have improved and we have obtained additional information regarding the financial structure of the proposed project.

Impact

Potentially positive. In the near term, we believe that a potential acquirer could pay approximately $31–33/share for PNG. If the KSL project did proceed, we believe it is possible that PNG could be worth $38–39/share; however, this value would not be realized until 2014 after the KSL pipeline and Kitimat LNG terminal were both constructed and commissioned.

Forecasts

There are no changes to our financial forecasts.

Valuation

We are increasing our target price to $26, which is consistent with our 2011E BVPS of $25.99. Our revised target price is close to the midpoint between our perception of fundamental value ($22/share) and the $32/share we believe PNG could be worth in a near-term acquisition scenario.

Recommendation

Given EOG's recent involvement in the Kitimat LNG initiative, we believe PNG's shares are reasonably valued. Our rating is Market Perform.

Changes

Target
$22.00 to $26.00

The KSL Project: Updating Our 'What If' Analysis, PNG Could be Worth Approximately $31–33 if Acquired

We are updating the "what if" analysis we published on January 18, 2010 following EOG Resources' announcement (EOG is rated Market Perform by Jim Byrne) that it had acquired Galveston LNG's 49% interest in the Kitimat LNG project and its 24.5% interest in Pacific Trail Pipelines LP ("PTP LP"; 50% PNG), the entity that is planning to construct a 463 km pipeline that would transmit natural gas from Spectra Energy's Westcoast Pipeline to the proposed gasification terminal. Since the time when performed our original "what if" analysis, market valuations have improved and we have obtained additional information regarding the financial structure of the proposed project.

EOG's involvement in the project is certainly positive for the Kitimat LNG initiative. While the project still faces a number of hurdles, participation from both EOG and Apache effectively means that natural gas supply for the project has been secured.

As a result of this latest development, we believe that PNG could become an acquisition target. Considering that many aspects of the project are still being evaluated, we believe that PNG could be worth approximately $31–33/share in an acquisition scenario. If the decision was made to go ahead with the project, PNG was able to raise its share of the financing related to the KSL pipeline, and both the KSL pipeline and Kitimat LNG terminal were completed on time and on budget, we believe that PNG could possibly be worth $38–39/share in 2014 after the entire Kitimat LNG initiative was commissioned.

With respect to valuation, we are increasing our target price to $26, which is consistent with our 2011E BVPS estimate of $25.99/share. Our revised target price is close to the midpoint between our perception of fundamental value ($22/share) and the $32/share we believe PNG could be worth in a near-term acquisition scenario.

At present, we believe that PNG will exhibit a binary return profile. If Apache and EOG definitively decide to proceed with the Kitimat LNG initiative, we would expect PNG's share price to reflect our near-term acquisition value of approximately $31–33/share. If the proposed project is significantly delayed or a decision is made not to proceed with the Kitimat LNG terminal, we believe that PNG's share price may decline to our fundamental valuation of approximately $22/share.

Given EOG's recent involvement in the Kitimat LNG initiative, we believe PNG's shares are reasonably valued. Our rating is Market Perform.

The Kitimat-to-Summit Lake Project: Our Revised 'What If' Analysis (Going Concern Basis)

We have updated the "what-if" analysis originally included in our January 18 report to reflect additional information regarding the financial structure of the proposed project and valuation multiples that are more reflective of normal financial markets.

With respect to the financial structure of the project, PNG currently owns a 50% interest in Pacific Trail Pipelines LP ("PTP LP"), the entity that is proposing to construct the Kitimat-to-Summit Lake pipeline. We understand that certain First Nations groups hold an option to acquire a 30% interest in Pacific Trail Pipelines LP. If the option is exercised, PNG's equity interest in PTP LP would fall to approximately 35%. We also understand, however, that PNG plans to contribute its natural gas transmission assets to PTP in return for an increased interest in PTP LP. Assuming that the transmission assets are valued at approximately $100 million, PNG's ultimate ownership in PTP LP would slightly exceed 42%.

Table 1: PNG's Equity Interest in PTP LP

	Assumption	Note
Capital cost ($mm)	1,300.0	
Equity (%)	35.0%	(1)
Equity required ($mm)	**455.0**	
Transmission assets	(100.0)	(2)
Cash equity required	**355.0**	
PNG's cash contribution	124.3	(3)
Transmission asset contribution	100.0	
First Nations payment	(30.0)	(4)
PNG's total contribution ($ mm)	**194.3**	
PNG's total contribution (%)	**42.7%**	

Source: BMO Capital Markets, Company Reports

Notes:

1. Assumes the KSL pipeline is financed with a capital structure of 35% equity, 65% debt. Revised capital cost of $1.3 billion is per PNG management.

2. Value of transmission assets contributed to PTP LP, per PNG management. After asset contribution, net cash equity required in the project is approximately $355 million.

3. Assume that a First Nations group acquires 30% of PTP LP. This would dilute PNG's ownership interest in PTP LP to 35% from 50%. In this instance PNG would be required to contribute 35% of the cash equity needed to construct the pipeline, approximately $124.3 million.

4. In order to maintain a 30% ownership interest in PTP LP, the First Nations group would need to pay PNG $30 million in cash after PNG contributed its natural gas transmission assets to PTP LP. As a result of these transactions, PNG will have contributed $194.3 million or 42.7% of the $455 million equity required by PTP LP.

In Table 2, we estimate PNG's pro forma net income, assuming that the KSL project was completed. Note that we have adjusted our pro forma income calculation to exclude the

earnings contribution from the $100 million of natural gas transmission assets which would be removed from PNG's rate base before being contributed to PTP LP. Table 3 sets out additional pro forma financial forecasts.

Table 2: Estimated Pro Forma Net Income, Assuming KSL Project Is Completed

Capital cost of KSL Project ($mm)	1,300.0
Equity (%)	35.0%
Equity ($mm)	**455.0**
ROE (%)	12.0%
Net Income ($mm)	**54.6**
PNG's ownership (%)	42.7%
PNG's share of earnings from PTP project ($mm)	**23.3**
Add: 2011E net earnings (existing assets)	7.5
Less: income from gas transmission assets contributed to JV	(4.6)
Pro-forma earnings ($mm)	**26.2**
Income from Assets Contributed to JV	
Gas transmission assets in rate base ($ mm)	100.0
Deemed equity thickness (%)	45.0%
Deemed ROE (%)	10.15%
Contribution from gas transmission assets ($mm)	**4.6**

Source: BMO Capital Markets, Company Reports

Table 3: Various Pro Forma Financial Forecasts, Assuming KSL Project is Completed

	PNG 2011E	PTP Pro-forma	Adj.	PNG + PTP
Net Income ($mm)	7.5	23.3	(4.6)	**26.2**
Equity ($mm)	92.4	124.3	-	**216.7**
Preferred Shares ($mm)	5.0	0.0	-	**5.0**
Net Debt ($mm)	88.3	360.8	(30.0)	**419.0**
# of outstanding shares	3.6	5.4	-	**9.0**
EPS	$2.10	N/A	N/A	**$2.93**
BVPS	$25.99	N/A	N/A	**$24.19**
Dividends per Share	$1.12	N/A	N/A	**$1.90**
Payout Ratio	53.3%	N/A	N/A	**65.0%**
Capitalization				
% Equity	49.8%	N/A	N/A	**33.8%**
% Preferred Shares	2.7%	N/A	N/A	**0.8%**
% Debt	47.5%	N/A	N/A	**65.4%**

Source: BMO Capital Markets

The assumptions used for our valuation analysis are set out in Table 4.

Table 4: Pacific Trail Pipeline Project Key Assumptions

	Assumption	Note
PNG's Share Price	$23.00	(1)
PNG's Ownership %	42.7%	
Useful Life (years)	25.0	
Tax Rate	30.0%	
Cost of Debt	6.0%	
Project Cost ($mm)	1,300.0	(2)
% Equity	35%	(3)
Deemed ROE	12.00%	(4)
New Equity Required ($mm)	194.3	
Cash Equity Required ($mm)	124.3	
# of Shares to be Issued (millions)	5.4	(5)
Net Income to PNG ($mm)	18.7	(6)

Source: BMO Capital Markets

Notes:

1. Assumes a 4% discount to PNG's current market price of approximately $24.
2. Revised capital cost, per PNG management.
3. Assumes the KSL pipeline is constructed with a capital structure of 35% equity, 65% debt.
4. Consistent with the ROE of 11.5% earned by the Brunswick Pipeline (100% Emera), which is a 145 km special purpose pipeline designed to transport gas from the Canaport LNG terminal to the Maritimes and Northeast Pipeline (12.9% Emera Inc.). We believe an additional 50 bps premium is warranted given the larger size of the KSL pipeline, and its location in a relatively remote geographic region.
5. Cash equity required ($124.3 million), divided by assumed share price ($23/share).
6. Per Table 2, incremental income of $23.3 million from KSL project, less forgone income of $4.6 million from the natural gas transmission assets removed from rate base.

Based on the methodology we use to value the utility companies in our coverage universe, we estimate that PNG could be worth approximately $38.50/share in 2014 if the KSL project was placed into service (Table 5).

Table 5: Pro Forma Valuation Analysis

	PNG	PNG + PTP (Current Multiples)	PNG + PTP (High Case)	Valuation Weight
Valuation Assumptions				
BVPS	1.0x	1.0x	**1.5x**	12.5%
P/E	13.0x	13.0x	**15.0x**	12.5%
Yield	5.50%	5.50%	**5.00%**	75.0%
Weighted Valuation Output				
Book Value Basis	$25.99	$24.19	**$36.28**	12.5%
P/E Basis	$27.34	$38.05	**$43.90**	12.5%
Yield Basis	$20.36	$34.59	**$38.05**	75.0%
Weighted Valuation	**$21.94**	**$33.72**	**$38.56**	**100.0%**

Source: BMO Capital Markets

What's PNG Worth to an Acquirer? We Believe $32–33 in the Near Term

We have prepared a second analysis to determine what PNG would be worth in an acquisition scenario using the assumptions set out in Table 4. In order to prepare this analysis, we have assumed that in return for assuming construction and financing risk an investor would be willing to acquire PNG at a premium as long as the post-acquisition returns generated from PNG's 42.7% interest in the PTP LP, calculated on an IRR basis over the expected useful life of the asset, exceeds the deemed ROE earned by the KSL pipeline.

Our analysis includes a number of other important assumptions:

- Per management, the KSL project would be amortized over a period of 25 years. We assume the KSL project's useful life is consistent with the amortization period;
- Debt used to finance the project is repaid over the useful life of the KSL project;
- For simplicity, we assume that the pipeline is taxable and that cash flow is levelized over a 25-year estimated useful life. In actuality tax shields associated with capital cost allowance would result in lower cash flow in the early years of the project's life and higher cash flow in the later years.
- Given the preliminary nature of the Kitimat LNG initiative, we assume that any investor would require a return on equity greater than the deemed ROE specified in any prospective tolling agreement for the KSL pipeline;

We have also assumed that PNG's remaining gas distribution system and 9.8 MW McNair Creek hydro facility are not of strategic value to a potential acquirer and are divested at book value. A calculation of the value of PNG's "redundant" assets to a potential acquirer is set out in Table 6.

Table 6: Estimated Value of Redundant Assets

	$mm	Notes
Additional Investment from First Nations	30.0	(1)
Proceeds from Sale of Gas Transmission Assets	70.0	(2)
Proceeds from Sale of McNair Creek	17.0	(3)
Less: Exisiting Debt (Q1/10)	(77.0)	(4)
Less: Estimated Debt Related to McNair Creek	(17.0)	(5)
Less: Face Value of Preferred Shares	(5.0)	(4)
Less: Estimated Transaction Costs & Fees	(2.2)	(6)
Incremental Value of Remaining Assets	**15.8**	
Fully-Diluted Shares Outstanding	3.9	
Value of Redundant Assets ($/share)	**$4.03**	

Source: BMO Capital Markets

Notes:

1. Payment of $30 million receivable from First Nations participating in PTP LP upon contribution of PNG's natural gas transmission assets into PTP LP.
2. Estimated rate base of natural gas distribution assets, per management.

3. Cost of April 7, 2010 acquisition of McNair Creek hydro facility.

4. Per Q1/10 financial statements.

5. As the purchase of McNair Creek was financed by a combination of the assumption of existing debt and PNG's credit lines, we assume that debt is equal to the acquisition cost of $17 million.

6. Assume transaction costs of 2% of sales proceeds, plus $0.5 million for out-of-pocket expenses such as legal fees, etc.

Table 7 sets out the value we believe that an investor may be willing to pay for PNG given the preliminary stage of the KSL pipeline. Our analysis assumes that levelized cash flow is equal to net income, plus depreciation, less principal repayment on debt financing. We further assume that the KSL pipeline earns a return on equity of 12%, and that a prospective investor requires an IRR of 15% on equity invested in this project.

Table 7: Estimated Near-Term Value of PNG in an Acquisition Scenario

KSL Project Economics		
Capital Cost ($mm)	$1,300	
PNG's Share in PTP	42.7%	
Equity Thickness	35.0%	
Deemed ROE	12.0%	
Cost of Debt	6.50%	
Required Equity IRR by Acquirer	15.0%	
Useful Life (years)	25.0	
PNG's Share of Pro-Forma Net Income from PTP	$23.3	
Add: PNG's Share of Depreciation from PTP	$22.2	
Less: PNG's Share of Debt Repayment for PTP	($6.1)	
PNG's Share of Levelized Cash Flow		**$39.4**
Cash Equity Required to Construct KSL Project ($mm)	$124.3	
Incremental Maximum Investment Required to Meet KSL Hurdle Rate	$112.6	
Total Equity Required to Acquire PNG + Construct KSL		**$236.8**
Value of KSL to a Potential Investor		
Incremental Equity From Above		**$112.6**
Add: Incremental Breakup Value of PNG's Remaining Assets		**$15.8**
Estimated Value of PNG in a Near-Term Acquisition Scenario		**$128.3**
# of Common Shares o/s (mm)	3.6	
Outstanding Options (mm)	0.3	
Total Diluted Share Count (mm)		**3.9**
Potential Acquisition Value ($/share)		**$32.78**

Source: BMO Capital Markets

The value of PNG in an acquisition scenario would likely greatly vary depending on the ultimate economics of the KSL pipeline and the return requirements of a potential investor. Table 8 sets out a sensitivity analysis of the valuation work performed in Table 6 under various pipeline ROE and investor return requirement scenarios. The range of outcomes that we believe to be the most probable is highlighted.

Table 8: Acquisition Value Sensitivity Analysis

Levered IRR Required by Infrastructure Investor	Allowed ROE on Pipeline				
	11.0%	11.5%	12.0%	12.5%	13.0%
17.0%	$23.19	$24.49	$25.83	$27.16	$28.46
16.0%	$26.36	$27.75	$29.18	$30.57	$31.98
15.0%	$29.87	$31.39	$32.87	$34.36	$35.87
14.0%	$33.82	$35.41	$37.02	$38.61	$40.23
13.0%	$38.23	$39.92	$41.64	$43.35	$45.07
12.0%	$43.18	$45.02	$46.89	$48.69	$50.56

Implied Potential Acquisition Price/Share

Source: BMO Capital Markets

Critical Path: Most Importantly, Apache Must Complete Front-End Engineering Work on Proposed LNG Terminal

Before the KSL project can proceed, a number of requirements must be finalized.

Most importantly, Apache must finalize front-end engineering and design work on the LNG terminal. This work, which will include revised construction cost estimates, will be performed throughout 2010. In late 2010 or early 2011, Apache will decide whether to proceed with the project.

Other significant requirements include:

- Securing firm off-take agreements for the LNG produced by the terminal;
- Securing firm transportation agreements for capacity on the KSL project;
- Obtaining financing for the pipeline;
- Completing agreements with First Nations groups;
- Receiving regulatory approvals for the KSL project, including a Certificate of Public Convenience and Necessity from the British Columbia Utilities Commission and other permits from the British Columbia Oil and Gas Commission.

Kitimat LNG Project – Major Milestones to Date

Since the beginning of 2009, the following major milestones have been completed:

- On June 1, 2009, Kitimat LNG announced that it had signed a memorandum of understanding ("MOU") with Korea Gas Corporation for the purchase of up to 40% of the annual LNG that would be produced at the proposed re-gasification terminal;
- On July 6, 2009, Kitimat LNG announced that it had signed an MOU with Gas Natural SDG, SA of Spain, under which Gas Natural would purchase up to 32 percent of the annual LNG produced by the proposed re-gasification terminal;

- On January 13, 2010, Apache Corporation announced that it would acquire a 51% interest in the Kitimat LNG Project and a 25.5% interest in the PTP LP. Apache has also reserved 51% of the terminal's capacity and will be the operator of the project.
- On May 18, 2010, EOG Resources announced that it had acquired Galveston LNG's interests in the Kitimat LNG project and the PTP LP. EOG now holds a 49% interest in the proposed Kitimat LNG project and a 24.5% interest in PTP LP.

Project Description: Kitimat LNG Terminal

Kitimat LNG Inc. is proposing to construct an LNG export terminal located in Bish Cove near the Port of Kitimat, B.C. If constructed, the Kitimat LNG Terminal will include marine on-loading, LNG storage, natural gas delivery, liquefaction and LNG send-out facilities. The terminal would take delivery of gas via a pipeline lateral, approximately 15 kilometres long, from the Kitimat to Summit Lake Pipeline, which will be connected to the existing Spectra Energy's Westcoast Pipeline system. The terminal will include two 210,000 m^3 LNG storage tanks (approximately 8.9 Bcf of natural gas) with potential future expansion to three tanks, and have a send-out capacity of 3.5–5.0 mmtpa. The most recent capital cost estimate for the LNG liquefaction facility was prepared in 2006. At this time, the project was expected to cost approximately $4 billion. The Kitimat LNG terminal project is owned 51% by Apache Corporation and 49% by EOG Resources. The terminal proponents are proposing an in-service date of 2014.

Project Description: Kitimat-to-Summit Lake Pipeline

Pacific Trail Pipelines LP is a joint venture that is proposing to construct the KSL project, a 463-km pipeline that would transport natural gas from Spectra Energy's Westcoast System to Kitimat LNG's proposed gasification terminal. PNG holds a 50% interest in the PTP LP, Apache Corporation has acquired a 25.5% interest in the LP, and EOG Resources now holds the remaining 24.5% interesting Pacific Trail Pipelines LP. If the decision to go ahead with the Kitimat LNG terminal is made, construction of the KSL project would need to begin in 2012 to facilitate the proposed 2014 in-service date for the LNG terminal.

Table 9: Consolidated Summary

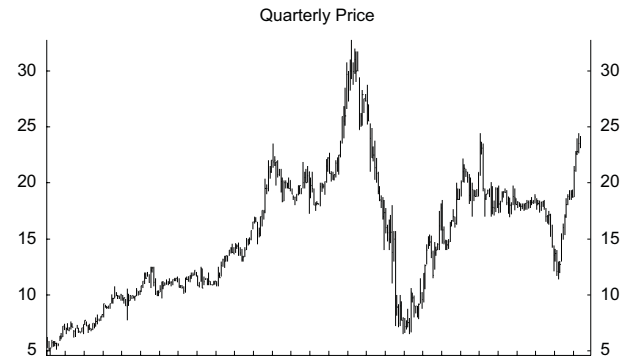
02-Jun-10 — Michael McGowan, BMO Capital Markets

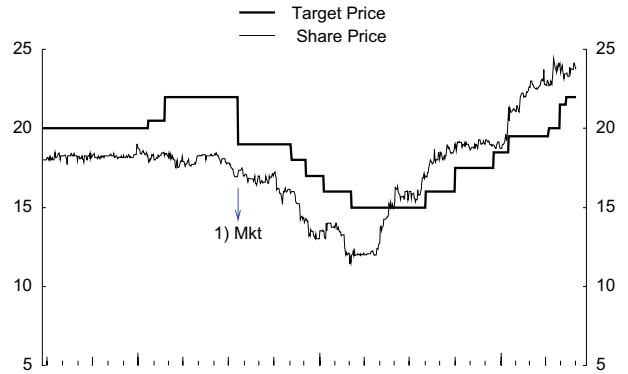
Current Price: $24.00
12-Month Target Price: $26.00
ROR: 13.0%
Recommendation: Market Perform

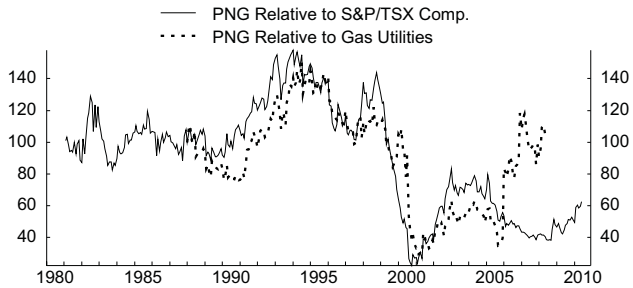
	Year Ended December 31									
	2002	2003	2004	2005	2006	2007	2008	2009	2010E	2011E
Total Earnings Per Share	$1.28	$1.49	$1.41	$1.75	$1.27	$1.11	$1.53	$1.72	$2.09	$2.10
Fully Diluted EPS	$1.25	$1.46	$1.38	$1.72	$1.25	$1.10	$1.52	$1.71	$2.07	$2.08
Dividends	$0.00	$0.80	$0.80	$0.80	$0.80	$0.80	$0.88	$0.96	$1.12	$1.12
Payout Ratio	0.0%	53.8%	56.8%	45.8%	63.0%	72.4%	57.6%	55.7%	53.5%	53.3%
Average Shares (mm)	3.5	3.6	3.6	3.6	3.6	3.6	3.7	3.6	3.6	3.6
Net Book Value	$21.62	$19.25	$20.52	$21.44	$21.91	$22.17	$22.85	$24.03	$25.00	$25.99
Market Valuation										
Price: High	$18.00	$19.50	$22.00	$24.00	$19.75	$19.00	$18.65	$19.30	-	-
Price: Low	$9.35	$14.00	$17.28	$17.37	$16.96	$17.50	$12.11	$11.40	-	-
Price: Current	-	-	-	-	-	-	-	-	$24.00	-
P/E Ratio: High	14.0	13.1	15.6	13.7	15.5	17.2	12.2	11.2	-	-
P/E Ratio: Low	7.3	9.4	12.3	9.9	13.3	15.8	7.9	6.6	-	-
P/E Ratio: Current	-	-	-	-	-	-	-	-	11.5	11.4
Price/Book Value: High	0.8	1.0	1.1	1.1	0.9	0.9	0.8	0.8	-	-
Price/Book Value: Low	0.4	0.7	0.8	0.8	0.8	0.8	0.5	0.5	-	-
Price/Book Value: Current	-	-	-	-	-	-	-	-	1.0	0.9
Yield: High Price	0.0%	4.1%	3.6%	3.3%	4.1%	4.2%	4.7%	5.0%	-	-
Yield: Low Price	0.0%	5.7%	4.6%	4.6%	4.7%	4.6%	7.3%	8.4%	-	-
Yield: Current	-	-	-	-	-	-	-	-	4.7%	4.7%
Balance Sheet ($mm)										
Debt (S-T)	4.1	7.0	10.1	14.4	10.0	11.2	5.4	6.1	19.8	23.7
Debt (L-T)	90.2	85.8	81.4	76.6	71.7	72.8	74.5	72.4	73.4	64.6
Deferred Items	17.0	17.9	15.8	15.7	24.0	18.5	13.8	14.0	15.5	17.0
Preferred Shares	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0
Shareholders' Equity	76.7	69.4	73.9	77.7	79.8	81.2	83.7	85.4	88.9	92.4
	193.0	185.1	186.4	189.4	190.5	188.9	182.5	182.9	202.6	202.7
Balance Sheet (%)										
Debt (S-T)	2.1%	3.8%	5.4%	7.6%	5.2%	6.0%	3.0%	3.4%	9.8%	11.7%
Debt (L-T)	46.7%	46.4%	43.7%	40.4%	37.6%	38.6%	40.8%	39.6%	36.2%	31.9%
Deferred Items	8.8%	9.7%	8.5%	8.3%	12.6%	9.8%	7.6%	7.6%	7.6%	8.4%
Preferred Shares	2.6%	2.7%	2.7%	2.6%	2.6%	2.7%	2.7%	2.7%	2.5%	2.5%
Shareholders' Equity	39.7%	37.5%	39.7%	41.1%	41.9%	43.0%	45.9%	46.7%	43.9%	45.6%
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Income Statement ($mm)										
Total Revenue	109.1	133.7	137.8	160.0	138.8	129.5	132.8	104.1	95.8	97.8
EBIT	19.5	18.5	17.5	18.6	17.6	14.3	14.9	14.6	17.6	17.6
NPAT	4.9	5.7	5.4	6.7	5.0	4.4	5.9	6.5	7.8	7.8
Preferred Share Dividends	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Net Earnings to Common	4.6	5.3	5.1	6.3	4.6	4.0	5.6	6.2	7.4	7.5
Cash Flow from Operations	13.1	12.2	16.4	11.8	17.6	(2.6)	16.8	18.9	18.4	18.6
Key Statistics										
Average Utility Rate Base ($mm)	166.8	165.4	167.2	165.2	162.4	165.6	167.9	171.3	168.8	165.9
Growth Rate	-1.98%	-0.87%	1.10%	-1.19%	-1.67%	1.95%	1.38%	2.02%	-1.45%	-1.71%
2007 - 2010 CAGR									0.64%	-0.39%
Allowed Return on Equity	9.88%	10.17%	9.80%	9.68%	9.45%	9.02%	9.27%	9.12%	10.15%	10.15%
Deemed Equity	36.00%	36.00%	36.00%	40.00%	40.00%	40.00%	40.00%	40.00%	45.00%	45.00%
Sensitivity										
100 bp Change ROE										
Change Total Income	0.6	0.6	0.6	0.7	0.6	0.7	0.7	0.7	0.8	0.7
Change Per Share	0.17	0.17	0.17	0.18	0.18	0.18	0.18	0.19	0.21	0.21
100 bp Change in Deemed Equity										
Change Total Income	0.2	0.2	0.2	0.2	0.2	0.1	0.2	0.2	0.2	0.2
Change Per Share	0.05	0.05	0.05	0.04	0.04	0.04	0.04	0.04	0.05	0.05
1.00% Change in Average Rate Base										
Change Total Income	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Change Per Share	0.02	0.02	0.02	0.02	0.02	0.02	0.02	0.02	0.02	0.02

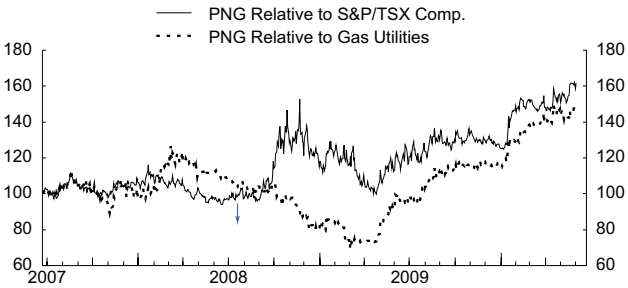
Source: BMO Capital Markets

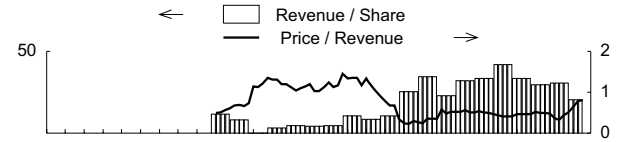
Pacific Nthn. Gas A (PNG)

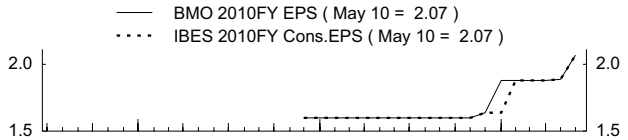


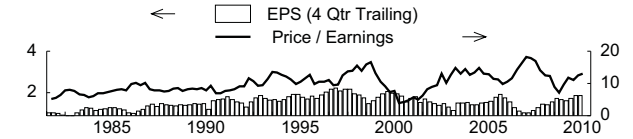


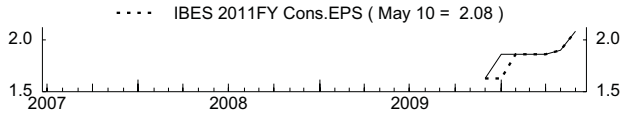












FYE (Dec.)	EPS $	P/E	DPS $	Yield %	Payout %	BV $	P/B	ROE %
1987	1.31	8	0.75	7.4	57	8.97	1.1	15
1988	1.34	8	0.75	6.6	56	9.24	1.2	15
1989	1.45	8	0.75	6.4	52	9.92	1.2	15
1990	1.61	7	0.75	6.7	47	10.76	1.0	16
1991	1.66	8	0.80	5.9	48	11.62	1.2	15
1992	1.55	11	0.80	4.8	52	12.37	1.3	13
1993	1.63	13	0.88	4.0	54	12.37	1.8	13
1994	1.80	11	0.88	4.3	49	12.37	1.6	15
1995	1.67	13	0.96	4.6	57	14.57	1.4	12
1996	2.01	11	0.96	4.3	48	15.61	1.4	13
1997	2.16	14	1.04	3.5	48	16.42	1.8	13
1998	1.73	16	1.12	4.1	65	17.39	1.6	10
1999	1.92	9	1.12	6.5	58	18.19	1.0	11
2000	1.83	4	1.12	14.1	61	19.44	0.4	10
2001	1.52	6	1.12	11.7	74	20.95	0.5	8
2002	1.25	13	1.12	6.3	82	19.27	0.9	6
2003	1.46	13	0.80	4.1	54	19.96	1.0	7
2004	1.38	15	0.80	3.8	57	20.52	1.0	7
2005	1.72	11	0.80	4.1	46	21.43	0.9	8
2006	1.25	14	0.80	4.4	63	21.91	0.8	6
2007	1.10	17	0.80	4.3	72	22.16	0.8	5
2008	1.52	9	0.88	6.5	58	24.21	0.6	7
2009	1.71	11	1.00	5.3	58	24.03	0.8	7
Current*	1.84	13	1.12	4.7	61	25.19	0.9	7
Average:		11		5.7	57		1.1	10.5
Growth(%):								
5 Year:	4.3		7.0			4.2		
10 Year:	-1.1		0.0			3.3		
20 Year:	1.3		2.0			4.8		

* Current EPS is the 4 Quarter Trailing to Q1/2010.

PNG - Rating as of 21-Jun-07 = OP

	Date	Rating Change	Share Price
1	18-Jul-08	OP to Mkt	$17.20

Last Daily Data Point: June 1, 2010

IMPORTANT DISCLOSURES

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Methodology and Risks to Target Price/Valuation
Methodology: Our target price is based on a weighted valuation approach: 13x 2011E diluted EPS (12.5%); 1.0x 2011E BVPS (12.5%) and a target yield of 5.5% based on 2011E dividends per share (75%).
Risks: The company's natural gas transmission business depends on the continued availability of natural gas. The BCUC approves PNG's customer rates and a fair return on the rate base. Changes in regulation may adversely affect performance. Natural gas and fuel oil compete with electricity for space heating in Pacific Northern Gas' service areas. Fluctuations in the price of natural gas could increase the working capital financing requirements and related costs for accounts receivable. In 2004, 75% of energy deliveries were made to four large industrial customers (67% to one customer, Methanex). Transportation service to Methanex was made pursuant to an agreement that expires in October 2009. On August 30, 2005, Methanex announced that it will close its Kitimat facilities in early 2006. On October 28, 2009 another large industrial customer (West Fraser Timber Co. Ltd. announced that it was permanently closing its mill on January 31, 2010.

Distribution of Ratings (Mar. 31, 2010)

Rating Category	BMO Rating	BMOCM US Universe*	BMOCM US IB Clients**	BMOCM US IB Clients***	BMOCM Universe****	BMOCM IB Clients*****	Starmine Universe
Buy	Outperform	32.9%	13.1%	36.4%	39.4%	47.9%	53%
Hold	Market Perform	63.2%	11.9%	63.6%	55.3%	48.5%	41%
Sell	Underperform	3.9%	0%	0%	5.2%	3.6%	6%

* Reflects rating distribution of all companies covered by BMO Capital Markets Corp. equity research analysts.
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Und = Underperform - Forecast to underperform the market;
(S) = speculative investment;
NR = No rating at this time;
R = Restricted – Dissemination of research is currently restricted.

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Pacific Northern Gas

(PNG-TSX)

October 27, 2010
Brief Research Note
Gas & Electric Utilities

Stock Rating: **Market Perform**
Stock Price: **$27.26**
Target Price: **$26.50**

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Michael.McGowan@bmo.com
Assoc: Mark Laing, CA, CFA

Q3/10 Results Below Expectations; Dividend Increased by 7.1%

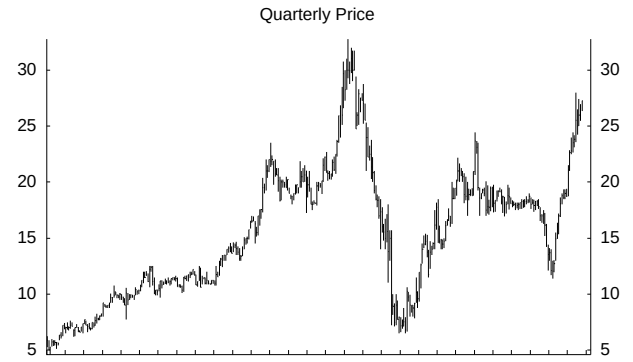
Impact

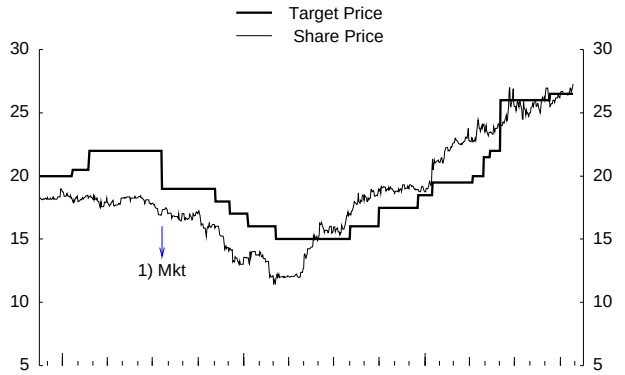
Mixed

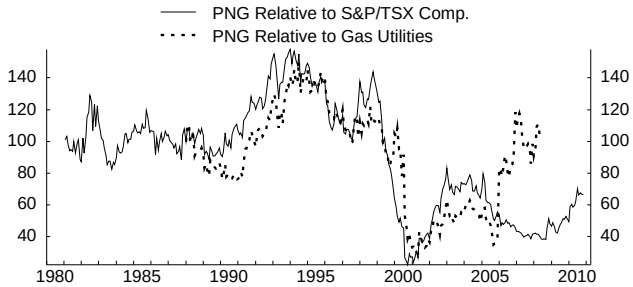
Details & Analysis

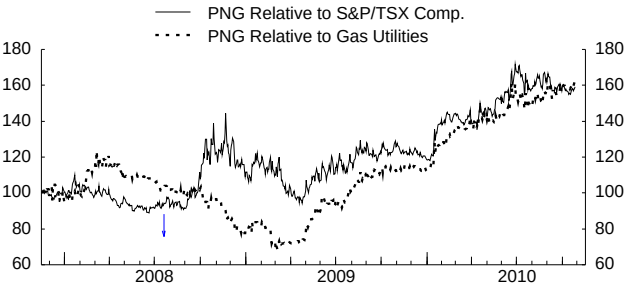
Pacific Northern Gas reported a Q3/10 loss per share of $0.64 versus our estimate of a loss per share of $0.55. The natural gas pipeline division reported a loss of $1.949 million versus our estimate of a loss of $1.789 million, while the renewable energy division reported a loss of $0.289 million versus our estimate of a loss of $0.181 million. During Q3/10, the company expensed approximately $0.145 million of acquisition and reorganization costs related to the McNair Creek hydro facility. Excluding these costs, the Q3/10 loss per share would have been $0.60. Given these non-recurring expenses, we largely attribute the variance between actual and expected results to seasonality. In addition, the earnings release contained the following noteworthy disclosures: (1) PNG increased its dividend by 7.1% to a new annualized rate of $1.20/share from $1.12/share; and (2) PNG spent $0.36 million during Q3/10 on engineering and technical studies related to the KSL project, all of which was capitalized. Although we believe that the dividend increase may be viewed favourably in an environment where many investors are seeking yield, we wonder whether the timing is prudent considering: (1) the potential for large capital expenditures associated with KSL; and (2) the decline in transportation volumes on the company's Western System due to the decision of West Fraser Timber Co. Ltd. to close its Kitimat linerboard mill.

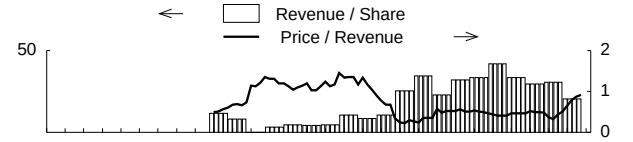
Pacific Nthn. Gas A (PNG)

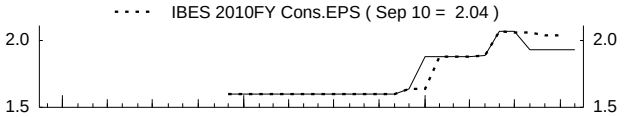


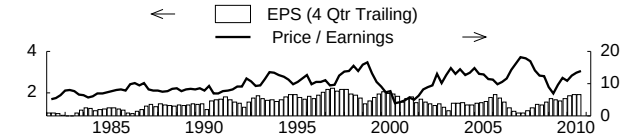


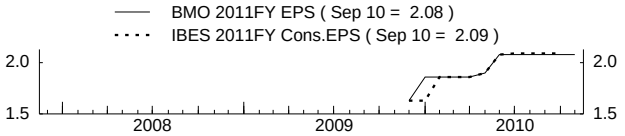












FYE (Dec.)	EPS $	P/E	DPS $	Yield %	Payout %	BV $	P/B	ROE %
1987	1.31	8	0.75	7.4	57	8.97	1.1	15
1988	1.34	8	0.75	6.6	56	9.24	1.2	15
1989	1.45	8	0.75	6.4	52	9.92	1.2	15
1990	1.61	7	0.75	6.7	47	10.76	1.0	16
1991	1.66	8	0.80	5.9	48	11.62	1.2	15
1992	1.55	11	0.80	4.8	52	12.37	1.3	13
1993	1.63	13	0.88	4.0	54	12.37	1.8	13
1994	1.80	11	0.88	4.3	49	12.37	1.6	15
1995	1.67	13	0.96	4.6	57	14.57	1.4	12
1996	2.01	11	0.96	4.3	48	15.61	1.4	13
1997	2.16	14	1.04	3.5	48	16.42	1.8	13
1998	1.73	16	1.12	4.1	65	17.39	1.6	10
1999	1.92	9	1.12	6.5	58	18.19	1.0	11
2000	1.83	4	1.12	14.1	61	19.44	0.4	10
2001	1.52	6	1.12	11.7	74	20.95	0.5	8
2002	1.25	13	1.12	6.3	82	19.27	0.9	6
2003	1.46	13	0.80	4.1	54	19.96	1.0	7
2004	1.38	15	0.80	3.8	57	20.52	1.0	7
2005	1.72	11	0.80	4.1	46	21.43	0.9	8
2006	1.25	14	0.80	4.4	63	21.91	0.8	6
2007	1.10	17	0.80	4.3	72	22.16	0.8	5
2008	1.52	9	0.88	6.5	58	24.21	0.6	7
2009	1.71	11	1.00	5.3	58	24.03	0.8	7
Current*	1.91	14	1.12	4.2	59	24.79	1.1	8
Average:		11		5.7	57		1.1	10.5
Growth(%):								
5 Year:	4.0		7.0			3.9		
10 Year:	-0.1		0.0			3.1		
20 Year:	2.4		2.0			4.7		

* Current EPS is the 4 Quarter Trailing to Q2/2010.

PNG - Rating as of 15-Nov-07 = OP

	Date	Rating Change	Share Price
1	18-Jul-08	OP to Mkt	$17.20

Last Daily Data Point: October 26, 2010

IMPORTANT DISCLOSURES

Analyst's Certification
I, Michael McGowan, CA, CFA, hereby certify that the views expressed in this report accurately reflect my personal views about the subject securities or issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report.
Analysts who prepared this report are compensated based upon (among other factors) the overall profitability of BMO Capital Markets and their affiliates, which includes the overall profitability of investment banking services. Compensation for research is based on effectiveness in generating new ideas and in communication of ideas to clients, performance of recommendations, accuracy of earnings estimates, and service to clients.
Methodology and Risks to Price Target/Valuation
Methodology: Our target price is approximately equal to 1x our 2012E BVPS of $26.84.
Risks: The company's natural gas transmission business depends on the continued availability of natural gas. The BCUC approves PNG's customer rates and a fair return on the rate base. Changes in regulation may adversely affect performance. Natural gas and fuel oil compete with electricity for space heating in Pacific Northern Gas' service areas. Fluctuations in the price of natural gas could increase the working capital financing requirements and related costs for accounts receivable. In 2004, 75% of energy deliveries were made to four large industrial customers (67% to one customer, Methanex). Transportation service to Methanex was made pursuant to an agreement that expires in October 2009. On August 30, 2005, Methanex announced that it will close its Kitimat facilities in early 2006. On October 28, 2009 another large industrial customer (West Fraser Timber Co. Ltd. announced that it was permanently closing its mill on January 31, 2010.

Distribution of Ratings (September 30, 2010)

Rating Category	BMO Rating	BMOCM US Universe*	BMOCM US IB Clients**	BMOCM US IB Clients***	BMOCM Universe****	BMOCM IB Clients*****	Starmine Universe
Buy	Outperform	36.5%	13.6%	40.7%	40.4%	49.1%	55.4%
Hold	Market Perform	60.2%	11.3%	55.9%	55.6%	49.1%	39.7%
Sell	Underperform	3.3%	12.5%	3.4%	4.0%	1.9%	4.8%

* Reflects rating distribution of all companies covered by BMO Capital Markets Corp. equity research analysts.
** Reflects rating distribution of all companies from which BMO Capital Markets Corp. has received compensation for Investment Banking services as percentage within ratings category.
*** Reflects rating distribution of all companies from which BMO Capital Markets Corp. has received compensation for Investment Banking services as percentage of Investment Banking clients.
**** Reflects rating distribution of all companies covered by BMO Capital Markets equity research analysts.
***** Reflects rating distribution of all companies from which BMO Capital Markets has received compensation for Investment Banking services as percentage of Investment Banking clients.

Ratings and Sector Key
We use the following ratings system definitions:
OP = Outperform - Forecast to outperform the market;
Mkt = Market Perform - Forecast to perform roughly in line with the market;
Und = Underperform - Forecast to underperform the market;
(S) = speculative investment;
NR = No rating at this time;
R = Restricted – Dissemination of research is currently restricted.

Market performance is measured by a benchmark index such as the S&P/TSX Composite Index, S&P 500, Nasdaq Composite, as appropriate for each company. BMO Capital Markets eight Top 15 lists guide investors to our best ideas according to different objectives (Canadian large, small, growth, value, income, quantitative; and US large, US small) have replaced the Top Pick rating.

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Pacific Northern Gas

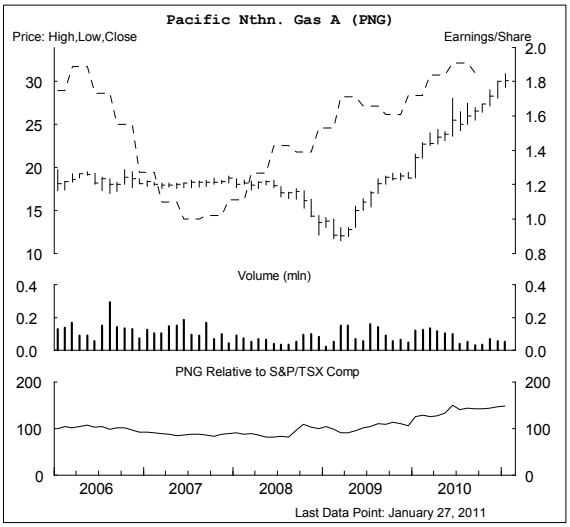
(PNG-TSX)

Stock Rating: **Market Perform**
Industry Rating: **Market Perform**

January 28, 2011
Research Comment
Toronto, Ontario

Michael McGowan, CA, CFA
BMO Nesbitt Burns Inc.
(416) 359-5807
Michael.McGowan@bmo.com
Assoc: Mark Laing, CA, CFA

Price (27-Jan)	$30.05	**52-Week High**	$30.85
Target Price	$31.00↑	**52-Week Low**	$21.00



Share Price Likely to Remain Elevated Until a Decision on the Kitimat LNG Terminal Is Reached

Event

We are increasing our price target to $31, which is consistent with the lower end of the $31-33 per share takeover value we calculated in our "What If" analysis published on June 2, 2010. A copy of this report can be found through this link (click here).

Impact

Slightly Positive. Although we are not increasing our target price in response to any specific news, we believe that as long as Apache and EOG Resources continue engineering work on the proposed Kitimat LNG export terminal, PNG's share price will likely reflect a takeover premium. We understand that a decision to proceed with the Kitimat LNG initiative will likely occur by mid-2011. PNG is involved in the Kitimat LNG initiative through its 50% ownership in Pacific Trail Pipelines LP, a joint venture that is planning to construct a 463 km pipeline that would connect supply to the export terminal.

Forecasts

There are no changes to our forecasts.

Valuation

Our revised target price of $31 is consistent with the lower end of the $31–33 range we believe that PNG could realize in a near-term acquisition scenario.

Recommendation

At current levels, we believe that PNG is reasonably valued. However, if a decision is made not to proceed with the Kitimat LNG export terminal, or the project loses momentum, we believe that PNG's share price may decline to a level more consistent with our estimated 2012E book value of approximately $26.50/share.

(FY-Dec.)	2009A	2010E	2011E	2012E
EPS	$1.71	$1.89	$2.08	$2.08
P/E		15.9x	14.4x	14.4x
CFPS	$5.25	$5.03	$5.24	$5.23
P/CFPS		6.0x	5.7x	5.7x
Div.	$0.96	$1.14	$1.20	$1.20
EV ($mm)	$141	$206	$201	$190
EBITDA ($mm)	$22.8	$25.4	$26.8	$25.9
EV/EBITDA	6.2x	8.1x	7.5x	7.3x

Quarterly EPS	Q1	Q2	Q3	Q4
2009A	$1.39	-$0.13	-$0.49	$0.95
2010E	$1.51a	-$0.06a	-$0.64a	$1.11↑
2011E	$1.59	-$0.03	-$0.55	$1.10

Dividend	$1.20	**Yield**	4.0%
Book Value	$25.27	**Price/Book**	1.2x
Shares O/S (mm)	3.6	**Mkt. Cap (mm)**	$108
Float O/S (mm)	3.6	**Float Cap (mm)**	$108
Wkly Vol (000s)	18	**Wkly $ Vol (mm)**	$0.4
Net Debt ($mm)	$93	**Next Rep. Date**	31-Mar (E)

Notes: All values in C$; Estimates are weather normal
Major Shareholders: Widely held
First Call Mean Estimates: PACIFIC NORTHERN GAS LTD 'A' (C$) 2010E: $1.92; 2011E: $2.06; 2012E: $2.05

Changes	Target
	$26.50 to $31.00

Table 1: Consolidated Summary

28-Jan-11
Current Price: $30.00
12-Month Target Price: $31.00
ROR: 7.3%

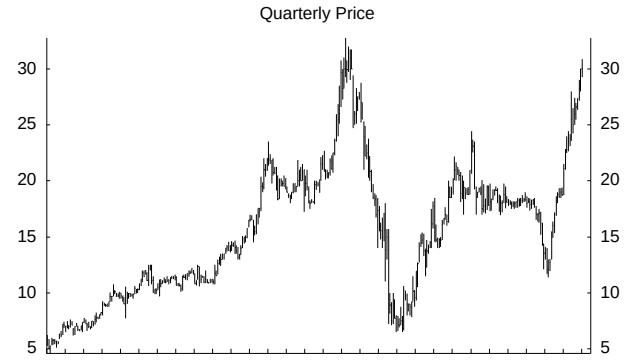
Michael McGowan
BMO Capital Markets

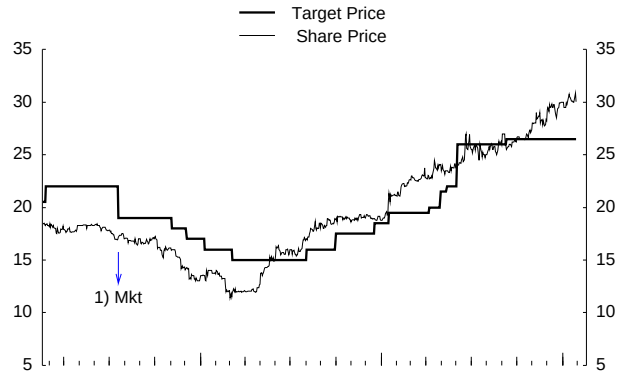
Recommendation: Market Perform

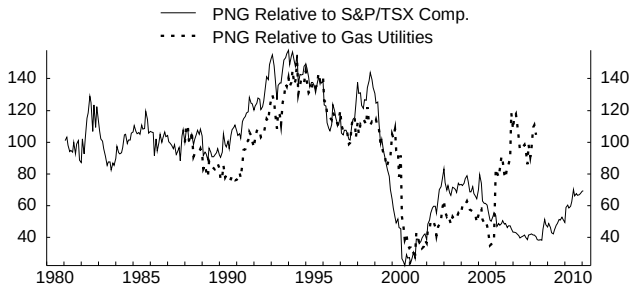
	Year Ended December 31										
	2002	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010E**	**2011E**	**2012E**
Total Earnings Per Share	$1.28	$1.49	$1.41	$1.75	$1.27	$1.11	$1.53	$1.72	$1.91	$2.10	$2.10
Fully Diluted EPS	$1.25	$1.46	$1.38	$1.72	$1.25	$1.10	$1.52	$1.71	$1.89	$2.08	$2.08
Dividends	$0.00	$0.80	$0.80	$0.80	$0.80	$0.80	$0.88	$0.96	$1.14	$1.20	$1.20
Payout Ratio	0.0%	53.8%	56.8%	45.8%	63.0%	72.4%	57.6%	55.7%	59.7%	57.1%	57.0%
Average Shares (mm)	3.5	3.6	3.6	3.6	3.6	3.6	3.7	3.6	3.6	3.6	3.6
Net Book Value	$21.62	$19.25	$20.52	$21.44	$21.91	$22.17	$22.85	$24.03	$24.80	$25.71	$26.62
Market Valuation											
Price: High	$18.00	$19.50	$22.00	$24.00	$19.75	$19.00	$18.65	$19.30	-	-	-
Price: Low	$9.35	$14.00	$17.28	$17.37	$16.96	$17.50	$12.11	$11.40	-	-	-
Price: Current	-	-	-	-	-	-	-	-	$30.00	-	-
P/E Ratio: High	14.0	13.1	15.6	13.7	15.5	17.2	12.2	11.2	-	-	-
P/E Ratio: Low	7.3	9.4	12.3	9.9	13.3	15.8	7.9	6.6	-	-	-
P/E Ratio: Current	-	-	-	-	-	-	-	-	15.7	14.3	14.3
Price/Book Value: High	0.8	1.0	1.1	1.1	0.9	0.9	0.8	0.8	-	-	-
Price/Book Value: Low	0.4	0.7	0.8	0.8	0.8	0.8	0.5	0.5	-	-	-
Price/Book Value: Current	-	-	-	-	-	-	-	-	1.2	1.2	1.1
Yield: High Price	0.0%	4.1%	3.6%	3.3%	4.1%	4.2%	4.7%	5.0%	-	-	-
Yield: Low Price	0.0%	5.7%	4.6%	4.6%	4.7%	4.6%	7.3%	8.4%	-	-	-
Yield: Current	-	-	-	-	-	-	-	-	3.8%	4.0%	4.0%
Balance Sheet ($mm)											
Debt (S-T)	4.1	7.0	10.1	14.4	10.0	11.2	5.4	6.1	20.8	24.9	8.0
Debt (L-T)	90.2	85.8	81.4	76.6	71.7	72.8	74.5	72.4	73.4	64.6	70.0
Deferred Items	17.0	17.9	15.8	15.7	24.0	18.5	13.8	14.0	15.5	17.0	18.5
Preferred Shares	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0
Shareholders' Equity	76.7	69.4	73.9	77.7	79.8	81.2	83.7	85.4	88.2	91.4	94.7
	193.0	185.1	186.4	189.4	190.5	188.9	182.5	182.9	202.8	202.9	196.1
Balance Sheet (%)											
Debt (S-T)	2.1%	3.8%	5.4%	7.6%	5.2%	6.0%	3.0%	3.4%	10.2%	12.3%	4.1%
Debt (L-T)	46.7%	46.4%	43.7%	40.4%	37.6%	38.6%	40.8%	39.6%	36.2%	31.8%	35.7%
Deferred Items	8.8%	9.7%	8.5%	8.3%	12.6%	9.8%	7.6%	7.6%	7.6%	8.4%	9.4%
Preferred Shares	2.6%	2.7%	2.7%	2.6%	2.6%	2.7%	2.7%	2.7%	2.5%	2.5%	2.6%
Shareholders' Equity	39.7%	37.5%	39.7%	41.1%	41.9%	43.0%	45.9%	46.7%	43.5%	45.1%	48.3%
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Income Statement ($mm)											
Total Revenue	109.1	133.7	137.8	160.0	138.8	129.5	132.8	104.1	95.9	97.8	99.8
EBIT	19.5	18.5	17.5	18.6	17.6	14.3	14.9	14.6	16.6	17.6	16.6
NPAT	4.9	5.7	5.4	6.7	5.0	4.4	5.9	6.5	7.1	7.8	7.8
Preferred Share Dividends	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Net Earnings to Common	4.6	5.3	5.1	6.3	4.6	4.0	5.6	6.2	6.8	7.5	7.5
Cash Flow from Operations	13.1	12.2	16.4	11.8	17.6	(2.6)	16.8	18.9	17.5	18.6	18.6
Key Statistics											
Average Utility Rate Base ($mm)	166.8	165.4	167.2	165.2	162.4	165.6	167.9	171.3	168.8	165.9	162.1
Growth Rate	-1.98%	-0.87%	1.10%	-1.19%	-1.67%	1.95%	1.38%	2.02%	-1.45%	-1.71%	-2.30%
2007 - 2010 CAGR									0.64%	-0.39%	-1.82%
Allowed Return on Equity	9.88%	10.17%	9.80%	9.68%	9.45%	9.02%	9.27%	9.12%	10.15%	10.15%	10.15%
Deemed Equity	36.00%	36.00%	36.00%	40.00%	40.00%	40.00%	40.00%	40.00%	45.00%	45.00%	45.00%
Sensitivity											
100 bp Change ROE											
Change Total Income	0.6	0.6	0.6	0.7	0.6	0.7	0.7	0.7	0.8	0.7	0.7
Change Per Share	0.17	0.17	0.17	0.18	0.18	0.18	0.18	0.19	0.21	0.21	0.21
100 bp Change in Deemed Equity											
Change Total Income	0.2	0.2	0.2	0.2	0.2	0.1	0.2	0.2	0.2	0.2	0.2
Change Per Share	0.05	0.05	0.05	0.04	0.04	0.04	0.04	0.04	0.05	0.05	0.05
1.00% Change in Average Rate Base											
Change Total Income	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Change Per Share	0.02	0.02	0.02	0.02	0.02	0.02	0.02	0.02	0.02	0.02	0.02

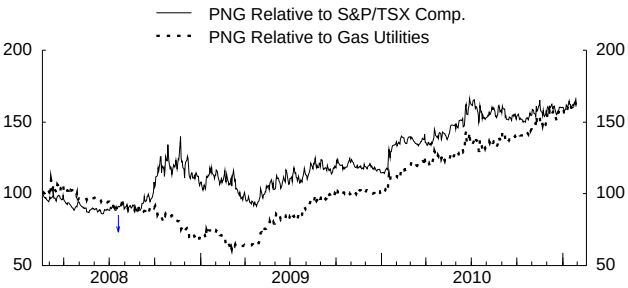
Source: BMO Capital Markets

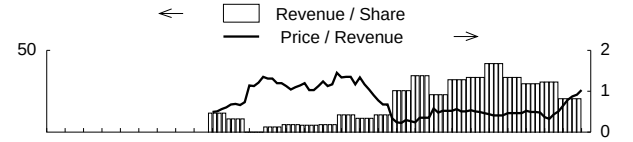
Pacific Nthn. Gas A (PNG)

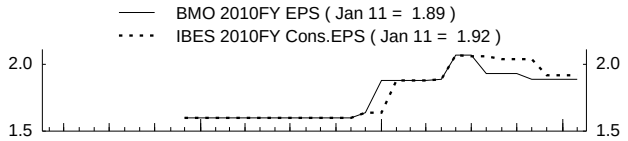


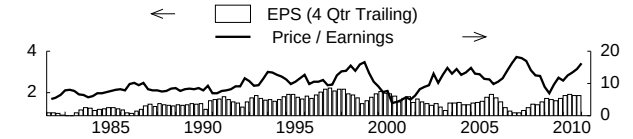


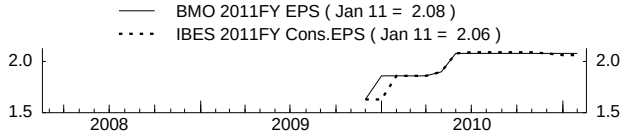












FYE (Dec.)	EPS $	P/E	DPS $	Yield %	Payout %	BV $	P/B	ROE %
1987	1.31	8	0.75	7.4	57	8.97	1.1	15
1988	1.34	8	0.75	6.6	56	9.24	1.2	15
1989	1.45	8	0.75	6.4	52	9.92	1.2	15
1990	1.61	7	0.75	6.7	47	10.76	1.0	16
1991	1.66	8	0.80	5.9	48	11.62	1.2	15
1992	1.55	11	0.80	4.8	52	12.37	1.3	13
1993	1.63	13	0.88	4.0	54	12.37	1.8	13
1994	1.80	11	0.88	4.3	49	12.37	1.6	15
1995	1.67	13	0.96	4.6	57	14.57	1.4	12
1996	2.01	11	0.96	4.3	48	15.61	1.4	13
1997	2.16	14	1.04	3.5	48	16.42	1.8	13
1998	1.73	16	1.12	4.1	65	17.39	1.6	10
1999	1.92	9	1.12	6.5	58	18.19	1.0	11
2000	1.83	4	1.12	14.1	61	19.44	0.4	10
2001	1.52	6	1.12	11.7	74	20.95	0.5	8
2002	1.25	13	1.12	6.3	82	19.27	0.9	6
2003	1.46	13	0.80	4.1	54	19.96	1.0	7
2004	1.38	15	0.80	3.8	57	20.52	1.0	7
2005	1.72	11	0.80	4.1	46	21.43	0.9	8
2006	1.25	14	0.80	4.4	63	21.91	0.8	6
2007	1.10	17	0.80	4.3	72	22.16	0.8	5
2008	1.52	9	0.88	6.5	58	24.21	0.6	7
2009	1.71	11	1.00	5.3	58	24.03	0.8	7
Current*	1.85	16	1.20	4.0	65	25.27	1.2	7
Average:		11		5.7	57		1.1	10.5
Growth(%):								
5 Year:	1.1		8.4			3.4		
10 Year:	0.1		0.7			2.7		
20 Year:	0.7		2.4			4.4		

* Current EPS is the 4 Quarter Trailing to Q3/2010.

PNG - Rating as of 18-Feb-08 = OP

	Date	Rating Change	Share Price
1	18-Jul-08	OP to Mkt	$17.20

Last Daily Data Point: January 27, 2011

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Methodology and Risks to Price Target/Valuation
Methodology: Our target price is consistent with the lower end of a range of $31–33 we believe PNG could realize in an acquisition scenario.
Risks: The company's natural gas transmission business depends on the continued availability of natural gas. The BCUC approves PNG's customer rates and a fair return on the rate base. Changes in regulation may adversely affect performance. Natural gas and fuel oil compete with electricity for space heating in Pacific Northern Gas' service areas. Fluctuations in the price of natural gas could increase the working capital financing requirements and related costs for accounts receivable. In 2004, 75% of energy deliveries were made to four large industrial customers (67% to one customer, Methanex). Transportation service to Methanex was made pursuant to an agreement that expires in October 2009. On August 30, 2005, Methanex announced that it will close its Kitimat facilities in early 2006. On October 28, 2009 another large industrial customer (West Fraser Timber Co. Ltd. announced that it was permanently closing its mill on January 31, 2010.

Distribution of Ratings (December 31, 2010)

Rating Category	BMO Rating	BMOCM US Universe*	BMOCM US IB Clients**	BMOCM US IB Clients***	BMOCM Universe****	BMOCM IB Clients*****	Starmine Universe
Buy	Outperform	35.3%	14.0%	39.1%	38.6%	45.1%	53.2%
Hold	Market Perform	62.3%	12.0%	59.4%	57.5%	51.8%	41.7%
Sell	Underperform	2.4%	8.3%	1.6%	3.9%	3.1%	5.1%

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Und = Underperform - Forecast to underperform the market;
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Pacific Northern Gas

(PNG-TSX)

February 7, 2011
Brief Research Note
Gas & Electric Utilities

Stock Rating: **Market Perform**
Stock Price: **$30.00**
Target Price: **$31.00**

Michael McGowan, CA, CFA
(416) 359-5807
Michael.McGowan@bmo.com
Assoc: Mark Laing, CA, CFA

50% Interest in PTP Sold

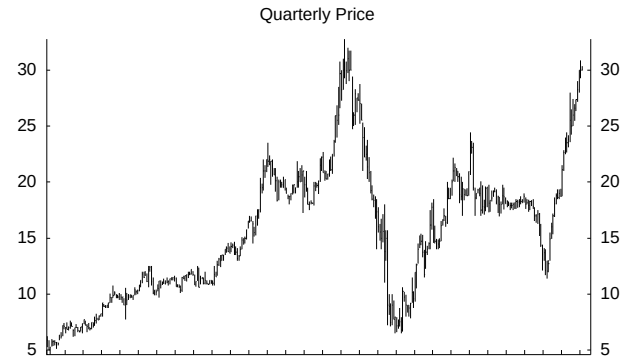
Impact

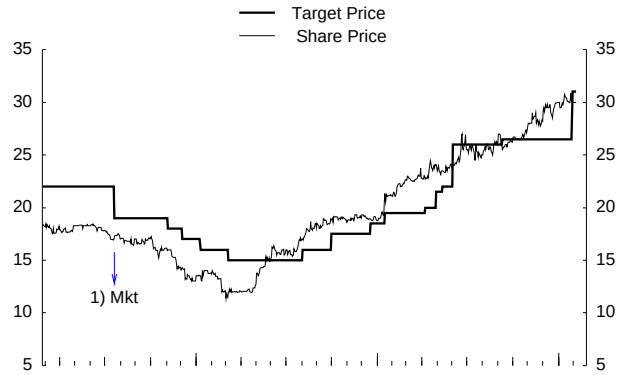
Positive

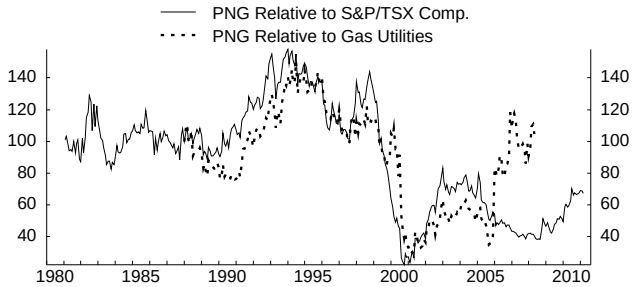
Details & Analysis

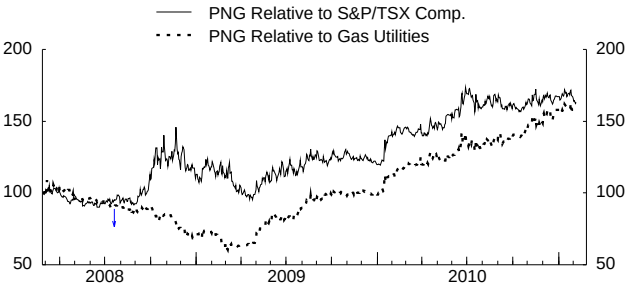
Pacific Northern Gas has announced that it has reached an agreement to divest its 50% interest in the Kitimat to Summit Lake project ("KSL") to Apache Canada and EOG Canada. Consideration will consist of a $30 million cash payment, and a contingent payment of $20 million to be released when Apache and EOG decide to proceed with construction of the facility. Details in the press release indicate that assuming the entire $50 million is received from Apache and EOG, the transaction is worth approximately $9-10/share after taxes and related expenses under the KSL management incentive plan. Based on Q3/10 financial statements, we believe that completion of the transaction could increase PNG's book value per share to approximately $32, which is consistent with the $31-33/share that we believed PNG could have realized in an acquisition scenario. Overall, we believe that this transaction is positive for PNG as it: (1) crystallizes value with respect to the KSL project; and (2) should increase throughput on PNG's pipeline system and lower tolls for existing customers, assuming that the LNG terminal proceeds. PNG has stated that its board of directors is currently reviewing its business strategy in light of the anticipated receipt of an initial $30 million in proceeds upon closing of the transaction. Conference call today at 1:00 p.m. ET. Tel: 1-866-696-5910 (passcode 1576766#); Replay: 1576766#; Webcast: www.png.ca

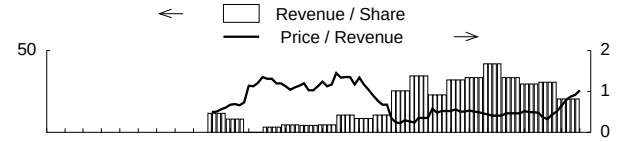
Pacific Nthn. Gas A (PNG)

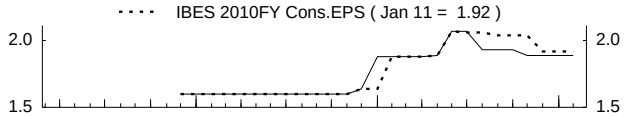


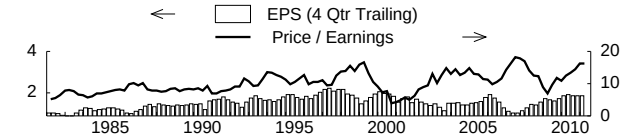


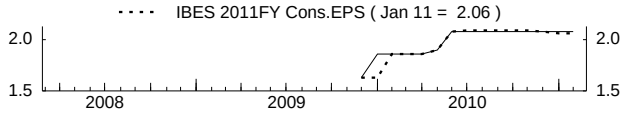












FYE (Dec.)	EPS $	P/E	DPS $	Yield %	Payout %	BV $	P/B	ROE %
1987	1.31	8	0.75	7.4	57	8.97	1.1	15
1988	1.34	8	0.75	6.6	56	9.24	1.2	15
1989	1.45	8	0.75	6.4	52	9.92	1.2	15
1990	1.61	7	0.75	6.7	47	10.76	1.0	16
1991	1.66	8	0.80	5.9	48	11.62	1.2	15
1992	1.55	11	0.80	4.8	52	12.37	1.3	13
1993	1.63	13	0.88	4.0	54	12.37	1.8	13
1994	1.80	11	0.88	4.3	49	12.37	1.6	15
1995	1.67	13	0.96	4.6	57	14.57	1.4	12
1996	2.01	11	0.96	4.3	48	15.61	1.4	13
1997	2.16	14	1.04	3.5	48	16.42	1.8	13
1998	1.73	16	1.12	4.1	65	17.39	1.6	10
1999	1.92	9	1.12	6.5	58	18.19	1.0	11
2000	1.83	4	1.12	14.1	61	19.44	0.4	10
2001	1.52	6	1.12	11.7	74	20.95	0.5	8
2002	1.25	13	1.12	6.3	82	19.27	0.9	6
2003	1.46	13	0.80	4.1	54	19.96	1.0	7
2004	1.38	15	0.80	3.8	57	20.52	1.0	7
2005	1.72	11	0.80	4.1	46	21.43	0.9	8
2006	1.25	14	0.80	4.4	63	21.91	0.8	6
2007	1.10	17	0.80	4.3	72	22.16	0.8	5
2008	1.52	9	0.88	6.5	58	24.21	0.6	7
2009	1.71	11	1.00	5.3	58	24.03	0.8	7
Current*	1.85	16	1.20	4.0	65	25.27	1.2	7
Average:		11		5.7	57		1.1	10.5
Growth(%):								
5 Year:	1.1		8.4			3.4		
10 Year:	0.1		0.7			2.7		
20 Year:	0.7		2.4			4.4		

* Current EPS is the 4 Quarter Trailing to Q3/2010.

PNG - Rating as of 26-Feb-08 = OP

	Date	Rating Change	Share Price
1	18-Jul-08	OP to Mkt	$17.20

Last Daily Data Point: February 4, 2011

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Distribution of Ratings (December 31, 2010)

Rating Category	BMO Rating	BMOCM US Universe*	BMOCM US IB Clients**	BMOCM US IB Clients***	BMOCM Universe****	BMOCM IB Clients*****	Starmine Universe
Buy	Outperform	35.3%	14.0%	39.1%	38.6%	45.1%	53.2%
Hold	Market Perform	62.3%	12.0%	59.4%	57.5%	51.8%	41.7%
Sell	Underperform	2.4%	8.3%	1.6%	3.9%	3.1%	5.1%

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Pacific Northern Gas

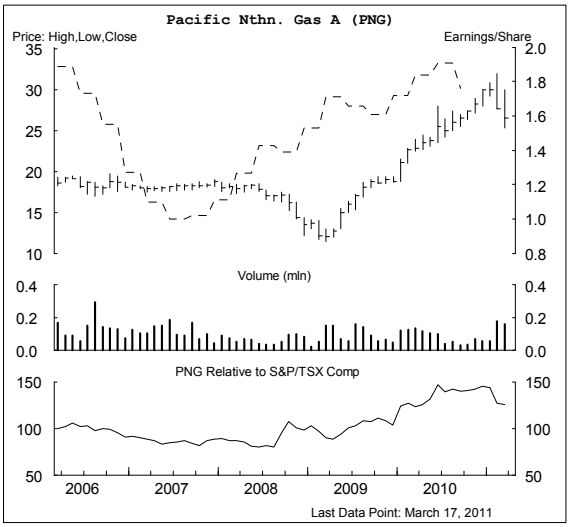
(PNG-TSX)

Stock Rating: **Market Perform**
Industry Rating: **Market Perform**

March 18, 2011
Research Comment
Toronto, Ontario

Michael McGowan, CA, CFA
BMO Nesbitt Burns Inc.
(416) 359-5807
Michael.McGowan@bmo.com
Assoc: Mark Laing, CA, CFA

Price (17-Mar)	$26.50	**52-Week High**	$31.99
Target Price	$27.00↓	**52-Week Low**	$22.60



Resuming Coverage Upon Completion of KSL Transaction: A "What Now?" Analysis

Event

We are resuming coverage of Pacific Northern Gas following the divestiture of the company's 50% interest in Pacific Trail Pipelines LP ("PTP LP"), the entity that owned the Kitimat to Summit Lake Pipeline project ("KSL"). While we were on research restriction, the company also reported Q4/10 results and declared a special dividend of $3 per share. Q4/10 basic EPS of $1.10 was in line with our Q4/10E EPS estimate of $1.11.

Impact

Positive.

Forecasts

We have updated our forecasts to reflect: 1) the sale of PNG's interest in PTP; 2) Q4/10 results; 3) the special dividend payment of $3 per share; and 4) the revised share count per PNG's Q4/10 financial statements. Our EPS estimates decline to $2.05, from $2.08, in 2011E and to $2.05, from $2.08, in 2012E.

Valuation

Our updated price target of $27 per share is consistent with our revised NAV analysis, which assumes that PNG will realize the contingent $20 million payment related to the sale of its 50% interest in PTP LP.

Recommendation

At current levels, we believe the shares are reasonably valued. Our rating is Market Perform.

(FY-Dec.)	2009A	2010A	2011E	2012E
EPS	$1.71	$1.83	$2.05↓	$2.05↓
P/E			12.9x	12.9x
CFPS	$5.25	$2.73	$4.78↓	$4.86↓
P/CFPS			5.5x	5.5x
Div.	$0.96	$1.14	$1.20	$1.20
EV ($mm)	$139	$190	$163	$153
EBITDA ($mm)	$22.8	$24.6	$25.8	$25.2
EV/EBITDA	6.1x	7.7x	6.3x	6.1x

Quarterly EPS	Q1	Q2	Q3	Q4
2009A	$1.39	-$0.13	-$0.49	$0.95
2010A	$1.51	-$0.06	-$0.64	$1.10
2011E	$1.55↓	-$0.04↓	-$0.54↑	$1.10

Dividend	$1.20	**Yield**	4.5%
Book Value	$24.63	**Price/Book**	1.1x
Shares O/S (mm)	3.6	**Mkt. Cap (mm)**	$95
Float O/S (mm)	3.6	**Float Cap (mm)**	$95
Wkly Vol (000s)	20	**Wkly $ Vol (mm)**	$0.5
Net Debt ($mm)	$96	**Next Rep. Date**	15-May (E)

Notes: All values in C$; Estimates are weather normal
Major Shareholders: Widely held
First Call Mean Estimates: PACIFIC NORTHERN GAS LTD 'A' (C$) 2010E: $1.94; 2011E: $2.05; 2012E: $2.06

Changes

Annual EPS	Annual CFPS	Quarterly EPS	Target
2011E $2.08 to $2.05	2011E $5.24 to $4.78	Q1/11E $1.59 to $1.55	$31.00 to $27.00
2012E $2.08 to $2.05	2012E $5.23 to $4.86	Q2/11E -$0.03 to -$0.04	
		Q3/11E -$0.55 to -$0.54	

Resuming Coverage Upon Completion of KSL Transaction: A "What Now?" Analysis

We are resuming coverage of Pacific Northern Gas following the divestiture of the company's 50% interest in Pacific Trail Pipelines LP ("PTP LP"), the entity that owned the Kitimat to Summit Lake Pipeline project ("KSL"). While we were on research restriction, the company also reported Q4/10 results and declared a special dividend of $3 per share. Q4/10 basic EPS of $1.10 was in line with our Q4/10E EPS estimate of $1.11. Results from both the natural gas transportation division and renewable energy divisions were generally consistent with our estimates.

More significant than the Q4/10 earnings release was the divestiture of PNG's 50% interest in PTP LP. PTP LP was proposing to construct a 463 km pipeline that would connect natural gas supply to a planned LNG terminal that would be located near Kitimat, BC. As discussed in greater detail below, while we believe that the sale of its 50% interest in PTP LP is positive as it crystallized value for shareholders; it also presents PNG with a new challenge. The KSL pipeline was PNG's largest and most visible growth prospect. Growth related to the company's core transportation and distribution system will likely remain limited and its push into renewable energy remains nascent. Before the sale of its 50% interest in PTP was completed, the biggest question regarding PNG was: "Will the Kitimat LNG initiative proceed?" Now that PNG has divested its interest in PTP LP, we believe the pertinent question is: "Where does PNG go from here?"

We are reducing our target price to $27 share in order to be consistent with our NAV valuation, which is based on the value we believe PNG could realize in a liquidation scenario. Our NAV also assumes that PNG will realize the contingent $20 million payment related to the sale of its 50% interest in PTP LP. At current levels, we believe that PNG's shares are reasonably valued. Accordingly, we are maintaining our Market Perform rating.

Transaction Crystallizes Value for PNG Shareholders; Potentially Lowers Tolls for Customers

On February 7, 2011, Pacific Northern Gas announced that it had reached an agreement to divest its 50% interest in PTP LP to Apache Canada and EOG Canada. Consideration will consist of a $30 million cash payment, and a contingent payment of $20 million to be released when Apache and EOG decide to proceed with construction of the facility. If a decision is made to proceed with the natural gas terminal, net proceeds to PNG are estimated to be approximately $39 million after taxes, management incentives and fees.

We view this transaction positively, as it: 1) crystallized value with respect to the KSL project; and 2) has the potential to increase throughput on PNG's pipeline system and lower tolls for existing customers, assuming that the LNG terminal proceeds. We believe this last point is particularly important as it would address the competitiveness of PNG's core natural gas distribution system, which has been affected by declining natural gas transportation volumes owing to the loss of a number of large industrial customers, Methanex and West Fraser being the most notable.

Transaction Supportive of a $30/Share Valuation Before Special Dividend; $27/ Share Post Special Dividend

As set out in Table 1, we believe that the sale of PTP LP supports a net asset valuation of approximately $27 per share, assuming that the additional $20 million in pretax proceeds is received. If the Kitimat LNG facility does not proceed, we believe the value of PNG would decline to approximately $23 per share (Table 1). Our analysis reflects the payment of a $3/share special dividend, which was declared on March 3, 2011 and will be payable on March 24 to shareholders of record as of March 15, 2011.

Our net asset valuation is consistent with the methodology we would use in conducting a breakup analysis. We implicitly assume that each of PNG's various business segments are divested, and then deduct existing liabilities and potential fees from the estimated proceeds.

Table 1: PNG Net Asset Value

	$ mm		
	High	**Low**	**Notes**
Assets			
PNG West	132.5	132.5	(1)
PNG (N.E.) Ltd. - Ft St John/Dawson Creek	39.2	39.2	(1)
Tumber Ridge	2.2	2.2	(1)
McNair Creek hydro facility	17.0	17.0	(2)
Proceeds from the sale of PTP (net)	39.0	22.0	
less:			
Liabilities			
Net Working Capital (Q4/10)	2.5	2.5	(3)
Regulatory and Other Liabilities	(10.9)	(10.9)	(3)
Preferred shares	(5.0)	(5.0)	(3)
Short-term debt	(13.0)	(13.0)	(3)
Long-term debt	(82.8)	(82.8)	(3)
Net Asset Value	**120.8**	**103.8**	
Transaction Fees	(2.4)	(2.1)	(4)
Net Asset Value Post Fees	**118.4**	**101.7**	
Special Dividend	(10.8)	(10.8)	
Net Asset Value Ex-Special Dividend	**107.5**	**90.9**	
Shares Outstanding (diluted)	3.9	3.9	(3)
Net Asset Value per Share Before Special Dividend	$30.15	$25.91	
Net Asset Value per Share Ex-Special Dividend	**$27.39**	**$23.14**	

Source: BMO Capital Markets, Company Reports

Notes:

1. Mid-year 2011E rate base per 2011 Revenue Requirement Application. In a break-up scenario, we believe PNG's assets could be sold for approximately 1.0x rate base.
2. Purchase price of McNair Creek acquisition announced on April 7, 2010.
3. Per Q4/10 financial statements.
4. 2% discount applied to NAV as an estimate of transaction fees that would result from divesting each of PNG's various business units.

Now that Pacific Trail Pipelines LP Has Been Sold, What's Next for PNG?

It is a pertinent question. Now that PNG has sold its 50% interest in PTP LP, where does the company go from here? Although the company did declare a special dividend of $3 per share, which represents approximately 50% of the initial tranche of proceeds receivable from the PTP LP transaction, we understand that the management team and board of directors are engaged in a strategic review regarding the future of the company. The review is expected to be completed by the time the company holds its annual meeting in May 2011.

We believe possible outcomes include:

- **Status quo - continuing to operate the existing business.** This is the simplest and most natural scenario as it would not require an organizational or strategic change. Although the completion of the Kitimat LNG terminal would increase the throughput on PNG's natural gas transmission and distribution systems (thereby lowering tolls for all customers), we believe growth prospects in the company's core operating region remain limited. Moreover, there are very few regulated utilities that are small enough for PNG to acquire. Under this scenario PNG would likely remain a small capitalization company, limited to its existing geographical footprint.

- **Expanding the company's focus on renewable energy.** PNG entered the renewable energy segment on April 7, 2010 when it acquired the 9.8 MW McNair Creek run-of-river hydro facility and formed a strategic alliance with Skookum Power. Although renewable energy is an area where PNG may pursue growth, it is a difficult business. The timing of the development of new facilities is generally dictated by request for proposal solicitations, which are inherently unpredictable. BC's most recent solicitation for green power experienced significant delays and became enmeshed in controversy when the British Columbia Utilities Commission initially rejected BC Hydro's Long-Term Acquisition Plan and declined to endorse the procurement of energy pursuant to the 2008 Clean Power Call. Contracts pursuant to the 2008 Clean Power Call were eventually awarded in March 2010, but it is unclear as to when a subsequent solicitation for renewable energy in British Columbia will be held.

  Alternatively, PNG could pursue the acquisition of operating renewable energy projects such as the McNair Creek facility. The acquisition market for renewable energy facilities is very competitive, however. Those that are successful in auctions usually either have a cost of capital advantage or are willing to pay significant purchase premiums, thereby lowering returns realized by shareholders. Accordingly, it is not inconceivable that PNG could earn a higher return on equity from its core natural gas distribution system (9.9 – 10.15%) than from the acquisition of a renewable energy facility purchased in a highly competitive auction.

- **Winding up the corporation and distributing the proceeds to shareholders.** Although this is the most extreme scenario, it is also the one upon which our NAV is predicated.

  Given PNG's small market capitalization and the geographic location of its natural gas transmission and distribution systems, we believe it will be difficult for the company to grow its pipeline business. Although the company's pipeline business faces a difficult

operating environment, most concerns regarding the possibility of rising tolls and the systems' long-term competitiveness vis-à-vis electricity would be eliminated if PNG's natural gas transmission and distribution assets became part of larger system, such as that owned by Terasen Gas.

Moreover, the renewable energy business is extremely competitive and there is no guarantee that PNG would be able to deliver shareholder returns that are higher than those that are earned on its regulated pipeline assets by pursuing a strategy focused on the acquisition of operating hydroelectric power plants. If the company decides to discontinue its focus on renewable energy, we believe it would be relatively easy to divest the McNair Creek facility.

We want to be clear that we are not advocating a liquidation of PNG; however, it is an option that the company's Board of Directors could consider.

While the outcome of the strategic review process remains uncertain, what has become clear is that there are no longer any easy choices for PNG. The management team did a great job of extracting value from the Kitimat LNG initiative through its investment in PTP LP. Finding another opportunity that is as profitable as PTP LP may prove difficult.

Estimates

We have updated our forecasts to reflect: 1) the sale of PNG's interest in PTP; 2) Q4/10 results; 3) the special dividend payment of $3 per share; and 4) the revised share count per PNG's Q4/10 financial statements.

Our EPS estimates decline to $2.05, from $2.08, in 2011E and to $2.05, from $2.08, in 2012E. The decrease in our EPS estimates stem largely from an increase in the number of shares outstanding at the end of Q4/10, versus what was reflected in our model.

Table 2: Consolidated Summary

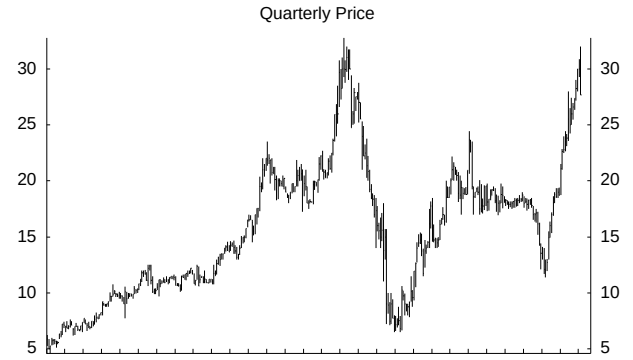
18-Mar-11 — Michael McGowan, BMO Capital Markets

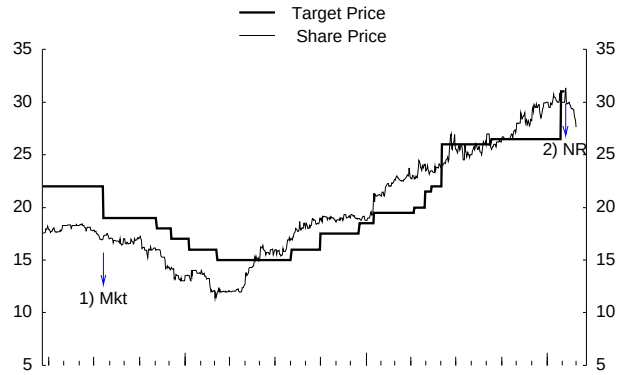
Current Price: $26.25
12-Month Target Price: $27.00
ROR: 7.4%
Recommendation: Market Perform

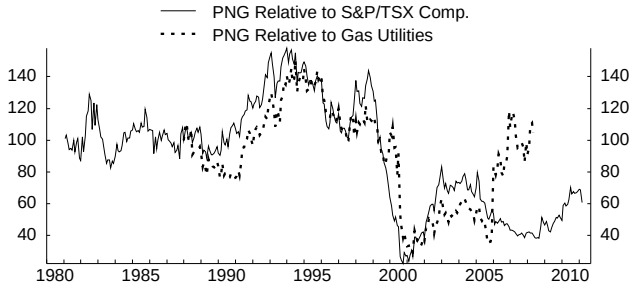
	Year Ended December 31										
	2002	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011E**	**2012E**
Total Earnings Per Share	$1.28	$1.49	$1.41	$1.75	$1.27	$1.11	$1.53	$1.72	$1.88	$2.07	$2.07
Fully Diluted EPS	$1.25	$1.46	$1.38	$1.72	$1.25	$1.10	$1.52	$1.71	$1.83	$2.05	$2.05
Recurring Dividends	$0.00	$0.80	$0.80	$0.80	$0.80	$0.80	$0.88	$0.96	$1.14	$1.20	$1.20
Payout Ratio	0.0%	53.8%	56.8%	45.8%	63.0%	72.4%	57.6%	55.7%	60.9%	58.0%	58.0%
Average Shares (mm)	3.5	3.6	3.6	3.6	3.6	3.6	3.7	3.6	3.6	3.6	3.6
Net Book Value	$21.62	$19.25	$20.52	$21.44	$21.91	$22.17	$22.85	$24.03	$24.63	$33.30	$34.17
Market Valuation											
Price: High	$18.00	$19.50	$22.00	$24.00	$19.75	$19.00	$18.65	$19.30	$30.00	-	-
Price: Low	$9.35	$14.00	$17.28	$17.37	$16.96	$17.50	$12.11	$11.40	$18.75	-	-
Price: Current	-	-	-	-	-	-	-	-	-	$26.25	-
P/E Ratio: High	14.0	13.1	15.6	13.7	15.5	17.2	12.2	11.2	16.0	-	-
P/E Ratio: Low	7.3	9.4	12.3	9.9	13.3	15.8	7.9	6.6	10.0	-	-
P/E Ratio: Current	-	-	-	-	-	-	-	-	-	12.7	12.7
Price/Book Value: High	0.8	1.0	1.1	1.1	0.9	0.9	0.8	0.8	1.2	-	-
Price/Book Value: Low	0.4	0.7	0.8	0.8	0.8	0.8	0.5	0.5	0.8	-	-
Price/Book Value: Current	-	-	-	-	-	-	-	-	-	0.8	0.8
Yield: High Price	0.0%	4.1%	3.6%	3.3%	4.1%	4.2%	4.7%	5.0%	3.8%	-	-
Yield: Low Price	0.0%	5.7%	4.6%	4.6%	4.7%	4.6%	7.3%	8.4%	6.1%	-	-
Yield: Current	-	-	-	-	-	-	-	-	-	4.6%	4.6%
Balance Sheet ($mm)											
Debt (S-T)	4.1	7.0	10.1	14.4	10.0	11.2	5.4	5.4	13.0	(10.9)	(24.1)
Debt (L-T)	90.2	85.8	81.4	76.6	71.7	72.8	74.5	71.8	82.8	74.5	77.3
Deferred Items	17.0	17.9	15.8	15.7	24.0	18.546	13.8	22.1	31.6	32.1	32.6
Preferred Shares	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0
Non-controlling Interest	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.3	0.3	0.3
Shareholders' Equity	76.7	69.4	73.9	77.7	79.8	81.2	83.7	85.4	89.0	120.4	123.5
	193.0	185.1	186.4	189.4	190.5	188.9	182.5	189.7	221.7	221.5	214.6
Balance Sheet (%)											
Debt (S-T)	2.1%	3.8%	5.4%	7.6%	5.2%	6.0%	3.0%	2.8%	5.9%	-4.9%	-11.2%
Debt (L-T)	46.7%	46.4%	43.7%	40.4%	37.6%	38.6%	40.8%	37.8%	37.3%	33.7%	36.0%
Deferred Items	8.8%	9.7%	8.5%	8.3%	12.6%	9.8%	7.6%	11.7%	14.3%	14.5%	15.2%
Preferred Shares	2.6%	2.7%	2.7%	2.6%	2.6%	2.7%	2.7%	2.6%	2.3%	2.3%	2.3%
Non-controlling Interest	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.1%	0.1%	0.1%
Shareholders' Equity	39.7%	37.5%	39.7%	41.1%	41.9%	43.0%	45.9%	45.0%	40.2%	54.3%	57.6%
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Income Statement ($mm)											
Total Revenue	109.1	133.7	137.8	160.0	138.8	129.5	132.8	104.1	95.2	94.7	96.8
EBIT	19.5	18.5	17.5	18.6	17.6	14.3	14.9	14.6	15.9	16.6	15.9
NPAT	4.9	5.7	5.4	6.7	5.0	4.4	5.9	6.5	7.1	7.8	7.8
Preferred Share Dividends	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Net Earnings to Common	4.6	5.3	5.1	6.3	4.6	4.0	5.6	6.2	6.8	7.5	7.5
Cash Flow from Operations	13.1	12.2	16.4	11.8	17.6	(2.6)	16.8	18.9	9.9	17.6	17.6
Key Statistics											
Average Utility Rate Base ($mm)	166.8	165.4	167.2	165.2	162.4	165.6	167.9	171.3	168.8	165.9	162.1
Growth Rate	-1.98%	-0.87%	1.10%	-1.19%	-1.67%	1.95%	1.38%	2.02%	-1.45%	-1.71%	-2.30%
2007 - 2010 CAGR									0.64%	-0.39%	-1.82%
Allowed Return on Equity	9.88%	10.17%	9.80%	9.68%	9.45%	9.02%	9.27%	9.12%	10.15%	10.15%	10.15%
Deemed Equity	36.00%	36.00%	36.00%	40.00%	40.00%	40.00%	40.00%	40.00%	45.00%	45.00%	45.00%
Sensitivity											
100 bp Change ROE											
Change Total Income	0.6	0.6	0.6	0.7	0.6	0.7	0.7	0.7	0.8	0.7	0.7
Change Per Share	0.17	0.17	0.17	0.18	0.18	0.18	0.18	0.19	0.21	0.21	0.20
100 bp Change in Deemed Equity											
Change Total Income	0.2	0.2	0.2	0.2	0.2	0.1	0.2	0.2	0.2	0.2	0.2
Change Per Share	0.05	0.05	0.05	0.04	0.04	0.04	0.04	0.04	0.05	0.05	0.05
1.00% Change in Average Rate Base											
Change Total Income	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Change Per Share	0.02	0.02	0.02	0.02	0.02	0.02	0.02	0.02	0.02	0.02	0.02

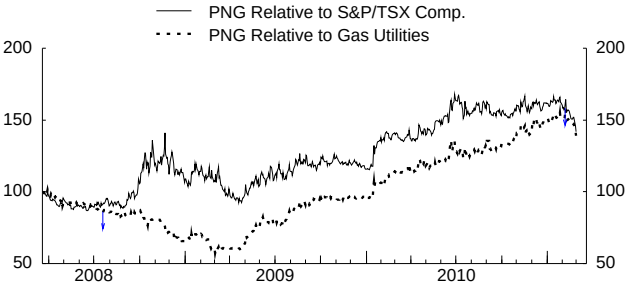
Source: BMO Capital Markets

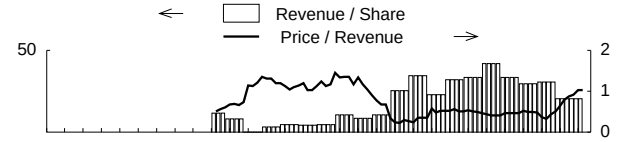
Pacific Nthn. Gas A (PNG)

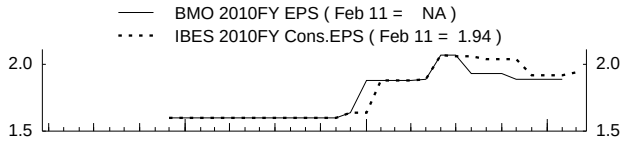


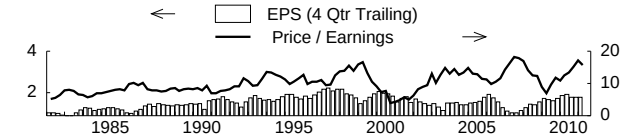


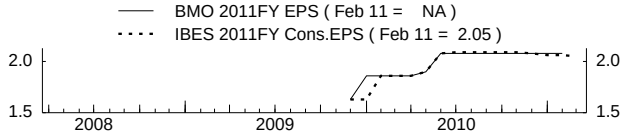












FYE (Dec.)	EPS $	P/E	DPS $	Yield %	Payout %	BV $	P/B	ROE %
1987	1.31	8	0.75	7.4	57	8.97	1.1	15
1988	1.34	8	0.75	6.6	56	9.24	1.2	15
1989	1.45	8	0.75	6.4	52	9.92	1.2	15
1990	1.61	7	0.75	6.7	47	10.76	1.0	16
1991	1.66	8	0.80	5.9	48	11.62	1.2	15
1992	1.55	11	0.80	4.8	52	12.37	1.3	13
1993	1.63	13	0.88	4.0	54	12.37	1.8	13
1994	1.80	11	0.88	4.3	49	12.37	1.6	15
1995	1.67	13	0.96	4.6	57	14.57	1.4	12
1996	2.01	11	0.96	4.3	48	15.61	1.4	13
1997	2.16	14	1.04	3.5	48	16.42	1.8	13
1998	1.73	16	1.12	4.1	65	17.39	1.6	10
1999	1.92	9	1.12	6.5	58	18.19	1.0	11
2000	1.83	4	1.12	14.1	61	19.44	0.4	10
2001	1.52	6	1.12	11.7	74	20.95	0.5	8
2002	1.25	13	1.12	6.3	82	19.27	0.9	6
2003	1.46	13	0.80	4.1	54	19.96	1.0	7
2004	1.38	15	0.80	3.8	57	20.52	1.0	7
2005	1.72	11	0.80	4.1	46	21.43	0.9	8
2006	1.25	14	0.80	4.4	63	21.91	0.8	6
2007	1.10	17	0.80	4.3	72	22.16	0.8	5
2008	1.52	9	0.88	6.5	58	24.21	0.6	7
2009	1.71	11	1.00	5.3	58	24.03	0.8	7
Current*	1.76	16	1.20	4.3	68	25.27	1.1	7
Average:		11		5.7	57		1.1	10.5
Growth(%):								
5 Year:	0.1		8.4			3.4		
10 Year:	-0.4		0.7			2.7		
20 Year:	0.5		2.4			4.4		

* Current EPS is the 4 Quarter Trailing to Q3/2010.

PNG - Rating as of 19-Mar-08 = OP

	Date	Rating Change	Share Price
1	18-Jul-08	OP to Mkt	$17.20
2	7-Feb-11	Mkt to NR	$31.35

Last Daily Data Point: February 28, 2011

IMPORTANT DISCLOSURES

Analyst's Certification
I, Michael McGowan, CA, CFA, hereby certify that the views expressed in this report accurately reflect my personal views about the subject securities or issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report.
Analysts who prepared this report are compensated based upon (among other factors) the overall profitability of BMO Capital Markets and their affiliates, which includes the overall profitability of investment banking services. Compensation for research is based on effectiveness in generating new ideas and in communication of ideas to clients, performance of recommendations, accuracy of earnings estimates, and service to clients.
Company Specific Disclosure
Disclosure 2: BMO Capital Markets has provided investment banking services with respect to this issuer within the past 12 months.
Disclosure 4: BMO Capital Markets or an affiliate has received compensation for investment banking services from this issuer within the past 12 months.
Disclosure 6: This issuer is a client (or was a client) of BMO NB, BMO Capital Markets Corp., BMO CM Ltd. or an affiliate within the past 12 months: Investment Banking Services.

Methodology and Risks to Price Target/Valuation
Methodology: Our target price is consistent with Our updated price target of $27/share is consistent with our revised NAV analysis, which assumes that PNG will realize the contingent $20 million payment related to the sale of its 50% interest in PTP LP.
Risks: The company's natural gas transmission business depends on the continued availability of natural gas. The BCUC approves PNG's customer rates and a fair return on the rate base. Changes in regulation may adversely affect performance. Natural gas and fuel oil compete with electricity for space heating in Pacific Northern Gas' service areas. Fluctuations in the price of natural gas could increase the working capital financing requirements and related costs for accounts receivable. In 2004, 75% of energy deliveries were made to four large industrial customers (67% to one customer, Methanex). Transportation service to Methanex was made pursuant to an agreement that expires in October 2009. On August 30, 2005, Methanex announced that it will close its Kitimat facilities in early 2006. On October 28, 2009 another large industrial customer (West Fraser Timber Co. Ltd. announced that it was permanently closing its mill on January 31, 2010.

Distribution of Ratings (December 31, 2010)

Rating Category	BMO Rating	BMOCM US Universe*	BMOCM US IB Clients**	BMOCM US IB Clients***	BMOCM Universe****	BMOCM IB Clients*****	Starmine Universe
Buy	Outperform	35.3%	14.0%	39.1%	38.6%	45.1%	53.2%
Hold	Market Perform	62.3%	12.0%	59.4%	57.5%	51.8%	41.7%
Sell	Underperform	2.4%	8.3%	1.6%	3.9%	3.1%	5.1%

* Reflects rating distribution of all companies covered by BMO Capital Markets Corp. equity research analysts.
** Reflects rating distribution of all companies from which BMO Capital Markets Corp. has received compensation for Investment Banking services as percentage within ratings category.
*** Reflects rating distribution of all companies from which BMO Capital Markets Corp. has received compensation for Investment Banking services as percentage of Investment Banking clients.
**** Reflects rating distribution of all companies covered by BMO Capital Markets equity research analysts.
***** Reflects rating distribution of all companies from which BMO Capital Markets has received compensation for Investment Banking services as percentage of Investment Banking clients.

Ratings and Sector Key
We use the following ratings system definitions:
OP = Outperform - Forecast to outperform the market;
Mkt = Market Perform - Forecast to perform roughly in line with the market;
Und = Underperform - Forecast to underperform the market;
(S) = speculative investment;
NR = No rating at this time;
R = Restricted – Dissemination of research is currently restricted.

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Pacific Northern Gas Ltd. (PNG.TO)

Rating	**NEUTRAL***
Price (11 Jun 10, C$)	24.60
Target price (C$)	26.00[1]
52-week price range	24.60 - 15.35
Market cap. (C$ m)	88.28
Enterprise value (C$ m)	187.54

**Stock ratings are relative to the relevant country benchmark.*
[1]Target price is for 12 months.

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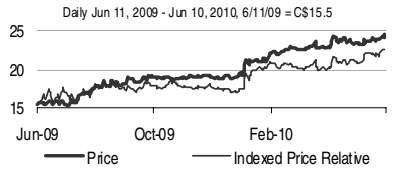
INITIATION

Pacific pipeline progress

- **Initiating coverage:** We initiate coverage of Pacific Northern Gas Ltd (PNG) with a Neutral rating and a C$26.00 target price. In our view, PNG faces an interesting pipeline investment opportunity that could more than double the company's existing size. With respect to geography, this small cap, British Columbia based gas transmission and gas utility company is well located for the potentially transformative Kitimat to Summit Lake (KSL) Project. That project would provide the Horn River Basin and Montney formations access to a proposed natural gas liquefaction facility in Kitimat, BC with plans to ship LNG to Asian markets. KSL partners include Apache and EOG.
- **Selected highlights:** PNG's existing asset base faces relatively low-growth prospects, however, the KSL project provides rather transformative growth. Yet, the PNG story is not completely reliant upon KSL alone as the company started to redeploy capital toward renewable power. Considering geography, the KSL partners and recent capital allocations, we believe PNG's growth prospects are positive relative to size and current valuation over the longer-term. Obviously, several major challenges exists, including: the pace of KSL development; and, future funding.
- **Investment thesis:** We believe Pacific Northern Gas provides low-growth infrastructure exposure with significant potential transformative growth for a somewhat reasonable valuation.
- **Valuation:** We initiate PNG with a Neutral rating and a C$26.00 target price. That target is based only on the existing operating assets and is obtained from multiple valuation approaches, including: a P/B multiple of 1.0x; a 12.5x P/E multiple; a 7.25x EV/EBITDA multiple on 2011 estimates; and, a DCF. The KSL project provides interesting upside which we project to be roughly in the low to mid C$30 per share; based on numerous assumptions. The project also contains selected uncertainties. We introduce our Neutral rating.

Share price performance



On 06/10/10 the Canada S&P/TSX Composite Index index closed at 11635.85

Quarterly EPS	Q1	Q2	Q3	Q4
2009A	1.38	-0.13	-0.49	0.94
2010E	1.48	-0.02	-0.52	1.11
2011E	1.61	-0.09	-0.52	1.10

Financial and valuation metrics

Year	12/09A	12/10E	12/11E	12/12E
EPS (CS adj.) (C$)	1.71	2.04	2.09	2.07
Prev. EPS (C$)	—	—	—	—
P/E (x)	14.4	12.0	11.8	11.9
P/E rel. (%)	76.5	84.6	97.6	108.2
Revenue (C$ m)	104.1	99.5	100.5	99.5
EBITDA (C$ m)	22.9	26.1	26.9	26.7
OCFPS (C$)	5.25	2.52	4.72	4.67
P/OCF (x)	3.6	9.8	5.2	5.3
EV/EBITDA (current)	7.2	7.2	6.8	6.6
Net debt (C$ m)	76	99	94	88
ROIC (%)	5.71	6.12	6.11	5.97

Number of shares (m)	3.59	IC (12/10E, C$ m)	218.17
BV/share (current, C$)	25.3	EV/IC (x)	0.86
Net debt (current, C$ m)	76.1	Dividend (current, C$)	1.12
Net debt/tot. cap. (%)(current,	45.7	Dividend yield (%)	4.6

Source: Company data, Credit Suisse estimates.

Investment summary

We initiate coverage of Pacific Northern Gas Ltd with a Neutral rating and a C$26.00 target price. In our view, PNG faces an interesting pipeline investment opportunity that could more than double the company's existing size. With respect to geography, this small cap, British Columbia based gas transmission and gas utility company is well located for the potentially transformative Kitimat to Summit Lake (KSL) Project. That project would provide the Horn River Basin and Montney formations access to a proposed natural gas liquefaction facility in Kitimat, BC with plans to ship LNG to Asian markets. KSL partners include Apache and EOG.

Rating: Neutral

Target: C$26.00

PNG's existing asset base faces relatively low-growth prospects, however, the KSL project provides rather transformative growth. Yet, the PNG story is not completely reliant upon KSL alone as the company started to redeploy capital toward renewable power. Considering geography, the KSL partners and recent capital allocations, we believe PNG's growth prospects are positive relative to size and current valuation over the longer-term. Obviously, several major challenges exists, including: the pace of KSL development; and, future funding.

Transformative growth potential with some challenges

Exhibit 1: Pacific Northern Gas asset map

Source: Company data

The bullets below contain a summary of our valuation approaches:

- In terms of multiples, we utilize a 1.0x price-to-book multiple; a 12.5x P/E multiple, and a 7.25x EV/EBTIDA multiple all based upon our 2011 estimates;
- With respect to yield approaches, our target price equates to roughly a 4.3% targeted dividend yield and a roughly 100 bps spread to a moderate Canadian 10-year bond yield outlook; and,
- Our DCF value falls within a range of C$24-C$30 under a modest set of assumptions.

We believe there is possible upside to the current share price a well as our target price if the KSL Project goes through with favourable economics. We believe the upside would be a share price of roughly in the low to mid C$30 per share; based on numerous assumptions. A share issuance in late 2011 or early 2012 if the KSL Project proceeds, will help increase liquidity and breath of ownership in the shares which are majority owned by retail investors.

Table of contents

Pacific pipeline progress

Rating: Neutral

Target: C$26.00

We initiate coverage of Pacific Northern Gas Ltd with a Neutral rating and a C$26.00 target price. In our view, PNG faces an interesting pipeline investment opportunity that could more than double the company's existing size. With respect to geography, this small cap, British Columbia based gas transmission and gas utility company is well located for the potentially transformative Kitimat to Summit Lake (KSL) Project. That project would provide the Horn River Basin and Montney formations access to a proposed natural gas liquefaction facility in Kitimat, BC with plans to ship LNG to Asian markets. KSL partners include Apache and EOG. Our Pacific Northern Gas report is divided into three parts:

(1) Building in BC;

(2) Financials; and,

(3) Valuation.

Each of these areas is addressed in detail below.

Building in BC

Pacific Northern Gas has a number of growth opportunities that the company is exploring. These growth opportunities are situated in the Province of British Columbia. The largest of which is the development of the KSL Project which will be used to transport natural gas from Summit Lake to a proposed LNG export terminal near Kitimat. The smaller scale projects include the company's expansion of its hydroelectric generation portfolio and a potential agreement to provide transportation service to a floating LNG vessel near Kitimat.

We have divided this portion of the research report into three areas: a) pipeline to the pacific; b) building the base; and, c) other opportunities. Each of these areas will be addressed in detail below.

Pipeline to the Pacific

The largest potential growth for PNG would be the successful completion of the KSL Project (Kitimat to Summit Lake), which at the moment PNG has a 50% interest in the project through its 50% interest in Pacific Trail Pipeline Limited Partnership (PTP). Construction of the pipeline is contingent on a Final Investment Decision (FID) by Apache Corp. on the Kitimat LNG project. This section is divided into the following parts: (a) Kitimat LNG; (b) KSL Project; and, (c) Horn River basin.

KSL is a critical project

Kitimat LNG

The largest near-term growth opportunity for PNG is the completion of the KSL Project. The KSL Project is contingent on the Kitimat LNG being completed.

The Kitimat LNG project was initially conceived to be an LNG import and regasification terminal starting in April 2004. The project was converted to an LNG export facility in September 2008. The liquefaction facility is located at Bish Cove near the Port of Kitimat. The facility is expected to have a send out capacity of roughly 700mmcfd (3 to 5 million tons per annum). Preliminary construction cost estimates is approximately C$3b (subject to revisions from the on-going front-end engineering and design (FEED). The project has received provincial and federal environmental approvals.

Originally an import facility, now an export terminal

Exhibit 2: **Kitimat LNG terminal location**

Source: Company data

Exhibit 3: **Proposed Kitimat LNG terminal**

Source: Company data

Kitimat LNG Inc. was a wholly owned subsidiary of Galveston LNG Inc., which is a privately owned Canadian energy development company. Apache Canada Ltd., a subsidiary of Apache Corporation (APA), on 13 January 2010, acquired a 51% stake in Kitimat LNG Inc. and became the operator of the project (for further details the please see the note "*Pursing Pacific potential*"). Apache is funding the FEED study and a final investment decision is expected in 2011. The first LNG shipment is expected to be in

Kitimat LNG ownership:

Apache Corp.: 51%

EOG Resources: 49%

2014. On 18 May 2010, EOG Resources Canada Inc. the Canadian subsidiary of EOG Resources Inc. announced the acquisition of the shares of Galveston LNG Inc. As part of the Galveston LNG Inc. acquisition EOG will gain a 49% interest in the Kitimat LNG project (see note "*Closing in on LNG reality?*").

Highlights regarding Kitimat LNG Inc., prior to EOG's purchase of Galveston LNG include:

MOUs signed for gas supply and LNG off-take

- Signed a memorandum of understanding (MOU) with EOG Resources Canada to supply natural gas feedstock to the terminal.
- Signed MOUs with Korea Gas Corporation (KOGAS) and Gas Natural SDG, SA in which they would purchase up to 30% and up to 40% respectively of LNG produced from the terminal.
- KOGAS, in Q1 2010 entered into a farm-out agreement with EnCana, which involves KOGAS investing roughly C$565m over three years to earn a 50% interest in EnCana's 154,000 acres of land in the Horn River and Montney shale plays.

Given the KOGAS agreement it seems rather logical for KOGAS to enter into a contract with Kitimat LNG.

We believe the acquisition by Apache and EOG of the Kitimat LNG project adds creditability to the project due to both company's financial resources as well as their large acreage positions in the Horn River basin.

Only other LNG export facility, Kenai LNG in Alaska

Currently the one and only liquefaction and LNG export terminal in North America is the Kenai LNG facility located in Nikiski, Alaska. The facility was completed in 1969 and owned by ConocoPhillips and Marathon Oil Corporation. The Kenai LNG plant exports natural gas from the Cook Inlet fields to Japan. The facility has a capacity of exporting 1.5 MTPA of LNG or roughly 128mmcf/d of natural gas.

Cheniere Energy plans for a liquefaction facility in its Sabine Pass LNG receiving terminal

The idea of exporting natural gas from North America to other markets is not only being developed by Kitimat LNG, but recently, Cheniere Energy Partners, LP (a subsidiary of Cheniere Energy, Inc.) announced plans to add liquefaction services at its Sabine Pass LNG receiving terminal in Cameron Parish, Louisiana, making the facility into the first bi-directional facility in North America. The Sabine Pass terminal is currently operating with sendout capacity of 4.0Bcf/d. Selected details on the liquefaction project include:

- The initial project would have the capacity to process 1Bcd/d (7MTPA);
- Initial project can be expandable to up to 4Bcf/d (14MTPA); and
- This facility would primarily target the European LNG market.

Cheniere's announcement reinforces the possible benefits to producers of having an export option for their natural gas given the unexpected increase in supply created by the development of the natural gas shale basin in the US and Canada.

KSL Project

Current KSL ownership:

PNG: 50%

Apache: 25.5%

EOG: 24.5%

The Pacific Trail Pipeline Limited Partnership (PTP) was formed in July of 2006 as a joint venture between PNG and Galveston LNG Inc. to develop the KSL Project. In conjunction with Apache and EOG acquisition of 51% and 49% respectively of the Kitimat LNG project, Apache and EOG will also acquired a 25.5% and 24.5% interest in PTP respectively.

The KSL Project is a project to loop PNG's mainline transmission system from Kitimal to Summit Lake. The project consist of building roughly 465km of 36 inch diameter pipeline and compression facilities from PNG's existing interconnection with Spectra Energy to the Kitimat LNG terminal. The pipeline is expected to have transportation capacity of roughly between 0.7bcf/d to 1.4bcf/d. The project is estimated to cost C$1.2 billion in 2006 dollars. With the Kitimat LNG FEED ongoing, there is also a parallel review of pipeline costs.

Construction of the facility is estimated to begin in 2012 with completion to coincide with the LNG terminal's in-service date which is expected to be in 2014.

A map of PNG's existing assets and the proposed KSL Project is shown in Exhibit 4.

Exhibit 4: PNG assets and proposed KSL Project (in red)

Source: Company data

The province of British Columbia also has an agreement with 15 of 16 First Nations bands in which lands the KSL Project passes through. The province will provide the First Nations C$32m to acquire an equity interest in PTP. The First Nations has the potential to acquire a 30% interest in the KSL Project. PTP is currently finalizing the agreements with the First Nations. If the First Nations acquires the maximum 30% interest in PTP, PNG expects it's ownership to remain greater than 40% after the contribution of its existing mainline transmission system to PTP, upon the completion of the KSL Project and regulatory and shareholder approval. The value is expected to be roughly C$100m.

First Nations can acquire up to a 30% interest in the KSL Project

Selected timelines for both the KSL Project and the LNG terminal are shown in Exhibit 5

Exhibit 5: Selected pipeline and terminal timelines

	Pacific Trail Pipelines	LNG Terminal
To Date	Provincial/Federal environmental approvals First Nations economic agreement with the BC government Apache joins project	Provincial/Federal environmental approvals. Apache joins projects.
2010	Secure shipper commitments File application with B.C. Utilities Commission Preliminary engineering	Commence front end engineering and design (FEED Study)
2011	BC Utilities Commission decision Secure debt commitments Final investment decision Raise equity	Final investment decision Award EPC contract Commence construction
2012	Commence construction	Continue construction
2013	Continue construction	Continue construction
2014	Targeted in service	Targeted in service

Source: Company data and Credit Suisse

Key conditions to begin construction of the pipeline would include securing capacity contracts; financing; regulatory approvals and a decision on the Kitimat LNG. Some risks exist on the KSL Project especially with regards to the FID on the LNG terminal as that process is controlled by Apache.

The KSL Project presents the Northeast BC shale producers another export option for their natural gas. This option will provide producers natural gas prices link to crude oil which should increase netbacks.

Horn River basin

Natural gas to supply the Kitimat LNG liquefaction terminal is expected to be sourced from the Horn River basin in Northeastern BC. Both BC shales, the Horn River and Montney have both been compared to the Barnett shale in Texas. Exhibit 6 shows a comparison for selected Canadian and US shales.

Exhibit 6: Selected characteristics of Canadian and US shales

	Barnett	Haynesville	Marcellus	Horn River	Montney
Depth (ft)	6,500-9,500	10,500-13,500	3,000-8,500	6,500-13,000	5,000-10,000
Thickness of Shale (ft)	100-500	200-300	50-250	300-600	300-500
Total Organic content (%)	3.0-7.0	3.0-5.0	3.0-12.0	3.0-10.0	2.5-6.0
Original Gas in place (Bcf/Section)	50-200	150-250	50-150	130-320	60-150
Recovery Factor (%)	20-40	20-40	20-40	20-40	20-40
Est. Ultimate recovery (Bcf/well)	1.0-4.0	4.5-8.5	2.2-4.1	3.0-9.0	2.0-6.0

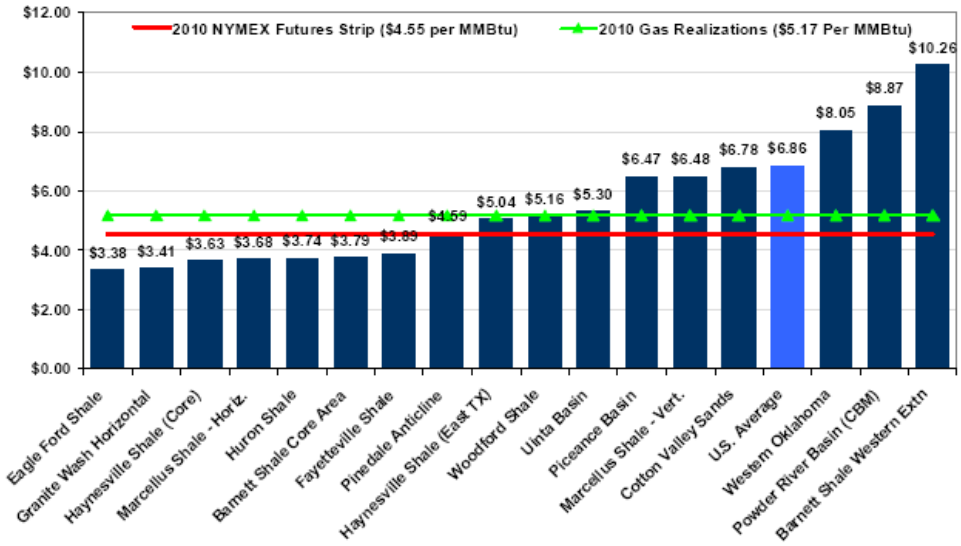
Source: Canadian Association of Petroleum Producers (CAPP)

A breakeven comparison on various US basins can be seen on Exhibit 7 which is from our US E&P team's report titled "*E&P Sector Book – 2010*" published on 4 May 2010.

Expected supply costs for Horn River US$4.39/MMbtu

The Horn River and Montney breakeven figures can be seen through EnCana Corp., who has a large position in both basins. In their 2010 Investor Day, EnCana stated that they expect their supply cost in the Horn River to decrease to US$4.39/MMBtu in 2010 from US$6.72/MMBtu in 2009. EnCana's supply cost for the Montney also drops to US$3.25-US$3.75/MMBtu in 2010 from US$3.50-US$4.00/MMBtu in 2009. Talisman Energy, in their 2010 Investor Day, expects full cycle break-even for 2010 in the Montney to be approximately US$4.00/MMBtu.

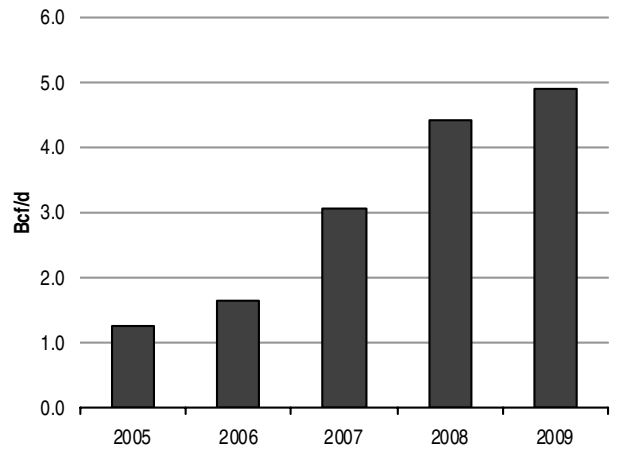
Exhibit 7: US Basin Breakeven NYMEX Natural Gas Prices for a 10% ATAX IRR ($ per MMBtu)



Note: Includes Direct Drilling plus acreage costs – PRB has 12-month dewatering period, Eagle Ford (20%) and Granite Wash (30-50%) include liquids. Source: Bloomberg, Company data, Credit Suisse estimates

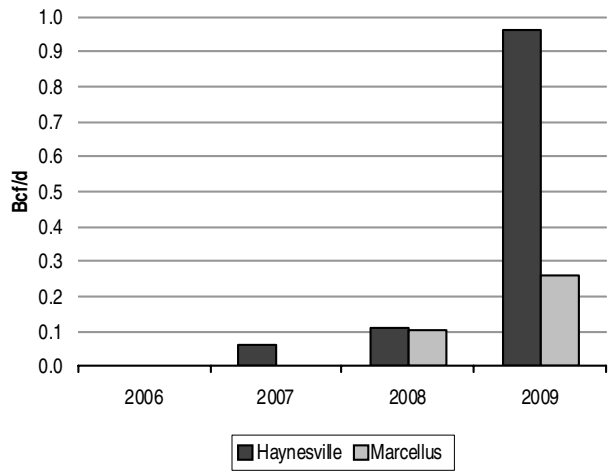
The Barnett shale has been called one of the more prolific shale basins for natural gas in North America. According to the Railroad Commission of Texas the shale has produced roughly 7.0Tcf of gas since 1993. Exhibit 8 and Exhibit 9 show daily gas production in the Barnett for the past five years as well as daily production from Haynesville and Marcellus since 2006.

Exhibit 8: Barnett shale production (Bcf/d)



Source: Energy Information Administration (EIA) and Credit Suisse

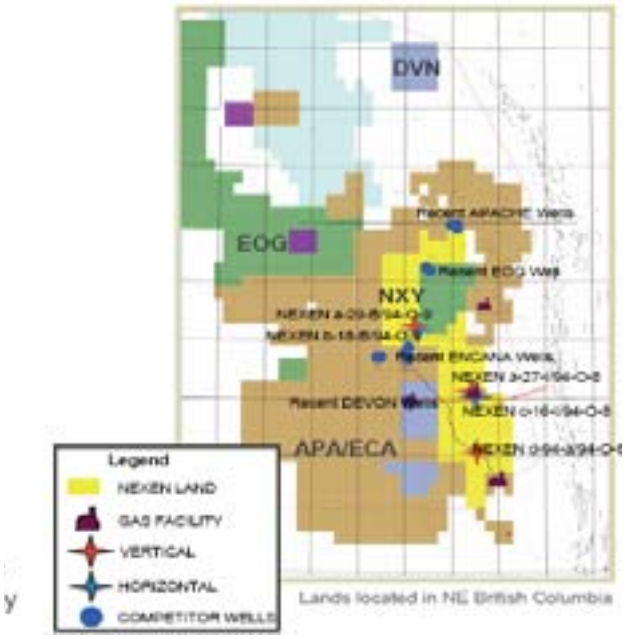
Exhibit 9: Haynesville & Marcellus production (Bcd/d)



Source: Energy Information Administration (EIA) and Credit Suisse

Exhibit 10 and Exhibit 11 shows select map of the Horn River and selected players and their respective net acreages. As can be seen from the table below, both Apache and EOG, who are involved in the Kitimat LNG liquefaction terminal, are large holders of land in the Horn River basin.

Exhibit 10: Selected acreage map of the Horn River



Source: Company data

Exhibit 11: Selected Horn River acreage owners

Company	Net Acreage ('000)
Exxon Mobil/Imperial Oil	309
EnCana	256
Apache Corp	220
Devon Energy	170
EOG Resources	158
QuickSilver Resources	130
ConocoPhillips	100
Nexen Inc	88
Pengrowth Energy Trust	70

Source: Company data and Credit Suisse

Horn River resource potential:

APA: 10Tcf

EOG: 9Tcf

Apache, earlier this year stated that their net estimated resource potential in the Horn River Basin exceeds 10Tcf. EOG Resources, in a recent investor presentation, estimates that its Horn River assets to have potential reserves of roughly 9Tcf (includes 850Bcf booked at the end of 2009). If the Horn River basin turns out to be as prolific as the Barnett, we believe that both partners in the Kitimat LNG terminal would have enough reserves in their Horn River acreage to be able to supply the liquefaction facility.

Construction of gas plant and pipelines to support natural gas growth in Northeast BC

A possible anecdotal evidence of the future potential productivity of the Horn River Basin is EnCana's proposal to build the Cabin Gas Plant located 60km north east of Fort Nelson, BC. The plant's initial capacity is 400mmcf/d and a potential final processing capacity of roughly 2.4bcf/d. The plant is supported by the Horn River Producers Group which consists of E&P companies that have acreage in the basin. The group includes Apache, Devon, EnCana, EOG, Nexen, Quicksilver, and Imperial Oil/ExxonMobil Canada. For greater detail see our Canadian Oil & Gas team's note titled "*Horn River Gas Plant Filing Highlights Resource Potential*" published on 6 January 2009.

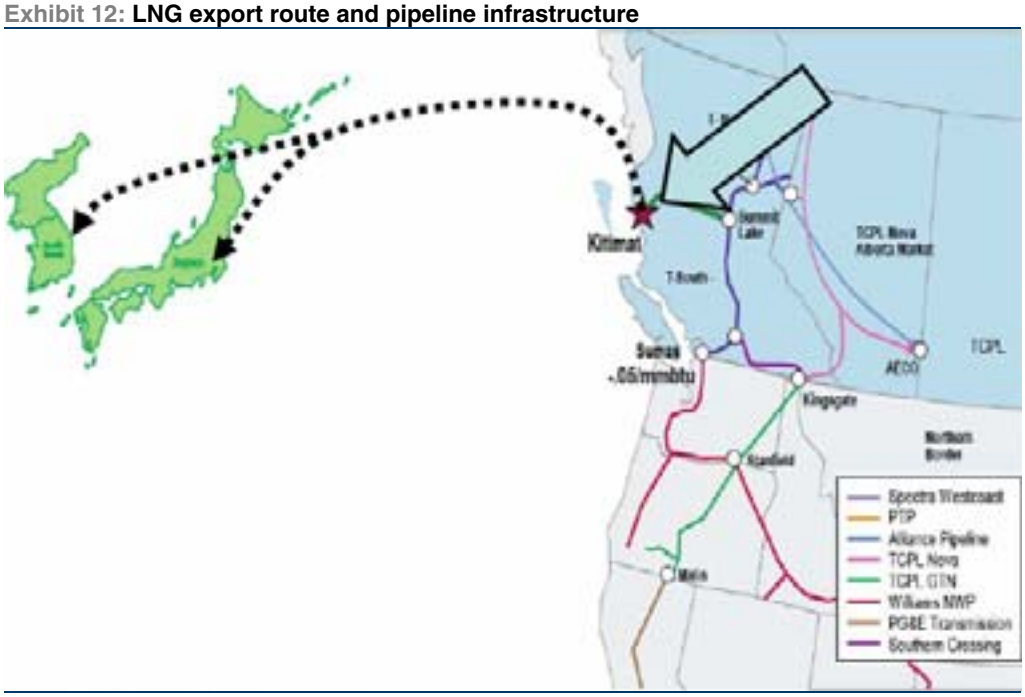
TransCanada is planning on building its Horn River pipeline which is a new 72km, 36 inch pipeline that will transport BC shale gas to its Alberta System. The pipeline has a capacity in excess of 1.0bcf/d. As of Q1 2010, TransCanada has received commitments for contracted gas of 503mmcf/d. The Horn River pipeline is expected to be in-service in Q2 2012 and will cost roughly C$310m.

Spectra Energy is also expanding its Fort Nelson asset base. The Fort Nelson expansion project, Spectra is a) reactivating existing processing capacity at its Fort Nelson gas plant; b) "looping and reconfiguration of area gathering and compression"; and, c) adding new processing capacity at its Cabin Lake compressor station. The expansion is expected to increase capacity by 790mmcd/d.

If the Horn River basin has similar productivity as the Barnett shale in Texas, there would be more than enough natural gas to accommodate planned natural gas infrastructures mentioned above.

Exhibit 12 shows the export route from Kitimat to Japan and South Korea. The map also shows pipeline options to take Horn River production through TransCanada's and Spectra Energy's pipeline network.

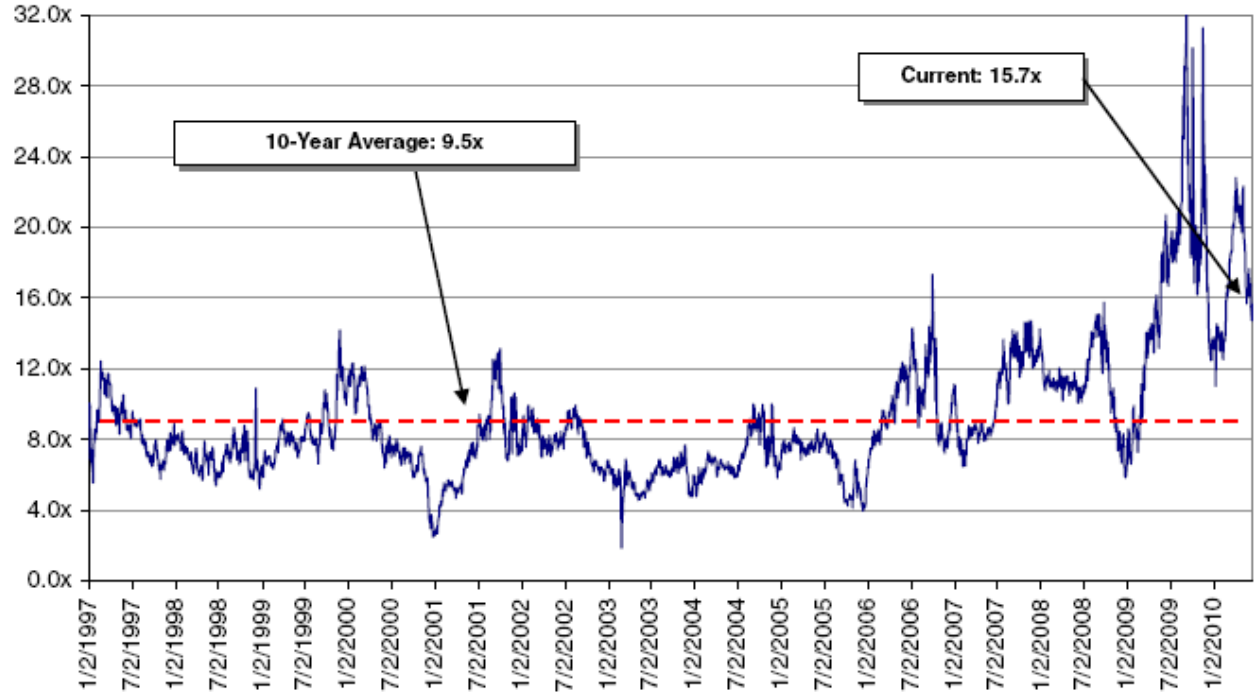
Exhibit 12: LNG export route and pipeline infrastructure



Source: Company data

One of the main reasons for the Kitimat LNG export terminal is for producers to be able to sell natural gas on a crude oil index basis in Asia. Exhibit 13, from our US E&P team's note titled "*EIA Reports 99 Bcf Fill*" on 10 June 2010, illustrates the historical crude oil to natural gas ratio. Theoretically, based on energy content the ration between crude oil and natural gas would be roughly 6.0. For the past 10 years the ratio has traded around 9.5x while currently it has increased to 15.7x. In Bloomberg, Japan LNG prices for USA LNG is roughly US$12.06/MMBtu.

Exhibit 13: Crude Oil to Natural Gas Ratio



Source: Bloomberg

Building the base

The largest growth opportunity for the company lies with the KSL Project, however there is growth within its existing asset base. This section is dividend into two sections, a) eastward expansion and b) filling up for FLNG (Floating Liquefied Natural Gas).

Eastward expansion

Pacific Northern Gas' existing assets are moving in diverging directions. Customer plant closures in the Western system caused a gradual decrease in volumes over the past years. The forestry industry located in the Western system has faced some challenges due to the strong Canadian dollar as well as the weak US housing market. The company is working on a project that could return the Western system to full capacity utilization. This project is discussed in more detail in the next section. On the other hand, the Northeast system continues to see customer additions due to the growth in the oil and gas sector in that area. The company is projecting to add roughly 250 new customers in the Northeast System (Dawson Creek division) in 2010. Exhibit 14 shows customer additions/subtractions within each of PNG's system.

Diverging asset performance

Exhibit 14: Customer additions

	2009	2008	2007	2006	2005
Northeast System	227	270	317	367	420
Western System	(227)	(185)	(255)	(151)	(416)
Net adds	-	85	62	216	4

Source: Company data and Credit Suisse

Exhibit 15 displays the company's natural gas deliveries.

Exhibit 15: System volumes (in TJ)

	2009	2008	2007	2006	2005
Sales: Western system	2,965	3,070	3,162	3,466	3,686
Sales: Northeast system	3,765	3,608	3,505	3,539	3,302
Transportation service: Western	3,214	3,572	4,469	3,516	24,018
Transportation service: Northeast	2,201	2,292	2,074	1,874	1,838
	12,145	12,542	13,210	12,395	32,844

Source: Company data and Credit Suisse

Filling up for FLNG

PNG is currently working on a project that could bring full capacity utilization to the Western system. The project involves an agreement which was approved by the BCUC (British Columbia Utilities Commission) in April 2009 that provides Merrill Lynch an option to contract for 75mmcfd of firm capacity on PNG's Western System. This option, if exercised will increase pipeline utilization to close to full capacity. Merrill Lynch will use the capacity to transport natural gas to Teekay Corporations' floating liquefied natural gas (FLNG) vessel on the Douglas Channel near Kitimat. The FLNG is expected to have a capacity to liquefy 75-100mmcfd. The LNG would then be transferred from the floating LNG plant to other LNG vessels for export. This project was initially expected to commence in 2012, however, in the Teekay LNG Partners LP Q4 2009 conference call, the company stated that they have currently put the project on the shelf due to the current expected lower economic returns.

Merrill Lynch agreement could bring Northwest system to full capacity utilization

Selected items about the Merrill Lynch agreement includes:

- The agreement between Merrill Lynch and PNG was for Merrill Lynch to have an exclusive option until December 2009 to contract for firm capacity for a two to five year primary term with a right to renew for an additional two to five year term.
- The Merrill Lynch paid a C$1m option extension fee to extend the option to June 30, 2010.

- Merrill Lynch can extend the option period by up to three six month periods for C$1m for each extension.
- The transportation agreement discussion between Merrill Lynch and PNG is ongoing. A transportation agreement would require BCUC approval. If the BCUC does not approve of the transportation agreement, PNG would have to refund Merrill Lynch the option fees.

Other opportunities

Aside from the KSL Project and organic growth within its base business, the company has other opportunities such as its expansion into hydroelectric generation. The company could be an acquisition target for some utility and infrastructure player willing to pay for the option value of the KSL Project. Yet we consider this type of acquisition to be a relatively low probability scenario. This section is dividend into two parts, a) highlighting hydro; b) takeover target thoughts; and, c) capital considerations.

Highlighting hydro

Hydroelectric generation expansion

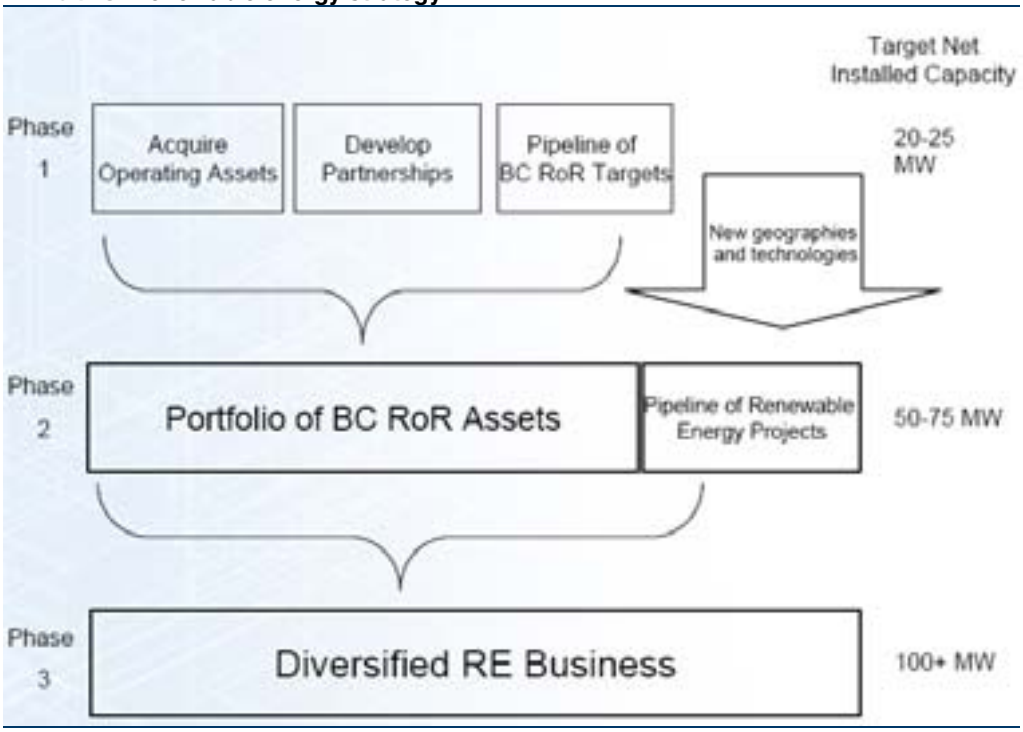
The company's entrance into renewable power generation, more specifically run-of-river, in April 2010 when the company announced the launch of its renewable power business by forming a partnership with Skookum Power Corporation and the acquisition of a 97% interest in the McNair Creek hydroelectric generation facility. McNair Creek is a 9.8MW run of river facility located on the B.C. Sunshine Coast near Port Mellon that commenced operation on November 2004. PNG's share of the C$17m acquisition costs was funded via assuming existing McNair Creek debt and the use of its existing bank facility.

Renewable partner were former Brookfield Renewable employees

The company also entered into a development and operating agreement with Skookum Power. The agreement would allow PNG to leverage off Skookum's extensive expertise in hydroelectric generation. Skookum Power management were formerly with Brookfield Renewable, which is one of the largest owners, operators and developers of hydroelectric generation in North America and Brazil. This partnership should give PNG the immediate expertise it requires to make sound investment decision in this sector while building up its internal capabilities.

The company's renewable energy strategy is illustrated in the exhibit below.

Exhibit 16: **Renewable energy strategy**



Source: Company data

According to its strategy, PNG will acquire existing operating run-of-river assets to create scale and expertise. Once a certain scale is achieved, the company will take on more development risk by targeting development run-of-river projects. The company's reasons for moving into the renewable energy field are as follows:

- "Utilize its operating skills, permitting expertise, project management capabilities, financing acumen and energy market and regulatory expertise" and
- "Existence of both operating projects and development projects that are available in sized which fit PNG's access to capital".

We believe the company's approach in its expansion into the renewable energy field is prudent as it's similar to that of another pipeline company's expansion into the solar energy field. With long-term PPAs attached to renewable generation with government counterparties, the risk profile is similar to that of its regulated pipeline/utility business.

Takeover target thoughts

Even though we believe it to be a low probability, Pacific Northern Gas could be a potential target for some utility and infrastructure player willing to pay for the option value of the KSL Project. PNG would be attractive for a number of reasons:

- Organic growth predominantly through the KSL Project and renewable generation
- Relationships with First Nations
- Stable regulatory regime

Potential acquirers could include Emera Inc., Fortis Inc. and various Canadian pension funds. We view the outright acquisition of PNG to be a relatively low a probability event.

Capital considerations

Pacific Northern Gas has stated in their investor presentations that they plan on accessing the equity capital markets to help them fund their portion of the KSL Project. The size of

the project is currently larger compared to the market capitalization of the company. A large equity issuance would be an opportunity to increase institutional ownership in PNG shares. Currently, PNG shares are largely held by retail investors.

We believe the company has other options aside from the capital markets. The company could also form a joint venture with financial partners such as pension funds. This would allow the company to lessen the equity issuance size.

Financials

Most fundamental to our approach for analyzing longer duration assets is the need to have explicit financial forecasts for an extended time horizon. This approach is obviously subject to a number of caveats and assumptions, however, it possesses great utility for assets like those in the capital intensive infrastructure industry. A major drawback for employing a longer-term financial model for Pacific Northern Gas is the lack of clarity/details surrounding the KSL Project due to the nature of the undertaking. As a result of the numerous assumptions that could still change in the KSL Project and the many challenges in accurately forecasting longer-term growth in its renewable generation segment, we place considerable reliance upon our five-year outlook which is highlighted throughout this section rather than our extended financial model. This outlook and forecast does not include the KSL Project or growth in its renewable business unless otherwise indicated.

Some of the highlights from our summary income statement (Exhibit 17) include:

- The increase in earnings for 2011 is based on increase in rate base from the growth in the Northeast System;
- Earnings gradually fade as we do not forecast future acquisition with PNG's renewable portfolio; and,
- Dividend increases is possible going forward due to the estimated 2010 pay out ratio which is roughly 55%. We do not forecast a dividend increase due to the uncertainly on the KSL Project.

Exhibit 17: Summary income statement
C$ in millions, unless otherwise stated

	2010	2011	2012	2013	2014	2015
Revenue	99.5	100.5	99.5	98.6	97.7	96.8
Cost of gas	47.5	47.9	47.4	46.9	46.4	45.9
Operating margin	52.1	52.5	52.1	51.7	51.3	50.9
Operating & maintenance	12.1	12.0	11.9	11.7	11.6	11.5
Administration & general	8.2	7.8	7.8	7.7	7.6	7.5
Other operating expenses	13.9	14.7	14.5	14.4	14.3	14.2
Total operating expense	34.3	34.5	34.1	33.8	33.5	33.2
Operating income	17.8	18.1	18.0	17.8	17.7	17.6
Other income	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)
Financiang & other expenses	7.1	7.4	7.4	7.4	7.4	7.4
Net inome before taxes	10.7	10.7	10.6	10.4	10.3	10.2
Taxes	2.9	2.7	2.6	2.6	2.6	2.6
Net income	7.8	8.0	7.9	7.8	7.7	7.7
Dividends on preferred shares	0.3	0.3	0.3	0.3	0.3	0.3
Income for common shares	7.5	7.7	7.6	7.5	7.4	7.3
Basic EPS (w/CS adjustments)	2.09	2.14	2.11	2.09	2.07	2.04
Diluted EPS (w/CS adjustments)	2.04	2.09	2.07	2.04	2.02	2.00
Basic Weighted Average Shares (m)	3.59	3.59	3.59	3.59	3.59	3.59
Diluted Weighted Average Shares (m)	3.66	3.66	3.67	3.67	3.67	3.67
Dividends declared per common share	1.12	1.12	1.12	1.12	1.12	1.12
Dividends declared per preferred share	1.69	1.69	1.69	1.69	1.69	1.69

Source: Company data and Credit Suisse estimates

We have included below in Exhibit 18, for illustrative purposes, a summary income statement which includes the KSLP Project. Selected assumptions used include:

- Construction commences in the beginning of 2012 and is completed at the beginning of 2014;
- Equity issuance to fund the project occurs at the beginning of 2012 at an issue price of C$25.00 per share, raising roughly C$125m;

Exhibit 18: Summary income statement including KSL Project (for illustrative purposes)
C$ in millions, unless otherwise stated

	2010	2011	2012	2013	2014	2015
Revenue	99.5	100.5	99.5	98.6	169.8	164.2
Cost of gas	47.5	47.9	47.4	46.9	16.9	16.9
Operating margin	52.1	52.5	52.1	51.7	152.9	147.3
Operating & maintenance	12.1	12.0	11.9	11.7	44.9	44.5
Administration & general	8.2	7.8	7.8	7.7	2.8	2.8
Other operating expenses	13.9	14.7	14.5	14.4	34.2	29.7
Total operating expense	34.3	34.5	34.1	33.8	81.9	76.9
Operating income	17.8	18.1	18.0	17.8	70.9	70.3
Other income	(0.0)	(0.0)	(14.4)	(38.2)	(0.0)	(0.0)
Financiang & other expenses	7.1	7.4	15.4	31.2	38.0	38.0
Net inome before taxes	10.7	10.7	17.0	24.8	33.0	32.4
Taxes	2.9	2.7	4.3	6.2	8.2	8.1
Net income	7.8	8.0	12.8	18.6	24.7	24.3
Dividends on preferred shares	0.3	0.3	0.3	0.3	0.3	0.3
Income for common shares	7.5	7.7	12.4	18.3	24.4	24.0
Basic EPS (w/CS adjustments)	2.09	2.14	1.45	2.13	2.84	2.79
Diluted EPS (w/CS adjustments)	2.04	2.09	1.43	2.11	2.82	2.77
Basic Weighted Average Shares (m)	3.59	3.59	8.59	8.59	8.59	8.59
Diluted Weighted Average Shares (m)	3.66	3.66	8.67	8.67	8.67	8.67
Dividends declared per common share	1.12	1.12	1.12	1.12	1.12	1.12
Dividends declared per preferred share	1.69	1.69	1.69	1.69	1.69	1.69

Source: Company data and Credit Suisse estimates

Dividends and earnings are obviously meaningful in the infrastructure industry, however, cash flow generation is arguably more important over a period of time. A summary cash flow statement appears in Exhibit 19. Notable points from our cash flow statement include:

- The majority of PNG's capital allocation going forward will be directed to the growth in the Northeast System;
- We do not forecast any acquisitions related to the company's renewable segment; and,

Exhibit 19: Summary cash flow statement
C$ in millions, unless otherwise stated

	2010	2011	2012	2013	2014	2015
Net Income	7.8	8.0	7.9	7.8	7.7	7.7
Future income taxes	0.1	0.1	0.1	0.1	0.1	0.1
Depreciation	9.0	8.8	8.7	8.6	8.6	8.5
Stock Option Expense	0.0	-	-	-	-	-
Inputed Interest On Deferred Charges	0.2	-	-	-	-	-
Other	(0.1)	-	-	-	-	-
	16.4	16.9	16.8	16.6	16.4	16.3
Non cash working capital changes	(7.4)	-	-	-	-	-
Cash from Operating Activities	9.0	16.9	16.8	16.6	16.4	16.3
Additions to plant, property and equipment	(11.0)	(5.7)	(5.7)	(5.6)	(5.6)	(5.5)
Additions to plant, property and equipment - Energy	(17.7)	(1.4)	(1.4)	(1.4)	(1.4)	(1.4)
Cash from Investing Activities	(28.6)	(7.1)	(7.0)	(7.0)	(6.9)	(6.9)
Bank Debt, Net	1.9	-	-	-	-	-
Issue of long term debt	21.5	-	-	-	-	-
Dividend Paid	(4.4)	(4.4)	(4.4)	(4.4)	(4.4)	(4.4)
Cash from Financing Activities	19.3	(4.4)	(4.4)	(4.4)	(4.4)	(4.4)
Net Change in Cash	(0.3)	5.5	5.4	5.3	5.2	5.1
Net Cash - Beginning Balance	1.5	1.2	6.7	12.1	17.4	22.6
Net Cash - Ending Balance	1.2	6.7	12.1	17.4	22.6	27.6

Source: Company data and Credit Suisse estimates

Our summary forecast balance sheet for the years 2010-2015 appears in Exhibit 20 below.

Exhibit 20: Summary balance sheet
C$ in millions, unless otherwise stated

	2010	2011	2012	2013	2014	2015
Cash	1.2	6.7	12.1	17.4	22.6	27.6
Accounts Receivable	16.8	16.8	16.8	16.8	16.8	16.8
Gas purchase variance recoverable	5.5	5.5	5.5	5.5	5.5	5.5
Inventories of supplies and natural gas	0.9	0.9	0.9	0.9	0.9	0.9
Prepaid Expenses	1.0	1.0	1.0	1.0	1.0	1.0
Derivative financial instruments	-	-	-	-	-	-
Future income taxes	1.5	1.4	1.2	1.1	1.0	0.8
Total Current Assets	26.9	32.3	37.6	42.7	47.8	52.7
Plant property and equipment	181.7	180.0	178.3	176.6	174.9	173.3
Total other assets	16.0	16.0	16.0	16.0	16.0	16.0
Total Assets	241.6	245.3	248.8	252.3	255.7	259.0
Bank Debt	2.5	2.5	2.5	2.5	2.5	2.5
Accounts payable and accrued liabilites	13.2	13.2	13.2	13.2	13.2	13.2
Income taxes payable	1.2	1.2	1.2	1.2	1.2	1.2
Other taxes payable	2.8	2.8	2.8	2.8	2.8	2.8
Current Portion LTD	2.8	2.8	2.8	2.8	2.8	2.8
Derivative financial instruments	6.3	6.3	6.3	6.3	6.3	6.3
Total Current Liabilities	28.7	28.7	28.7	28.7	28.7	28.7
Long Term Debt	95.2	95.2	95.2	95.2	95.2	95.2
Future income taxes	16.8	16.8	16.8	16.8	16.8	16.8
Other Long Term Liabilities	6.5	6.5	6.5	6.5	6.5	6.5
Total Liabilities	147.2	147.2	147.2	147.2	147.2	147.2
Preferred Shares	5.0	5.0	5.0	5.0	5.0	5.0
Common Shares	9.0	9.0	9.0	9.0	9.0	9.0
Surplus	4.1	4.1	4.1	4.1	4.1	4.1
Retained Earning	76.3	80.0	83.5	87.0	90.4	93.7
Total Equity	94.4	98.0	101.6	105.1	108.4	111.8
Total Liabilities & Shareholders' Equity	241.6	245.3	248.8	252.3	255.7	259.0

Source: Company data and Credit Suisse estimates

Valuation

Consistent with our past practice, we utilize multiple valuation methodologies to obtain our Pacific Northern Gas target price and rating. Our Neutral rating and C$26.00 target price are largely the result of three distinct types of analysis, including:

(1) multiple analyses;

(2) yield analyses; and,

(3) a discounted cash flow.

Rating: Neutral

Target: C$26.00

Each of these areas will be addressed in the sections below.

Our comparative analyses appearing below relied substantially upon FactSet and Bloomberg. We note that comparisons of companies within the energy infrastructure sector have been challenging for many reasons, including: business mix; asset quality; regulatory regimes; the nature and extent of commodity exposure; and business risks. Our comparative universe is divided into two distinct parts: (a) selected Canadian companies including: Emera, Fortis; Enbridge, Canadian Utilities; and, TransCanada; and, (b) selected small capitalized US utilities including: Corning Natural Gas Corp.; Energy Inc.; RGC Resources; Delta Natural Gas Company; Chesapeake Utilities Corp.; and, Central Vermont Public Service Corp. A brief discussion of these comparable companies and a comparative valuation table are included in Appendices I and II.

As a caveat, investors should be aware that much of the valuation data was obtained from FactSet and Bloomberg. Therefore, the data should be internally consistent with FactSet's and Bloomberg's approach, but it may not be entirely consistent with other methods of financial reporting or analysis. From our perspective, the potential utility and internal consistency of the FactSet and Bloomberg data outweighs any apparent inconsistency between calculation methods. Yet, investors should be aware of the above caveat.

Discussion around Pacific Northern Gas' valuation in this section consist of the company's current business and does not include the KSL Project and potential growth in its renewable generation business, unless otherwise noted.

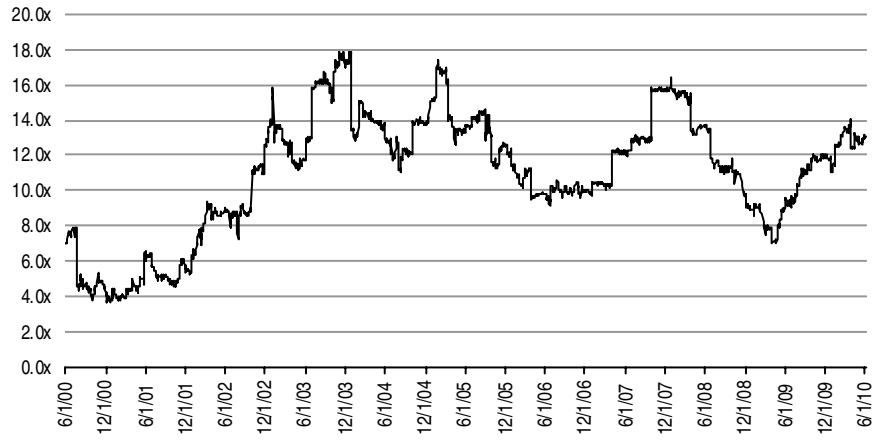
Multiple analyses

Our analysis in this section is divided into three areas: (a) price-to-earnings; (b) price-to-book; and, (c) EV/EBTIDA.

Price-to-earnings

According to Bloomberg data, over the last 10 years, Pacific Northern Gas has traded at an average trailing P/E multiple of 10.99x within a range of 3.66x-17.89x. A statistical summary of the company's price-to-earnings ratio appears below in tabular form and as a chart.

Exhibit 21: Historical price-to-earnings multiple



Source: Bloomberg and Credit Suisse

Exhibit 22: 10-year P/E

Mean	10.99x
Median	11.43x
Standard Deviation	3.44
Range	14.23
Minimum	3.66x
Maximum	17.89x

Source: Bloomberg and Credit Suisse

Our comparative trailing earnings multiple analysis appears in the Exhibit 23 below.

Exhibit 23: Comparable company historical P/E multiples

	Canadian Utilities	Enbridge Inc.	Fortis Inc.	Emera Inc.	Corning Natural Gas	Energy Inc.	RGC Resources	Delta Natural Gas	Chesapeake Utilities	Central Vermont Public Service	TransCanada Corp.	Pacific Northern Gas
6 month average	13.37	19.90	18.82	16.08	17.78	7.97	14.36	18.94	13.54	12.41	18.11	12.66
1 year average	12.49	18.66	17.85	15.80	16.88	9.31	13.54	17.82	14.30	12.11	16.78	11.76
2 year average	12.71	19.13	16.91	15.22	18.06	10.52	13.50	14.75	14.23	11.99	15.96	10.83
3 year average	13.87	20.11	18.40	15.82	22.64	13.79	14.00	15.01	14.98	14.22	16.89	11.98
4 year average	14.68	20.54	19.31	16.47	26.83	14.04	14.71	15.40	15.57	16.35	17.49	11.60
5 year average	15.44	21.44	20.00	16.80	25.17	14.38	15.27	15.49	16.06	121.31	18.16	11.68
10 year average	14.83	19.68	17.21	15.91	24.72	27.76	14.50	15.54	15.45	69.66	16.99	10.99

Source: FactSet, Bloomberg and Credit Suisse

Trailing earnings multiples have some utility for valuation purposes, however, we rely upon forward multiples to a much greater degree. Some of the tables below provide forward earnings data for Pacific Northern Gas and the comparable companies sourced from FactSet data with IBES estimates over various time frames.

Exhibit 24: IBES 1 year forward P/E multiples

	Canadian Utilities	Enbridge Inc.	Fortis Inc.	Emera Inc.	Corning Natural Gas	Energy Inc.	RGC Resources	Delta Natural Gas	Chesapeake Utilities	Central Vermont Public Service	TransCanada Corp.	Pacific Northern Gas
6 month average	14.29	19.25	17.22	15.86	n/a	n/a	n/a	17.89	14.37	12.57	17.22	12.36
1 year average	13.47	18.71	17.05	15.45	n/a	n/a	n/a	16.53	14.68	12.24	16.45	11.88
2 year average	13.54	19.49	16.52	15.69	n/a	n/a	n/a	14.69	14.62	12.64	15.86	10.88
3 year average	14.67	20.20	17.33	16.19	n/a	n/a	n/a	15.27	15.10	15.39	16.62	11.92
4 year average	15.47	20.49	17.93	16.69	n/a	n/a	n/a	15.55	15.57	15.39	17.32	12.97
5 year average	16.11	20.70	18.21	17.08	n/a	n/a	n/a	15.74	16.07	15.39	17.81	12.78
10 year average	15.22	18.94	16.28	15.84	n/a	14.80	13.31	15.99	15.18	15.39	16.48	12.59

Source: FactSet, Bloomberg and Credit Suisse

Exhibit 25: IBES 2 year forward P/E multiples

	Canadian Utilities	Enbridge Inc.	Fortis Inc.	Emera Inc.	Corning Natural Gas	Energy Inc.	RGC Resources	Delta Natural Gas	Chesapeake Utilities	Vermont Public Service	TransCanada Corp.	Pacific Northern Gas
6 month average	13.63	17.55	15.90	15.59	n/a	n/a	n/a	n/a	13.23	12.15	15.63	11.88
1 year average	12.90	17.07	15.80	15.15	n/a	n/a	n/a	13.65	13.52	11.91	14.92	11.46
2 year average	13.24	17.45	15.59	15.21	n/a	n/a	n/a	14.74	13.51	12.12	14.78	10.39
3 year average	14.41	18.23	16.11	15.60	n/a	n/a	n/a	15.47	14.02	14.22	15.52	10.71
4 year average	15.32	18.73	16.61	16.05	n/a	n/a	n/a	15.61	14.47	14.22	16.16	10.82
5 year average	15.83	19.04	16.93	16.22	n/a	n/a	n/a	15.58	14.98	14.22	16.66	11.03
10 year average	14.71	17.34	15.24	14.95	n/a	13.72	11.76	15.72	14.31	14.22	15.53	11.09

Source: FactSet, Bloomberg and Credit Suisse

In Exhibit 26 we provide a share price matrix using a range of P/E multiples for a select earnings range.

Exhibit 26: Share price at different earnings per share and multiples

	1.70	1.80	1.90	2.00	2.10	2.20
8.0x	13.60	14.40	15.20	16.00	16.80	17.60
9.0x	15.30	16.20	17.10	18.00	18.90	19.80
10.0x	17.00	18.00	19.00	20.00	21.00	22.00
11.0x	18.70	19.80	20.90	22.00	23.10	24.20
12.0x	20.40	21.60	22.80	24.00	25.20	26.40
13.0x	22.10	23.40	24.70	26.00	27.30	28.60
14.0x	23.80	25.20	26.60	28.00	29.40	30.80
15.0x	25.50	27.00	28.50	30.00	31.50	33.00

Source: Credit Suisse estimates

In Exhibit 27 we provide a share price matrix using a range of P/E multiples for our forecasted earnings.

Exhibit 27: Share price at future earnings per share and different multiples

	2010	2011	2012	2013	2014
8.0x	16.35	16.74	16.54	16.35	16.17
9.0x	18.39	18.84	18.61	18.40	18.20
10.0x	20.44	20.93	20.67	20.44	20.22
11.0x	22.48	23.02	22.74	22.49	22.24
12.0x	24.52	25.11	24.81	24.53	24.26
13.0x	26.57	27.21	26.87	26.57	26.28
14.0x	28.61	29.30	28.94	28.62	28.31
15.0x	30.65	31.39	31.01	30.66	30.33

Source: Credit Suisse estimates

On a price-earnings basis, we utilize a 12.5x multiple on our 2011 EPS estimate to obtain our C$26.00 target price.

Given the final investment decision won't be made by Apache with regards to Kitimat LNG until next year and the final cost estimates for the KSL Project has yet to be completed, we provide a hypothetical share price matrix that includes the KSL Project using EPS at 2014 which we assume to be the first full year of the KSL Project. Due to multiple assumptions that have yet to be finalize such as total project costs, return of equity, allowed capital structure, ownership interest, etc., we view the following table for illustrative purposes.

Exhibit 28: Hypothetical share price base on 2014 EPS at different multiples and different equity issue price with KSL Project

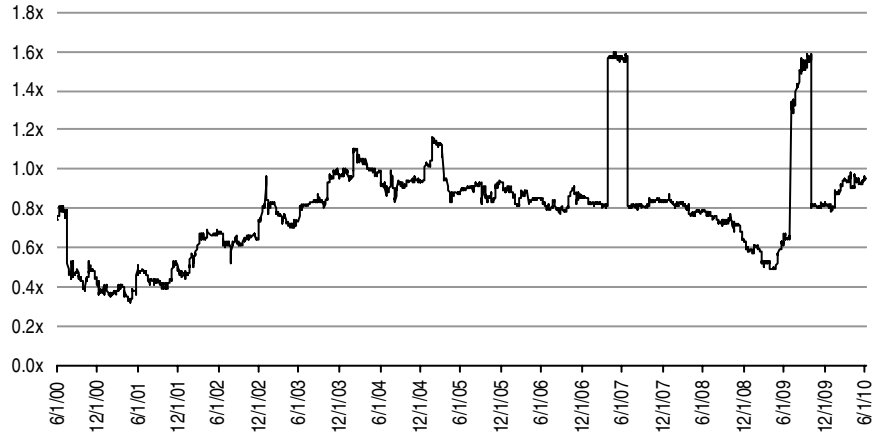
	Equity Issue Price					
	20.00	**22.00**	**24.00**	**26.00**	**28.00**	**30.00**
8.0x	19.69	20.89	22.00	23.04	24.02	24.93
9.0x	22.15	23.50	24.75	25.92	27.02	28.04
10.0x	24.61	26.11	27.50	28.80	30.02	31.16
11.0x	27.07	28.72	30.25	31.68	33.02	34.28
12.0x	29.54	31.33	33.00	34.56	36.02	37.39
13.0x	32.00	33.94	35.75	37.44	39.03	40.51
14.0x	34.46	36.55	38.50	40.32	42.03	43.63
15.0x	36.92	39.16	41.25	43.21	45.03	46.74

Source: Credit Suisse estimates

Price-to-book

On a historic basis, Pacific Northern Gas has traded at a 10 year average price-to-book multiple of 0.80x and within a range of 0.32x-1.59x. A statistical summary of the company's price-to-book ratio appears below in tabular form and as a chart.

Exhibit 29: Historical price-to-book multiple



Source: Bloomberg and Credit Suisse

Exhibit 30: 10-year P/B

Mean	0.80x
Median	0.82x
Standard Deviation	0.25
Range	1.27
Minimum	0.32x
Maximum	1.59x

Source: Bloomberg and Credit Suisse

We provide a comparative trailing book value analysis that appears in Exhibit 31 below. As evidence by the table, PNG consistently trades at a lower price-to-book multiple that many of its peers, however over the years it can be seen that the company's historical P/B multiples have increased.

Exhibit 31: Comparable company historical price-to-book multiples

	Canadian Utilities	Enbridge Inc.	Fortis Inc.	Emera Inc.	Corning Natural Gas	Energy Inc.	RGC Resources	Delta Natural Gas	Chesapeake Utilities	Central Vermont Public Service	TransCanada Corp.	Pacific Northern Gas
6 month average	1.84	2.50	1.51	1.85	1.71	1.24	1.47	1.63	1.39	1.04	1.61	0.90
1 year average	1.73	2.34	1.45	1.72	1.71	1.20	1.40	1.53	1.53	1.01	1.54	1.01
2 year average	1.79	2.36	1.43	1.62	1.70	1.21	1.36	1.45	1.56	1.05	1.62	0.83
3 year average	1.98	2.50	1.51	1.64	1.82	1.56	1.38	1.47	1.64	1.26	1.79	0.84
4 year average	2.06	2.61	1.66	1.64	1.98	1.61	1.37	1.49	1.72	1.29	1.93	0.87
5 year average	2.10	2.68	1.71	1.63	1.87	1.61	1.37	1.53	1.81	1.24	2.02	0.87
10 year average	1.99	2.59	1.61	1.52	1.77	1.52	1.30	1.56	1.73	1.16	1.95	0.80

Source: FactSet, Bloomberg and Credit Suisse

Our C$26.00 target price equates to a roughly a 1.0x price-to-book multiple applied to our year end 2011 book value per share estimate. Exhibit 32 highlights a valuation matrix under our forecast book values per share and various multiples.

Exhibit 32: Share price at forecast book value per share and different multiples

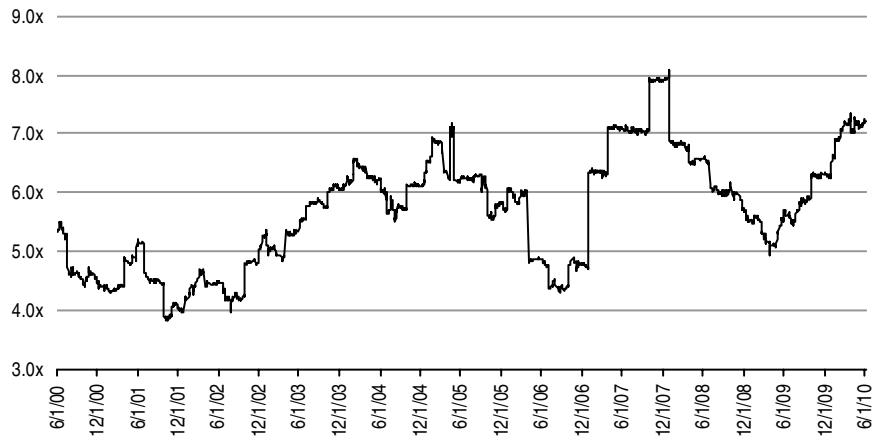
	2010	2011	2012	2013	2014
0.5x	12.46	12.97	13.46	13.94	14.41
0.6x	14.96	15.57	16.15	16.73	17.30
0.7x	17.45	18.16	18.84	19.52	20.18
0.8x	19.94	20.75	21.53	22.30	23.06
0.9x	22.43	23.35	24.22	25.09	25.94
1.0x	24.93	25.94	26.91	27.88	28.83
1.1x	27.42	28.54	29.61	30.67	31.71
1.2x	29.91	31.13	32.30	33.46	34.59

Source: Credit Suisse estimates

EV/EBITDA

Our analysis of 10-year of Bloomberg data concluded that Pacific Northern Gas' average EV/EBITDA multiple has been 5.68x and within a range of 3.82x to 8.07x. A statistical summary and a chart appear below.

Exhibit 33: Historical EV/EBITDA multiple



Source: Bloomberg and Credit Suisse

Exhibit 34: 10 year EV/EBITDA

Mean	5.68x
Median	5.79x
Standard Deviation	0.96
Range	4.25
Minimum	3.82x
Maximum	8.07x

Source: Bloomberg and Credit Suisse

A comparative trailing EV/EBITDA analysis appears in Exhibit 35.

Exhibit 35: Comparable company historical EV/EBITDA multiples

	Canadian Utilities	Enbridge Inc.	Fortis Inc.	Emera Inc.	Corning Natural Gas	Energy Inc.	RGC Resources	Delta Natural Gas	Chesapeake Utilities	Central Vermont Public Service	TransCanada Corp.	Pacific Northern Gas
6 month average	8.17	16.01	10.64	10.47	18.78	6.30	6.62	9.84	8.35	11.39	11.21	6.94
1 year average	7.72	14.83	10.32	10.79	17.35	5.83	6.09	9.40	8.10	11.43	10.54	6.44
2 year average	7.58	14.50	10.15	9.98	16.07	6.75	6.29	8.57	7.95	11.04	10.07	6.08
3 year average	7.86	14.32	12.69	9.44	12.12	6.65	6.50	8.53	8.02	11.59	9.95	6.43
4 year average	7.87	14.16	15.06	9.24	5.51	6.74	6.76	8.59	8.17	11.24	9.92	6.20
5 year average	7.92	14.01	15.24	9.20	6.35	6.74	7.00	8.66	8.18	11.59	9.87	6.12
10 year average	7.61	13.41	12.13	9.22	8.22	8.41	6.69	8.74	7.65	9.80	8.97	5.68

Source: FactSet, Bloomberg and Credit Suisse

Exhibit 36 displays an EV/EBITDA matrix.

Exhibit 36: Share price on forecasted future EBITDA at different multiples

	2010	2011	2012	2013	2014
5.0x	7.23	9.72	10.92	12.09	13.25
6.0x	14.37	17.06	18.19	19.32	20.42
7.0x	21.51	24.40	25.47	26.54	27.59
8.0x	28.65	31.73	32.75	33.76	34.76
9.0x	35.79	39.07	40.02	40.99	41.94
10.0x	42.93	46.40	47.30	48.21	49.11

Source: Credit Suisse estimates

Our C$26.00 target price implies roughly a 7.25x EV/EBITDA multiple based upon 2011 estimates.

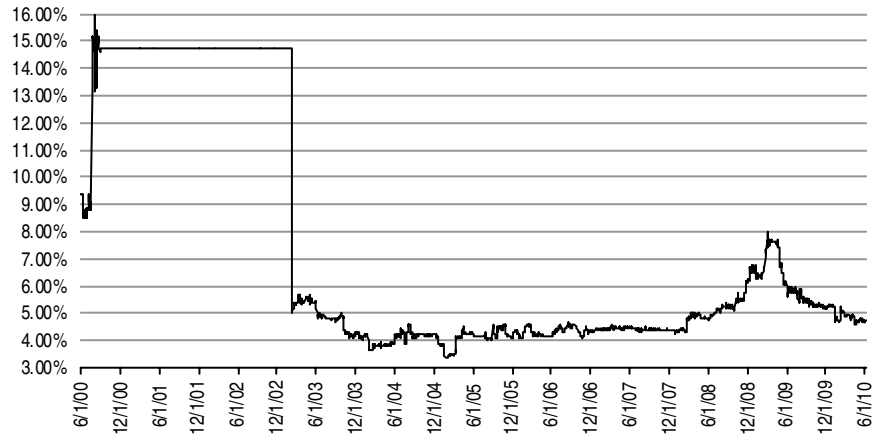
Yield analyses

As with much of the Canadian infrastructure sector, we believe it is useful to consider yield related analysis. Specifically, we address: (a) the dividend yield; and, (b) the dividend yield spread.

Dividend yield

According to Bloomberg data, Pacific Northern Gas has traded at an average dividend yield of 7.3% over the last 10 years and within a range of 3.3% to 15.9% (see Exhibit 37 and Exhibit 38).

Exhibit 37: Historical Pacific Northern Gas dividend yield



Source: Bloomberg and Credit Suisse

Exhibit 38: 10-year dividend yield

Mean	7.3%
Median	4.9%
Standard Deviation	0.04
Range	12.6%
Minimum	3.3%
Maximum	15.9%

Source: Bloomberg and Credit Suisse

For several reasons, we believe these metrics should be compared to movements in the Canadian 10-year bond yield (Exhibit 39).

Exhibit 39: Canadian 10 year bond yield

Source: Bloomberg and Credit Suisse

The sensitivity of dividend yield valuation is clearly evident in the matrix below with various distribution levels at various targeted yields.

Exhibit 40: Share value based on various dividends at various yields

	0.90	1.00	1.10	1.20	1.30
4.0%	22.50	25.00	27.50	30.00	32.50
4.5%	20.00	22.22	24.44	26.67	28.89
5.0%	18.00	20.00	22.00	24.00	26.00
5.5%	16.36	18.18	20.00	21.82	23.64
6.0%	15.00	16.67	18.33	20.00	21.67
6.5%	13.85	15.38	16.92	18.46	20.00
7.0%	12.86	14.29	15.71	17.14	18.57
7.5%	12.00	13.33	14.67	16.00	17.33
8.0%	11.25	12.50	13.75	15.00	16.25

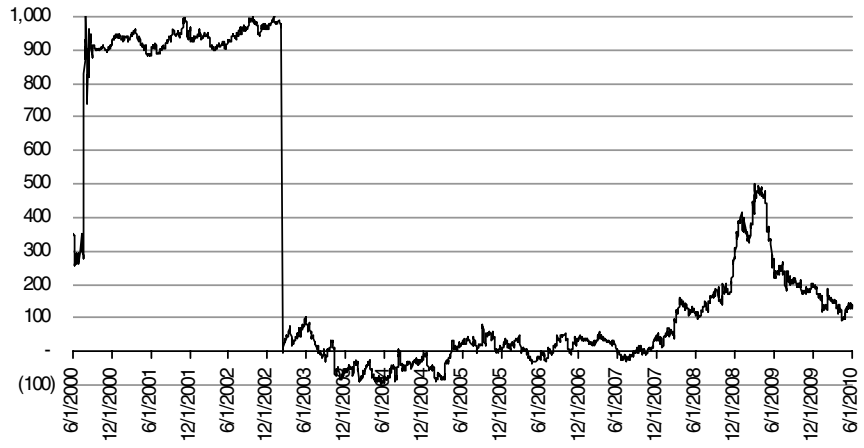
Source: Credit Suisse estimates

Our C$26.00 target price is based upon an approximately 4.3% targeted dividend yield.

Dividend yield spread

We believe that one should not solely rely upon distribution yield based metrics. In our view, many yield based metrics should be considered in the context of comparable nominal interest rates available in the marketplace. For a number of reasons, we have considered Pacific Northern Gas' historic dividend yield against the Government of Canada 10-year bond yield on a spread basis. Exhibit 41 and Exhibit 42 highlight this relationship.

Exhibit 41: Dividend yield spread versus the Canadian 10 year (bps)



Source: Bloomberg and Credit Suisse

Exhibit 42: 10 year yield spread

Mean	290.79
Median	86.70
Standard Deviation	392.27
Range	1,118.65
Minimum	(104.14)
Maximum	1,014.51

Source: Bloomberg and Credit Suisse

Naturally, the yield spread relationship highlights the potential for meaningful sensitivity to interest rate movements. Many fundamental reasons exist for this relationship, however, we must note that interest rate sensitive investments like Pacific Northern Gas usually do not exhibit perfect correlations. Clearly, some near-term uncertainty has impacted the valuation of many interest rate sensitive investment vehicles. Yet, in historic terms, the interest rate environment continues to be accommodative which underpins valuations for companies like Pacific Northern Gas. Thus, we apply a roughly 100 bps spread to a moderate outlook on 10-year Canadian bond yield to obtain our C$26.00 target price.

Discounted cash flow

Given the long-cycle nature of the infrastructure sector, we do not believe simple multiples effectively convey all of the potential value within these types of companies. Therefore, we place significant emphasis upon longer-term explicit financial models which then utilize discounted cash flows to ascertain corporate value. Admittedly, there is a considerable amount of valuation variability arising from a DCF valuation methodology when one considers the tremendous sensitivity of the cost of capital and asset turns on valuation. Despite those issues, we believe that valuation variability is outweighed by the benefits of long-term forecasts that attempt to comprehend the real economic value of long duration assets.

Obviously, a tremendous number of limitations exist for any cash flow analysis and method of valuation. Most importantly, any DCF approach largely consists of assumptions being built upon assumptions. Even with these limitations, we believe it necessary and worthwhile to focus on our Pacific Northern Gas valuation with our financial forecast extending until 2014.

Our DCF valuation approach consists of three steps:

1. Generation of free cash flow forecast;
2. Estimation of a discount rate; and,
3. Discounting the free cash flows to the present.

Considering the above, our DCF analysis starting point is our free cash flow forecast. A summary version of our financial model appears in Exhibit 43 below. Our summary is based upon our explicit financial forecasts until 2014.

Exhibit 43: Free cash flow summary
C$ in millions, unless otherwise stated

	2010E	2011E	2012E	2013E	2014E
Operating Cash Flow	9.0	16.9	16.8	16.6	16.4
After tax interest cost	5.1	5.4	5.4	5.4	5.4
Capex	(11.0)	(5.7)	(5.7)	(5.6)	(5.6)
Free cash flow to firm	3.2	16.7	16.5	16.4	16.3

Source: Credit Suisse estimates

In the second step of our DCF analysis, we employ two methods of calculation to obtain our cost-of-equity: (a) the capital asset pricing model (CAPM); and, (b) a bond yield plus risk premium approach.

CAPM: Cost of equity = Risk free rate + (Beta x Market risk premium)

Therefore, using a risk-free rate of 4.0%, an estimated 0.6 beta and an equity risk premium of 5.0%, we obtain a cost of equity of roughly 7.0%. A corporate bond yield approach (corporate bond + equity risk premium) generated a higher cost of equity based upon a corporate bond yield of 7.5% and an equity risk premium of 500 bps. Ultimately, we employ roughly a WACC of approximately 8.8% for our analysis.

With these assumptions and using our longer-term free cash flow to the firm methodology, we generated the following range of valuations highlighted in Exhibit 44.

Exhibit 44: Share price under different DCF assumptions

		WACC				
		7.5%	8.0%	8.5%	9.0%	9.5%
Long-term growth rate	0.00%	34.98	31.62	28.65	26.00	23.63
	0.25%	35.63	32.16	29.10	26.37	23.94
	0.50%	36.33	32.73	29.57	26.76	24.26
	0.75%	37.08	33.34	30.07	27.18	24.61
	1.00%	37.89	33.99	30.60	27.62	24.98

Source: Credit Suisse estimates

As evidenced by the matrix appearing in Exhibit 44 and a modest long-term growth rate of 0.5%, our DCF value falls within a range of C$24-C$30.

Valuation summary

We initiate Pacific Northern Gas coverage with a Neutral rating a C$26 target price. The bullets below contain a summary of our valuation approaches:

- In terms of multiples, we utilize a 1.0x price-to-book multiple; a 12.5x P/E multiple and a 7.25x EV/EBTIDA multiple all based upon our 2011 estimates;
- With respect to yield approaches, our target price equates to roughly a 4.3% targeted dividend yield and a roughly 100 bps spread to a moderate Canadian 10-year bond yield outlook; and,
- Our DCF value falls within a range of C$24-C$30 under a modest set of assumptions.

We believe there is possible upside to the current share price a well as our target price if the KSL Project goes through with favourable economics. We believe the upside would be a share price of roughly in the low to mid C$30 per share; based on numerous assumptions. A share issuance in late 2011 or early 2012 if the KSL Project proceeds, will help increase liquidity and breath of ownership in the shares which are majority owned by retail investors.

Risks

We believe Pacific Northern Gas faces a number of business and financial risks, including:

- **Regulation:** Pacific Northern Gas' assets and operations are subject to many different forms of regulation. Thus, investors should not underestimate the potential impact of changes to the regulatory environment.
- **Execution / development:** The KSL Project is a large undertaking for the company. The project is dependent on certain factors beyond the company's control, most notably the final investment decision by Apache to construct the Kitimat LNG terminal.
- **Energy market dynamics:** Pacific Northern Gas faces a multitude of factors related to broader energy markets that it cannot control, including: fossil fuel commodity prices; electricity prices; weather; demand management activities; substitution activities; fuel availability; water levels; and, wind availability. These factors, among others, may ultimately affect our investment thesis.
- **Commodity prices:** Pacific Northern Gas has some direct and indirect commodity exposure that could meaningfully impact our investment thesis.
- **Interest rate movements:** A number of sources of interest rate risk exist, including: refinancing; regulatory earnings streams; and, relative investment value.
- **Environmental legislation:** Emissions regimes are still in development in Canada and certain forms of regulation may meaningfully impact the company's entrance into renewable generation.
- **Access to capital markets**: Given the company's capital program as it relates to the KSL Project, we believe that access to capital markets on reasonable terms is critical.
- **Abundance of competition**: As evidenced by the number of players proposing various renewable generation projects in the most recent BC Clean Power Call RFP, we believe there could be some risk to returns arising from increased competition.

Appendices

List of Appendices

Appendix I: Comparable company descriptions

Exhibit 45: Comparable company descriptions

Corning Natural Gas	CNIG	Corning Natural Gas Corporation, a natural gas transportation and distribution company with 385 miles of pipeline, serves 15 townships in Corning and Hammondsport, New York. It provides wholesale gas delivery services to New York State Electric & Gas in Elmira and the Village of Bath, New York. The company has a storage capacity of nearly 586,000 decatherms.
Energy Inc	EGAS	Energy Inc., formerly Energy West, is a natural gas utility operating in Montana, Wyoming, North Carolina, Maine, Ohio and Pennsylvania. The company has four business segments: Natural gas, Marketing and Production, Pipeline, and Corporate and Others. The Pipeline division has two natural gas pipelines: the 40-mile long Glacier natural gas gathering pipeline helps transport production gas for processing and the 30-mile long bidirectional Shoshone transmission pipeline transports natural gas between Montana and Wyoming.
RGC Resource Inc	RGCO	RGC Resources is an energy services company primarily regulated sale and distribution of natural gas to nearly 56,100 residential, commercial, and industrial customers in the Roanoke Valley and Bluefield areas of southwestern Virginia, as well as southern West Virginia. Its subsidiaries are Roanoke Gas, Diversified Energy Company, and RGC Ventures of Virginia, Inc.
Central Vermont Public Service Corp	CV	Central Vermont Public Service Corporation (CV) purchases, produces, transmits, distributes, and sells electricity to over 159,000 customers, generating most of its revenues through retail electricity sales. Its wholly owned subsidiaries include Custom Investment Corporation, C.V. Realty, Inc., Central Vermont Public Service Corporation - East Barnet Hydroelectric, Inc. ("East Barnet") and Catamount Resources Corporation ("CRC") and it has equity ownership interests in companies including Vermont Yankee Nuclear Power Corporation ("VYNPC"), Vermont Electric Power Company, Inc. ("VELCO"), among others.
Emera Inc	EMA.TO	Emera Inc. is an energy and services company having $5.3 billion in assets as of Dec-09. It operates two regulated utility subsidiaries in northeast North America—Nova Scotia Power and Bangor Hydro-Electric—that together account for over 90% of the total revenues. It also owns interest in other companies including Maritimes & Northeast Pipeline (12.9% interest), a natural gas pipeline; Grand Bahama Power Company Limited (25%); joint venture interest in Bear Swamp - a hydroelectric facility; and Brunswick Pipeline (100%), a 145 km gas pipeline in New Brunswick.
Fortis Inc.	FTS.TO	Fortis Inc. is a Canada-based distribution utility catering to around 2,100,000 gas and electric customers. Its regulated holdings include electric distribution utilities in five Canadian provinces and three Caribbean countries and a natural gas utility in British Columbia. The ratio of the company's asset base comprising regulated utility assets and non-regulated generation assets is 93:7. The non-regulated generation assets mainly comprise hydroelectric (in Canada, Belize, and Upper New York State) and hotels and commercial real estate in Canada.
Enbridge Inc.	ENB.TO	Enbridge Inc., an energy transportation and distribution company, which operates the world's longest crude oil and liquids pipeline system in Canada and US. The company has four business segments: Liquids Pipelines (contributes around 29% to the total earnings), Natural Gas Delivery and Services (41%), Sponsored Investments (9%), and Corporate (21%). Its pipeline systems have operated for over 55 years and comprises nearly 13,500 kilometers (8,500 miles) of pipeline, delivering over 2 million barrels of crude oil and liquids per day.
TransCanada Corp.	TRP.TO	TransCanada Corporation is a Canada-based energy infrastructure company, with a network of about 60,000 kilometers (37,500 miles) of pipeline linked to all major gas-supply basins in North America. It has approximately 380 billion cubic feet of storage capacity and owns and controls a portfolio of about 11,700 MW of power generation.
Canadian Utilities	CU.TO	Canadian Utilities Limited is a diversified, international group of companies based in Canada with nearly $9.1 billion in assets as of Dec-09.It operates through three business segments: Utility, Energy, and Corporate and Other. The Utility segment, which includes ATCO Electric and its subsidiaries, the ATCO Gas and ATCO Pipelines, transmits and delivers natural gas and electricity to over 1.2 million customers. The Energy segment owns and operates both regulated and non-regulated generating plants, including coal, natural gas-fired, and hydroelectric generating plants in Canada, UK, and Australia. The Corporate and Other segment includes ATCO I Tek, the company's commercial real estate in Alberta, and the company's 24.5% equity investment in ATCO Structures & Logistics.
Delta Natural Gas Company, Inc.	DGAS	Delta Natural Gas Company Inc distributes and transports natural gas in central and southeastern Kentucky serving approximately 37,000 customers. It operates through two business segments: Regulated and Non-regulated. The company has three wholly owned subsidiaries: Delta Resources, Inc. (buys gas and resells to industrial or other customers on Delta's system); Delgasco, Inc. (buys gas and resells it to Delta Resources, Inc. and customers not on Delta's system); and Enpro, Inc. (owns and operates production properties and undeveloped acreage).
Chesapeake Utilities	CPK	Chesapeake Utilities Corporation is a diversified utility company serving a total of approximately 200,000 customers. It has three business segments: Regulated Energy; Unregulated Energy; and Other. The Regulated segment includes transmission and distribution of natural gas and electricity. The Unregulated segment comprises natural gas marketing operation, while the Other segment consists of advanced information services and intercompany real estate.

Source: Company data

Appendix II: Comparable company valuation tables

Exhibit 46: Comparable company overview

Company	Ticker	Currency	Rating	Price Target	Price 6/10/2010	Shares O/S (mm)	Market Cap	Enterprise Value	Indicated Dividend 2010 $	Indicated Dividend 2010 Payout	Price Appr	Div Yield	Total Return
Canadian													
Canadian Utilities -Cl A	CU.TO	CAD	Not Rated	NR	$43.98	125.8	5,534.5	9,008.6	$1.51	45.6%	n/a	3.4%	n/a
Emera Inc	EMA.TO	CAD	Neutral	$26.00	$24.99	113.0	2,823.4	5,531.2	$1.13	65.7%	4.0%	4.5%	8.6%
Fortis Inc	FTS.TO	CAD	Neutral	$30.00	$27.53	172.2	4,739.8	10,312.8	$1.12	66.8%	9.0%	4.1%	13.0%
Enbridge Inc	ENB.TO	CAD	Neutral	$50.00	$48.86	380.1	18,572.0	32,694.0	$1.70	64.1%	2.3%	3.5%	5.8%
Transcanada Corp	TRP.TO	CAD	Neutral	$38.00	$35.97	687.0	24,711.4	45,605.4	$1.60	76.6%	5.6%	4.4%	10.1%
Pacific Northern Gas Ltd	PNG.TO	CAD	Neutral	$26.00	$24.50	3.6	87.9	164.0	$1.12	54.8%	6.1%	4.6%	10.7%
US Utilities													
Corning Natural Gas Corp	CNIG	USD	Not Rated	NR	$22.00	1.0	22.9	40.0	$0.60	n/a	n/a	2.7%	n/a
Chesapeake Utilities Corp	CPK	USD	Not Rated	NR	$30.33	9.5	286.9	441.5	$1.32	58.1%	n/a	4.4%	n/a
Delta Natural Gas Co Inc	DGAS	USD	Not Rated	NR	$29.01	3.3	96.6	159.0	$1.30	81.3%	n/a	4.5%	n/a
Energy Inc	EGAS	USD	Not Rated	NR	$11.87	6.1	72.1	93.2	$0.54	n/a	n/a	4.5%	n/a
Rgc Resources Inc	RGCO	USD	Not Rated	NR	$31.36	2.3	70.9	91.4	$1.32	n/a	n/a	4.2%	n/a

Source: FactSet, Bloomberg and Credit Suisse estimates

Exhibit 47: Comparable company valuation

Company	Ticker	Currency	Operating EPS 2009	Operating EPS 2010E	Operating EPS 2011E	EBITDA 2009	EBITDA 2010E	EBITDA 2011E	P/E 2009	P/E 2010E	P/E 2011E	EV/EBITDA 2009	EV/EBITDA 2010E	EV/EBITDA 2011E
Canadian														
Canadian Utilities -Cl A	CU.TO	CAD	3.40	3.31	3.42	1,163	1,249	1,318	12.9x	13.3x	12.9x	7.7x	7.2x	6.8x
Emera Inc	EMA.TO	CAD	1.53	1.72	1.68	547	619	736	16.3x	14.5x	14.9x	10.1x	8.9x	7.5x
Fortis Inc	FTS.TO	CAD	1.49	1.68	1.80	1,065	1,152	1,228	18.5x	16.4x	15.3x	9.7x	9.0x	8.4x
Enbridge Inc	ENB.TO	CAD	2.35	2.65	2.83	2,025	2,577	3,199	20.7x	18.4x	17.3x	16.1x	12.7x	10.2x
Transcanada Corp	TRP.TO	CAD	2.03	2.09	2.53	4,137	4,316	5,100	17.7x	17.2x	14.2x	11.0x	10.6x	8.9x
Pacific Northern Gas Ltd	PNG.TO	CAD	1.71	2.04	2.09	23	26	27	14.3x	12.0x	11.7x	7.2x	6.3x	6.1x
Average									**16.8x**	**15.3x**	**14.4x**	**10.3x**	**9.1x**	**8.0x**
US Utilities														
Corning Natural Gas Corp	CNIG	USD	n/a	n/a	n/a	4	n/a	n/a	n/a	n/a	n/a	10.9x	n/a	n/a
Chesapeake Utilities Corp	CPK	USD	2.15	2.27	2.29	60	58	62	14.1x	13.3x	13.2x	7.4x	7.6x	7.1x
Delta Natural Gas Co Inc	DGAS	USD	1.58	1.60	n/a	16	n/a	n/a	18.4x	18.1x	n/a	10.0x	n/a	n/a
Energy Inc	EGAS	USD	0.73	n/a	n/a	14	n/a	n/a	16.3x	n/a	n/a	6.6x	n/a	n/a
Rgc Resources Inc	RGCO	USD	1.53	n/a	n/a	n/a	n/a	n/a	20.5x	n/a	n/a	n/a	n/a	n/a
Average									**17.3x**	**15.7x**	**13.2x**	**8.7x**	**7.6x**	**7.1x**

Source: FactSet, Bloomberg and Credit Suisse estimates

Appendix III: Management highlights

Exhibit 48: Senior management

Management	Title	Comments
Roy G. Dyce	President, Chief Executive Officer	Mr. Dyce was appointed President and CEO in 1994 and has served as a director of Pacific Northern Gas since 1982. He began his career with Westcoast Energy Inc. in 1966 and was responsible for corporate development, marketing and regulatory affairs. He was involved in launching PNG in the late 1960s and later joined PNG in 1980.
Greg B. Weeres, P.Eng, C.I.M	Vice President, Operations and Engineering	Mr. Weeres joined Pacific Northern Gas Ltd. in 1998. Prior to PNG, he had 15 years of experience with BC Gas Utility Ltd. and its predecessor company Inland Natural Gas Ltd. He is also a member of the Association of Professional Engineers and Geoscientists of British Columbia, the Canadian Institute of Management, the Standing Committee on Operations for the Canadian Gas Association and a member of the board of directors of the Canadian Standards Association.
Janet P. Kennedy	Vice President, Finance	Ms. Kennedy joined Pacific Northern Gas Ltd. in October 2007 as VP of Finance. Prior to joining the company, she was with Terasen Inc. from 1993 to 2006, most recently as Director, Financial Planning & Projects. Ms. Kennedy worked as an independent consultant from 2006 to 2007. Ms. Kennedy started her career with KPMG in 1987 and is a Chartered Accountant.
Kevin R. Teitge	Vice President, Corporate Development and Treasurer	Mr. Teitge is VP of Corporate Development and Treasurer for Pacific Northern Gas Ltd. He joined the company in early 2004 as Senior Financial Officer and acted as interim CFO for six months starting in March 2004. Prior to joining PNG he was an independent consultant for a brief period and before that spent seven years with Westcoast Energy, most recently as Director, Corporate and Project Finance. Mr. Teitge has also worked for the Ministry of Energy, Mines and Petroleum Resources of the Province of British Columbia and Alberta Energy Company (now EnCana Corp.).
Craig P. Donohue	Director, Regulatory Affairs & Gas Supply and Assistant Secretary	Mr. Donohue was appointed as the Director Regulatory Affairs and Gas Supply for Pacific Northern Gas Ltd. in 1998. He commenced employment with PNG in 1990 as Manager of Regulatory Affairs. In late 2003, he was also appointed to the position of Assistant Secretary. He started his career with Westcoast Energy in 1980 in their legal department.

Source: Company data

Appendix IV: Board of Directors

Exhibit 49: Board of Directors

Director	Title	Since
Robert F. Chase	Mr. Chase was appointed as the Chair of the Board in 2002. He is the President and CEO of New West Energy Services Inc. (previously Lexacal Investment Corporation) based in Vancouver, BC. He was associated with the Westar Group from 1979 to 1994,	1995
Wayne M. Bingham	Mr. Bingham is the Executive Vice-President and CFO of Superior Plus Corp. He has held senior financial positions with leading Canadian corporations, both regulated and unregulated, including VP, Finance with Westcoast Energy and CFO of Union Gas, Ontario Power Generation and Finning International. He is a Chartered Accountant.	2007
Roy G. Dyce	Mr. Dyce was appointed President and CEO of the company in 1994. He started his career with Westcoast Energy Inc. in 1966 in the areas of corporate development, marketing and regulatory affairs. He was involved with launching PNG in the late 1960s and joined PNG in 1980.	1982
Diane M. Fulton	Ms. Fulton is the VP and Chief Investment Officer of the Vancouver Foundation. Ms. Fulton's career was predominantly spent in investment banking. She is currently on the Board of Directors and Investment Committee of the Insurance Corporation of British Columbia and also serves as a director of the Pension Investment Association of Canada.	2005
Robert B. Johnston	Mr. Johnston is the Executive Vice President & Chief Strategy Officer of The InterTech Group of North Charleston, South Carolina. The InterTech group is an affiliate of The Jerry Zucker Revocable Trust which holds a greater than 10% interest in Pacific Northern Gas.	2008
David G. Unruh	Mr. Unruh served as the Corporate Secretary of the company from February 1994 to April 2002. He retired from DukeEnergy Gas Transmission as SVP, General Counsel in 2003 and continued as Vice Chair until April 2005. Prior to joining Westcoast energy, Mr. Unruh was a partner at the law firm Aikins, MacAulay & Thorvaldson Barristers and Solicitors.	2002
Arthur H. Willms	Mr. Willms is the retired President of Westcoast Energy Inc. Prior to joining Westcoast Energy Inc., Mr. Willms was a public school teacher in Alberta and later became a lecturer in Economics at the University of Calgary. Mr. Willms current sits on the boards of BC Lotteries Corporation, Angiotech Pharmaceuticals and serves as chair of the Vancouver Symphony Society.	1983
Janet P. Woodruff	Ms. Woodruff is the VP, Corporate Services and CFO of British Columbia Transmission Corporation. From 2003 to 2007, Ms. Woodruff held the position of CFO & VP Systems Development & Performance of Vancouver Coastal Health. Prior to that she was with Westcoast Energy Inc. Ms. Woodruff is a Chartered Accountant.	2006

Source: Company data

Appendix V: Corporate governance highlights

For greater details on Pacific Northern Gas' corporate governance practices, we believe investors should consult various securities filings. Yet, we highlight selected corporate governance practices below, including:

- "A majority of the directors are independent."
- "The Board has adopted a written code of business ethics for its directors, officers and employees."
- "The Code is reviewed annually by the corporate Governance Committee. In addition, it is disseminated annually to every director, officer, and employee, each of whom is required to certify that he/she has read the Code and understands it."
- "The overall effectiveness of the Board, its Committees and the Chair is assessed through the auspices of the Corporate Governance Committee."
- "The Company's corporate governance practices comply with the governance rules of the Canadian Securities Administrators ("CSA") and are in compliance with the CSA's Multilateral Instrument 52-110, *Audit Committees*, National Policy 58-201, *Corporate Governance Guidelines*, and National Instrument 58-101, *Disclosure of Corporate Governance Practices*."

Appendix VI: Company asset descriptions

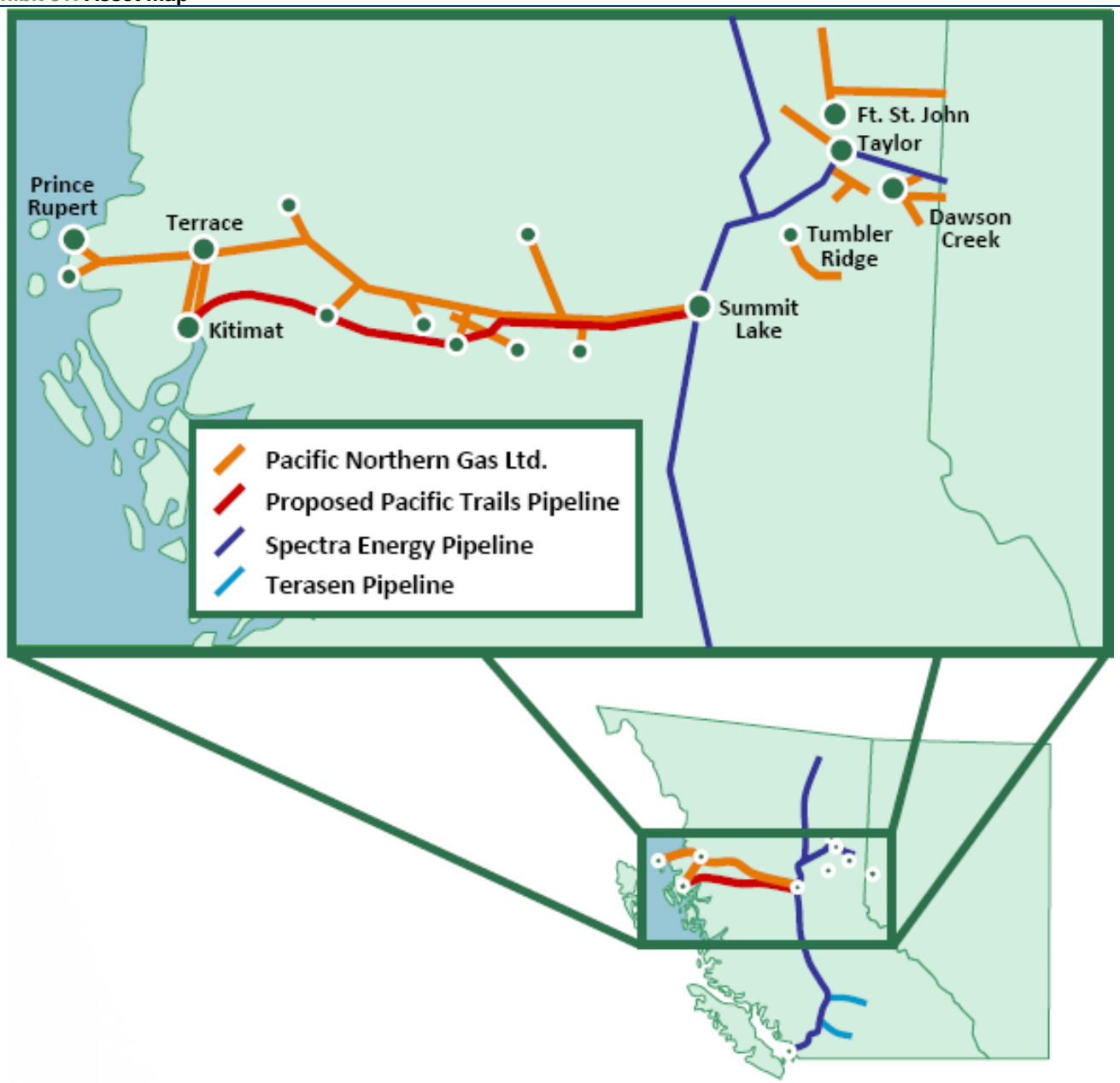
Exhibit 50: **PNG asset/project description**

Assets	Description
Western System	The Western System extends from Summit Lake to Prince Rupert and Kitimat. It has approximately 1,180 km of distribution pipelines. The transmission pipeline connects with the Spectra Energy pipeline system near Summit Lake and extends 587 km to the west at Prince Rupert. The pipeline between Summit Lake and Terrace has been partially paralleled, or looped, with a second line to increase throughput capacity. The company also owns and operates over 300 km of lateral transmission pipelines extending into the various communities served by it, the most significant being dual lines extending approximately 57 km into Kitimat.
Northeast System	The Northeast System consists of roughly 160 km of transmission lines, 1,490 km of distribution lines and a gas processing plant near Tumbler Ridge with a capacity of 120 10^3 m^3/d (4.2mmcf/d). The system serves the Fort St. John and Dawson Creek area through interconnections with the Spectra Energy system. The system also connects with a Canadian Natural Resources Limited pipeline to obtain supply for the Fort St. John area. It connects with a producer's pipeline and the Spectra Energy pipeline system near Chetwynd, British Columbia to serve the Dawson Creek and Tumbler Ridge areas respectively.
McNair Creek	The McNair Creek facility, located on B.C. Sunshine Coast, has been in operation for more than five years now. The company announced a partnership with Skookum Power Holding Corporation on April 7, 2010 to acquire the 9.8MW McNair Creek hydro electricity generation facility from Kiewit Hydropower Investors Inc and Renewable Power Corp. The transaction closed on April 19, 2010 with the PNG acquiring 97% interest in the facility.
Pacific Trail Pipelines (KSL Project)	The company has 50% equity interest in Pacific Trail Pipelines. It is developing a natural gas transmission pipeline system to deliver gas from the Spectra Energy Transmission pipeline system at Summit Lake B.C. to the Kitimat LNG Inc export terminal near Kitimat, B.C. The project entails the construction of approximately 470 km of up to 36 inch diameter pipeline and associated compression facility, at an estimated cost of roughly C$1.2bn.

Source: Company data and Credit Suisse

Appendix VII: Asset map

Exhibit 51: **Asset map**



Source: Company data

Companies Mentioned *(Price as of 11 Jun 10)*
Apache Corp. (APA, $93.64, RESTRICTED [V])
Brookfield Asset Management (BAM, $23.82, OUTPERFORM [V], TP $32.00)
Brookfield Renewable Power Fund (BRC_u.TO, C$19.62, NEUTRAL, TP C$20.00)
Canadian Utilities Ltd. (CU.TO, C$43.33)
Cheniere Energy Inc. (LNG, $2.91)
Chesapeake Utilities Corp (CPK, $30.00)
ConocoPhillips (COP, $53.50, OUTPERFORM, TP $68.00)
Corning Natural Gas Corp. (CNIG, $22.50)
Delta Natural Gas Company Inc. (DGAS, $29.07)
Devon Energy Corp (DVN, $68.16, NEUTRAL [V], TP $75.00)
Emera Inc. (EMA.TO, C$25.01, NEUTRAL, TP C$26.00)

Enbridge Inc. (ENB.TO, C$48.72, NEUTRAL, TP C$50.00)
EnCana Corp. (ECA, $34.66, OUTPERFORM [V], TP $39.00)
Energy Inc. (EGAS, $11.79)
EOG Resources (EOG, $109.86, UNDERPERFORM [V], TP $104.00)
ExxonMobil Corporation (XOM, $61.86, NEUTRAL, TP $75.00)
Fortis Inc. (FTS.TO, C$27.65, NEUTRAL, TP C$30.00)
Gas Natural (GAS.MC, Eu12.28, OUTPERFORM, TP Eu15.20, MARKET WEIGHT)
Imperial Oil Ltd (IMO.TO, C$40.66, NEUTRAL, TP C$45.00)
Korea Gas Corp (036460.KS, W43,850, NEUTRAL, TP W45,500)
Marathon Oil Corp (MRO, $32.37, OUTPERFORM, TP $41.00)
Nexen Inc. (NXY.TO, C$22.93, NEUTRAL [V], TP C$30.00)
Pacific Northern Gas Ltd. (PNG.TO, C$24.60, NEUTRAL, TP C$26.00)
Pengrowth Energy Trust (PGF_u.TO, C$9.97, OUTPERFORM [V], TP C$13.00)
Quicksilver Resources, Inc. (KWK, $13.33, NEUTRAL [V], TP $14.00)
RGC Resources Inc. (RGC Resources Inc., $31.02)
Spectra Energy Corp (SE, $20.62)
Talisman Energy Inc. (TLM.TO, C$17.66, OUTPERFORM [V], TP C$25.00)
Teekay Corporation (TK, $27.42, OUTPERFORM [V], TP $32.00)
TransCanada Corp. (TRP.TO, C$36.00, NEUTRAL, TP C$38.00)

Disclosure Appendix

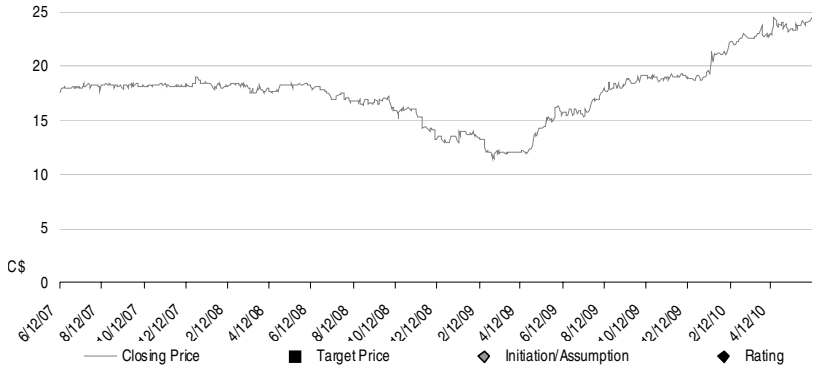
Important Global Disclosures

I, Paul Tan, certify that (1) the views expressed in this report accurately reflect my personal views about all of the subject companies and securities and (2) no part of my compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this report.

See the Companies Mentioned section for full company names.

3-Year Price, Target Price and Rating Change History Chart for PNG.TO

PNG.TO Date	Closing Price (C$)	Target Price (C$)	Rating	Initiation/ Assumption



O=Outperform; N=Neutral; U=Underperform; R=Restricted; NR=Not Rated; NC=Not Covered

The analyst(s) responsible for preparing this research report received compensation that is based upon various factors including Credit Suisse's total revenues, a portion of which are generated by Credit Suisse's investment banking activities.

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Outperform (O): The stock's total return is expected to outperform the relevant benchmark* by at least 10-15% (or more, depending on perceived risk) over the next 12 months.

Neutral (N): The stock's total return is expected to be in line with the relevant benchmark* (range of ±10-15%) over the next 12 months.

Underperform (U): The stock's total return is expected to underperform the relevant benchmark* by 10-15% or more over the next 12 months.

Relevant benchmark by region: As of 29th May 2009, Australia, New Zealand, U.S. and Canadian ratings are based on (1) a stock's absolute total return potential to its current share price and (2) the relative attractiveness of a stock's total return potential within an analyst's coverage universe, with Outperforms representing the most attractive, Neutrals the less attractive, and Underperforms the least attractive investment opportunities. Some U.S. and Canadian ratings may fall outside the absolute total return ranges defined above, depending on market conditions and industry factors. For Latin American, Japanese, and non-Japan Asia stocks, ratings are based on a stock's total return relative to the average total return of the relevant country or regional benchmark; for European stocks, ratings are based on a stock's total return relative to the analyst's coverage universe**. For Australian and New Zealand stocks a 22% and a 12% threshold replace the 10-15% level in the Outperform and Underperform stock rating definitions, respectively, subject to analysts' perceived risk. The 22% and 12% thresholds replace the +10-15% and -10-15% levels in the Neutral stock rating definition, respectively, subject to analysts' perceived risk.*

***An analyst's coverage universe consists of all companies covered by the analyst within the relevant sector.*

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**An analyst's coverage universe consists of all companies covered by the analyst within the relevant sector.*
***The broad market benchmark is based on the expected return of the local market index (e.g., the S&P 500 in the U.S.) over the next 12 months.*

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	Global Ratings Distribution	
Outperform/Buy*	45%	(63% banking clients)
Neutral/Hold*	41%	(60% banking clients)
Underperform/Sell*	13%	(55% banking clients)
Restricted	2%	

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See the Companies Mentioned section for full company names.
Price Target: (12 months) for (PNG.TO)
Method: Our C$26.00 target price is based solely on current operating assets and is obtained from multiple valuation methodologies including: a 12.5x P/E multiple applied to our 2011 EPS estimate; a P/B multiple of 1.0x; a 7.25x EV/EBITDA multiple; and, a discounted cash flow.
Risks: There are a number of risks to our C$26 target price for Pacific Northern Gas such as: execution/development risks regarding the KSL Project; access to capital markets to fund the KSL Project; North American energy market dynamics; regulatory; commodity prices; and interest rates. Moreover, one should never underestimate the power of the regulator in any regulated business.

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Pacific Northern Gas Ltd. (PNG.TO)

INCREASE TARGET PRICE

Rating	**NEUTRAL***
Price (26 Oct 10, C$)	27.26
Target price (C$)	(from 26.00) 28.00[1]
52-week price range	27.26 - 18.62
Market cap. (C$ m)	97.82
Enterprise value (C$ m)	194.03

**Stock ratings are relative to the relevant country benchmark.*
[1]Target price is for 12 months.

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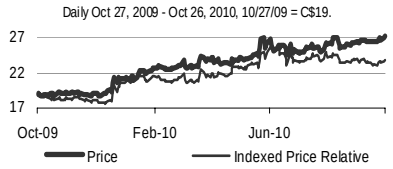
Delightful dividend

- **Earnings results:** Pacific Northern Gas (PNG) reported Q3 2010 headline loss of C$0.64 which was below our -C$0.50 and that of the Streets at a loss of C$0.525 (albeit there are only two estimates). The difference was largely the result of PNG's approach of expensing of McNair Creek acquisition and reorganization costs. Positively and surprisingly the company announced a 7% increase in quarterly dividend to C$0.30/shr from C$0.28/shr. In light of weather related impacts from the company's natural gas distribution utility, the earnings dispersion among the quarters can often be considerable. Yet, that dispersion does not generally impact allowed returns and full year earnings. Moreover, the long-cycle nature of most of our coverage universe, we do not place undue emphasis on quarterly results.
- **Selected highlights:** Notable items include: (a) PNG expects agreement on renewal terms on some of its credit facilities during Q4 2010; (b) PNG started the detailed designed phase of the KSL Project during the third quarter; and, (c) the company has "secured contingent financial support from prospective shippers for this phase of the project".
- **Investment thesis:** We believe Pacific Northern Gas provides low-growth infrastructure exposure with significant potential transformative growth for a somewhat reasonable valuation.
- **Valuation:** Given the dividend boost, our target price increases to C$28.00 from the previous C$26.00. That target price is based only on the existing operating assets and is obtained from multiple valuation methods, including: a P/B multiple of 1.1x; a 13.5x P/E multiple; a 7.4x EV/EBITDA multiple on 2011 estimates; and, a DCF. The KSL project provides interesting upside which we project to be roughly in the low to mid C$30 per share; based on numerous assumptions. The project also contains selected uncertainties. We reiterate our Neutral rating.

Share price performance



On 10/26/10 the Canada S&P/TSX Composite Index index closed at 12684.68

Quarterly EPS	Q1	Q2	Q3	Q4
2009A	1.38	-0.13	-0.49	0.94
2010E	1.48	-0.06	-0.64	1.12
2011E	1.59	-0.09	-0.52	1.09

Financial and valuation metrics

Year	12/09A	12/10E	12/11E	12/12E
EPS (CS adj.) (C$)	1.71	1.92	2.08	2.05
Prev. EPS (C$)	—	2.04	2.09	2.07
P/E (x)	16.0	14.2	13.1	13.3
P/E rel. (%)	77.7	91.3	99.9	110.7
Revenue (C$ m)	104.1	98.6	100.5	99.5
EBITDA (C$ m)	22.9	25.2	26.9	26.7
OCFPS (C$)	5.25	2.39	4.69	4.64
P/OCF (x)	3.6	11.4	5.8	5.9
EV/EBITDA (current)	7.6	7.7	7.0	6.9
Net debt (C$ m)	76	96	91	86
ROIC (%)	5.71	5.65	6.08	5.96

Number of shares (m)	3.59	IC (12/10E, C$ m)	219.43
BV/share (current, C$)	23.9	EV/IC (x)	0.88
Net debt (current, C$ m)	95.5	Dividend (current, C$)	1.20
Net debt/tot. cap. (current, %)	52.6	Dividend yield (%)	4.4

Source: Company data, Credit Suisse estimates.

Pacific Northern Gas (PNG) reported Q3 2010 headline loss of C$0.64 which was below our -C$0.50 and that of the Streets at a loss of C$0.525 (albeit there are only two estimates). The difference was largely the result of PNG's approach of expensing of McNair Creek acquisition and reorganization costs. Positively and surprisingly the company announced a 7% increase in quarterly dividend to C$0.30/shr from C$0.28/shr. Given the long-dated nature of PNG's asset base, we do not place undue emphasis on quarterly results. This research note is divided into three parts: (a) results, (b) outlook, and (c) valuation.

Positive dividend boost

Results

Exhibit 1 highlights selected results for Pacific Northern Gas.

Exhibit 1: Highlights
C$ in millions, unless otherwise stated

	Q3 2010	Q3 2009	chg %
Net income/(loss)	(2.24)	(1.66)	-34.9%
Revenues	9.68	10.50	-7.8%
Operating margin	6.59	7.11	-7.3%
Earnings/(loss) per share	(0.64)	(0.49)	-30.6%

Source: Company data and Credit Suisse

Selected financial highlights include:

- PNG announced a roughly 7% increase in quarterly dividends. On an annualized basis dividends per share will increase to C$1.20 from the previous C$1.12.
- The quarter's net loss increased by approximately 34.9% largely due to the recognition of the Methanex amortization payment in Q3 2009, partially offset by the higher weighted average return on equity earned in Q3 2010 of 10.09% compared to 9.07% in the Q3 2009.
- McNair Creek's acquisition and reorganization costs as well at operating losses also contributed to the decline in the earnings. The weak operating results were due to seasonality of the business leading to only 10% of overall production in third quarter.
- Losses were partially offset by the impact of 5% higher common equity component on the company's Western system and a 4% higher common equity component on company's Northeast system in Q3 2010 compared to Q3 2009.

Our operating segment analysis now follows.

Pipeline

Seasonality exists within the company's natural gas distribution business. Deliveries to residential and commercial customers tend to be temperature sensitive with 75% of deliveries occurring in Q1 & Q4.

Select highlights during the quarter include:

- Gas sales and transportation services in Q3 2010 increased to C$9.2m from C$8.7m during Q3 2009;
- Off system gas sales in the current period increased to C$0.09m from C$0.06m during Q3 2009;
- Residential deliveries was lower by 2% due to a lower number of customers and declining use per customer in the Western system which was offset by higher deliveries to residential customers in the Northeast region because of colder weather. (See Appendix Exhibit 5 and Exhibit 6) Commercial deliveries was higher by 7% in Q3 2010 compared to Q3 2009.;

- Industrial deliveries were lower by approximately 32% for the current quarter compared to Q3 2009, mainly due to the closure of the West Fraser Kitimat linerboard mill;
- "On August 11, 2010 Merrill Lynch assigned and novated the TSA to LNG Partners, LLC.";
- Project development expenditure for KSL amounted to C$0.027m during Q3 2010.
- PNG started the detailed design phase of the KSL project during the third quarter and "secured contingent financial support from prospective shippers for this phase of the project".

Energy

PNG launched its renewable segment in April 2010 with the acquisition of the 9.8MW McNair Creek facility and the formation of a partnership with Skookum Power Corporation. Select highlights in this segment include:

- Net loss of C$0.289m in Q3 2010 due to seasonality leading to only 10% of production in the third quarter ; and,
- PNG expensed the acquisition and reorganization costs associated with the acquisition of McNair Creek as part of its adoption of the new accounting standards for business combinations.

Outlook

In our view, Pacific Northern Gas investors, whether existing or prospective, should consider several issues, including: (1) Pacific pipeline; (2) Highlighting hydro; and, (3) Capital considerations.

Pacific pipeline

The largest potential growth for PNG continue to be the successful completion of the KSL Project (Kitimat to Summit Lake), which at the moment PNG has a 50% interest. The other partners in the project are Apache and EOG with 25.5% and 24.5% interest respectively. The roughly 465km 36 inch pipeline from Summit Lake to Kitimat is to transport growing Northeast BC shale gas to the proposed Kitimat LNG terminal for export to Asian markets. The pipeline cost in 2006 dollars is roughly C$1.2 billion. Construction of the pipeline is contingent on a Final Investment Decision (FID) by Apache Corp. on the Kitimat LNG Project to be made sometime in 2011.

Exhibit 2: PNG assets and proposed KSL Project (in red)

Source: Company data

Selected timelines for both the KSL Project and the LNG terminal are shown in Exhibit 3.

Exhibit 3: Selected pipeline and terminal timelines

	Pacific Trail Pipelines	LNG Terminal
To Date	Provincial/Federal environmental approvals First Nations economic agreement with the BC government Apache joins project	Provincial/Federal environmental approvals. Apache joins projects.
2010	Secure shipper commitments File application with B.C. Utilities Commission Preliminary engineering	Commence front end engineering and design (FEED Study)
2011	BC Utilities Commission decision Secure debt commitments Final investment decision Raise equity	Final investment decision Award EPC contract Commence construction
2012	Commence construction	Continue construction
2013	Continue construction	Continue construction
2014	Targeted in service	Targeted in service

Source: Company data and Credit Suisse

Highlighting hydro

Expanding hydro

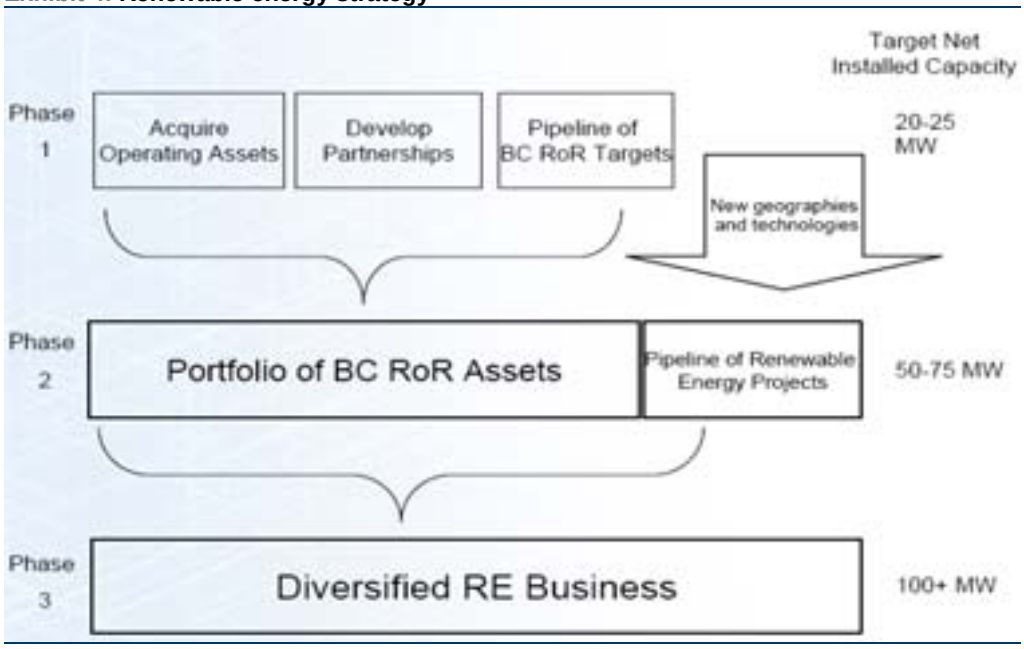
The company's entrance into renewable power generation, more specifically run-of-river, began with forming a partnership with Skookum Power Corporation and the acquisition of a 97% interest in the McNair Creek hydroelectric generation facility. McNair Creek is a 9.8MW run of river facility located on the B.C. Sunshine Coast near Port Mellon that commenced operation on November 2004.

The company entered into a development and operating agreement with Skookum Power. The agreement would allow PNG to leverage off Skookum's extensive expertise in hydroelectric generation. Skookum Power management were formerly with Brookfield Renewable, which is one of the largest owners, operators and developers of hydroelectric generation in North America and Brazil. This partnership should give PNG the immediate expertise it requires to make sound investment decision in this sector while building up its internal capabilities.

Renewable partner were former Brookfield Renewable employees

The company's renewable energy strategy is illustrated in the exhibit below.

Exhibit 4: Renewable energy strategy



Source: Company data

According to its strategy, PNG will acquire existing operating run-of-river assets to create scale and expertise. Once a certain scale is achieved, the company will take on more development risk by targeting development run-of-river projects. The company's reasons for moving into the renewable energy field are as follows:

- "Utilize its operating skills, permitting expertise, project management capabilities, financing acumen and energy market and regulatory expertise" and
- "Existence of both operating projects and development projects that are available in sized which fit PNG's access to capital".

We believe the company's approach in its expansion into the renewable energy field is prudent as it's similar to that of another pipeline company's expansion into the solar energy field. With long-term PPAs attached to renewable generation with government counterparties, the risk profile is similar to that of its regulated pipeline/utility business. British Columbia's Clean Power Call will give PNG opportunity to acquire hydro projects.

Capital considerations

Pacific Northern Gas has stated in their investor presentations that they plan on accessing the equity capital markets to help them fund their portion of the KSL Project. The size of the project is currently larger compared to the market capitalization of the company. A large equity issuance would be an opportunity to increase institutional ownership in PNG shares as well as increase liquidity.

We believe the company has other options aside from the capital markets. The company could also form a joint venture with financial partners such as pension funds. This would allow the company to lessen the equity issuance size.

Valuation

Rating: Neutral

Target: To C$28.00 from C$26.00

Given the increase in dividend we increase our target price to C$28.00 from the previous C$26.00. That target price is based only on the existing operating assets and it obtained from multiple valuation approaches, including a 1.1x price-to-book multiple; a 13.5x P/E multiple, a 7.4x EV/EBTIDA multiple and a 4.3% targeted dividend yield all based upon our 2011 estimates and a discounted cash flow. After the quarter we decrease our earnings per share estimates to C$1.92, C$2.08 and C$2.05 from C$2.04, C$2.09 and C$2.07 for 2010, 2011 and 2012 respectively. We reiterate our Neutral rating.

We believe there is possible upside to the current share price as well as our target price if the KSL Project goes through with favourable economics. We believe the upside would be a share price of roughly in the low to mid C$30 per share; based on numerous assumptions. A share issuance in late 2011 or early 2012 if the KSL Project proceeds, will help increase liquidity and breath of ownership in the shares. We reiterate our Neutral rating.

Appendix

Exhibit 5: Fort St. John

Temperature	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Historical Avg.	-14.2	-10.5	-4.4	4.0	10.0	13.8	15.7	14.6	9.9	3.9	-6.7	-12.1
2010	-14.4	-8.2	-0.7	5.4	8.4	14.7	17.3	14.9	8.8			
2009	-14.5	-10.7	-9.8	3.0	8.1	14.3	16.8	16.0	12.6	0.9	-2.8	-15.8
2008	-14.1	-11.6	-4.4	1.8	10.7	14.3	16.8	16.5	11.5	6.0	-3.6	-18.0
2007	-5.9	-14.8	-8.8	1.9	9.4	14.5	18.0	13.0	9.6	5.0	-5.7	-13.1
2006	-9.6	-7.3	-9.4	6.7	11.1	16.3	18.2	15.5	12.0	3.1	-16.5	-5.5
2005	-16.8	-5.0	-0.5	5.8	11.5	13.4	14.8	13.6	9.8	4.5	-1.4	-5.9
2010 vs Historical	-0.2	2.3	3.7	1.4	-1.6	0.9	1.6	0.3	-1.1			
2009 vs Historical	-0.3	-0.2	-5.4	-1.0	-1.9	0.5	1.1	1.4	2.7	-3.0	3.9	-3.7
2008 vs Historical	0.1	-1.1	0.0	-2.2	0.7	0.5	1.1	1.9	1.6	2.1	3.1	-5.9
2007 vs Historical	8.3	-4.3	-4.4	-2.1	-0.6	0.7	2.3	-1.6	-0.3	1.1	1.0	-1.0
2006 vs Historical	4.6	3.2	-5.0	2.7	1.1	2.5	2.5	0.9	2.1	-0.8	-9.8	6.6
2005 vs Historical	-2.6	5.5	3.9	1.8	1.5	-0.4	-0.9	-1.0	-0.1	0.6	5.3	6.2

Source: Environment Canada and Credit Suisse

Exhibit 6: Terrace A

Temperature	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Historical Avg.	-4.3	-1.4	2.3	6.2	10.3	13.7	16.4	16.3	12.2	6.4	0.6	-2.9
2010	-0.9	2.4	3.6	6.6	11.1	13.4	17.2	17.1	12.1			
2009	-3.1	-2.7	-0.3	5.4	9.5	15.0	19.7	16.8	12.0	6.0	1.6	-6.8
2008	-4.0	-1.6	1.9	4.4	10.8	11.8	14.4	15.7	12.3	5.5	2.7	-6.8
2007	-1.7	0.0	1.3	4.2	9.6	13.1	15.8	15.8	11.8	6.3	0.9	-4.6
2006	0.7	-1.1	1.2	5.7	10.6	16.0	17.1	15.7	12.9	6.5	-3.0	-0.3
2005	-5.5	0.5	3.7	8.5	13.5	15.8	15.4	17.1	11.6	6.2	2.6	-0.2
2010 vs Historical	3.4	3.8	1.3	0.4	0.8	-0.3	0.8	0.8	-0.1			
2009 vs Historical	1.2	-1.3	-2.6	-0.8	-0.8	1.3	3.3	0.5	-0.2	-0.4	1.0	-3.9
2008 vs Historical	0.3	-0.2	-0.4	-1.8	0.5	-1.9	-2.0	-0.6	0.1	-0.9	2.1	-3.9
2007 vs Historical	2.6	1.4	-1.0	-2.0	-0.7	-0.6	-0.6	-0.5	-0.4	-0.1	0.3	-1.7
2006 vs Historical	5.0	0.3	-1.1	-0.5	0.3	2.3	0.7	-0.6	0.7	0.1	-3.6	2.6
2005 vs Historical	-1.2	1.9	1.4	2.3	3.2	2.1	-1.0	0.8	-0.6	-0.2	2.0	2.7

Source: Environment Canada and Credit Suisse

Companies Mentioned *(Price as of 26 Oct 10)*
Pacific Northern Gas Ltd. (PNG.TO, C$27.26, NEUTRAL, TP C$28.00)

Disclosure Appendix

Important Global Disclosures

I, Paul Tan, certify that (1) the views expressed in this report accurately reflect my personal views about all of the subject companies and securities and (2) no part of my compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this report.

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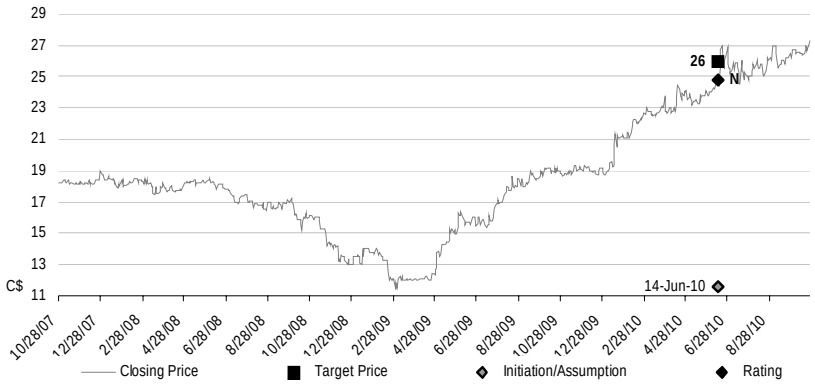
3-Year Price, Target Price and Rating Change History Chart for PNG.TO

PNG.TO Date	Closing Price (C$)	Target Price (C$)	Rating	Initiation/ Assumption
6/14/10	24.8	26	N	X



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Underperform (U): The stock's total return is expected to underperform the relevant benchmark* by 10-15% or more over the next 12 months.

Relevant benchmark by region: As of 29th May 2009, Australia, New Zealand, U.S. and Canadian ratings are based on (1) a stock's absolute total return potential to its current share price and (2) the relative attractiveness of a stock's total return potential within an analyst's coverage universe, with Outperforms representing the most attractive, Neutrals the less attractive, and Underperforms the least attractive investment opportunities. Some U.S. and Canadian ratings may fall outside the absolute total return ranges defined above, depending on market conditions and industry factors. For Latin American, Japanese, and non-Japan Asia stocks, ratings are based on a stock's total return relative to the average total return of the relevant country or regional benchmark; for European stocks, ratings are based on a stock's total return relative to the analyst's coverage universe**. For Australian and New Zealand stocks a 22% and a 12% threshold replace the 10-15% level in the Outperform and Underperform stock rating definitions, respectively, subject to analysts' perceived risk. The 22% and 12% thresholds replace the +10-15% and -10-15% levels in the Neutral stock rating definition, respectively, subject to analysts' perceived risk.*

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Analysts' coverage universe weightings are distinct from analysts' stock ratings and are based on the expected performance of an analyst's coverage universe* versus the relevant broad market benchmark**:

Overweight: Industry expected to outperform the relevant broad market benchmark over the next 12 months.

Market Weight: Industry expected to perform in-line with the relevant broad market benchmark over the next 12 months.

Underweight: Industry expected to underperform the relevant broad market benchmark over the next 12 months.

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***The broad market benchmark is based on the expected return of the local market index (e.g., the S&P 500 in the U.S.) over the next 12 months.*

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	Global Ratings Distribution	
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Neutral/Hold*	40%	(59% banking clients)
Underperform/Sell*	12%	(51% banking clients)
Restricted	2%	

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See the Companies Mentioned section for full company names.
Price Target: (12 months) for (PNG.TO)
Method: Our C$28.00 target price is based solely on current operating assets and is obtained from multiple valuation methodologies including: a 13.5x P/E multiple applied to our 2011 EPS estimate; a P/B multiple of 1.1x; a 7.4x EV/EBITDA multiple; and, a discounted cash flow.
Risks: There are a number of risks to our C$28 target price for Pacific Northern Gas such as: execution/development risks regarding the KSL Project; access to capital markets to fund the KSL Project; North American energy market dynamics; regulatory; commodity prices; and interest rates. Moreover, one should never underestimate the power of the regulator in any regulated business.

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Pacific Northern Gas Ltd. (PNG.TO)

COMPANY UPDATE

Rating	**NEUTRAL***
Price (04 Feb 11, C$)	30.00
Target price (C$)	28.00[1]
52-week price range	30.75 - 21.05
Market cap. (C$ m)	108.24
Enterprise value (C$ m)	204.45

**Stock ratings are relative to the relevant country benchmark.*
[1]Target price is for 12 months.

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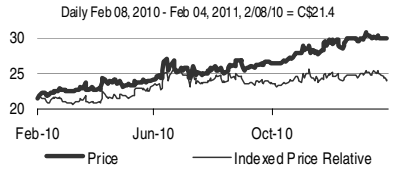
Profitable Pacific pipeline

- **Punting PTP:** Surprisingly, Pacific Northern Gas Ltd. (PNG) announced the sale of its 50% interest in Pacific Trail Pipelines Limited Partnership (PTP) for C$50m to partners Apache Canada Ltd. and EOG Resources Canada Inc. Under the agreement, PNG will operate the KSL Pipeline for at least the first seven years following the project's expected 2015 completion. Clearly, we appreciate the challenges facing a small cap company attempting to build a large project. Therefore, this transaction may be viewed positively in terms of overall risk management, for PNG's utility rate payers and near-term value creation. Yet, disposing of a unique project generates questions about PNG's capital market positioning and uses of the excess capital.
- **Cash consideration:** Upon transaction close at the end of February, PNG will receive C$30m with another C$20m contingent upon APA and EOG's proceeding with the Kitimat LNG project. PNG stated cash proceeds will be roughly C$9-C$10/sh after taxes and related expenses. We believe capital redeployment and strategic positioning are critical topics. In our view, the cash position may be applied to growing the hydro-electric business, but a special dividend is also possible.
- **Conference call:** PNG will be holding a conference call to discuss the transaction at 1:00pm (eastern). That call will be accessible via 1-866-696-5910 or at 416-340-2217 / passcode 1576766.
- **Valuation:** Our Neutral rating and C$28.00 target is based only on the existing operating assets and is obtained from multiple valuation methods, including: a P/B multiple of 1.1x; a 13.5x P/E multiple; a 7.4x EV/EBITDA multiple on 2011 estimates; and, a DCF. Prior to today's announcement, the KSL project provided meaningful upside not included in our numbers that has now been monetized. We look forward to capital allocation clarity.

Share price performance



On 02/04/11 the Canada S&P/TSX Composite Index index closed at 13791.85

Quarterly EPS	Q1	Q2	Q3	Q4
2009A	1.38	-0.13	-0.49	0.94
2010E	1.48	-0.06	-0.64	1.12
2011E	1.59	-0.09	-0.52	1.09

Financial and valuation metrics

Year	12/09A	12/10E	12/11E	12/12E
EPS (CS adj.) (C$)	1.71	1.92	2.08	2.05
Prev. EPS (C$)	—	—	—	—
P/E (x)	17.6	15.6	14.4	14.6
P/E rel. (%)	78.7	92.5	101.1	112.1
Revenue (C$ m)	104.1	98.6	100.5	99.5
EBITDA (C$ m)	22.9	25.2	26.9	26.7
OCFPS (C$)	5.11	2.27	4.50	4.45
P/OCF (x)	3.7	13.3	6.7	6.7
EV/EBITDA (current)	8.0	8.1	7.4	7.3
Net debt (C$ m)	76	96	91	86
ROIC (%)	5.71	5.81	6.08	5.96

Number of shares (m)	3.61	IC (12/10E, C$ m)	219.43
BV/share (current, C$)	23.9	EV/IC (x)	0.93
Net debt (current, C$ m)	95.5	Dividend (current, C$)	1.12
Net debt/tot. cap. (current, %)	51.1	Dividend yield (%)	3.7

Source: Company data, Credit Suisse estimates.

Companies Mentioned *(Price as of 04 Feb 11)*
Apache Corp. (APA, $116.84, OUTPERFORM, TP $129.00)
EOG Resources (EOG, $106.78, NEUTRAL, TP $87.00)
Pacific Northern Gas Ltd. (PNG.TO, C$30.00, NEUTRAL, TP C$28.00)

Disclosure Appendix

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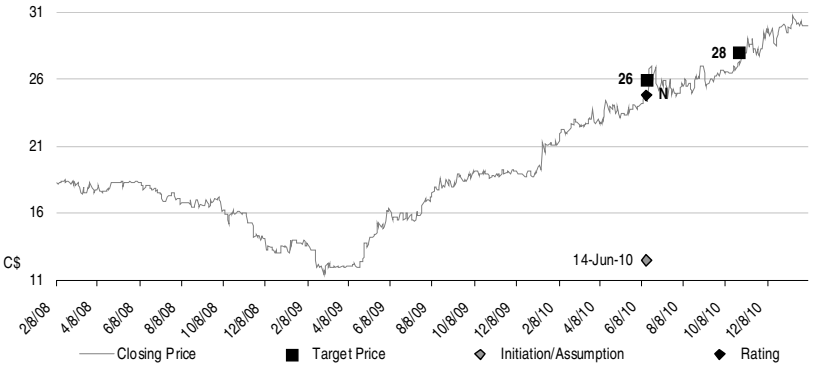
6/14/10	24.8	26	N	X
10/27/10	27.38	28		



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Outperform/Buy*	45%	(62% banking clients)
Neutral/Hold*	41%	(59% banking clients)
Underperform/Sell*	11%	(53% banking clients)
Restricted	2%	

**For purposes of the NYSE and NASD ratings distribution disclosure requirements, our stock ratings of Outperform, Neutral, and Underperform most closely correspond to Buy, Hold, and Sell, respectively; however, the meanings are not the same, as our stock ratings are determined on a relative basis. (Please refer to definitions above.) An investor's decision to buy or sell a security should be based on investment objectives, current holdings, and other individual factors.*

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Pacific Northern Gas Ltd. (PNG.TO)

MARKET COMMENTARY/STRATEGY

Rating	**NEUTRAL***
Price (01 Mar 11, C$)	27.50
Target price (C$)	30.00[1]
52-week price range	31.35 - 22.51
Market cap. (C$ m)	99.22
Enterprise value (C$ m)	195.43

**Stock ratings are relative to the relevant country benchmark.*
[1]Target price is for 12 months.

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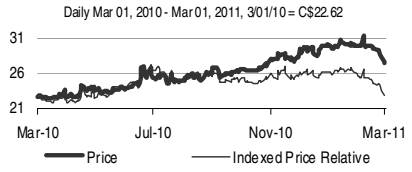
Prowling for Pacific pipeline projects?

- **Pacific pipeline Part 2?:** We believe opportunities exist for Pacific Northern Gas (PNG) to be involved in potential future LNG projects on the west coast of British Columbia. The company's experience in developing LNG related infrastructure, such as the KSL Pipeline, will be a clear asset. The recent announcement of PNG's sale of a 50% interest in Pacific Trail Pipeline (PTP) Limited Partnership to existing partners, Apache Canada and EOG Canada for C$50m (see "*Profiting from Pacific pipeline*" on 7 February 2011 for details), will provide the company resources to begin exploring other pipeline opportunities. The PTP Partnership was developing the KSL Pipeline Project.
- **Expanding exports:** At Credit Suisse's recent Energy Summit, Royal Dutch Shell plc (Shell) openly stated the possibility of exporting gas out of Western Canada (Montney shale) and is currently in discussions with its Asian partners in China, Korean and Japan. The recent joint ventures by Asian companies with Canadian E&Ps on Western Canadian natural gas assets provide a backdrop for the possibility of exporting Western Canadian natural gas into the Asia Pacific region. PNG is uniquely positioned for further LNG development off the BC coast. We believe further LNG development is a medium- to longer-term event.
- **Investment thesis:** We believe Pacific Northern Gas provides low-growth infrastructure exposure with some growth opportunities involving further expansion of natural gas exports from Western Canada to Asian markets.
- **Valuation:** Our Neutral rating and target price of C$30 is obtained from multiple valuation methods, including: a P/B multiple of 1.1x; a 14.5x P/E multiple; a 7.6x EV/EBITDA multiple on 2012 estimates; and, a DCF. We reiterate our Neutral rating.

Share price performance



On 03/01/11 the Canada S&P/TSX Composite Index index closed at 14122.85

Quarterly EPS	Q1	Q2	Q3	Q4
2009A	1.38	-0.13	-0.49	0.94
2010E	1.48	-0.06	-0.64	1.12
2011E	1.59	-0.09	-0.52	1.09

Financial and valuation metrics

Year	12/09A	12/10E	12/11E	12/12E
EPS (CS adj.) (C$)	1.71	1.92	2.08	2.05
Prev. EPS (C$)	—	—	—	—
P/E (x)	16.1	14.3	13.2	13.4
P/E rel. (%)	70.4	82.7	90.4	100.2
Revenue (C$ m)	104.1	98.6	100.5	99.5
EBITDA (C$ m)	22.9	25.2	26.9	26.7
OCFPS (C$)	5.11	2.27	4.50	4.45
P/OCF (x)	3.7	13.3	6.1	6.2
EV/EBITDA (current)	7.6	7.8	7.1	6.9
Net debt (C$ m)	76	96	91	86
ROIC (%)	5.71	5.81	6.08	5.96

Number of shares (m)	3.61	IC (12/10E, C$ m)	219.43
BV/share (current, C$)	23.9	EV/IC (x)	0.89
Net debt (current, C$ m)	95.5	Dividend (current, C$)	1.12
Net debt/tot. cap. (current, %)	51.1	Dividend yield (%)	4.1

Source: Company data, Credit Suisse estimates.

We believe opportunities exist for Pacific Northern Gas (PNG) to be involved in potential future LNG projects on the west coast of British Columbia. The company has experience in the development of pipeline infrastructure related to LNG projects, such as the KSL Pipeline Project. At Credit Suisse's recent Energy Summit, Royal Dutch Shell plc (Shell) openly stated the possibility of exporting gas out of Western Canada (Montney shale) and is currently in discussions with its Asian partners in China, Korean and Japan. We view another LNG export terminal in the BC coast to be a medium to longer-term development. This research note is divided into three parts: (a) possible Pacific pipelines, (b) outlook, and (c) valuation.

Possible Pacific pipelines

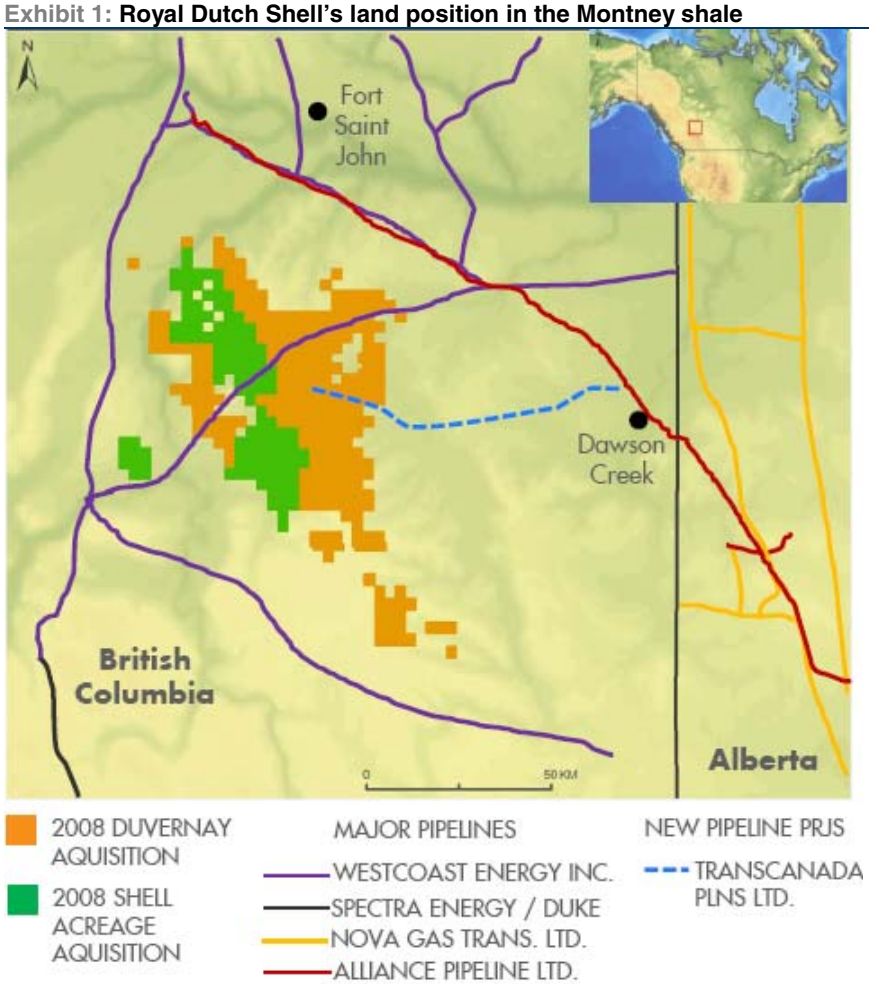
We divided this portion of the research report into three areas: a) expanding exports?; b) long on LNG; and, c) calling card and the cash. Each of these areas will be addressed in detail below.

Expanding exports?

At Credit Suisse's recent Energy Summit in Vail, Colorado, Royal Dutch Shell plc (Shell) stated that it is open to the possibility of exporting gas out of Western Canada (Montney shale) and is currently in discussions with its Asian partners in China, Korean and Japan. Our European energy team believes a Shell LNG terminal in the British Columbia coast is still in its early days. Shell has roughly 210,000 net acres in the Groundbirch area of the Montney shale play. Exhibit 1 illustrates Shell's land holding in the Groundbirch.

Shell's sizable exposure in the Montney shale play

Exhibit 1: Royal Dutch Shell's land position in the Montney shale



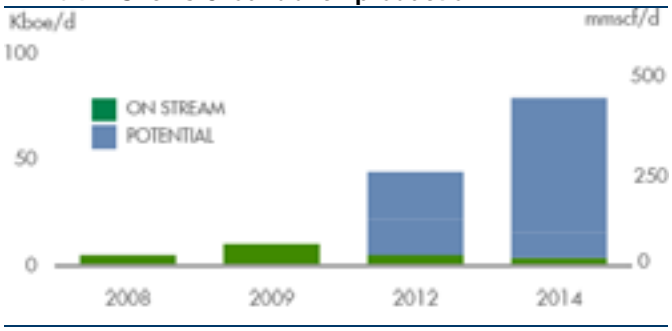
Source: Company data

Key highlights of Shell's Groundbirch asset as presented during the company's North America Investor Visit on September of 2010 included:

- A 20 year drilling inventory of roughly 3,000 wells
- "Groundbirch resource estimate >8 Tcfe"
- Break even gas price is roughly US$3/mcfe
- ">1 bcfe/day production potential"; and,
- "40 year producing life".

Shell's production as well as its rig and well count for the Groundbirch area can be seen on Exhibit 2 and Exhibit 3, respectively.

Exhibit 2: Shell's Groundbirch production



Source: Company data

Exhibit 3: Shell's Groundbirch rig & well count

Source: Company data

Recently, Asian companies have been involved in transactions around natural gas assets in Western Canada. The Asian buyers are predominately from South Korea, China and Japan, which are the primary importers of LNG in the region. See Exhibit 4 for select transactions involving Asian companies acquiring interest in Western Canadian natural gas assets.

Exhibit 4: Select acquisitions of Canadian natural gas assets by Asian companies

Announce date	Seller	Buyer	Transaction value	Comment
2/9/2011	Encana Corp.	PetroChina International Investment Company Limited	C$5.4 billion	PetroChina acquires 50% stake in Encana Corp.'s Cutbank Ridge assets in British Columbia and Alberta covering 635,000 net acres. The asset's proved reserves are about 1Tcfe and currently produces roughly 255 mmcfe/d.
12/14/2010	Hunt Oil	Korea National Oil Corporation (KNOC)	C$525 million	KNOC purchased Hunt Oil's Canadian assets. Total proven and probable reserves are estimated at 51 million boe.
8/26/2010	Encana Corp.	STX Energy	C$152 million	STX acquired Encana's interest in the Maxhamish gas field in BC with possible reserves of roughly 120 bcf.
8/24/2010	Penn West Energy Trust	Mitsubishi Corp	C$250 million cash plus C$600 million of exploration & development capital	Formed a 50/50 joint venture to develop Penn West's shale gas assets in the Cordova Embayment and conventional assets in Wildboy area. The assets has production of roughly 30 mmcf/d, including 550,000 gross acres of land including 120,000 acres targeting shale gas.
2/26/2010	Encana Corp.	Kogas Canada Ltd. (KOGAS)	C$565 million over three years	KOGAS will invest C$565 over 3 years to earn a 50% interest in 154,000 acres in the Horn River and Montney resource plays.
10/21/2009	Harvest Energy Trust	Korea National Oil Corporation (KNOC)	C$4.1 billion	KNOC acquired Harvest Energy Trust. Harvest production is roughly around 50,000 boe/d (oil weighted production). Assets have approximately 199.5 mmboe of P+P reserves.

Source: Company data, Bloomberg and Credit Suisse

Long on LNG

Asian companies involved in recent transactions are listed on Exhibit 4. Collectively, they have significant experience in building/operating LNG liquefaction plants around the globe. That expertise may be brought to Canada to export their equity gas to their respective countries. Asian companies that showed interest in the Kitimat LNG project included:

- **Mitsubishi Corp:** Mitsubishi and Kitimat LNG Inc., on 13 January 2009 signed a "Heads of Agreement under which Mitsubishi will acquire terminal capacity and an equity stake in Kitimat LNG's proposed liquefied natural gas (LNG) export terminal". This agreement has not been executed.

- **KOGAS:** On 1 June 2009 KOGAS and Kitimat LNG signed a memorandum of understanding (MOU), "under which KOGAS will acquire up to 40 per cent of Kitimat LNG's production and an option to acquire an equity stake in Kitimat LNG's liquefied natural gas (LNG) export terminal." This agreement has not been executed.

Exhibit 5 contains a select list of LNG liquefaction plants that involved Shell, Mitsubishi, KOGAS and/or PetroChina.

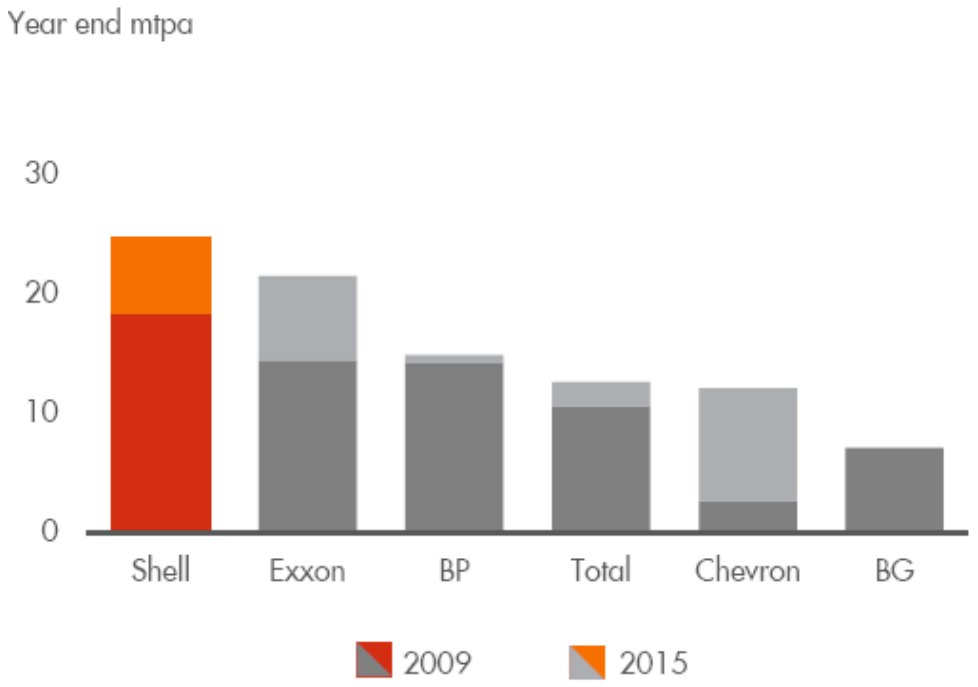
Exhibit 5: Select LNG liquefaction projects involving Shell, KOGAS, Mitsubishi or PetroChina

Project name	Area	Companies Involved	LNG Plant capacity (mtpa)	Operation date	Description	Fields
Brunei LNG	Brunei Darussalam, Lumut	Brunei Government (50%), Shell (25%), Mitsubishi (25%)	6.7	1972	Natural gas liquefaction plant	Jamallul Alam and Maharaja Lela
Malaysia LNG	Malaysia, Bintulu	Petronas, Shell, Mitsubishi, Others	23.0	1983	Eight LNG trains	Sarawak offshore field
North West Shelf Venture	Australia, Karratha	BHP Billiton, BP, Japan Australia LNG (MIMI) Pty Ltd., Shell, Woodside, Chevron	16.3	1989	Five LNG trains in total, the latest train started operation in 2008. Total investment of A$27b.	Gas fields in the Carnarvon Basin
Oman LNG	Oman, Qalhat	Government of Oman (51%), Shell (30%), Mitsubishi (2.77%), Others	10.4	2000	Three LNG trains.	Central Oman gas fields
Sakhalin II	Russia, Sakhalin Island	Shell (27.5%), Gazprom (50%), Mitsui (12.5%), Mitsubishi (10%)	9.6	2009	Two trains with an annual capacity of 9.6 million	Piltun-Astokhskoye (PA) oil field, Lunskoye gas field
Yemen LNG	Yemen, Balhaf	Total (39.62%), Hunt (17.22%), Yemen Gas (16.73%), KOGAS (6%), Others	6.7	2009	Two LNG trains.	Block 18 near Marib
Qatargas 4	Qatar, Ras Laffan	Shell (30%), Qatar Petroleum (70%)	7.8	2011	LNG train and production plants	Qatar's North Field
Pluto LNG Project	Australia, Near Karratha	Woodside (90%), Tokyo Gas (5%), Kansai Electric (5%)	4.3	2011	One LNG train. Completed FEED for the next two onshore trains.	Pluto and Xena gas fields in the Carnarvon Basin
Donngi-Senoro LNG	Indonesia, Uso area	Mitsubishi, Pertamina, PT. Medco LNG Indonesia, KOGAS	2.0	2014	Estimated cost US$2.8b.	Matindok and Senoro-Toili fields
Gorgon LNG	Australia, Barrow Island	Chevron (~47%), ExxonMobil (25%), Shell (25%), Others	15.0	2014	Under construction. Three trains.	Gorgon and Jansz-Io gas fields
GLNG	Australia, Curtis Island	Santos (30%), PETRONAS (27.5%), Total (27.5%) and KOGAS (15%).	7.8	2015	Project sanctioned. Cost roughly US$16b. Two LNG trains.	Coal seam gas from Surat and Bowen basins
Prelude (FLNG)	Australia, W. Australia	Shell (100%)	3.6	n/a	Front end engineering and design (FEED)	Prelude and Concerto gas fields in the Browse Basin
Browse LNG	Australia, W. Australia	Woodside, BHP Billiton, BP, Chevron, Shell	12.0	n/a	Up to three trains with capacity of 12mtpa. Final investment decision by mid-2012.	Brecknock, Calliance and Torosa Gas Fields
Arrow LNG	Australia, Curtis Island	Shell, PetroChina	16.0	n/a	Stage 1 includes 2 trains of 4mtpa of LNG each.	Coal seam gas from Surat and Bowen basins

Source: Company data

Royal Dutch Shell is one of the leaders in LNG. See Exhibit 6 for LNG capacity rankings, taken from a Shell presentation dated 15 September 2010.

Exhibit 6: **Global leadership in LNG**



Shell a leader in LNG

Note: Projects in operation or under construction. Source: Company data

Another LNG export terminal along the British Columbia coast, aside from the Kitimat LNG project, maybe a possibility in the medium to longer-term.

Calling card and the cash

Pacific Northern Gas does not typically host earnings conference calls. PNG hosted a conference call when the PTP sale was announced. We believe PNG wanted to showcase their LNG infrastructure development capabilities in addition to providing transaction commentary. We highlight slide eleven of the presentation that came with the conference call with a subtitle "*PNG is the obvious partner for the LNG industry*". The bullet points included:

- "Experience in obtaining pipeline permits
- Capabilities in pipeline operations, maintenance
- Strong relationship with local communities
- Excellent environmental track record
- Has agreements in support of two LNG projects"

The two LNG projects that PNG is involved in are:

PNG's involvement in two LNG projects off the British Columbia coast

(1) **Kitimat LNG project:** PNG through an operating and transportation service agreement, will operate and maintain the KSL pipeline for an initial term of seven years starting in 2015. The agreement is subject to five year renewals thereafter.

(2) **LNG Partners:** Pacific Northern Gas has a transportation agreement that will use its existing capacity on its Western System to transport natural gas onto a floating LNG vessel to be located on Douglas Channel near Kitimat, BC.

The sale of PNG's stake in the PTP Partnership will generate net proceeds of roughly C$9-C$10 per share. PNG will have the financial flexibility to pursue other pipeline projects related to further LNG developments in the region.

Pacific Northern Gas is uniquely positioned to be able to benefit from further growth in exports of natural gas to Asia. We believe the company is capable of developing pipeline infrastructure in British Columbia that will be used to transport natural gas to potential LNG liquefaction terminals in the BC coast, similar to the KSL Pipeline Project.

Outlook

In our view, Pacific Northern Gas investors, whether existing or prospective, should consider several issues, including: (1) possible Pacific pipeline and capital considerations; (2) highlighting hydro; and, (3) takeover target thoughts.

Possible Pacific pipeline and capital considerations

Potential for other LNG projects on the British Columbia coast

Another LNG export terminal along the British Columbia coast, aside from the Kitimat LNG project, is a possibility given the statements made by Royal Dutch Shell plc (Shell) at the Credit Suisse Energy Summit in Vail on February 2011. Shell stated that they are open to the possibility of exporting natural gas out of Western Canada (Montney shale) and is currently in discussions with its Asian partners in China, Korean and Japan. Our European energy team believe a Shell LNG export facility is in the early stages. We believe another LNG liquefaction facility on the BC coast will be a medium to longer-term development.

Pacific Northern Gas is uniquely positioned to be able to benefit from further growth in exports of natural gas to Asia through LNG development. We believe the company is capable of developing pipeline infrastructure in British Columbia that will be used to transport natural gas to potential LNG terminals in the BC coast, similar to the KSL Pipeline Project.

A number of capital redeployment options

Pacific Northern Gas announcement to sell its interest in PTP to Apache Canada and EOG Canada will remove risks associated with a potential large equity issuance to fund the company's share of the KLS pipeline project. This elimination of capital issuance risks may be viewed positively for existing holders of the stock. Yet, questions clearly exist about PNG's capital market uniqueness without the PTP stake.

Given the significant amount of cash proceeds coming from the sale of PTP, the company has numerous options for capital redeployment. PNG's board is currently reviewing its business strategy and will update investors in the near future likely before the Annual General Meeting scheduled on 11 May 2011. Redeployment options would include:

- Pursuing further pipeline opportunities related to British Columbia LNG exports;
- Growing its renewable energy business;
- Special dividend; and/or,
- Share purchases.

Highlighting hydro

Expanding hydro

The company's entrance into renewable power generation, more specifically run-of-river, began by forming a partnership with Skookum Power Corporation and the acquisition of a 97% interest in the McNair Creek hydroelectric generation facility. McNair Creek is a 9.8MW run of river facility located on the B.C. Sunshine Coast near Port Mellon that commenced operation on November 2004.

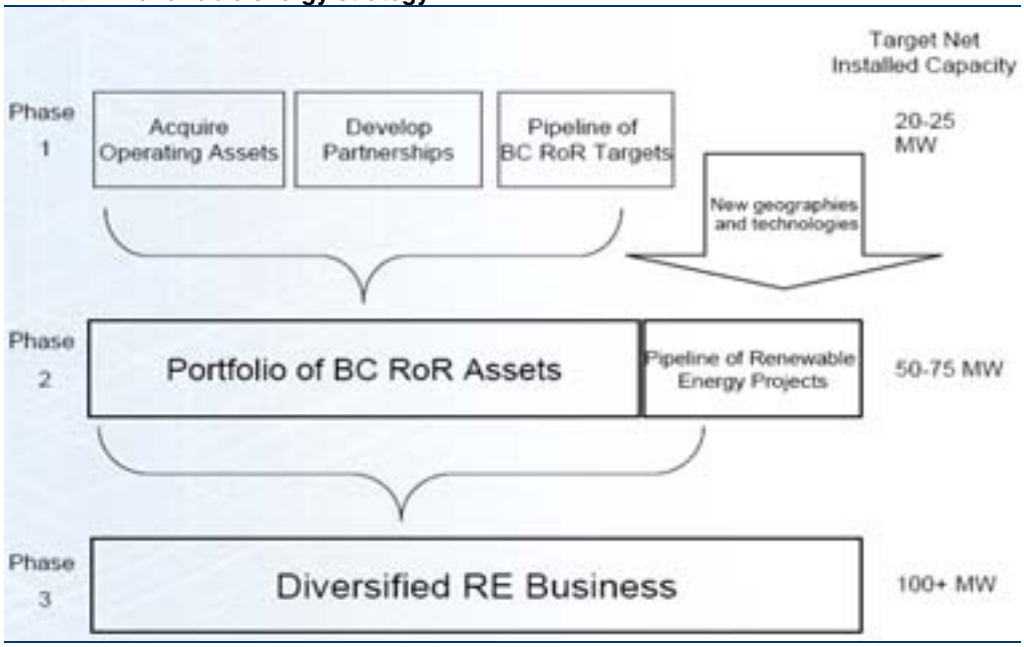
Renewable partner were former Brookfield Renewable employees

The company entered into a development and operating agreement with Skookum Power. The agreement would allow PNG to leverage off Skookum's extensive expertise in hydroelectric generation. Skookum Power management were formerly with Brookfield Renewable, which is one of the largest owners, operators and developers of hydroelectric

generation in North America and Brazil. This partnership should give PNG the immediate expertise it requires to make sound investment decision in this sector while building up its internal capabilities.

The company's renewable energy strategy is illustrated in the exhibit below.

Exhibit 7: Renewable energy strategy



Source: Company data

According to its strategy, PNG will acquire existing operating run-of-river assets to create scale and expertise. Once a certain scale is achieved, the company will take on more development risk by targeting development run-of-river projects. The company's reasons for moving into the renewable energy field are as follows:

- "Utilize its operating skills, permitting expertise, project management capabilities, financing acumen and energy market and regulatory expertise" and
- "Existence of both operating projects and development projects that are available in sized which fit PNG's access to capital".

We believe the company's approach in its expansion into the renewable energy field is prudent as it's similar to that of another pipeline company's expansion into the solar energy field. With long-term PPAs attached to renewable generation with government counterparties, the risk profile is similar to that of its regulated pipeline/utility business. British Columbia's Clean Power Call will give PNG opportunity to acquire hydro projects.

Takeover target thoughts

Even though we believe it to be a low probability, Pacific Northern Gas could be a potential target for some utility and infrastructure player. The sale of PTP clarifies the value of the KSL Project which was a largely difficult to quantify. PNG would be attractive for a number of reasons:

- Access existing right of way
- Relationships with First Nations
- Stable regulatory regime

Potential acquirers could include Emera Inc., Fortis Inc. and various Canadian pension funds. We view the outright acquisition of PNG to be a relatively low a probability event.

Valuation

Our Neutral rating and target price of C$30.00 is obtained from multiple valuation methods, including: a P/B multiple of 1.1x; a 14.5x P/E multiple; a 7.6x EV/EBITDA multiple on 2012 estimates; and, a DCF. We reiterate our Neutral rating.

Rating: Neutral

Target: C$30.00

Companies Mentioned *(Price as of 01 Mar 11)*
Apache Corp. (APA, $120.86, OUTPERFORM, TP $129.00)
EOG Resources (EOG, $107.93, NEUTRAL, TP $87.00)
Pacific Northern Gas Ltd. (PNG.TO, C$27.50, NEUTRAL, TP C$30.00)
Royal Dutch Shell plc (RDSa.L, 2187.00 p, OUTPERFORM, TP 2560.00 p, MARKET WEIGHT)

Disclosure Appendix

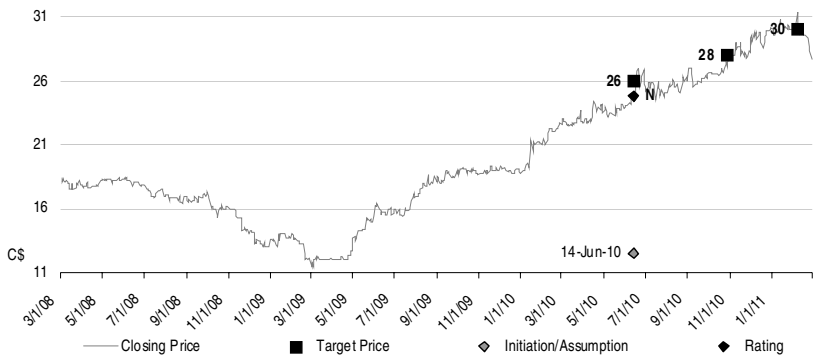
Important Global Disclosures

I, Paul Tan, certify that (1) the views expressed in this report accurately reflect my personal views about all of the subject companies and securities and (2) no part of my compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this report.

See the Companies Mentioned section for full company names.

3-Year Price, Target Price and Rating Change History Chart for PNG.TO

PNG.TO Date	Closing Price (C$)	Target Price (C$)	Rating	Initiation/ Assumption
6/14/10	24.8	26	N	X
10/27/10	27.38	28		
2/8/11	30.2	30		



O=Outperform; N=Neutral; U=Underperform; R=Restricted; NR=Not Rated; NC=Not Covered

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Outperform (O): The stock's total return is expected to outperform the relevant benchmark* by at least 10-15% (or more, depending on perceived risk) over the next 12 months.

Neutral (N): The stock's total return is expected to be in line with the relevant benchmark* (range of ±10-15%) over the next 12 months.

Underperform (U): The stock's total return is expected to underperform the relevant benchmark* by 10-15% or more over the next 12 months.

Relevant benchmark by region: As of 29th May 2009, Australia, New Zealand, U.S. and Canadian ratings are based on (1) a stock's absolute total return potential to its current share price and (2) the relative attractiveness of a stock's total return potential within an analyst's coverage universe, with Outperforms representing the most attractive, Neutrals the less attractive, and Underperforms the least attractive investment opportunities. Some U.S. and Canadian ratings may fall outside the absolute total return ranges defined above, depending on market conditions and industry factors. For Latin American, Japanese, and non-Japan Asia stocks, ratings are based on a stock's total return relative to the average total return of the relevant country or regional benchmark; for European stocks, ratings are based on a stock's total return relative to the analyst's coverage universe**. For Australian and New Zealand stocks a 22% and a 12% threshold replace the 10-15% level in the Outperform and Underperform stock rating definitions, respectively, subject to analysts' perceived risk. The 22% and 12% thresholds replace the +10-15% and -10-15% levels in the Neutral stock rating definition, respectively, subject to analysts' perceived risk.*

***An analyst's coverage universe consists of all companies covered by the analyst within the relevant sector.*

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Overweight: Industry expected to outperform the relevant broad market benchmark over the next 12 months.
Market Weight: Industry expected to perform in-line with the relevant broad market benchmark over the next 12 months.
Underweight: Industry expected to underperform the relevant broad market benchmark over the next 12 months.
**An analyst's coverage universe consists of all companies covered by the analyst within the relevant sector.*
***The broad market benchmark is based on the expected return of the local market index (e.g., the S&P 500 in the U.S.) over the next 12 months.*

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	Global Ratings Distribution	
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Neutral/Hold*	41%	(60% banking clients)
Underperform/Sell*	11%	(52% banking clients)
Restricted	2%	

**For purposes of the NYSE and NASD ratings distribution disclosure requirements, our stock ratings of Outperform, Neutral, and Underperform most closely correspond to Buy, Hold, and Sell, respectively; however, the meanings are not the same, as our stock ratings are determined on a relative basis. (Please refer to definitions above.) An investor's decision to buy or sell a security should be based on investment objectives, current holdings, and other individual factors.*

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See the Companies Mentioned section for full company names.
Price Target: (12 months) for (PNG.TO)
Method: Our C$30.00 target price is based solely on current operating assets and is obtained from multiple valuation methodologies including: a 14.5x P/E multiple applied to our 2012 EPS estimate; a P/B multiple of 1.1x; a 7.6x EV/EBITDA multiple (enterprise value/earnings before interest, taxes, depreciation, and amortization); and, a discounted cash flow.
Risks: There are a number of risks to our C$30 target price for Pacific Northern Gas such as: execution/development risks regarding the KSL Project; access to capital markets to fund the KSL Project; North American energy market dynamics; regulatory; commodity prices; and interest rates. Moreover, one should never underestimate the power of the regulator in any regulated business.

Please refer to the firm's disclosure website at www.credit-suisse.com/researchdisclosures for the definitions of abbreviations typically used in the target price method and risk sections.

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The following disclosed European company/ies have estimates that comply with IFRS: RDSa.L.

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Pacific Northern Gas Ltd. (PNG.TO)

Rating	**NEUTRAL***
Price (03 Mar 11, C$)	27.00
Target price (C$)	30.00[1]
52-week price range	31.35 - 22.51
Market cap. (C$ m)	97.42
Enterprise value (C$ m)	193.62

**Stock ratings are relative to the relevant country benchmark.*
[1]Target price is for 12 months.

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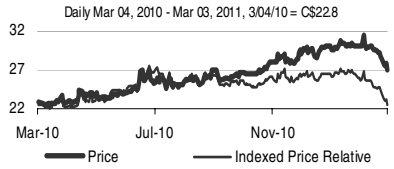
RESULTS

At a glance: Significant special dividend

- **Preliminary earnings results:** Pacific Northern Gas (PNG) reported Q4 2010 diluted earnings of C$1.06 which was below our C$1.12 and that of the Streets at C$1.07 and within the C$1.04 to C$1.16 range. The difference was largely below the operating margin line which is challenging to asses as we await the full financial release. PNG announced a C$3.00/shr special dividend on top of the regular C$0.30/shr quarterly dividend to be paid on 24 March 2011 to shareholders of record at the close of 15 March 2011. In light of weather related impacts from PNG's natural gas distribution utility, the earnings dispersion among the quarters can often be considerable. Yet, that dispersion does not generally impact allowed returns and full year earnings. Moreover, the long-cycle nature of most of our coverage universe, we do not place undue emphasis on quarterly results.
- **Details on dividend:** The C$3.00/shr special dividend is roughly fifty percent of the net proceeds from the initial payment of C$30m from the sale of PNG's interest in the Pacific Trail Pipelines Limited Partnership which closed on 2 March 2011. The company stated "PNG believes that it stands to benefit from the LNG industry…PNG believes there is room in Kitimat for more LNG terminals, and room for additional pipelines along the corridor." We share a similar view on potential for further LNG developments as can be seen from our recent reports "*Prowling for Pacific pipeline projects?*" and "*Profitable Pacific pipeline*" on 1 March and 7 February 2011, respectively.
- **Investment thesis:** We believe Pacific Northern Gas provides low-growth infrastructure exposure with some growth opportunities involving further expansion of natural gas exports from Western Canada to Asian markets.
- **Valuation:** Our Neutral rating and target price of C$30 is obtained from multiple valuation methods, including: a P/B multiple of 1.1x; a 14.5x P/E multiple; a 7.6x EV/EBITDA multiple on 2012 estimates; and, a DCF. We reiterate our Neutral rating.

Share price performance



On 03/03/11 the Canada S&P/TSX Composite Index index closed at 14214.72

Quarterly EPS	Q1	Q2	Q3	Q4
2009A	1.38	-0.13	-0.49	0.94
2010E	1.48	-0.06	-0.64	1.12
2011E	1.59	-0.09	-0.52	1.09

Financial and valuation metrics

Year	12/09A	12/10E	12/11E	12/12E
EPS (CS adj.) (C$)	1.71	1.92	2.08	2.05
Prev. EPS (C$)	—	—	—	—
P/E (x)	15.8	14.0	13.0	13.1
P/E rel. (%)	69.2	81.3	88.9	98.5
Revenue (C$ m)	104.1	98.6	100.5	99.5
EBITDA (C$ m)	22.9	25.2	26.9	26.7
OCFPS (C$)	5.11	2.27	4.50	4.45
P/OCF (x)	3.7	13.3	6.0	6.1
EV/EBITDA (current)	7.5	7.7	7.0	6.9
Net debt (C$ m)	76	96	91	86
ROIC (%)	5.71	5.81	6.08	5.96

Number of shares (m)	3.61	IC (12/10E, C$ m)	219.43
BV/share (current, C$)	23.9	EV/IC (x)	0.88
Net debt (current, C$ m)	95.5	Dividend (current, C$)	1.12
Net debt/tot. cap. (current, %)	51.1	Dividend yield (%)	4.1

Source: Company data, Credit Suisse estimates.

Companies Mentioned *(Price as of 03 Mar 11)*
Pacific Northern Gas Ltd. (PNG.TO, C$27.00, NEUTRAL, TP C$30.00)

Disclosure Appendix

Important Global Disclosures

I, Paul Tan, certify that (1) the views expressed in this report accurately reflect my personal views about all of the subject companies and securities and (2) no part of my compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this report.

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3-Year Price, Target Price and Rating Change History Chart for PNG.TO

PNG.TO Date	Closing Price (C$)	Target Price (C$)	Rating	Initiation/ Assumption
6/14/10	24.8	26	N	X
10/27/10	27.38	28		
2/8/11	30.2	30		

O=Outperform; N=Neutral; U=Underperform; R=Restricted; NR=Not Rated; NC=Not Covered

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Underperform (U): The stock's total return is expected to underperform the relevant benchmark* by 10-15% or more over the next 12 months.

Relevant benchmark by region: As of 29th May 2009, Australia, New Zealand, U.S. and Canadian ratings are based on (1) a stock's absolute total return potential to its current share price and (2) the relative attractiveness of a stock's total return potential within an analyst's coverage universe, with Outperforms representing the most attractive, Neutrals the less attractive, and Underperforms the least attractive investment opportunities. Some U.S. and Canadian ratings may fall outside the absolute total return ranges defined above, depending on market conditions and industry factors. For Latin American, Japanese, and non-Japan Asia stocks, ratings are based on a stock's total return relative to the average total return of the relevant country or regional benchmark; for European stocks, ratings are based on a stock's total return relative to the analyst's coverage universe**. For Australian and New Zealand stocks a 22% and a 12% threshold replace the 10-15% level in the Outperform and Underperform stock rating definitions, respectively, subject to analysts' perceived risk. The 22% and 12% thresholds replace the +10-15% and -10-15% levels in the Neutral stock rating definition, respectively, subject to analysts' perceived risk.*

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Outperform/Buy*	46%	(62% banking clients)
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Underperform/Sell*	11%	(52% banking clients)
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Price Target: (12 months) for (PNG.TO)

Method: Our C$30.00 target price is based solely on current operating assets and is obtained from multiple valuation methodologies including: a 14.5x P/E multiple applied to our 2012 EPS estimate; a P/B multiple of 1.1x; a 7.6x EV/EBITDA multiple (enterprise value/earnings before interest, taxes, depreciation, and amortization); and, a discounted cash flow.

Risks: There are a number of risks to our C$30 target price for Pacific Northern Gas such as: execution/development risks regarding the KSL Project; access to capital markets to fund the KSL Project; North American energy market dynamics; regulatory; commodity prices; and interest rates. Moreover, one should never underestimate the power of the regulator in any regulated business.

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Pacific Northern Gas Ltd. (PNG.TO)

Rating	**NEUTRAL***
Price (17 Mar 11, C$)	26.50
Target price (C$)	30.00[1]
52-week price range	31.35 - 22.64
Market cap. (C$ m)	97.53
Enterprise value (C$ m)	188.01

**Stock ratings are relative to the relevant country benchmark.*
[1]Target price is for 12 months.

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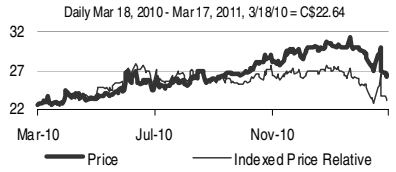
MARKET COMMENTARY/STRATEGY

Pushing up probability for payment?

- **Higher probability:** The Kitimat LNG project partners, Apache Canada Ltd. and EOG Resources Canada Inc., announced Encana Corp. (ECA) agreed to acquire a 30% interest in the planned Kitimat LNG project along with the Pacific Trail Pipelines (PTP). The new ownership structure includes: (a) Apache as the operator with 40%; and, (b) EOG and ECA, each with a 30% interest in the project. We believe this announcement and the previous KBR award for the Front End Engineering and Design contract for the Kitimat LNG project on March 4th are positives for PNG. Specifically, this news flow increases PNG's likelihood of receiving the second tranche of proceeds totaling C$20m from the PTP sale (for further details see our note "*Prowling for Pacific pipeline projects?*" on 1 March 2011). Final Investment Decision (FID) for this project remains likely in late 2011.
- **Future LNG developments:** We continue to believe that additional LNG development off British Columbia's coast is a possibility. That view is partly supported by Shell's commentary of during Credit Suisse's Energy Summit in February. In our view, Pacific Northern Gas is uniquely positioned to be able to benefit from further growth in export of natural gas to Asia given the company's ability to develop pipeline infrastructure in British Columbia such as the KSL Pipeline Project.
- **Investment thesis:** We believe Pacific Northern Gas provides low-growth infrastructure exposure with some growth opportunities involving further expansion of natural gas exports from Western Canada to Asian markets.
- **Valuation:** Our Neutral rating and target price of C$30 is obtained from multiple valuation methods, including: a P/B multiple of 1.1x; a 14.5x P/E multiple; a 7.6x EV/EBITDA multiple on 2012 estimates; and, a DCF. We reiterate our Neutral rating.

Share price performance



On 03/17/11 the Canada S&P/TSX Composite Index index closed at 13746.15

Quarterly EPS	Q1	Q2	Q3	Q4
2010A	1.48	-0.06	-0.64	1.06
2011E	1.52	-0.03	-0.56	1.14
2012E	1.50	-0.03	-0.55	1.13

Financial and valuation metrics

Year	12/10A	12/11E	12/12E	12/13E
EPS (CS adj.) (C$)	1.83	2.08	2.05	2.05
Prev. EPS (C$)	—	—	—	—
P/E (x)	14.5	12.7	12.9	12.9
P/E rel. (%)	87.7	91.0	101.0	—
Revenue (C$ m)	95.2	99.4	98.4	98.0
EBITDA (C$ m)	24.7	27.0	26.9	26.8
OCFPS (C$)	2.58	4.46	4.43	4.41
P/OCF (x)	11.7	5.9	6.0	6.0
EV/EBITDA (current)	7.8	7.0	6.8	6.7
Net debt (C$ m)	94	90	86	81
ROIC (%)	5.68	6.05	5.92	5.83

Number of shares (m)	3.68	IC (12/11E, C$ m)	225.14
BV/share (current, C$)	25.0	EV/IC (x)	0.84
Net debt (current, C$ m)	93.9	Dividend (current, C$)	1.20
Net debt/tot. cap. (current, %)	49.9	Dividend yield (%)	4.5

Source: Company data, Credit Suisse estimates.

Companies Mentioned *(Price as of 17 Mar 11)*
Pacific Northern Gas Ltd. (PNG.TO, C$26.50, NEUTRAL, TP C$30.00)

Disclosure Appendix

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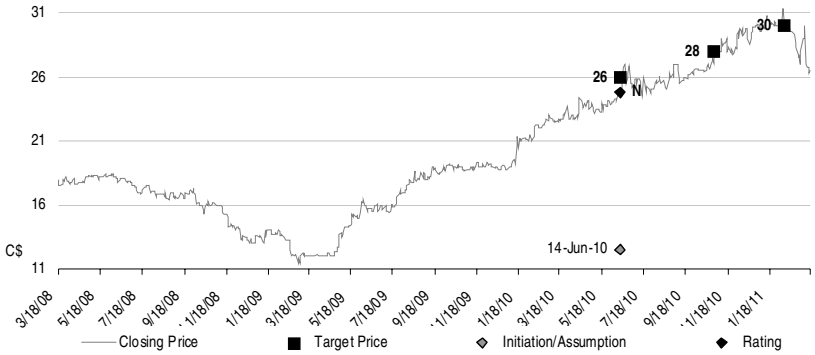

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NATIONAL BANK FINANCIAL

PNG (T)	**Cdn$19.20**
Stock Rating:	**Outperform** (Unchanged)
Target:	**Cdn$23.40** (Was Cdn$23.00)
Risk Rating:	**Low** (Unchanged)

Stock Data:	
52-week High-Low (Canada)	$17.00 - $20.05
Bloomberg/Reuters: Canada	PNG CN / PNG.TO

(Year-End Dec 31)	2005a	2006e	2007e
EPS	$1.75	$1.64	$1.68
P/E	11.2x	11.7x	11.4x
EPS Change Y/Y	24.1%	-6.3%	2.4%
Book Value	$21.43	$22.27	$23.15
P/BV	0.9x	0.9x	0.8x
Dividend Yield	4.1%	4.2%	4.2%

Financial Data:	
Shares Outstanding (mln)	3.63
Book Value per Share	$22.62
Market Capitalization (mln)	$70
Price/Book Ratio	0.8x
Debt/Total Cap.	51%
Dividend per share	$0.80
Dividend Yield	4.17%

Industry Rating:
(NBF Economics & Strategy Group)

Company Profile:
PNG is British Columbia's second largest and an almost pure natural gas (gas) utility. PNG provides the transmission and distribution of gas in west-central and northeastern B.C.

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Pacific Northern Gas

Q1 2006 results higher than expected

Potential income trust conversion, pipeline expansion, and Methanex contract in limbo

HIGHLIGHTS

- **Q1 2006 reported net income: $4.836 million or $1.33 per share vs. $3.9 million or $1.08 per share in Q1 2005 (y/y)**
  The higher earnings y/y were the result of deliveries to residential and commercial customers representing a higher proportion of annual deliveries compared with last year when Methanex Corp. (TSX-MX) (its then largest industrial customer) was still operating its methanol/ammonia facility.

- **Three potential drivers of earnings and share price growth remain in limbo**
  They are:

  1) Resolution of the aftermath of the termination of the Methanex Corp. (TSX-MX) gas-transportation contract;

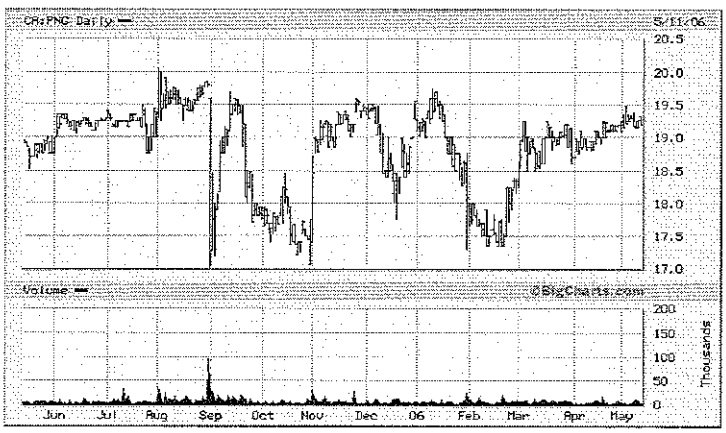
  2) Recapitalization in the form of an income trust; and

  3) Flow reversal and looping of PNG's Kitimat-to-Summit-Lake (KSL) pipeline.

- **Based on the status quo, we are maintaining our EPS estimates.**

- **Our Outperform rating is sustained.**

Stock Performance



Assessment

Q1 2006 EPS were, historically, high, because of the impact of weather seasonality, following the closure of MX's plant. PNG states that Q1 2006 net income was about $1.2 million higher y/y, and that everything being equal, PNG would record about $1.2 million less during the balance of 2006 compared with 2005.

PNG's Future – *resembles a marionette play (with third-parties pulling the strings)*

PNG's future depends on the outcome of a "marionette drama in suspense, in three acts," two of which hinge on regulatory fiat, with the latter depending on supply/demand conditions for natural gas (gas) in Western, if not all, of North America that may/may not warrant construction of the LNG-receipt terminal (LNGRT) proposed by Kitimat LNG (KLNG). In other words, PNG can pull few, if any, strings to influence its future. About the only decision PNG can and has to make is how hard it wishes to push the income trust conversion versus flow reversal of the KSL-line. This is, in part, a matter of timing.

Here are the forces influencing PNG's destiny:

(1) Resolution of the regulatory aftermath resulting from the termination of the Methanex Corp. (TSX-MX) gas-transportation contract;

(2) PNG's recapitalization into an income trust; and

(3) Construction of the KLNG-terminal, requiring flow reversal and massive expansion of PNG's KSL-line in the event KLNG proceeds.

Predicting with any degree of certainty the outcome a hazardous task, given the nature of these issues.

However, rather than sit on the fence, we are predicting that:

- The British Columbia Utilities Commission (BCUC) may confirm, as early as by month-end, the interim rates, where under PNG is now operating. If it does, PNG will be allowed to recover an annual revenue deficiency of about $4 million in 2006, resulting from the existence of otherwise "stranded assets," left behind by MX, until they have reached the end of their regulatory lives. Should, however, another customer of PNG use all or part of these assets, their annual carrying costs, otherwise payable by PNG's remaining customers, would be reduced.
- There is ample precedent for this predicted outcome.
- The odds of PNG's ability to recapitalize itself in the form of an income trust are 50/50.
- However, oddly enough, we could argue that the KSL-project and the income trust conversion are mutually exclusive. On that basis, the "suspense drama" would have two acts only.

Why are we suggesting this potential outcome?

- Proceeding with the development of a project as large as KSL's (possibly in the $600+-million range), would make PNG a net-capital user during the development phase, and make it probably very difficult to make consistent distributions if PNG were recapitalized. While it would likely record an allowance for funds during construction (AFUDC) of pipeline looping, the associated "earnings" would be non-cash. This is clearly inconsistent with reorganizing PNG in the form of an income trust, and, **then**, proceeding with the KSL-project.
- Moreover, we would also argue that a project, such as KSL's, would create a very large pool of capital-cost allowances (CCA) (@ 8% per year versus 4% previously), that would enable PNG to postpone the cross-over between current and future (deferred) taxes for a very long period of time.
- In other words, maximizing the use of CCA would minimize a liability for cash taxes. This is hardly suitable for an income trust.
- However, lest someone suggest that, if a regulator would allow PNG to utilize the

income-tax allocation instead of the taxes-payable method for the KSL-project, we would counter by stating that 1) it is irrelevant which of the methods is used during the construction of the KSL project, because PNG would not be generating revenues until after its completion of the "cross-over;" and 2) after the KSL-project is operating, the "cross-over" would be so far in the future, that the collection of future income taxes would threaten the viability of the project, because every fraction of a penny saved per cubic metre of regasified LNG transmitted through the KSL-line would enhance the competitiveness of imported regasified LNG. This, we suggest, is crucial to the financial and economic viability of the entire Kitimat LNG-project. If we had to develop its LNG-terminal, we would, if we had to, stand on our head and argue in favour of the income-taxes-payable method, and would most likely prevail, and hence, PNG will have to be most careful which of the pedals it may want to push. Pushing them simultaneously would likely cause the PNG-wagon to careen out of control. Given the recent and current lack of "noise" around the income-trust issue could, at least in theory, cause us to conclude that the KSL-line has assumed priority, and that the income-trust notion has been placed on the back burner, set at minimum temperature. **Hence, we are inclined to view the income-trust option not as a current pot boiler.** However, PNG is in a far better position than we in stating its current intent; hence, we defer to its wisdom.

What are Shareholder's Risks/Uncertainty and Potential Upside?

- If nothing were to happen
  except for a favourable resolution of the aftermath of the termination of the MX-contract, there is downside protection through very modest earnings and dividend growth. This would mean that PNG would continue as a somewhat staid owner of gas-distribution utilities, and might, unless the BCUC increases the common-equity component of PNG's regulated capitalization, dividend-out the excess common equity. This would generate, at the very least, a consolation prize for PNG's common shareholders;
- If the recapitalization succeeds, PNG would resemble a Mexican piñata, albeit a small one, with the "door to the future" (i.e. KSL-line) boarded-up;
- If someone of the ranks of Kinder Morgan Inc. (NYSE-KMI) were to lasso-in PNG, its shareholders would stand to be rewarded for their patience, while receiving a dividend in the interim, followed by, hopefully, a strong bump-up in PNG's share prices;
- If the flow of the KSL-line is reversed and PNG loops it, there could potentially be enormous upside. If our assessment of income trust-versus-KSL-project has merit, we would think that PNG's shareholders would prefer a large-carat diamond to a Mexican piñata.

If the KSL-project materializes, the significance of the potential recapitalization would be all but irrelevant.

Hence, it is hard to sneeze at PNG's shares, especially since PNG would, at least, be maintaining its quarterly DPS at $0.20, paying shareholders for waiting. We actually would argue that, post-February 2007, PNG might be unable to resist the temptation to raise the DPS a snick or so, because, by then, it would have shovelled a few tax dollars into Ottawa's insatiable ovens.

Q1 2006 highlights

Q1 2006 reported net income: $4.836 million or $1.33 per share vs. $3.9 million or $1.08 per share in Q1 2005 (y/y). The higher earnings y/y were the result of deliveries to residential and commercial customers representing a higher proportion of PNG's annual deliveries compared with last year, when MX, formerly its largest industrial customer, was still operating its methanol/ammonia facility in Kitimat, B.C. (closed on Nov. 1, 2005).

In Q1 2006, operating revenues increased to $56.6 million from $47.8 million y/y mostly due higher gas supply costs in customer rates and a $2.1 million increase in revenues from off-system gas sales, whose profits/losses are being deferred for future refunds/recoveries from PNG's customers..

Q1 2006 operating margin increased to $17.3 million from $16.1 million due to a higher proportion of annual operating margin being recovered from residential and commercial customers in Q1 compared with the same period last year as Q1 and Q4 deliveries typically account for more than 75% of annual deliveries. PNG expects this higher operating margin of $1.2 million to be offset by lower levels in Q2 and Q3 vs. last year, everything else being equal.

The rate stabilization adjustment mechanism recently approved by the BCUC is contributing to the stability of PNG's earnings. This mechanism allows the recording of 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. PNG's net income was $0.4 million higher in Q1 2006 as a result of this deferral account.

In Q1 2006, deliveries to residential customers declined by 11% y/y with customers reducing consumption as the weather was 1% warmer y/y and natural gas prices were 28% higher y/y. Commercial deliveries only decreased by 1% as these customers are typically less temperature sensitive.

Deliveries to industrial customers dropped by 77% y/y primarily due to the closure of MX's Kitimat facility on Nov. 1, 2005. This reduction in deliveries did not significantly impact net income due to the existence of a deferral account.

Potential income trust conversion

On Sept. 12, 2005, PNG announced that the BCUC had conditionally approved the proposed recapitalization of PNG under an income trust structure. This was PNG's second attempt to receive BCUC approval for income trust conversion following a rejection in July 2004.

On Oct. 7, 2005, PNG applied for reconsideration and variance of the income trust decision, requesting the BCUC to approve the interest rates on the subordinated debt as originally applied for by PNG. On Oct. 28, 2005, the BCUC approved the applied-for interest rates on the notes to be issued for the recapitalization. While significant, approval of the application for reconsideration changes the prospects for a recapitalization very little. On Nov. 18, 2005, the BCUC requested that the Lieutenant Governor in Council of the Province of B.C. approve the corporate amalgamation of PNG and its subsidiaries, a requirement before the conversion to an income trust can proceed.

In the event of approval of its conversion application, we would establish an entirely new target price and rating were PNG to become an income trust and relevant metrics become predictable.

Our View: Despite significant financial implications, a recapitalization in the form of an income trust, although monetarily real, would do little more than enhance the post-tax value of cash paid to investors, and would not affect PNG's business fundamentals in any real sense. However, the share price would likely bounce.

Methanex-Factor

On Nov. 1, 2005, MX closed its 500,000-Megagram (Mg) Kitimat methanol plant due to the soaring cost of natural gas. On Aug. 31, 2005, it had given notice of termination of its Firm and Interruption Gas Transportation Service Agreement with PNG.

Based on the terms of the Agreement, MX paid PNG a termination payment of about $23.3 million on Feb. 28, 2005. This amount represents the net present value of the remaining firm payment obligations under the Agreement, net of PNG's avoided costs.

So far, the agreement's termination has not affected PNG's net income. **For subsequent years, the impact on net income will depend on future regulatory decisions including the appropriate regulatory treatment of the termination payment.** PNG is proposing to the BCUC an, in its opinion, appropriate regulatory treatment for the termination payment. PNG expects a decision late in Q2 2006. We expect approval of a deferral account covering amortization over about 44 months.

PNG had forecast that with the shutdown of MX's Kitimat plant, the revenue available to service its debt in 2010 would fall by $3.5 million, disregarding MX's contractual buyout

obligation and the BCUC's regulatory treatment of the buyout revenues payable by MX.

In 2005, MX accounted for about 62% of PNG's delivered gas volumes and about 7.6% of PNG's operating revenues.

Our View: If the BCUC would rule that the cash proceeds from the termination of the Methanex contract would be capitalized and amortized over the same term as that of the Methanex contract, PNG's annual earnings could essentially be equal to those, had the contract survived and expired, as agreed to. This would mean, as Shakespeare said: "Much ado about nothing."

However, there is also the issue of stranded former "MX-assets." We believe that PNG's remaining customers would, in aggregate, pay for their carrying costs until the end of their regulatory lives.

Kitimat Summit Lake Looping Project (KSL)

We expect Kitimat LNG to proceed with its LNG-receiving terminal, albeit with some delay, until all up- and downstream commercial arrangements have been agreed to.

PNG is currently in negotiations with Kitimat LNG Inc. (KLNG) to utilize PNG's (by then flow-reversed) KSL-line, for delivering regasified LNG from KLNG's proposed LNG import terminal into the Duke Energy Gas Transmission system (DEGT) at Summit Lake. If KLNG's LNG terminal is constructed, PNG will seek to reverse the flow of its pipeline and expand the capacity from the current 115 mmcf/d or so to accommodate the delivery of 610 mmcf/d into the DEGT.

Our View: We view the fate of the KSL-project as far more important than anything in the past decade or so, because, if it materializes, it would hugely benefit PNG's business, earnings and cash-flow and dividend outlook. Should the project proceed, PNG would face a massive pipeline looping program between "Station 4" (Summit Lake station) and Kitimat and a reversal of gas flows, because instead of flowing from East to West, gas would be flowing in reverse transporting regasified imported LNG instead of Western Canadian gas. If this LNG-project proceeds, it could potentially cause Kitimat to become one of the few gateways for LNG-imports along North America's Pacific Coast. If it did, it would drive future expansions of PNG's KSL. PNG's earnings, cash flow and dividends would bounce, and it would probably not be long for salivating investors to crawl out of the woodwork and fall all over themselves, beating a trail to PNG's Vancouver offices on skis (if in 2010) or without them thereafter.

Valuation

Based on status-quo: for the 12-month period ending March 2008; estimated EPS are $1.69 and DPS $0.90; retained EPS of $0.79; the retained EPS multiple is 5x, and the assumed long-term corporate bond yield of 6.25% nominally is tax-effected to 4.63%, using a 1.35 dividend-tax-credit divisor. Support price $19.44; residual price $3.95. Target Price $23.40 (rounded).

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SECONDARY STOCK RATING: Under Review – Our analyst has withdrawn the rating because of insufficient information and is awaiting more information and/or clarification; **Tender** – Our analyst is recommending that investors tender to a specific offering for the company's stock; **Restricted** – Because of ongoing investment banking transactions or because of other circumstances, NBF policy and/or laws or regulations preclude our analyst from rating a company's stock.

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NATIONAL BANK FINANCIAL

PNG (T)	**Cdn$17.79**
Stock Rating:	**Outperform** (Unchanged)
Target:	**Cdn$21.75** (Unchanged)
Risk Rating:	**Low** (Unchanged)

Stock Data:	
52-week High-Low (Canada)	$17.35 - $19.84
Bloomberg/Reuters: Canada	PNG CN / PNG.TO

(Year-End Dec 31)	2005a	2006e	2007e
EPS	$1.75	$0.98	$1.68
P/E	11.2x	18.2x	10.6x
EPS Change Y/Y	24.1%	-44.0%	71.4%
Book Value	$21.43	$21.61	$22.49
P/BV	0.9x	0.8x	0.8x
Dividend Yield	4.1%	4.5%	4.5%

Financial Data:	
Shares Outstanding (mln)	3.63
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Market Capitalization (mln)	$65
Price/Book Ratio	0.8x
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Dividend Yield	4.50%

Industry Rating:
(NBF Economics & Strategy Group)

Company Profile:
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Pacific Northern Gas

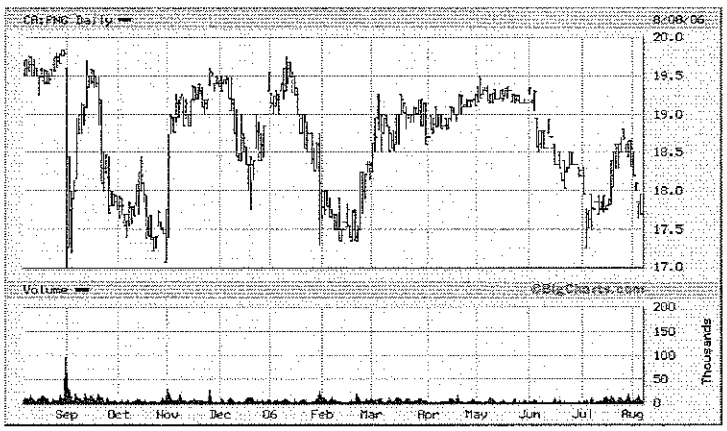
Q2 2006 results consistent with expectation

Good-bye Income Trust, Welcome Pacific Trail Partnership

HIGHLIGHTS

- **Q2 2006 reported: net loss of $0.922 million or $0.25 per share vs. net income of $0.052 million or $0.02 per share in Q2 2005 (y/y).**
- **The lower earnings y/y were the result of a shift in the timing of the recovery of operating margin since deliveries to residential and commercial customers are temperature-sensitive and represent a higher proportion of annual deliveries in 2006 vs. 2005.**
- **In Q2 2006, deliveries to residential customers declined by 7% y/y with customers reducing consumption, mostly in reacting to natural gas prices (on average 20% higher y/y). Commercial deliveries remained unchanged. Deliveries to industrial customers dropped 81% y/y primarily due to the closure of Methanex Corp.'s Kitimat facility on Nov. 1, 2005.**
- **On July 17, PNG and Galveston LNG Inc. (parent company of Kitimat LNG (KLNG)), announced the formation of the 50/50 Pacific Trail Pipelines Limited Partnership (PTP), which will develop the Kitimat-to-Summit Lake Pipeline (KSL Project) to serve KLNG's proposed $500-million, 1-bcf/d LNG-receiving terminal near Kitimat, B.C.**
- **We are maintaining our Outperform rating.**

Stock Performance



Assessment

We had viewed PNG's recapitalization in the form of an income trust and expansion of PNG's transmission line from Summit Lake to Kitimat, British Columbia, as mutually exclusive. This, PNG has now confirmed.

Expansion of PNG's transmission line and its flow reversal would constitute the single-largest capital project ever constructed by PNG. However, its realization hinges on the ability of Galveston LNG Inc. (GLNG) to enter into commercial arrangements for the supply and sale of LNG and to have its subsidiary Kitimat LNG (KLNG) proceed with its LNG-receiving terminal (LNGRT) at Kitimat.

So far, KLNG has been progressing. In our judgment, if all requisite arrangements can be made, we would expect KLNG to become operational in 2010.

If built timely, KLNG's LNGRT would be the first one constructed on North America's West Coast. The supply of imported LNG would have the capacity of beginning to fundamentally change gas-supply and delivery fundamentals in the western part of North America. Currently, Sempra Energy (NYSE-SRE) is proceeding with its Costa Azul LNGRT in Mexico, on Central America's Pacific Coast, for completion by 2008.

For now, we expect no change in PNG's quarterly dividend rate, because it would have to preserve cash required for financing its pipeline project.

Q2 2006 highlights

Q2 2006 reported net loss: $0.922 million or $0.25 per share vs. net income of $0.052 million or $0.02 per share in Q2 2005 (y/y). The lower earnings y/y were the result of a shift in the timing of the recovery of operating margin since deliveries to residential and commercial customers are temperature sensitive and represent a higher proportion of annual deliveries in 2006 vs. 2005. Residential and commercial customers are now representing a higher proportion of PNG's annual deliveries compared with last year, because Methanex Corp. (TSX-MX), formerly PNG's largest industrial customer, ceased operations of its Kitimat, B.C. methanol/ammonia facility on Nov. 1, 2005.

In Q2 2006, operating revenues decreased to $20.2 million from $30.3 million y/y mostly due to a reduction of $10.2 million in revenues from the sale of gas surplus to the needs of its off-system gas sales customers as well as a reduction of $4.2 million in transportation services revenue from MX, offset by higher gas supply costs embedded in sales customers' rates compared with the prior year.

Q2 2006 operating margin decreased to $9.1 million from $9.8 million due to a higher proportion of annual operating margin being recovered from residential and commercial customers in Q2 compared with the same period last year when MX was operating its Kitimat facility.

In Q2 2006, deliveries to residential customers declined by 7% y/y with customers reducing consumption mostly due to the fact that natural gas prices averaged 20% higher y/y. Commercial deliveries remained unchanged.

Deliveries to industrial customers dropped 81% y/y primarily due to the closure of MX's Kitimat facility on Nov. 1, 2005. Excluding the impact of the MX plant closure, deliveries to large industrial customers were 4% higher y/y. A deferral account is in place that recovers or refunds differences resulting from large industrial customers' demand varying from the forecast approved for ratemaking purposes.

Pacific Trail Pipelines Limited Partnership (PTP)

On July 17, 2006, PNG and Galveston LNG Inc. (parent company of Kitimat LNG (KLNG)), announced the formation of the 50/50 **Pacific Trail Pipelines Limited Partnership (PTP),** which will develop the **Kitimat-to-Summit Lake Pipeline (KSL Project)** to serve KLNG's proposed $500-million, 1 bcf/d LNG-receiving terminal near Kitimat, B.C.

KLNG received a B.C. environmental assessment certificate on June 6, 2006, and on June 26, 2006, signed a joint partnership agreement with the Haisla First Nation to provide the project with Aboriginal certainty through the construction and operation of the terminal. It

expects construction of the terminal to commence in fall 2006 with operations scheduled to begin in 2009, subject to obtaining LNG supply, financing and BCUC approval for the KSL Project. We view this timetable as very ambitious.

PNG had commenced the environmental regulatory review process for the KSL Project in September 2005, but it is now to be led by PTP. It expects to file regulatory applications with the BCUC, the B.C. Environmental Assessment Office (BCEA) and Canadian Environmental Assessment Agency by early spring 2007. Construction of the KSL Project is expected to begin by Q1 2008 subject to the start of the construction of KLNG and obtainment of requisite approvals. Operational start-up is expected to coincide with the completion of KLNG in 2009.

The KSL Project will increase PNG's existing transmission capacity to about 1 bcf/d from 115 mmcf/d and will require the building of about 470-km of a 762- or a 914-mm OD pipeline and any required compression facilities at an estimated cost of $900 million or $1.2 billion, respectively.

Upon completion of the KSL Project, PNG's existing mainline transmission system will be transferred to PTP and integrated with the KSL Project facilities. In addition to its partnership interest in the KSL Project, PNG will continue to own and operate its existing gas distribution systems including its Customer Care Centre in Terrace, B.C.

We expect Kitimat LNG to proceed with its LNG-receiving terminal, albeit with some delay, pending agreement about all upstream and downstream commercial arrangements.

KSL Project capital expenditures

Prior to the formation of PTP, PNG had deferred all KSL Project expenses with the approval of the BCUC. Now, until PTP is considered a public utility, all capital expenditures related to the KSL Project will be expensed within PTP.

In Q2 2006, PNG charged $0.4 million (or $0.11 per share) of previous period expenses related to the KSL Project (2005-$0.3 million; Q1 2006-$0.1 million) and will expense further 2006 costs until commercial arrangements for firm gas transportation services by PTP are achieved. PNG stated that if anticipated capital expenditures for the H2 2006 period are expensed, then 2006 earnings will be further reduced by an estimated $1.9 million or about $0.53 per share. We note that we had already reduced our estimated 2006 EPS to $0.98 from $1.64 in our last NBF Bulletin note to reflect the expensing of costs.

Shelving of income trust conversion plans

With the PTP formation, PNG will use corporate financing for its part of the partnership, and therefore, has decided not to convert into an income trust while it pursues the KSL Project, confirming our view that the KSL Project and the income trust conversion are mutually exclusive.

Financial

At the end of Q2 2006, PNG's cash and short-term investments was $26.95 million mostly due to the receipt in February 2006 of the MX termination payment of about $23.3 million. PNG has planned capital expenditures for H2 2006 of about $7 million for the maintaining of the T&D system and for minor expansions of its distribution system to service new customers.

Since the PTP announcement, we have been no longer estimating an increase in the per share dividend for 2006 or 2007, as we expect PNG to preserve cash.

Valuation

For the 12-month period ending June 2008, estimated EPS are $1.69 and DPS $0.80; retained EPS is $0.89; the retained EPS multiple is 5x, and the assumed long-term corporate bond yield of 6.25% nominally is tax-effected to 4.63%, using a 1.35 dividend-tax-credit divisor. Support price $17.28; residual price $4.45. Target Price $21.75 (rounded).

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NATIONAL BANK FINANCIAL

PNG (T)	**Cdn$17.06**
Stock Rating:	**Outperform** (Unchanged)
Target:	**Cdn$21.75** (Unchanged)
Risk Rating:	**Low** (Unchanged)

Stock Data:	
52-week High-Low (Canada)	$17.06 - $19.84
Bloomberg/Reuters: Canada	PNG CN / PNG.TO

(Year-End Dec 31)	2005a	2006e	2007e
EPS	$1.75	$0.96	$1.68
P/E	11.2x	17.4x	10.2x
EPS Change Y/Y	24.1%	-44.0%	71.4%
Book Value	$21.43	$21.61	$22.49
P/BV	0.9x	0.8x	0.8x
Dividend Yield	4.1%	4.7%	4.7%

Financial Data:	
Shares Outstanding (mln)	3.63
Book Value per Share	$22.14
Market Capitalization (mln)	$62
Price/Book Ratio	0.8x
Debt/Total Cap.	47%
Dividend per share	$0.80
Dividend Yield	4.69%

Industry Rating: N/A
(NBF Economics & Strategy Group)

Company Profile:
PNG is British Columbia's second largest and an almost pure natural gas (gas) utility. PNG provides the transmission and distribution of gas in west-central and northeastern B.C.

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Pacific Northern Gas

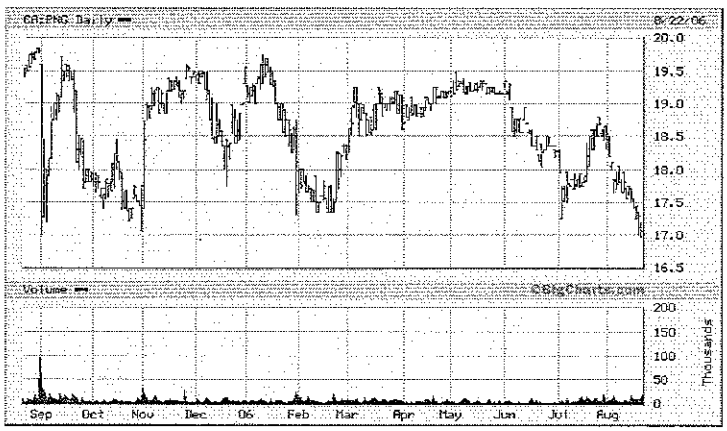
2006 Revenue Requirements Decisions

Favourable 2006 Revenue Requirements Decisions dispel Naysayers' dire predictions

HIGHLIGHTS

- By Orders dated Aug. 21, 2006, the British Columbia Utilities Commission (BCUC) approved substantially the applied-for 2006 rates for PNG-West and the rates agreed to in PNG-N.E.'s negotiated settlement.
- The Orders are consistent with our prediction and dispel the naysayers' dire predictions of the outcome of PNG's 2006 revenue-requirement applications.
- For 2006, PNG-W and -Tumbler Ridge are allowed to earn a rate of return on the common equity component of its rate base of 9.45% based on 40% common equity and PNG-N.E. 9.20% and 36%, respectively.
- The BCUC approved PNG's proposal to amortize Methanex Corp.'s (TSX-MX) $23.3 million termination payment over 44 months from March 2006 to October 2009, and to credit to its 2006 revenue requirements $5.6 million to reflect the termination payment.
- We are maintaining our Outperform rating.

Stock Performance



Pacific Northern Gas (PNG)
Decisions And Orders Of The British Columbia Utilities Commission (BCUC) On PNG's 2006 Revenue Requirements Application

Assessment

It is no surprise that the BCUC's rate Orders contain no surprises. In essence, the BCUC endorsed PNG's negotiated settlements for 2006, as we had expected. Although PNG is directed to make rate refunds to account for the differences between interim and approved rates, the manner in which PNG accounted for them obviates any changes to PNG's 2006 earnings. This leaves PNG's naysayers whistling in the wind.

BCUC Decisions and Orders

In its Orders of Aug. 21, 2006, the BCUC approves, effective Jan. 1, 2006:

- PNG's 2006 Revenue Requirements Application for PNG-West and Granisle (PNG-W), subject to certain required (minor) adjustments, and
- PNG's Negotiated Settlement Agreement for PNG (N.E.).
- Since the approved rates are less than the interim rates, that have been in effect since Jan. 1, 2006, PNG is to notify and inform its customers in each of its two operating divisions of the final rates, and provide a method for refunding excess payments to its customers;
- Estimated refunds do not impact PNG's 2006 earnings, because it had been accruing its refund liability on its books and reflected revenues based on the Negotiated Settlement Process.

Key Issues

Prior to the rendering of the BCUC's Orders, the Street's buzz was ripe with speculation about a disallowance of the rate of return on the common-equity component of rate base (CECRB) for PNG-W and a sharing of the "Methanex Rate Deficiency" between PNG's shareholders and its customers in PNG-W.

We had dismissed such speculation as devoid of merit, and this is confirmed in the BCUC's Order.

Actually, the BCUC approved substantially all of the terms of PNG's negotiated settlement agreements in each of its two divisions.

The PNG-W Order states (Page 26):

"The Commission Panel accepts that PNG has taken all prudent steps to manage and reduce its costs and that there are no unnecessary or unreasonable costs in the 2006 cost of service."

The following deals with highlights of the BCUC's Orders.

Common Equity Components of Rate Bases

PNG-W: 40% (unchanged from 2005)

PNG-N.E*: 36% (unchanged from 2005)
Note: includes Tumbler Ridge

Rate of Return on the Common Equity Component of Rate Base

PNG-W: 9.45% (versus 9.68% in 2005)

PNG-N.E.*: 9.20% (versus 9.43% in 2005)
PNG-Tumbler Ridge: 9.45% (versus 9.68% in 2005)
Note: * excludes Tumbler Ridge

Methanex Revenue Deficiency

Methanex Corporation (TSX-MX) closed its Kitimat methanol/ammonia complex on Nov. 1, 2005 (prior to the expiry of the stated term of its gas-transportation agreement of October 2009). PNG and MX had agreed that, in the event of the plant closure prior thereto, MX would pay PNG the net present value of its remaining contractual-revenue entitlements.
Following the plant's closure, on Feb. 28, 2006, MX paid PNG $23.3 million.

PNG had proposed to amortize the MX termination payment over 44 months from March 2006 to October 2009.

The BCUC approved PNG's proposal and it also approved PNG's proposal to credit to its 2006 revenue requirements $5.6 million to reflect the termination payment.

The remaining 2006 revenue deficiency of PNG-W is not borne by PNG's shareholders, but by all of PNG-W's customers, as we had predicted.

Minor Matter

Recapitalization-Application Hearing Costs

When PNG applied to the BCUC in its 2004 revenue-requirement application for the approval of a recapitalization under an income trust structure, the BCUC decided on July 29, 2004 that the costs associated with the regulatory review of the Jan. 30, 2004 Recapitalization Application should be shared between PNG's customers and shareholders.

However, the BCUC's Decision of Sept. 9, 2005 notes that one of the approvals sought by PNG is subject to the conditions that "no costs associated with this [recapitalization application] and no transaction costs, including amalgamation and securities issuance and redemption costs, related top the foregoing transactions shall be recovered through customers rates."

PNG stated that it had recorded all of the 2005 income-trust-application hearings costs before the BCUC in a deferral account, pending obtaining all of the approvals required for the conversion to proceed.

Given the status of the matter, the BCUC's Panel "considers that the costs associated with the subsequent Recapitalization Application [dated Dec. 17, 2004] should perhaps more properly be to the sole account of the shareholders as reflected in PNG's proposed condition."

Hence, the BCUC denied PNG's request to amortize the customers' $169,855 post-tax share of intervenor costs in the second Recapitalization Application, and ordered that this amount remain in a deferral account, subject to the appropriate disposition in the next revenue-requirements application.

PNG's own costs related to the recapitalization proceedings are in rate base, allowing it to earn a rate of return thereon.

Valuation

For the 12-month period ending June 2008, estimated EPS are $1.69 and DPS $0.80; retained EPS is $0.89; the retained EPS multiple is 5x, and the assumed long-term corporate bond yield of 6.25% nominally is tax-effected to 4.63%, using a 1.35 dividend-tax-credit divisor. Support price $17.28; residual price $4.45. Target Price $21.75 (rounded).

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NATIONAL BANK FINANCIAL

Pipelines & Utilities News

LTCBY still falling

Industry Ratings:
(Utilities): Overweight

(O&G Gas Storage & Transportation): Market Weight

(O&G Refining, Marketing): Underweight

(NBF Economics & Strategy Group)

Bond yields lower from a week ago

On Sept. 27, 2006, the long-term corporate bond yield (LTCBY) decreased to 5.18% from 5.28%, the lowest since Jan. 18, 2006.

Dividend yields – O&G STORAGE & TRANSPORTATION AND UTILITIES INDEX HIGHER – Common Share price – based on relative dividend yields, some modest upside

The dividend yield of the O&G STORAGE & TRANSPORTATION and UTILITIES INDEX, and their common share prices, compared with their low and high relative dividend target yields, closed as follows:

	CURRENT		TARGET PRICES	
	Yields	Price	High	Low
O&G Storage & Transportation	3.44%	$35.60	$47.71	$35.70
Utilities	3.49%	$27.11	$34.57	$26.25
Combined Index	**3.46%**	**$32.26**	**$42.51**	**$31.97**

Relative dividend yields RDY **Comparative dates**

27 September 2006 66.74% (last week was 64.44%)

Long-term corporate bond yield (LTCBY)

27 September 2006 5.18% (lowest since Jan. 18, 2006)

Pipelines & Utilities News and commentary round-up

- The **S&P/TSX Utilities Index** decreased by 2.02% for the Sept. 25 to Oct. 4, 2006, period, while the **S&P/TSX composite index** increased by 0.31%.
- Last week's LTCBY of 5.18% was the lowest since mid-January 2006, and caused the spread between our assumed LTCBY of 6.25% to widen to 107 basis points, significantly higher than the spread of 50-75 basis points that we typically like to maintain.
- Will this cause us to do a "180" and lower our assumed yield to, perhaps 6%, and trigger an increase in the value of dividends in our share-price formula? No.
- Why not? At this point, it appears that the multi-pipeline rate of return on the common-equity component of rate base for Class 1 pipelines may be reduced slightly for 2007 from 8.88% for 2006, approved by the National Energy Board (NEB).
- Should this come to pass, then 2007 pipeline earnings would be lower than for 2006, assuming everything else remains constant, and lower earnings would most likely mean lower increases in dividends per share, unless pipeline owners would choose to let dividend-pay-outs increase.
- However, this would reduce retained earnings per share and hence the residual-share-price component in our share-price formula.
- Hence, we are not prepared at this time to reduce our assumed LTCBY for late 2007 below 6.25%.

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Nova Scotia Power's large industrial customer, Stora Enso, restarts its Port Hawkesbury paper mill

- On Sept. 29, 2006, **Emera Inc.'s (TSX-EMA)** wholly owned Nova Scotia Power Inc. (NSPI) subsidiary, was notified by large industrial customer Stora Enso that it would restart its Port Hawkesbury paper mill following a 10-month shutdown. The Nova Scotia Utility and Review Board (NSURB) had recently approved a lower electricity rate for very large industrial customers, which is based on the actual cost to NSPI to produce electricity.
- The Port Hawkesbury mill had been originally closed due to a labour strike. A labour contract was completed in June, however, the mill re-start was delayed pending the resolution of electricity tariffs. The mill is now in the restart phase. With the NSURB decision (dealing with NSPI's extra large Industrial Interruptible Rate Tariff), Stora Enso can interrupt the receipt of electricity and run the mill at off-peak times subject to various conditions.
- **Our View:** EMA has indicated its expectation that NSPI will be "kept whole," because to the extent that its large industrial customers, including Stora Enso, do not pay the "full freight," other classes of customers will pick-up otherwise unabsorbed fixed costs. On that basis, we view the NSURB's decision positively.
- On Oct. 16, 2006, NSPI will submit to the NSURB its compliance filing. Thirty days later, NSPI's two large industrial customers have to file their choice of tariff. 1) To the extent that one or both are able to shift load at peak demand, the choice of real-time pricing may be most attractive. However, this entails that customers have to be able, at the system peak, to not use electricity supplied by NSPI, or that they will use electricity from other sources, e.g. self-generation and/or third-party purchases.
- Load shifting would free NSPI from having to use higher-cost sources of electricity supply at peak conditions. This is the benefit load shifting would confer on NSPI and the rest of its customers.
- 2) The other rate option is the "extra-large industrial interruptible rate" that currently exists, subject to some recalculation.
- NSPI's two extra-large customers will be able to choose Alternative 1 or 2. Following the choice, one or both are required to give five years' notice to shift to the alternate rate. It appears that NSPI is indifferent as to the customers' choice.

Duke Energy's Algonquin Gas Transmission offers opportunity to move new supplies to high-growth East Coast markets

- On Sept. 29, 2006, **Duke Energy's (NYSE-DUK)** Algonquin Gas Transmission (AGT) unit announced that it is offering capacity on its system to shippers seeking to move new supplies, including LNG, into existing delivery points in the high-growth East Coast markets.
- Service on the "East to West Expansion" could commence as early as Nov. 1, 2008. The project will use existing mainline infrastructure and will add incremental expansion if needed.
- **Our View:** This project will directly benefit actual (e.g. Canaport) and potential LNG-projects that will be clamouring for pipeline space after the regasification of the LNG.
- **However, we see more than may meet the eye.** We believe that AGT's East-to-West expansion will entail a reversal of the flow of gas, at least in part, enabling AGT to deliver gas to markets off its system physically and directly rather than through backhauls, as is AGT's current practice. Once the direction of AGT's gas flow changes, the direction of gas flow on Texas Eastern Transmission, another unit of DUK, can and will change, enabling TETCO to supply markets East and West of its pipeline. As a result, the "null-point" of

TETCO's system will move South/Southwest. Finally, AGT's East-to-West expansion will probably assist Duke Energy Gas Transmission (DEGT) in enhancing the capability of the Southeast Supply Header, currently under development. As part thereof, DEGT will probably be able to deliver more gas into Florida (over and above current and future deliveries on its Gulfstream system).

- In other words, AGT's East-to-West Expansion is expected to have cascading effects on the flow of gas on TETCO and the emerging Southeast Supply Header. This process is likely to evolve in time, enhancing TETCO's and AGT's market position. Part of this process includes deliveries of regasified LNG from Canaport on Maritimes & Northeast Pipeline (M&E) as of 2008. We expect that LNG-deliveries will reduce the tolls on M&E, benefiting its customers and enhancing the netbacks of the Sable Offshore producers and Repsol (owner of the LNG delivered to Canaport).
- Finally, we expect the arrival of offshore LNG in the Maritimes and the U.S. Northeast to benefit DUK's earnings and cash flow. In this context, we expect the profitability of DUK to increase, partly because of its merger with Cinergy and partly because of earnings enhancements at DEGT, triggered by AGT's expansion. If DUK proceeds with the spin-down of DEGT to its shareholders, the Canadian holders of DUK's exchangeable are also expected to benefit. This assumes, of course, that DUK will spin-down DEGT in whole.

Kitimat LNG signs supply agreement with Australian shipper

- On Sept. 26, 2006, Kitimat LNG Inc. announced that it had signed a Heads of Agreement (HOA) with Liquefied Natural Gas Ltd. (ASX-LNG) of Australia that would supply 1.8 million metric tonnes per year of liquefied natural gas to the Kitimat LNG Terminal.
- Under the HOA, LNG sales from Liquefied Natural Gas Ltd. (LNG) would be purchased on a delivered basis at Kitimat LNG Terminal.
- **Our View:** Securing LNG supply is required for the development of Kitimat LNG that received required environmental approvals last August. The Heads of Agreement (HOA) with Liquefied Natural Gas Ltd. of Australia is positive, even though it only covers one-quarter of the required LNG-volumes; however, it is indicative of the potential interests of Australian LNG-suppliers in delivering LNG to Kitimat LNG for marketing in North America. Should the HOA be translated into a final agreement, "LNG" would deliver LNG to the Kitimat terminal CIF.
- LNG has been formed to act as a link between gas resources and existing and potentially new gas markets identified by "LNG."
- On April 10, 2006, Golar LNG Limited announced an Equity-Subscription Agreement with "LNG" to subscribe for 23 million shares of "LNG," whereof about 39% is subject to shareholder approval. If obtained, Golar will become "LNG's" largest shareholder. Golar expects to hold ultimately 19.83% of "LNG's" shares. Golar expects that "LNG's" innovative strategies will facilitate the joint development of several new LNG-project opportunities enhancing Golar's ambitions to expand further into the LNG logistical chain. Golar is largest independent owner of LNG-vessels, its sole business activity.
- We understand that Galveston LNG Inc., parent of Kitimat LNG Inc., is in discussions with various potential LNG-suppliers, principally in Australia, aimed at securing sufficient LNG to proceed with the Kitimat LNG receiving terminal. While we expect Galveston LNG to succeed, this outcome is not assured. However, against our expectations, should Galveston LNG fail in its endeavours, we expect **Pacific Northern Gas (TSX-PNG)** to resume pursuit of its "Plan B," namely recapitalization in the form of an income trust. In the interim, PNG's shareholders are paid an attractive dividend as the "prize for being patient."

CenterPoint Energy receives FERC approval to build a US$425-million East Texas to Louisiana pipeline

- On Oct. 3, 2006, **CenterPoint Energy (NYSE-CNP)** received approval from the Federal Energy Regulatory Commission (FERC) to build a US$425 million 277-km natural gas pipeline from Carthage, Texas to the Perryville Hub in northeast Louisiana. The pipeline is expected to be in service by Q1 2007 and will have a capacity of 1.2 bcf/d by mid-2007, expandable to 1.5 bcf/d by the end of 2007.
- **Our View:** The FERC-approval was fully expected. CNP is also working on two other pipeline projects with **Duke Energy (NYSE-DUK)** including the Mid-Continent Crossing pipeline which aims to transport natural gas from Texas to Pennsylvania.
- CNP is in the process of expanding its role as a gas-pipeline infrastructure company, while DUK is in the process of developing two businesses, electric utility and natural gas. It plans to spin the latter down to its shareholders. However, this is will not preclude DUK from selling all or part of DEGT opportunistically prior to the planned spin-down. ***In any event, we expect DUK's earnings power and, hopefully, its share prices to reflect these value-creating processes.***

	Ticker	Oct.4/06 Price	52 Week High	52 Week Low	Y-T-D Change	1 Mth Change	3 Mth Change	6 Mth Change	12 Mth Change
S&P/TSX Utilities Index and O&G Storage & Transportation Sub-Industry (Cdn$)									
ATCO Ltd.	ACO.X	$ 43.34	$ 44.00	$ 33.10	5.84%	3.60%	15.97%	23.43%	4.17%
Canadian Utilities	CU	$ 40.54	$ 46.20	$ 35.15	-7.82%	0.92%	9.06%	5.17%	0.17%
Emera Inc.	EMA	$ 20.53	$ 21.09	$ 17.69	-2.42%	1.39%	7.53%	7.47%	3.39%
Enbridge Inc.	ENB	$ 35.95	$ 38.82	$ 31.75	-1.07%	-2.05%	4.19%	8.62%	-2.00%
Fortis Inc.	FTS	$ 24.75	$ 25.64	$ 20.36	1.98%	-1.13%	8.50%	9.96%	1.59%
TransAlta Corporation	TA	$ 23.21	$ 26.91	$ 21.88	-8.66%	-4.85%	-0.60%	2.07%	-4.77%
TransCanada Corporation	TRP	$ 35.50	$ 37.90	$ 30.77	-3.14%	-0.70%	9.63%	5.97%	-0.28%
U.S. Diversified Energy Companies & Independent Generators (US$)									
American Electric Power	AEP	$ 37.36	$ 40.80	$ 32.27	0.73%	1.82%	8.09%	8.94%	-7.08%
CenterPoint Energy	CNP	$ 14.61	$ 14.90	$ 11.62	13.70%	-0.83%	14.98%	18.86%	-0.69%
Dominion Resources	D	$ 76.78	$ 86.97	$ 68.72	-0.54%	-4.12%	0.89%	6.40%	-10.29%
Duke Energy	DUK	$ 31.28	$ 31.39	$ 25.06	13.95%	4.02%	6.02%	7.58%	10.70%
Dynegy	DYN	$ 5.47	$ 6.38	$ 4.06	13.02%	-12.46%	0.19%	11.09%	12.01%
El Paso Corp.	EP	$ 13.24	$ 16.39	$ 10.76	8.88%	-10.42%	-13.10%	8.29%	0.23%
Entergy Corp.	ETR	$ 80.45	$ 80.62	$ 66.78	17.19%	3.50%	12.32%	14.79%	7.83%
Exelon Corp.	EXC	$ 61.00	$ 61.98	$ 46.62	14.79%	0.07%	4.57%	13.30%	14.41%
PG&E Corp.	PCG	$ 42.41	$ 42.51	$ 34.54	14.25%	1.25%	5.99%	4.99%	7.75%
Sempra Energy	SRE	$ 51.45	$ 51.64	$ 41.10	14.74%	3.02%	10.70%	9.97%	10.20%
Southern Co.	SO	$ 35.01	$ 36.33	$ 30.48	1.39%	1.99%	8.08%	6.83%	-2.49%
Southern Union	SUG	$ 26.55	$ 27.75	$ 21.66	12.36%	-3.35%	-2.89%	6.25%	3.68%
TXU Corp.	TXU	$ 62.52	$ 67.21	$ 44.01	24.57%	-7.29%	1.56%	33.58%	10.65%
Williams Companies	WMB	$ 22.95	$ 25.58	$ 19.35	-0.95%	-6.65%	-2.32%	8.57%	-5.93%
Xcel Energy	XEL	$ 20.89	$ 21.05	$ 17.80	13.16%	-0.10%	7.74%	11.92%	7.01%

Source: Bloomberg

Pipelines & Utilities Current Coverage	Ticker	Stock Rating	Shares O/S (Mln)	Stock Price (10/04)	Last Year Reported	EPS (A) Last FY	EPS est. FY1	EPS est. FY2	P/E FY1	P/E FY2	Dividend ind.	Dividend %	12-Mth Price Target
Pipelines													
Enbridge Inc.	ENB	Sector Perform	350.9	35.95	Dec-05	1.60	1.80	2.09	19.97	17.20	1.15	3.2%	38.45
TransCanada Corporation	TRP	Sector Perform	487.8	35.50	Dec-05	1.71	1.87	1.96	18.98	18.11	1.28	3.6%	36.75
Gas/Electrical Utilities & Other													
AltaGas Income Trust (units)	ALA.UN	Sector Perform	55.4	26.95	Dec-05	1.54	1.84	2.12	14.65	12.71	2.04	7.6%	30.20
ATCO	ACO.X	Underperform	59.6	43.34	Dec-05	2.49	2.70	2.86	16.05	15.15	0.82	1.9%	41.45
Cdn. Utilities	CU	Underperform	126.3	40.54	Dec-05	2.09	2.23	2.37	18.18	17.11	1.16	2.9%	39.85
Caribbean Utilities	CUP.U	Outperform	25.3	11.86u	Apr-06	0.87u	0.98u	1.02u	12.10	11.63	0.66u	5.6%	14.60u
Emera Inc.	EMA	Outperform	110.4	20.53	Dec-05	1.09	1.18	1.28	17.40	16.04	0.89	4.3%	23.85
Fortis Inc.	FTS	Sector Perform	103.5	24.75	Dec-05	1.19	1.29	1.42	19.19	17.43	0.76	3.1%	26.55
Pacific Northern Gas	PNG	Outperform	3.6	18.50	Dec-05	1.75	0.98	1.68	18.88	11.01	0.80	4.3%	21.75
TransAlta Corporation	TA	Outperform	200.6	23.21	Dec-05	0.88	1.17	1.31	19.84	17.72	1.00	4.3%	26.95

u= US dollar

TSX O&G Storage & Transportation and Utilities Relative Dividend Yields (RDY)

TSX O&G Storage & Transportation & Utilities Index ('06) Date: 27-Sep-06	O&G STORAGE-TRANSP. DPS	O&G STORAGE-TRANSP. YIELD	L-T CORP. BOND YIELD 27-Sep-06	RELATIVE DIVIDEND YIELD	VERSUS LAST WEEK	RELATIVE TARGET LOW	DIVIDEND YIELD HIGH	PERCENTAGE POINTS BELOW LOW	PERCENTAGE POINTS TARGET HIGH	CURRENT MARKET PRICE	CURRENT TARGET PRICE LOW *RDY	CURRENT TARGET PRICE HIGH *RDY
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)
Enbridge Inc.	$1.15	3.18%	5.18%	61.41%	HIGHER	41.93%	56.78%	-19.48%	-4.63%	$36.15	$52.95	$39.10
TransCanada Corporation	$1.28	3.64%	5.18%	70.18%	HIGHER	55.25%	73.30%	-14.93%	3.12%	$35.21	$44.72	$33.71
O&G STORAGE-TRANSP.	$1.23	3.44%	5.18%	66.46%	HIGHER	49.59%	66.28%	-16.86%	-0.17%	$35.60	$47.71	$35.70
	GAS & ELECTRIC UTILITIES		MULTI-UTILITIES	IPP								
Atco**	$0.82	1.91%	5.18%	36.94%	HIGHER	27.02%	39.60%	-9.92%	2.66%	$42.85	N/A	N/A
Can. Util. Y	$1.16	2.79%	5.18%	53.95%	HIGHER	47.60%	59.58%	-6.35%	5.63%	$41.51	$47.05	$37.59
Can. Util. X	$1.16	2.77%	5.18%	53.45%	HIGHER	47.78%	59.94%	-5.67%	6.49%	$41.90	$46.87	$37.36
Emera Inc.	$0.89	4.41%	5.18%	85.06%	HIGHER	66.58%	77.65%	-18.48%	-7.41%	$20.20	$25.81	$22.13
Fortis	$0.64	2.65%	5.18%	51.08%	HIGHER	56.46%	80.17%	5.38%	29.09%	$24.19	$21.88	$15.41
Pacific Northern Gas	$0.80	4.48%	5.18%	86.52%	HIGHER	54.94%	79.46%	-31.58%	-7.06%	$17.85	$28.11	$19.44
TransAlta Corp. ***	$1.00	4.27%	5.18%	82.39%	HIGHER	49.93%	70.73%	-32.46%	-11.66%	$23.43	$38.66	$27.29
UTILITIES	$0.95	3.49%	5.18%	67.30%	HIGHER	52.77%	69.49%	-14.53%	2.18%	$27.11	$34.57	$26.25
TOTAL INDEX	$1.12	3.46%	5.18%	66.74%	HIGHER	50.64%	67.34%	-16.09%	0.61%	$32.26	$42.51	$31.97

*NOTE: * RDY (Relative Dividend Yield); ** Indicated companies not included in index calculations; *** No longer a utility*

Based on the TSX O&G Storage & Transp. and Utilities Index Relative Dividend Yield of 66.74%, the index is -0.91% away from our high RDY target and 24.12% away from our low RDY target

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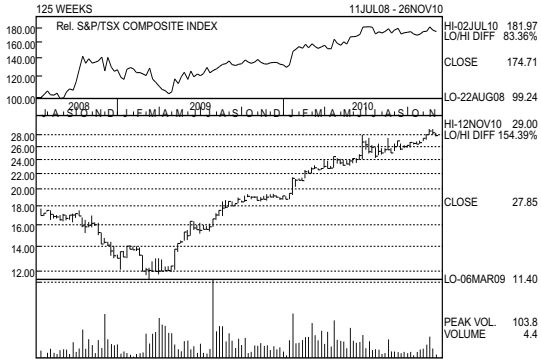

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FY Dec	2009A	2010E	2011E	2012E
EPS (Op) - Basic	1.72	1.96	2.02	2.06
P/E	16.2x	14.2x	13.8x	13.5x
EPS (Op) - FD	1.71	1.91	1.97	2.01
Annual Div.	0.96	1.14	1.22	1.30

EPS (Op) - Basic	Q1	Q2	Q3	Q4
2009	1.39A	(0.13)A	(0.49)A	0.95A
2010	1.51A	(0.06)A	(0.64)A	1.16E
2011	1.77E	(0.12)E	(0.71)E	1.09E

All values in CAD unless otherwise noted.

INITIATION | COMMENT

NOVEMBER 29, 2010

Pacific Northern Gas Ltd. (TSX: PNG)

Initiating Coverage: On the Cusp of a Transformation

Sector Perform
Average Risk

Price:	27.85	**Price Target:**	28.00
		Implied All-In Return:	5%
Shares O/S (MM):	3.6	**Market Cap (MM):**	100
Dividend:	1.20	**Yield:**	4.3%

Large Holder: 15% interest

Event

We are initiating coverage of the shares of Pacific Northern Gas with a Sector Perform, Average Risk ranking.

Investment Opinion

- **A "Base" Utility Business + Potential Upside for KSL.** PNG's current assets primarily consist of a gas utility business in northern British Columbia. The company also owns an interest in a 9.8 MW hydro plant in addition to a 50% interest in Pacific Trail Pipelines, a partnership that is pursuing the KSL pipeline project to transport gas to the proposed Kitimat LNG liquefaction terminal. The pipeline project has not yet received binding commitments from shippers.
- **KSL: A Transformational Project.** We expect PNG's equity investment in KSL to be roughly $200 million (including about $100 million of existing assets to be vended in), which exceeds the current market cap of almost $100 million. If commercial arrangements are put in place, the KSL project would give the company increased scope and scale. We estimate that an Asian LNG price of $8.50 to $9.00 per Mcf is needed to support acceptable returns to western Canadian gas producers with current Asian pricing near, or modestly higher than, these levels (depending on the index).
- **A Possible Takeover Candidate Down the Road.** In our view, the KSL pipeline makes PNG a more attractive target due to the number of parties interested in pipeline assets compared to a small gas utility. Potential acquirors would include the publicly-traded energy infrastructure companies and trusts, infrastructure funds and private equity. While the company is not "for sale", management does not appear to be fundamentally opposed to a sale at some point in the future.
- **Valuation Appears Reasonable; At the End of the Day, it All Seems to Hinge on KSL.** Our $28.00/share price target is based on a 12.5x forward P/E for the existing assets plus a $2.00/share (50% risked) present value for the KSL project. As a pure utility business, the shares appear to be mildly overvalued, but overall we view the shares as appropriately reflecting the value of the base utility business plus an option value for the KSL project. Should the KSL project proceed, the de-risking of the project would allow us to reflect a $4/share valuation for KSL resulting in an overall $32/share valuation for the company.

Priced as of prior trading day's market close, EST (unless otherwise noted).

For Required Non-U.S. Analyst and Conflicts Disclosures, see page 19.

Investment Thesis

We rank the shares of Pacific Northern Gas Sector Perform, Average Risk for the following reasons:

- **Share Price Appears to Reflect Both the Value of the Base Business Plus the Upside Option for KSL.** We believe that the existing utility and hydro assets are worth roughly $26/share and that the discounted value (50% risked) for the KSL pipeline is worth about $2/share. With the current share price at roughly $28.00, we believe that the shares are fairly valued at this time.
- **Some Downside if KSL Does Not Proceed.** In our opinion, there is about $2/share of downside if the KSL project does not proceed. Further, as the pipeline is tied to the proposed LNG export project (that PNG is not part of), the success of the KSL pipeline is somewhat out of PNG's control.
    - **Low Trading Liquidity Limits Upside Potential.** Although we see about $2/share of upside (present value) if KSL proceeds, the stock generally trades about 5,000 shares per day. As such, accumulating a position in anticipation of a positive announcement on KSL is likely to move the share price such that the potential upside is eroded.

Base Business + Pipeline Option = Fairly Valued for Now

We believe that the base utility and hydro business is worth about $26/share and that the probability weighted present value of the KSL option is worth about $2/share. As such, our price target is $28.00, which, based on an expected total return of 5%, is consistent with a Sector Perform ranking. Our analysis relies primarily upon a P/E valuation for the base business plus a discounted cash flow analysis for the KSL project. Our price target is also supported by a rate base valuation for the utility business and an EV/EBITDA valuation for the hydro asset.

Based on our analysis, we believe that the shares are fairly valued. Given the low trading liquidity, we recommend that current shareholders continue to hold their shares. Investors interested in gaining exposure to the potential for LNG export to Asia should monitor the shares for a more attractive entry point.

Impediments to our price target include whether the KSL project proceeds with economics consistent with our assumptions, the impact of regulatory decisions, new projects and acquisitions that fail to gain the confidence of investors, and the level of long-term interest rates (impact on valuation).

We Estimate the Value of the Base Business is $26.00/share

We have valued the existing business primarily using a P/E approach, which is similar to our valuation methodology for our regulated utility and pipeline coverage universe. In addition, we have looked at a rate base valuation, which is more often used in a takeover scenario.

P/E Valuation

We value utilities primarily based on a P/E multiple due to the regulated nature of the business that focuses on return on equity. We have looked at the trading multiples for other companies in our coverage universe with a high degree of regulated utility assets, such as Canadian Utilities, Emera and Fortis. In selecting our valuation multiples, we have considered a number of factors, including:

- **Small Size of the Company and Low Trading Liquidity:** The market cap of PNG is roughly $100 million with the stock generally trading less than 5,000 shares per day. We believe that both of these factors contribute to the valuation discount to other companies that we cover, and we expect the valuation discount to persist.
- **Mature Utility Assets.** As a whole, the company's utility businesses are expected to experience very modest, if any, rate base growth. This compares less attractively to faster growing utilities that we cover, such as Canadian Utilities, Emera and Fortis, with forecast rate base growth generally in the range of 4% to 7%.

For a P/E valuation, we have used a 12.5x multiple applied to our 2012E EPS estimate to arrive at a $26.00 value per share. The 12.5x multiple used in our valuation is a 1x discount to what we use for Canadian Utilities, which is a larger company with a higher organic growth profile and higher trading liquidity.

Exhibit 1: Comparison Table ($MM except per share figures)

	Ticker	PRICE 25-Nov-10	Normalized Basic EPS FY09	FY10E	FY11E	FY12E	P/E Ratio FY09	FY10E	FY11E	FY12E	Current Yield	Recommendation	Risk
Canadian Utilities	CU	$51.49	$3.35	$3.56	$3.59	$3.85	15.4x	14.5x	14.3x	13.4x	2.9%	Sector Perform	Average
Emera	EMA	$31.84	$1.55	$1.69	$1.80	$1.88	20.5x	18.8x	17.7x	16.9x	4.1%	Outperform	Average
Fortis	FTS	$31.73	$1.54	$1.63	$1.78	$1.89	20.6x	19.5x	17.8x	16.8x	3.5%	Sector Perform	Average
Average							**18.8x**	**17.6x**	**16.6x**	**15.7x**	**3.5%**		
Pacific Northern Gas	PNG	$27.75	$1.72	$1.96	$2.02	$2.06	16.1x	14.2x	13.7x	13.5x	4.3%	Sector Perform	Average

Source: Company reports; RBC Capital Markets estimates

Rate Base Valuation

We also think it is insightful to look at the value of the company compared to its rate base, although this valuation metric tends to be used in a takeover scenario. Based on recent acquisitions of similar size (e.g. AltaGas Utility, Great Lakes Power Distribution), the valuation could range from roughly 100% to 120% of rate base. As a going concern, we believe the valuation should be no more than 100% of rate base, which may also be the appropriate takeover valuation in the case of PNG as the utilities are mature (i.e., little or no expected growth in rate base). Typically, acquirors are willing to pay a premium to rate base only if there are significant growth opportunities.

At 100% of rate base, the stock would be worth about $25.50/share assuming the hydro plant is valued at 11x EBITDA.

We See the KSL Option Being Worth About $2.00/share

Upon full commissioning, we estimate that the KSL project could add roughly $6.00/share to $7.00/share of value when commissioned in 2014 or 2015. We conclude that the current share price is reasonable after discounting the KSL valuation from the expected in-service date in 2014 or 2015 (at a 12% levered equity discount rate) and assuming a 50% probability factor that the project will move forward.

A detailed analysis of the KSL project is set out later in this report.

Exhibit 2: Valuation of the KSL Project ($/share)

	2011E	2012E	2013E	2014E
Discounted Value	$4.63	$5.18	$5.80	$6.50
Probability Weighted	50%			
Probability Weighted Present Value	$2.31			

Source: RBC Capital Markets estimates

Company Overview and Strategy

Pacific Northern Gas owns and operates two systems: the Western system, which is a regulated natural gas transmission and distribution utility operating within the west-central portion of northern B.C.; and the Northeast system, which is a regulated gas distribution utility in northeast B.C. Collectively operating over 3,500 kilometres of transmission and distribution pipeline, the company serves residential, commercial and industrial customers in the two resource-based areas. It also owns a small propane vapour distribution system in Granisle, B.C.

PNG is looking to increase shareholder value by optimizing its existing assets and achieving diversified growth in its portfolio through targeted acquisitions and development opportunities. The company is focused on enhancing value from its regulated business, continuing development of the KSL project and evaluating other opportunities.

- **Existing Regulated Transmission and Distribution Business.** PNG's transmission and distribution business is subject to regulation by the B.C. Utilities Commission (BCUC), which sets rates that are designed to allow for a fair return on, and of, capital. The company's total rate base for 2009 was approximately $169 million.
- **Mature, Cost-of-Service Regulated Utility.** We view PNG's utility businesses as having a below average risk profile owing to the cost-of-service regulation by the BCUC. Under this form of regulation, PNG earns a return on, and of, capital with almost all other costs being a flow through to rate payers. The assets are mature, with the company's rate base expected to stay relatively flat.
  - **Negotiated Settlement on Capital Structure and Equity Risk Premium.** In May 2010, PNG announced that the BCUC approved the negotiated settlement for the company's capital structure and equity risk premium application, which provides PNG with the opportunity to increase overall earnings in 2010 by roughly $0.6 million ($0.17 per share). The new capital structure and allowed ROEs for PNG's utility assets are set out in Exhibit 3.

Exhibit 3: Regulated Returns and Capital Structures

	Allowed ROE	Equity Component
Western System	10.15%	45%
Fort St. John/Dawson Creek	9.90%	40%
Tumbler Ridge	10.15%	40%

Source: Company reports; RBC Capital Markets

- **Development of KSL Project.** Through PNG's 50% stake in Pacific Trail Pipelines (PTP), the company continues to pursue its project to loop its mainline transmission system from Kitimat to Summit Lake (KSL Project), which would initially provide gas transportation services with a capacity of up to 1 Bcf/day, primarily for the proposed LNG export terminal (Kitimat LNG) to be located southwest of Kitimat. PNG's cost estimate is $1.2 billion (2006 dollars), which is expected to be updated following the completion of the front-end engineering and design (FEED) study. Based on increases in pipeline capital costs observed since 2006 (e.g. Northern Gateway), we expect the revised cost to come in closer to $1.5 billion, if not higher. The KSL project consists of roughly 465 kilometres of up to 36-inch diameter pipeline and associated compression facilities. Subject to various conditions including the securing of contracts, financing and regulatory approvals, construction of the KSL project is currently scheduled to begin in 2011 for targeted completion in 2014.
  - **Big Hitters Behind the Kitimat LNG Project.** In May 2010, EOG Resources Canada (EOG) agreed to acquire a 24.5% partnership interest in PTP and a 49% interest in the Kitimat Terminal. In January 2010, Apache Canada acquired a 25.5% stake in PTP as well as a 51% stake in the Kitimat Terminal from Galveston LNG. With two major gas companies behind the project, the supply side of the equation appears to be in good shape. The major hurdle will be finding Asian buyers of the LNG at a price that makes the project economical.
- **Targeted Growth Through Hydro Power Development and Acquisition Opportunities.** While the company recognizes the limited opportunities to expand through the acquisition of Canadian natural gas distribution utilities, it has determined that independent hydro power development projects with long-term power sales contracts are its best growth alternative due to the availability of fixed-price power sales contracts in several Canadian jurisdictions, and the smaller project sizes which fit well with PNG's access to capital. The company intends to leverage off of its experience in operations, permitting, project management and regulatory matters.
  - **First Hydro Project Acquired Earlier This Year.** In April 2010, PNG announced that it has partnered with Skookum Power in acquiring a 9.8 MW run of river hydro facility from Kiewit Hydropower Investors and Renewable Power. Located on the B.C. Sunshine Coast, the McNair Creek facility has been in operation for five years with its generation output sold to BC Hydro under a long-term contract. PNG's 97% share of the approximately $17.5-million acquisition was funded through the assumption of $9.4 million of existing non-recourse debt and incremental borrowings under its current bank facility.
  - **Partnership with Skookum Power Brings Hydro Expertise.** As part of the strategy to develop the company's internal expertise for hydro power, PNG further entered into a development and operating agreement with Skookum Power, the principals of which were former power company executives with collectively 50 years of experience in the hydro power and energy sectors. The agreement allows PNG to gain access to expertise in hydrology engineering and commercial development.
- **Working Towards a Higher Dividend Yield.** The company is working to gradually increase its target payout ratio to a level more in line with other publicly traded utility companies (i.e., 60% to 70%). In February 2010, PNG increased its dividend to an annualized rate of $1.12/share (from $1.00/share announced in July 2009) and in October 2010, the company raised the dividend to $1.20/share.

Exhibit 4: Map of Operations

Source: Company reports

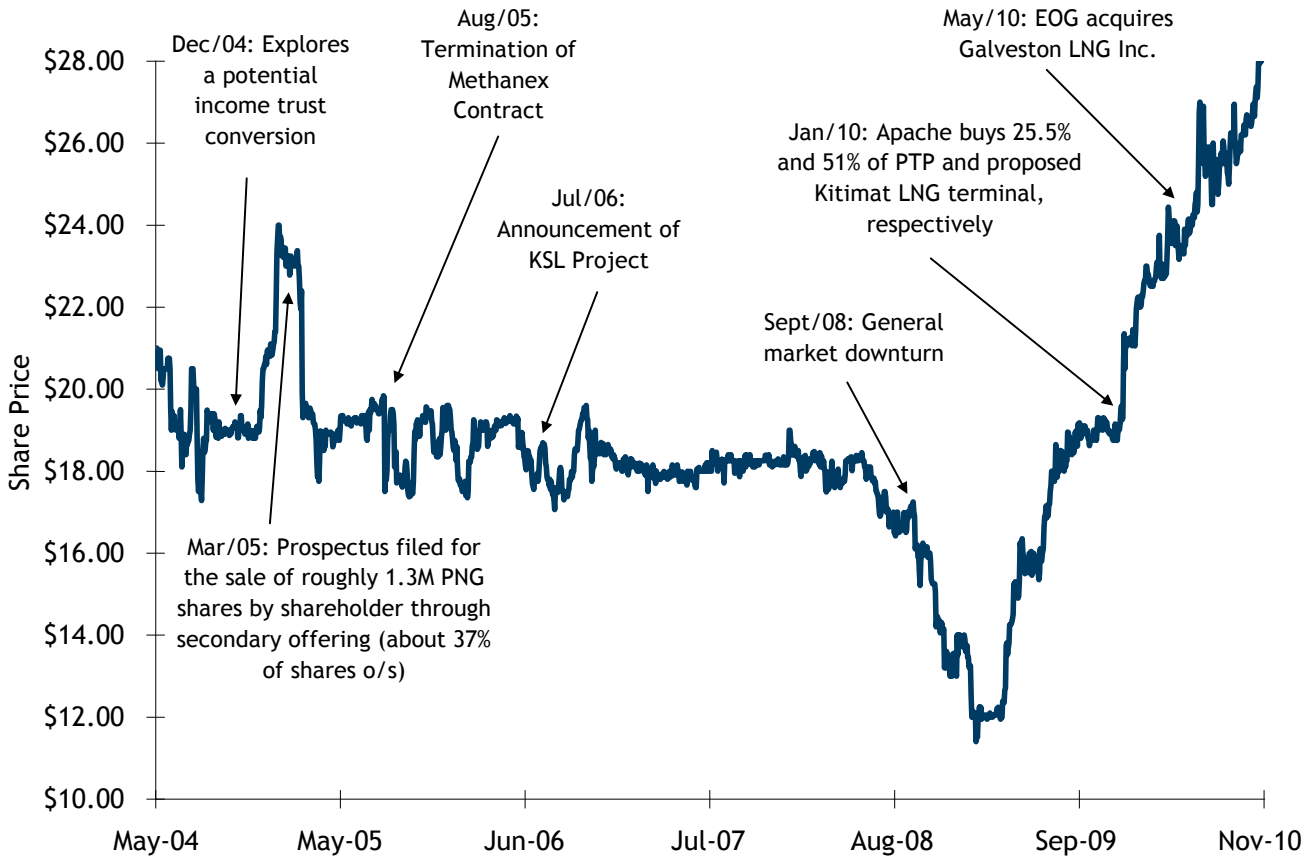
Corporate Structure and History

PNG was incorporated on October 28, 1965 and became a public company on November 4, 1968. In 1968, the company constructed a gas transmission line 50 kilometres north of Prince George at Summit Lake from what is now the Spectra Energy pipeline system through to Prince Rupert and Kitimat. A year later, gas transmission services were provided to mainly large industrial customers, to be followed by PNG's development of gas distribution services to communities adjacent to the transmission line.

In 1993, PNG acquired Northland Utilities, which expanded the company's service to the Dawson Creek and Tumbler Ridge areas. In 1997, PNG completed three more acquisitions: the Centra Gas Fort St. John system, which expanded its customer base in the Fort St. John area; the Granisle grid, a small propane vapour distribution system located adjacent to the company's western service area; and Peace River Transmission Company, which owned the transmission pipeline used to transport gas between Spectra Energy's pipeline facilities and the Dawson Creek distribution system.

In July 2006, PNG formed PTP for the purpose of developing the KSL Project as a 50/50 partnership with Galveston LNG, which subsequently sold a 25.5% interest in PTP and 51% of the proposed Kitimat LNG terminal to Apache Canada on January 13, 2010. On May 18, 2010, EOG acquired the shares of Galveston LNG and acquired a 24.5% stake in PTP as well as a 49% stake in the proposed Kitimat LNG terminal as part of the transaction.

Exhibit 5: Share Performance



Source: Company reports; Bloomberg; RBC Capital Markets

Description of Assets

Western System: Gas Transmission

The transmission pipeline system in the Western system service area connects with Spectra Energy's BC Pipeline near Summit Lake, B.C., and extends 587 kilometres to Prince Rupert. The pipeline between Summit Lake and Terrace is partially looped with a second line to increase capacity. PNG also owns and operates over 300 kilometres of lateral transmission pipelines to service various communities, the most significant being lines extending approximately 57 kilometres into Kitimat. The capacity of the transmission pipeline system is approximately 115 MMcf/d.

- **Option Agreement with LNG Partners, LLC for Gas Transportation Capacity**. PNG has an agreement that provides LNG Partners an option to contract for 80 MMcf/d of firm gas transportation service using PNG's existing capacity on the Western system for a two-to-five-year primary term with the right to extend for an additional two-to-15-year term. If LNG Partners exercises the option, it would use the transportation service to deliver natural gas to an LNG export facility (potentially a floating liquefaction terminal) in Kitimat.
  - On June 17, 2010, the BCUC accepted the Transportation Service Agreement (TSA) between PNG and Merrill Lynch, which subsequently assigned the contract to LNG Partners in August 2010. The TSA increased the contract capacity to 80 MMcf/d.
  - The company received $3.5 million in option fees, with the option expiring at the end of 2010. LNG Partners can extend the option for up to three, six-month periods (i.e., up to a total of 18 months) at a cost of $1 million per extension.
  - **Positive for the Competitiveness of the System, but No Material Impact to Earnings.** The revenues under this agreement (both option payments and long-term transportation revenues if the option is exercised) are for the benefit of rate payers (i.e., revenues received reduce customer bills). Nevertheless, there is the potential for PNG to recover a modest amount of previously deferred costs via a regulatory application. Although the agreement does not materially benefit earnings, reducing customer bills improves the competitiveness of natural gas versus electricity.

Western System: Gas Distribution

PNG owns and operates 1,180 kilometres of natural gas distribution pipelines to serve customers in its Western system. The communities served by the Western system's distribution network had a population of roughly 83,700 in 2009.

- **Majority of Distribution Franchise Agreements Renewable in 2011**. PNG has exclusive 21-year term franchise agreements with the municipalities of Prince Rupert, Port Edward, Kitimat, Terrace, Smithers, Burns Lake, Houston, Fraser Lake and Vanderhoof, entitling it to supply and distribute natural gas within those municipalities. The Kitimat, Terrace, Smithers, Burns Lake, Houston and Vanderhoof franchise agreements have an initial term of 21 years, which expire in 2011. Recently, the Port Edward agreement was renewed for a further 21-year term. The Prince Rupert and Fraser Lake agreements expire in 2015. All of the agreements are renewable at the option of either party for further terms of 21 years.
- **Operating Agreements with Unlimited 10-Year Renewal Terms.** PNG has operating agreements with the municipalities of Telkwa and Fort St. James that entitle the company to install and operate gas distribution facilities in the municipalities. Each agreement provides for an unlimited number of 10-year renewal terms, and PNG is currently operating within renewal terms that expire in 2011 and 2019 for Telkwa and Fort St. James, respectively. If the parties cannot agree on renewal terms, the BCUC can determine such terms.

Northeast System: Gas Transmission and Distribution Facilities

PNG's Northeast system consists of approximately 160 kilometres of transmission lines, 1,490 kilometres of distribution lines and a gas processing plant near Tumbler Ridge. The communities served by the Northeast system's network services had a population of roughly 58,000 in 2009.

- **Northeast System Under Exclusive Franchise Agreements and Operating Agreements**. PNG has exclusive franchise agreements with the District of Taylor and the cities of Dawson Creek and Fort St. John for 21-year terms, expiring in 2012, 2014 and 2018, respectively, as well as an operating agreement with the Village of Pouce Coupe that expires in 2016. The Dawson Creek and Fort St. John agreements provide for payment of a 3% fee on gross revenues from sales of gas to residential, commercial, public and institutional customers, and 3% of the gross revenue from the sale of the first 328,000 GJ per year to any industrial customer. PNG (N.E.) operates its gas distribution facilities in the Tumbler Ridge area pursuant to a certificate of public convenience and necessity issued by the commission. No franchise fees are payable to the municipality of Tumbler Ridge.

Renewable Energy Business

- **McNair Creek 9.8 MW Hydro Facility.** On April 19, 2010, in partnership with Skookum Power, PNG closed the acquisition of 97% ownership in the 9.8 MW McNair Creek hydro facility from Kiewit Hydropower Investors Inc. and Renewable Power Corp. Located on B.C.'s Sunshine Coast, the McNair facility has been in operation for more than five years with its generation output sold under a long-term contract to BC Hydro.
  - **Accretive to EPS in 2011.** The total purchase price was approximately $17.5 million and was funded in part by the assumption of $9.4 million in non-recourse debt and the remainder in cash. The transaction is expected to be cash flow positive for 2010 and is expected to be accretive to PNG's EPS in 2011.

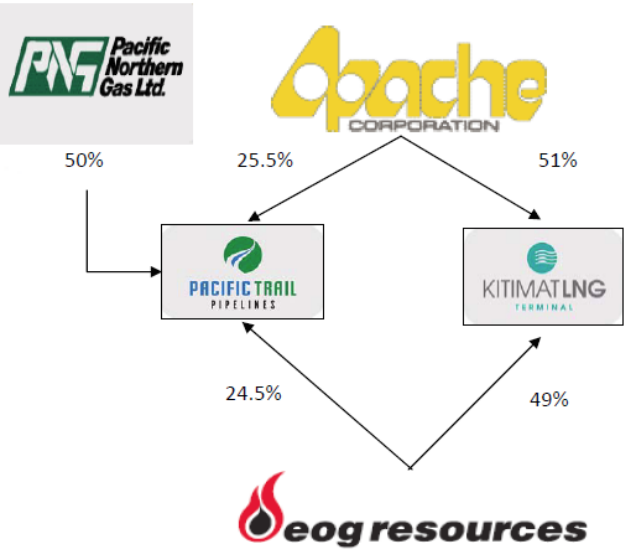
KSL Pipeline Project: A Potentially Transformational Project

Through its 50% interest in the PTP, PNG continues to pursue the KSL project, which consists of approximately 465 kilometres of up to 36-inch diameter pipeline and associated compression facilities, at a cost of $1.2 billion based on estimates made in 2006. Based on cost escalation since that time, we estimate that costs could be revised closer to $1.5 billion, if not higher. The KSL project would provide gas transportation services for up to 1 Bcf/d, primarily for the Kitimat Terminal to be located approximately 15 kilometres southwest of Kitimat.

The KSL project is a natural gas pipeline system expansion from Summit Lake to Kitimat, B.C. which will serve the Kitimat Terminal. The pipeline will partially loop the existing PNG pipeline between Summit Lake and Kitimat to increase the system's capacity via a more direct pipeline route. The project will connect the Kitimat Terminal with a direct connection to the Spectra Energy Transmission pipeline system at Summit Lake (Station 4A) and access to natural gas supplies in B.C. and Alberta.

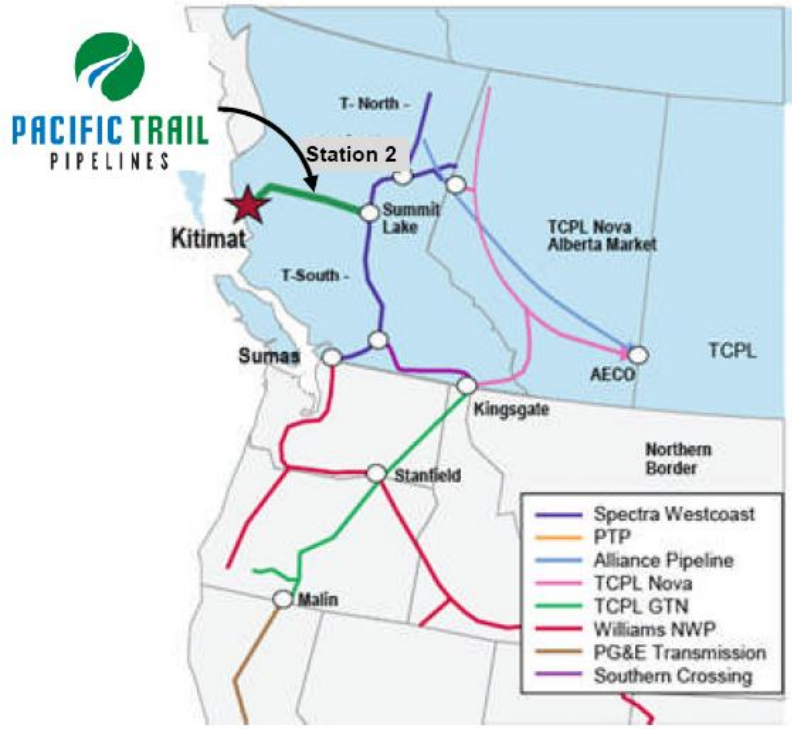
- **First Nations Option.** PNG owns 50% in PTP subject to an investment option in favour of certain First Nations and if the option is exercised, PNG's ownership will still remain greater than 40% after contributing its existing gas transmission assets into PTP.

Exhibit 6: Current Project Ownership



Source: Company reports

Exhibit 7: Map of PTP Pipelines



Source: Company reports

Evaluation of the Potential Pipeline Economics

Our base analysis of the pipeline assumes a levelized toll structure that has become common for many new pipelines. Similar to the Alliance pipeline, we have assumed that a return-on-rate-base approach and cost-of-service principles are used to set the toll with a depreciation schedule that is shaped to provide a levelized toll over time. We have also examined the economics of other tolling structures and find the equity IRRs to be similar.

We have examined the economics using the following key assumptions:

- **Capital Cost:** The most recent capital cost estimate for the pipeline is $1.2 billion (in 2006 dollars). We believe that when costs are updated, the estimate is likely to be closer to $1.5 billion (if not higher) based on the increase in forecast capital costs (from the original estimate in late 2005). In our analysis, we have used a capital cost of $1.5 billion and we assume that the project is completed on budget.
- **Capacity and Toll:** We have assumed that the initial capacity is 700 MMcf/day. Based on this volume of throughput, we estimate a toll of $0.70/Mcf assuming that the entire capacity is contracted for a 25-year period.
- **Realized Equity IRR:** We have assumed a 12% levered equity IRR, which is consistent with returns for similar projects.
- **Equity Thickness:** Our analysis assumes a 30% equity capitalization, which is at the lower end of what we generally see for pipelines. However, we believe that appropriate credit metrics can be maintained through the use of non-recourse, project financing. The lower equity component helps reduce the overall toll.
- **Depreciation:** We have shaped depreciation to levelize tolls over a 25-year term, resulting in lower depreciation of the rate base in earlier years with a higher depreciation rate towards the end of the contract.
- **Interest Expense:** We assume that the 70% debt is project financed on a non-recourse basis at a 7% interest rate. Our analysis also assumes that the debt is repaid in line with the decline in rate base to maintain a constant capital structure.
- **Taxes:** To keep the toll as competitive as possible, we have assumed that only cash taxes are collected in tolls. This concept is consistent with what we have observed recently for other regulated assets.

Exhibit 8 sets out the forecast cash flows for the construction period in addition to the first 10 years of the project's operations.

Exhibit 8: Forecast KSL Pipeline Cash Flows for the First 10 Years of Operations ($MM)

	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E
Opening Rate Base	$0	$225	$750	$1,500	$1,472	$1,441	$1,408	$1,371	$1,331	$1,291	$1,248	$1,204	$1,158
Depreciation	0	0	0	(28)	(31)	(33)	(37)	(40)	(41)	(42)	(44)	(46)	(48)
Capex	225	525	750	0	0	0	0	0	0	0	0	0	0
Ending Rate Base	$225	$750	$1,500	$1,472	$1,441	$1,408	$1,371	$1,331	$1,291	$1,248	$1,204	$1,158	$1,110
Average Rate Base				1,486	1,457	1,424	1,389	1,351	1,311	1,269	1,226	1,181	1,134
Equity Component				446	437	427	417	405	393	381	368	354	340
ROE				13%	13%	13%	13%	13%	13%	13%	13%	13%	13%
Net Income				$58	$57	$56	$54	$53	$51	$50	$48	$46	$44
Income Tax				0	0	0	0	0	3	5	7	9	11
Pre-Tax Income				58	57	56	54	53	54	54	55	55	55
Interest Expense				73	71	70	68	66	64	62	60	58	56
Depreciation				28	31	33	37	40	41	42	44	46	48
EBITDA				159	159	159	159	159	159	159	159	159	159
Operating Costs				20	20	20	20	20	20	20	20	20	20
Revenue Requirement				$179	$179	$179	$179	$179	$179	$179	$179	$179	$179
Throughput (Bcf/year)				256	256	256	256	256	256	256	256	256	256
Toll ($/Mcf)				$0.70	$0.70	$0.70	$0.70	$0.70	$0.70	$0.70	$0.70	$0.70	$0.70
Levered Cash Flow													
EBITDA				$159	$159	$159	$159	$159	$159	$159	$159	$159	$159
Interest Expense				(73)	(71)	(70)	(68)	(66)	(64)	(62)	(60)	(58)	(56)
Cash Tax				0	0	0	0	(0)	(3)	(5)	(7)	(9)	(11)
Capex	(225)	(525)	(750)	0	0	0	0	0	0	0	0	0	0
Debt Funding of Capex	158	368	525	0	0	0	0	0	0	0	0	0	0
Rate Base Debt Repayment	0	0	0	(20)	(21)	(23)	(26)	(28)	(29)	(30)	(31)	(32)	(34)
Levered Cash Flow	($68)	($158)	($225)	$66	$66	$66	$65	$65	$63	$62	$61	$60	$59

Levered Equity IRR	12%

Source: Company reports; RBC Capital Markets estimates

What the Pipeline Could be Worth to PNG

Ownership Interest Likely in the 40% to 45% Range

PNG holds a 50% interest in the pipeline project. However, there are two moving pieces that are likely to change the economics: (1) certain First Nations have the option to acquire up to a 30% interest in the project (which would initially reduce PNG's interest); and (2) PNG intends to contribute existing pipeline assets, with an estimated value of $100 million, from the Western system into the project (which would serve to increase PNG's interest). PNG's ultimate ownership in the project is dependent on the First Nations exercising their option, the value of the pipeline assets that PNG contributes to the project, the capital cost of the project and the equity component of the capital structure. With respect to the potential sale of interests by any of the parties in the pipeline, there are no rights of first refusal, put options or tag-along/drag-along provisions.

In Exhibit 9, we have set out the expected ownership interest of 42.8% in addition to sensitivity tables showing PNG's interest based on a range of capital costs for the pipeline, a range of values for the pipeline assets contributed to the project and various equity components of the capital structure.

Exhibit 9: PNG's Forecast Ownership Interest in the KSL Project ($MM)

Total Capital	$1,500
Equity Component	30%
Total Equity	$450
PNG Assets Vended In	100
Cash Equity	$350

	PNG		First Nations		Apache/EOG	
	$	%	$	%	$	%
Cash Equity	$123	35%	$105	30%	$123	35%
PNG Assets Vended In	100					
Total Equity	$223	49%	$105	23%	$123	27%
First Nations Equalization	(30)	-7%	30	7%		
Pro Forma Interests	$193	43%	$135	30%	$123	27%
Total Cash Required	$93		$135		$123	

		Capital Cost		
		$1,300	$1,500	$1,700
Equity Component	25.0%	45.8%	44.3%	43.2%
	27.5%	44.8%	43.5%	42.5%
	30.0%	44.0%	42.8%	41.9%
	32.5%	43.3%	42.2%	41.3%
	35.0%	42.7%	41.7%	40.9%

		Capital Cost		
		$1,300	$1,500	$1,700
Value of Assets Vended In	$80	42.2%	41.2%	40.5%
	$90	43.1%	42.0%	41.2%
	$100	44.0%	42.8%	41.9%
	$110	44.9%	43.6%	42.5%
	$120	45.8%	44.3%	43.2%

Source: Company reports; RBC Capital Markets estimates

The Project Could Add $6.00 to $7.00 per Share to Value

We forecast the equity book value of the project to be $450 million based on a $1.5 billion capital cost and 30% equity capitalization. When operational, we believe that the project could be "re-rated" from a 12% levered IRR to a 10% levered IRR. Upon commissioning, a $600 million equity book value results in a 10% levered IRR, implying $150 million of upside (en bloc). Based on PNG's 42.8% projected ownership, the company's share of the upside is roughly $64 million, or about $6/share to $7/share (assuming common equity is issued to fund PNG's equity portion of the project).

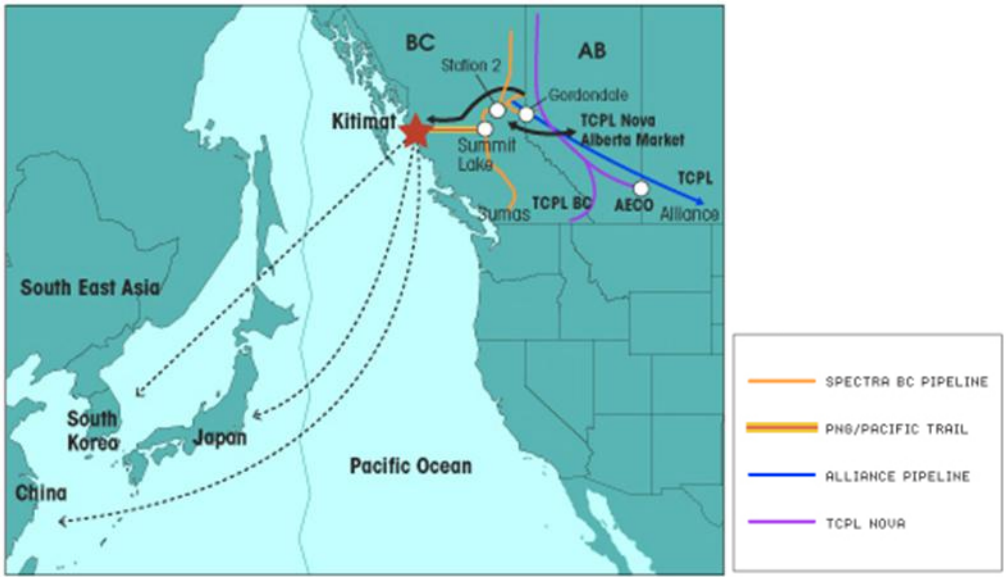
The Kitimat LNG Terminal: The Future of KSL Depends on It

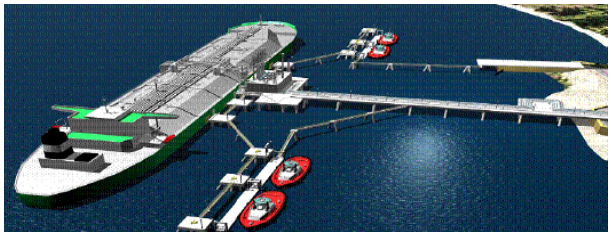
The Kitimat LNG Terminal is the proposed liquefied natural gas terminal at Bish Cove near the Port of Kitimat, B.C., at which natural gas from the Western Canada Sedimentary Basin (WCSB) will be cooled and liquefied in preparation for export via ship to growing global markets. The Kitimat terminal will take delivery of gas from the KSL pipeline project.

Although PNG has no economic interest in the Kitimat LNG terminal, the future of the KSL pipeline project depends on whether the LNG terminal proceeds.

- **An Interesting Outlet for Northeast B.C. Gas Producers.** The Kitimat LNG option may make sense for northeast B.C. gas producers given its geographic proximity in addition to the potential for higher gas prices in Asian markets due to current pricing that is based off of crude oil. For a detailed assessment of the Horn River Basin (one of the major gas plays in northeast B.C.), please refer to our comprehensive report titled *Horn River Basin Shale Gas: Awakening the Northern Giant*. The report was published on September 27, 2010 by RBC's Global Energy Research Team.
- **The Project Needs Contracts.** For the Kitimat LNG project (and in turn, the KSL pipeline project) to proceed, we believe the key will be the ability to find Asian buyers of LNG willing to sign long-term contracts with pricing at, or above, our preliminary estimate of US$8.50/Mcf to US$9.00/Mcf (i.e., Japan Crude Cocktail pricing) needed to result in an attractive netback to Horn River gas producers. The project has signed several memorandums of understanding (MOU), but we are waiting to see if those MOUs will be turned into binding commitments.
  - **GAS NATURAL:** In July 2009, Kitimat LNG and GAS NATURAL signed an MOU under which GAS NATURAL intends to acquire up to 30% of production from Kitimat LNG's proposed export terminal. GAS NATURAL plans to purchase up to 1.6 Mtpa of LNG from the terminal for 20 years.
  - **KOGAS:** In June 2009, Kitimat LNG signed an MOU with Korea Gas Corporation (KOGAS) under which KOGAS will acquire up to 40% of Kitimat LNG's production and an option to acquire an equity stake in the Kitimat Terminal. KOGAS plans to purchase 2.0 Mtpa of LNG from the proposed terminal for 20 years. In February 2010, KOGAS signed a farm-out agreement with Encana to invest $564 million over three years to earn a 50% interest in certain Horn River and Montney gas plays.
  - **Mitsubishi:** In January 2009, the project signed a Heads of Agreement under which Mitsubishi would acquire terminal capacity (1.5 Mtpa) in addition to a minority equity stake in the project.

Exhibit 10: Map of Kitimat LNG Terminal





Source: Company reports

- **Project Description.** To be located at Bish Cove near the Port of Kitimat, about 650 kilometres north of Vancouver, B.C., the proposed Kitimat LNG export terminal has a planned capacity of approximately 700 MMcf/d of natural gas or 5 million metric tonnes of LNG per year. With a preliminary cost estimate of $3 billion, the project is expected to export four to five shipments per month, and consists of a 40-hectare LNG export terminal site with marine on-loading, LNG storage (two 210,000 m^3 LNG storage tanks which roughly equates to 8.9 Bcf of natural gas), natural gas delivery, liquefaction and LNG send-out facilities. The Kitimat Terminal received its Provincial Environmental Certificate in late 2008 and Federal Environmental Assessment permit in early 2009.
- **KSL Pipeline Project Connection.** The Kitimat terminal will receive its natural gas supply by connecting to the Spectra BC Pipeline, through the existing Pacific Northern Gas Pipeline and the KSL pipeline project. Once received at the terminal, the gas will then be chilled to minus 160 degrees Celsius, at which point it becomes LNG that can be stored in full containment tanks, and shipped to Asian markets. In addition to the proximity to natural gas transmission infrastructure, Bish Cove is located in a deepwater fjord that offers a port for year-round access to potential LNG participants.
- **Ownership Structure.** The LNG terminal project is under development by Apache Canada, which also holds a 25.5% interest in the KSL pipeline project, and has a 51% stake in Kitimat LNG, and EOG, which also holds a 24.5% interest in the KSL project, has the remaining 49% stake in the LNG project.

Project Timeline

- The Kitimat LNG Terminal received its environmental assessment certificate from the BC Environmental Assessment Agency and was granted federal environmental approval for a regasification terminal in 2006.
- Kitimat LNG received its Provincial Environmental Certificate for the liquefaction terminal in late 2008 and the Federal Environmental Certificate in January 2009.
- Exhibit 11 below sets out the timeline from previous PNG disclosures. However, discussions with the participants and others in the industry lead us to believe that the timeline could be pushed back.

Exhibit 11: Currently Disclosed Project Timeline and Milestones of LNG Terminal Project

	Pacific Trail Pipelines	LNG Terminal
To Date	Provincial/Federal environmental approvals First Nations economic agreement with the BC government Apache joins project	Provincial/Federal environmental approvals Apache joins project
2010	Secure shipper commitments File application with B.C. Utilities Commission Preliminary engineering	Commence front end engineering and design (FEED Study)
2011	B.C. Utilities Commission decision Secure debt commitments Final investment decision Raise equity	Final investment decision Award EPC contract Commence construction
2012	Commence construction	Continue construction
2013	Continue construction	Continue construction
2014	Targeted in service	Targeted in service

Source: Company reports; RBC Capital Markets

The Target Market is Asia. The Kitimat Terminal provides an opportunity for participants to take advantage of the established difference in natural gas pricing between North America and Asian LNG pricing that is based on crude oil derivatives. Furthermore, the Kitimat Terminal on the Pacific Northwest coast is the shortest route between Pacific Basin LNG markets and the North American energy market. The following table shows sailing times to key Pacific Basin market locations from Kitimat Terminal versus liquefaction terminals in the Atlantic basin. Target markets include Japan, the largest importer of LNG in the world, as well as South Korea, China and Taiwan. With the exception of India, transit times for LNG supplied to Asian markets from Australia, Indonesia and Papua New Guinea would be slightly less than Kitimat.

Exhibit 12: Table of Transit Times (in days)

	Kitimat	Trinidad & Tobago	Nigeria	Algeria
Tokyo	8.6	30.7	24.0	21.1
Seoul	10.3	29.5	23.0	26.4
Shanghai	10.4	59.3	22.2	19.6
Fujian	11.4	58.1	21.3	18.5
India	30.1	32.2	22.3	15.3

Source: Company reports; RBC Capital Markets

Financial Forecast

In Exhibits 13 through 16, we have set out our forecast income statement, balance sheet cash flow statement and other metrics for 2010 to 2012. Our financial forecast is based on the following key assumptions:

- **Utility Returns:** We have assumed that the allowed capital structures for each of the company's utilities remain unchanged through our forecast period. Pending the BCUC's review of the ROE formula that is likely to occur in 2011, we have assumed that the ROE remains unchanged at 10.15% for the Western system and Tumbler Ridge, and 9.90% for the Fort St. John/Dawson Creek system.
- **Utility Rate Base:** Our forecast reflects utility capital expenditures of roughly $7 million in 2010 and $8 million in 2011 and 2012. We project a modest annual decline in rate base for the Western system and modest increases for both the Fort St. John/Dawson Creek and Tumbler Ridge systems.
- **Stable Regulatory Environment:** In addition to our assumptions for the utilities as previously described, we have assumed that there is a stable regulatory environment with no major negative (or positive) decisions.
- **KSL Not in Our Numbers:** We have not included the potential capex and related financing for KSL in our financial forecast. Further, we have assumed that project development costs, including $2.3 million that PNG expects to spend by the end of 2010, will be capitalized.
- **No Acquisitions or Divestitures:** We have assumed that the company does not make any major acquisitions or divest any material assets throughout our forecast period.
- **Dividends:** We assume that PNG increases its annual dividend modestly to $1.28 and $1.36 in late 2011 and late 2012, respectively. From a timing perspective, we forecast that the increases will be announced in the fall, resulting in the higher dividend being received for Q4 (i.e., the actual cash dividends received for 2011 and 2012 are forecast to be $1.22 and $1.30, respectively).

Exhibit 13: Income Statement ($MM except per share amounts or otherwise stated)

	2008	2009	2010E	2011E	2012E
Gas Sales and Transportation Services	$39.7	$40.5	$47.7	$47.1	$47.7
Hydro	0.0	0.0	1.3	2.0	2.0
Other	7.0	6.4	2.2	2.2	2.2
Total Operating Margin	46.7	46.9	51.2	51.3	51.9
Operating and Maintenance	(12.0)	(12.3)	(12.2)	(13.0)	(13.2)
Administrative and General	(6.5)	(7.3)	(8.7)	(8.0)	(8.0)
Municipal and Other Taxes	(4.7)	(4.6)	(4.8)	(4.9)	(5.0)
Investment and Other Income	0.1	0.0	0.0	0.0	0.0
EBITDA	23.6	22.7	25.4	25.4	25.8
Depreciation and Amortization	(8.6)	(8.1)	(8.7)	(8.7)	(8.7)
Interest Expense, Net	(7.0)	(5.6)	(6.4)	(6.4)	(6.4)
Project Development Expenditures	(0.8)	(0.2)	(0.6)	0.0	0.0
Current Taxes	(0.9)	(2.2)	(1.2)	(1.3)	(1.3)
Future Taxes	(0.3)	(0.1)	(1.2)	(1.3)	(1.3)
Non-Controlling Interest	0.0	0.0	0.0	0.0	0.0
Net Income	5.9	6.5	7.4	7.7	8.0
Less: Dividends on Preferred Shares	(0.3)	(0.3)	(0.3)	(0.3)	(0.3)
Net Income to Common	$5.6	$6.2	$7.1	$7.4	$7.7
Average Diluted Shares O/S (MM)	3.7	3.6	3.7	3.8	3.8
EPS (Basic)	$1.53	$1.72	$1.96	$2.02	$2.06
EPS (Diluted)	$1.52	$1.71	$1.91	$1.97	$2.01

Source: Company reports; RBC Capital Markets estimates

Exhibit 14: Balance Sheet ($MM)

	2008	2009	2010E	2011E	2012E
Cash	$0.6	$1.5	$2.0	$6.3	$10.7
Other	37.2	27.1	20.3	19.0	17.6
Current Assets	37.8	28.6	22.2	25.3	28.3
Property Plant and Equipment	177.8	178.4	195.7	194.9	194.2
Other	6.5	13.2	22.8	22.8	22.8
Total Assets	$222.0	$220.2	$240.7	$243.1	$245.4
Bank Indebtedness	3.0	2.6	0.0	0.0	0.0
Termination Payment Deferral	3.8	0.0	4.9	3.2	1.6
Short-term Debt	2.4	2.8	7.8	8.8	2.8
Other	35.8	30.5	20.2	20.2	20.2
Current Liabilities	44.9	35.9	32.9	32.2	24.6
Long-term Debt	74.5	71.8	85.4	84.4	90.4
Future Income Taxes	0.0	16.5	19.9	19.9	19.9
Other Liabilities	13.8	5.7	7.7	7.8	7.9
Non-Controlling Interest	0.0	0.0	0.2	0.2	0.2
Preferred Shares	5.0	5.0	5.0	5.0	5.0
Shareholders' Equity	83.7	85.4	89.6	93.5	97.4
Total Liabilities and Equity	$222.0	$220.2	$240.7	$243.1	$245.4

Source: Company reports; RBC Capital Markets estimates

Exhibit 15: Cash Flow Statement ($MM)

	2008	2009	2010E	2011E	2012E
Reported Net Income (Loss)	$5.9	$6.5	$7.4	$7.7	$8.0
Future Tax	0.3	0.1	1.2	1.3	1.3
Depreciation and Amortization	8.7	8.2	8.7	8.7	8.7
Other Amortization	(6.6)	(5.5)	(0.1)	(1.6)	(1.6)
Other	0.3	(0.2)	(0.5)	0.1	0.1
Cash Flow from Operations	8.7	9.2	16.6	16.2	16.5
Change in Working Capital	9.3	9.7	(7.0)	0.0	0.0
Operating Cash Flow	18.0	18.9	9.6	16.2	16.5
Capital Expenditures	(10.4)	(9.5)	(10.0)	(8.0)	(8.0)
Acquisitions	0.0	0.0	(7.7)	0.0	0.0
Other	(0.0)	(0.1)	5.0	0.0	0.0
Cash Flow from Investing	(10.4)	(9.6)	(12.7)	(8.0)	(8.0)
Increase (Decrease) in Debt	(4.2)	(2.9)	6.6	(0.0)	0.0
Issuance (Repurchase) of Shares	0.0	(1.8)	0.0	0.0	0.0
Employee Stock Options Exercised	0.0	0.1	1.0	1.0	1.0
Dividends Paid on Common Shares	(3.6)	(3.6)	(4.0)	(4.5)	(4.8)
Dividends Paid on Preferred Shares	0.0	(0.2)	(0.3)	(0.3)	(0.3)
Other	0.0	0.0	0.2	0.0	0.0
Cash Flow from Financing	(7.8)	(8.3)	3.5	(3.8)	(4.2)
Net Change in Cash	(0.2)	0.9	0.5	4.4	4.4
Opening Cash Balance	0.8	0.6	1.5	2.0	6.3
Ending Cash Balance	$0.6	$1.5	$2.0	$6.3	$10.7

Source: Company reports; RBC Capital Markets estimates

Exhibit 16: Summary Metrics

	2008	2009	2010E	2011E	2012E
Summary Debt Metrics					
Net Debt/Cap	48%	46%	50%	48%	45%
FFO/Net Debt	11%	12%	18%	18%	19%
Net Debt/EBITDA	3.5x	3.4x	3.7x	3.5x	3.3x
Other Metrics					
Dividend Per Share	$0.88	$0.96	$1.14	$1.22	$1.30
Payout Ratio	58%	56%	60%	62%	65%

Source: Company reports; RBC Capital Markets estimates

Senior Management

Roy G. Dyce - President and Chief Executive Officer

Mr. Dyce was appointed President and CEO in 1994 and has served as a Director of Pacific Northern Gas since 1982. He began his career with Westcoast Energy in 1966 in the Engineering Department and during his 13 years with Westcoast, Mr. Dyce's main areas of responsibility were in corporate development, marketing and regulatory affairs. He was involved in the launch of Pacific Northern Gas in the late 1960s and joined the company in 1980. Mr. Dyce is also a member of the board of directors of the Canadian Gas Association.

Greg B. Weeres - Vice President, Operations and Engineering

Prior to joining Pacific Northern Gas in 1998, Mr. Weeres was with BC Gas and its predecessor company Inland Natural Gas for 15 years. He began his career in Vancouver for Inland Natural Gas in the design engineering area in 1983, and relocated to Prince George, B.C. two years later to take over the engineering responsibilities for the northern part of Inland's operation. Mr. Weeres has held a number of different positions including Operations Manager, District Manager and Manager Customer Services which provides him with experience in the areas of Engineering, Construction, Customer Service, Marketing, Sales, Government Relations and Regulatory Affairs.

Janet P. Kennedy - Vice President, Finance

Ms. Kennedy joined Pacific Northern Gas in October 2007 as Vice President of Finance. Prior to joining Pacific Northern Gas, she worked for Terasen from 1993 to 2006, most recently as Director, Financial Planning & Projects. During her 13 years at Terasen, Ms. Kennedy's main areas of responsibility were in financial planning, M&A projects, strategic planning, financial reporting, financial accounting, plant accounting and budgeting, and the oversight of various corporate investments. Ms. Kennedy began her career with KPMG in 1987 and is a Chartered Accountant.

Kevin R. Teitge - Vice President, Corporate Development and Treasurer

Mr. Teitge joined the company in early 2004 as Senior Financial Officer and acted as Interim CFO of the Company for six months commencing March 2004. Prior to joining Pacific Northern Gas, Mr. Teitge spent a brief period as an independent consultant in 2003 following seven years with Westcoast Energy, most recently as Director, Corporate and Project Finance where he participated in the development and execution of the finance plan for Westcoast. Mr. Teitge's other work experience included tenures with the Ministry of Energy, Mines and Petroleum Resources of the Province of B.C., and the Alberta Energy Company.

Craig P. Donohue - Director, Regulatory Affairs & Gas Supply and Assistant Secretary

Mr. Donohue was appointed as the Director, Regulatory Affairs and Gas Supply for Pacific Northern Gas in 1998. He joined PNG in 1990 as Manager of Regulatory Affairs, and was also appointed to the position of Assistant Secretary in late 2003. Mr. Donohue began his career with Westcoast Energy in 1980 in Westcoast's legal department, and during his 10 years with Westcoast, Mr. Donohue's main areas of responsibility were in corporate/commercial legal matters relating to the company's day-to-day business activities.

Investment Risks and Price Target Impediments

Regulatory Decisions

The company's utility assets, which contribute the vast majority of the earnings and cash flow, are subject to regulation by the B.C. Utilities Commission. Decisions by the BCUC, including but not limited to returns, capital structure and the timely recovery of the utilities' costs of service, could have a material positive or negative impact on the company.

KSL Project

PNG continues to pursue the KSL Project with the project's construction scheduled to commence in 2012 for completion in 2014. Conditions to construction include the securing of contracts for use of the project's transportation capacity, financing for construction of the KSL Project, and additional regulatory approvals for the KSL Project such as a Certificate of Public Convenience and Necessity (CPCN) from the BCUC and other permits from the B.C. Oil and Gas Commission. If construction of the KSL Project does not proceed, PNG will remain reliant on its existing customer base and assets. Management has estimated that the construction of the KSL Project will cost approximately $1.2 billion based on estimates made in 2006. Development and construction costs could be higher than expected.

Rising Interest Rates

Energy infrastructure stocks have traditionally paid a high dividend, which has been viewed as attractive in low interest rate environments. Our analysis indicates that rising long-term interest rates have historically had a significant negative effect on sector valuations. As a result, a significant rise in long-term interest rates is expected to have an adverse effect on PNG's share price.

Potential Acquisitions and Project Development

Acquisitions are part of PNG's growth strategy, particularly for hydro assets. An acquisition that is not strategic and accretive runs the risk that it will not gain the support of investors, which could negatively impact the share price. From a project development perspective, meaningful cost overruns or contracts priced with a low IRR could negatively impact the value of the company.

Competitiveness of Natural Gas

Although PNG's utilities do not have direct exposure to natural gas prices due to the flow-through mechanism in customer rates, the overall competitiveness of natural gas is a driver behind customer growth. Lower gas prices are generally positive for the business as they drive conversions to natural gas (from other heating sources), retain existing customers, and keep industrial customers competitive.

Valuation

Our $28.00/share price target is based on a 12.5x forward P/E for the existing assets plus a $2.00/share (50% risked) present value for the KSL project. The 12.5x multiple used in our valuation is a discount to the other Canadian regulated utility companies that we cover. We believe a discount is reasonable given small size of the company, the low trading liquidity and the mature utility assets that have very modest organic growth potential.

Price Target Impediment

Impediments to our price target include the success of the KSL pipeline on economic terms consistent with our assumptions, regulatory decisions, the economy in the company's service territories, investments or acquisitions that fail to gain the confidence of investors and the level of long-term interest rates.

Company Description

Pacific Northern Gas owns and operates two systems: the Western system, which is a regulated natural gas transmission and distribution utility operating within the west-central portion of northern B.C.; and the Northeast system, which is a regulated gas distribution utility in northeast B.C. Collectively operating over 3,500 kilometres of transmission and distribution pipeline, the company serves residential, commercial and industrial customers in the two resource-based areas. In addition to the regulated utility business, the company owns a 9.8 MW run-of-river hydro plant. PNG is focused on enhancing value from its regulated business, continuing development of the KSL project and evaluating other opportunities.

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			Investment Banking Serv./Past 12 Mos.	
Rating	Count	Percent	Count	Percent
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Rating and Price Target History for: Pacific Northern Gas Ltd. as of 11-26-2010 (in CAD)

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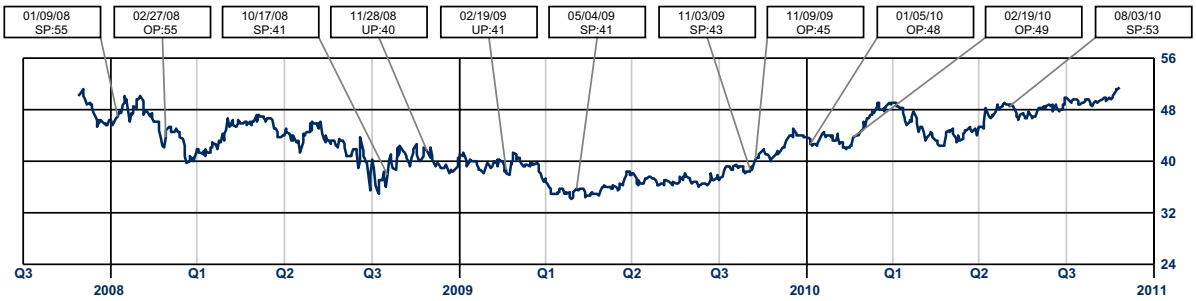
Rating and Price Target History for: Canadian Utilities Limited as of 11-26-2010 (in CAD)



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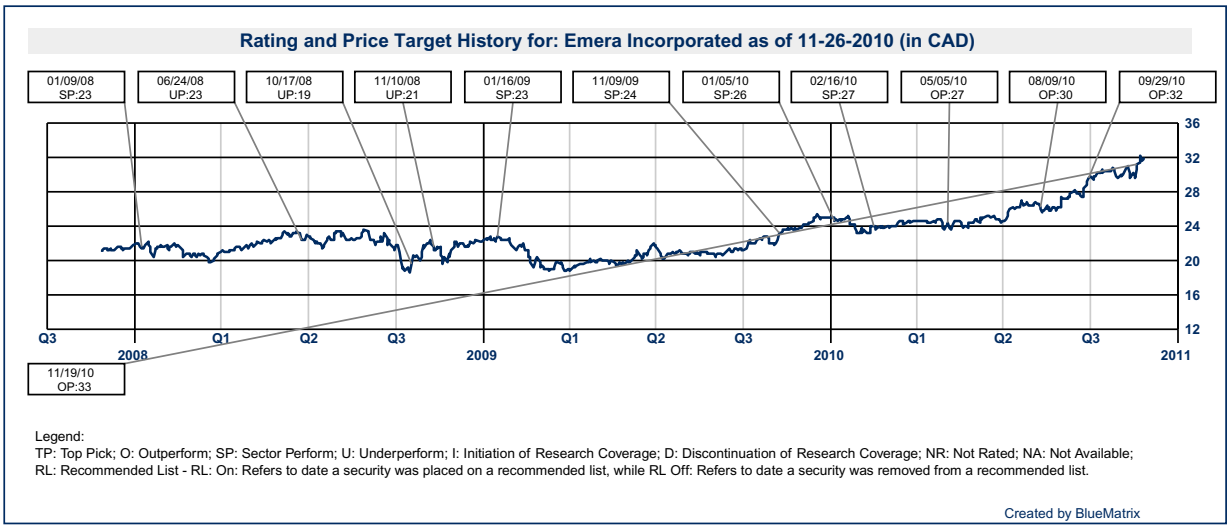

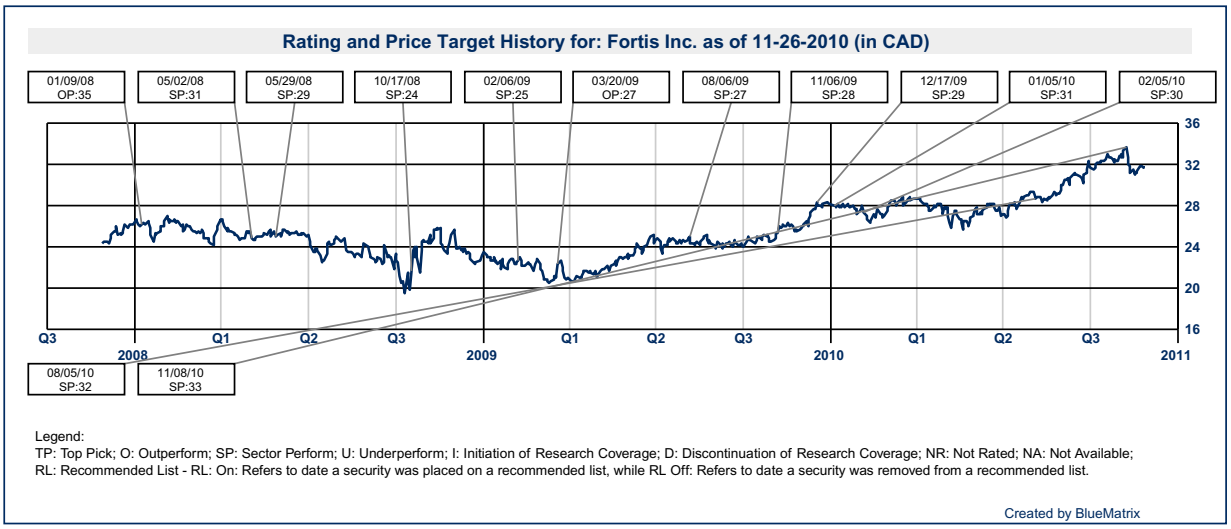

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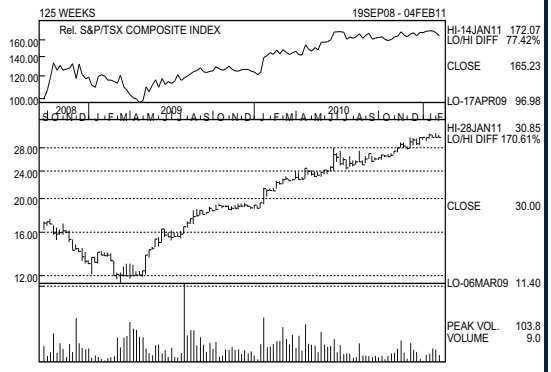

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FY Dec	2009A	2010E	2011E	2012E
EPS (Op) - Basic	1.72	1.96	2.02	2.06
Div. Yield	3.1	3.6	3.9	4.1
P/E	18.2x	16.0x	15.5x	15.2x
EPS (Op) - FD	1.71	1.91	1.97	2.01
Annual Div.	0.96	1.14	1.22	1.30

EPS (Op) - Basic	Q1	Q2	Q3	Q4
2009	1.39A	(0.13)A	(0.49)A	0.95A
2010	1.51A	(0.06)A	(0.64)A	1.16E
2011	1.77E	(0.12)E	(0.71)E	1.09E

All values in CAD unless otherwise noted.

PRICE TARGET REVISION | COMMENT

FEBRUARY 8, 2011

Pacific Northern Gas Ltd. (TSX: PNG)

Agrees to Sell 50% Stake in KSL Project; Increasing Price Target to $33.00

Sector Perform
Average Risk

Price:	31.35	**Price Target:**	33.00 ↑ 28.00
		Implied All-In Return:	9%
Shares O/S (MM):	3.6	**Market Cap (MM):**	113
Dividend:	1.20	**Yield:**	3.8%

Large Holder: 15% interest

Event

PNG agreed to sell its 50% stake in the KSL Project; increasing price target to $33.00 (from $28.00).

Investment Opinion

- **Agreement to Sell KSL Project Stake.** Pacific Northern Gas announced that it has agreed to sell its 50% stake in the KSL Project (moving Horn River gas to a proposed LNG export facility in Kitimat, BC) to Apache Canada and EOG Canada, the proponents of the LNG export facility in Kitimat, for $30 million upon closing and an additional $20 million when Apache and EOG decide to proceed with the construction of the LNG export terminal. The transaction is expected to close later this month.
- **Good Value for Shareholders.** After tax and other expenses, management estimates that the total payment will generate $9/share to $10/share of value. In our initiating coverage report published on November 29, 2010, our analysis placed a total value for the project of $6/share to $7/share when commissioned in 2014 or 2015. As such, this transaction crystallizes value immediately in addition to providing a stronger-than-expected overall value for the project.
- **Further Guidance Over the Coming Weeks on Use of Proceeds.** PNG's board is currently reviewing its strategy in light of the up-front payment, and further guidance is expected to be announced over the coming weeks. On the conference call, management mentioned that "everything is on the table" (e.g., share repurchase, a special dividend, acquisitions and a sale of the company). Given the small size of the company, we do not expect meaningfully sized share repurchases or special dividends to be likely outcomes.
- **Valuation: Increasing Price Target to $33.00 (from $28.00) to Reflect the KSL Project Sale.** Our increased price target is based on a 12.5x forward P/E for the existing assets (unchanged) plus $5/share for the up-front payment for the KSL Project sale and about $2/share (50% risked) for the payment contingent upon the KSL Project going forward. The 12.5x multiple used in our valuation is a discount to the other Canadian regulated utility companies that we cover. We believe a discount is reasonable given the company's small size, the low trading liquidity and the mature utility assets that have very modest organic growth potential.

Priced as of prior trading day's market close, EST (unless otherwise noted).

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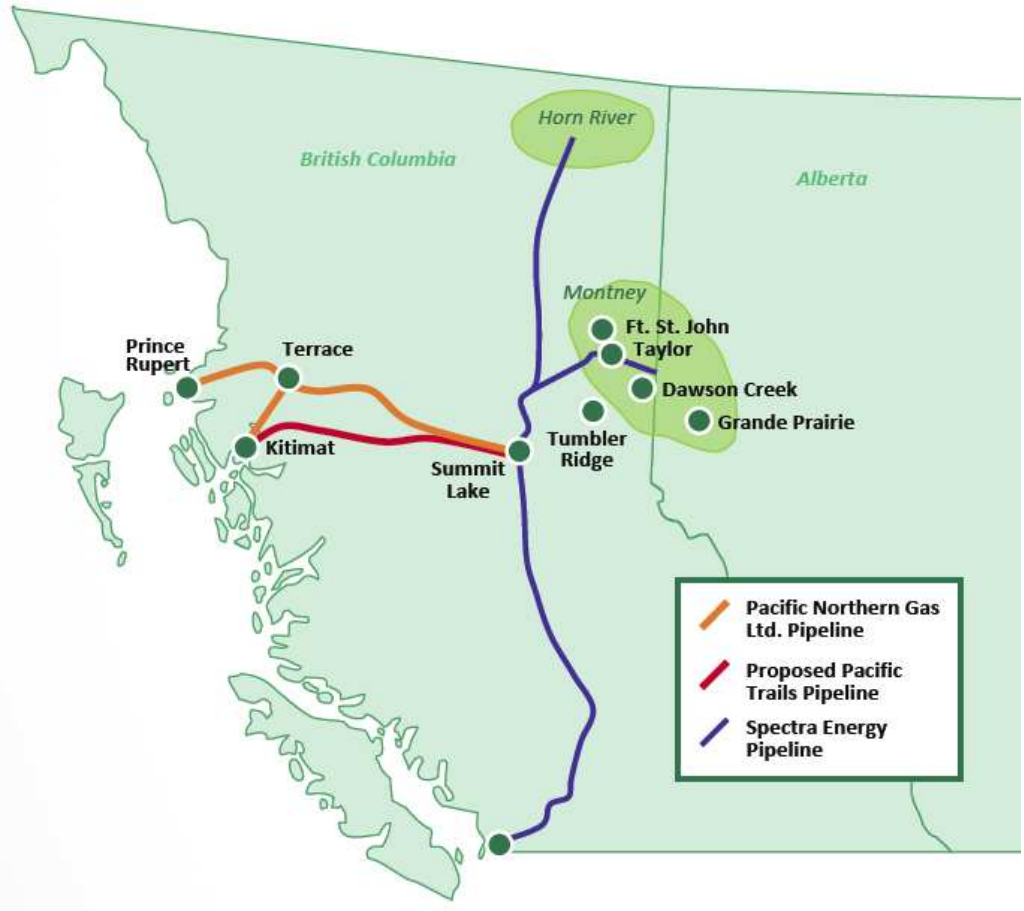
Full Value Received for KSL Project

Pacific Northern Gas announced that it has agreed to sell its 50% stake in Pacific Trails Pipelines (PTP is the company in pursuit of the KSL Project) to Apache Canada and EOG Canada, the proponents of the proposed LNG export facility in Kitimat (Kitimat LNG), for $30 million upon closing and an additional $20 million when Apache and EOG decide to proceed with the construction of Kitimat LNG. Pending standard industry conditions and consents, the transaction is expected to close by the end of February 2011. The KSL Project (please refer to Exhibit 1) would provide gas transportation services with a capacity of up to 1 Bcf/day by looping Pacific Northern Gas' mainline transmission system from Kitimat to Summit Lake.

Exhibit 1: Map of KSL Project (Pacific Trails Pipeline)



Source: Company reports

Attractive Value Crystallized for Shareholders

On the conference call, management estimated that due to transaction expenses being deducted from the first tranche payment, the total payment of $50 million (after tax and other expenses), which is equivalent to about $9/share to $10/share of value, would be roughly evenly split between the up-front payment and the payment when the project goes ahead. As such, we estimate that the up-front payment will be about $5/share. In our initiating coverage report published on November 29, 2010, our analysis placed a total value of the project of $6/share to $7/share when commissioned in 2014 or 2015. As such, this transaction crystallizes value immediately in addition to providing a stronger-than-expected overall value of the project. Management noted that PNG's investment for the KSL Project to-date was approximately $7.5 million ($5 million after-tax).

Good Value for Rate Payers via Rate Reductions

As part of the transaction, PNG negotiated operating and transportation service agreements such that it will operate the KSL pipeline for at least seven years following the expected completion date in 2015, subject to five-year renewals thereafter. The revenue generated would reduce gas delivery rates for rate payers, similar to the reduced levels if PNG had kept its stake in the KSL Project. Further, PNG's existing mainline capacity will be underpinned by 20-year transportation service agreements that would require

Apache and EOG to use a portion of PNG's current pipeline capacity, in the event that it is not first claimed by a separate LNG export project. The increased utilization on the existing mainline would further reduce customer rates. We expect the agreements to be approved by the B.C. Utilities Commission (BCUC) due to the benefit to ratepayers.

Company Outlook Post-Transaction

Upon completion of the transaction, guidance to be provided over the coming weeks on the use of proceeds should provide greater clarity on PNG's future cash flows and its core businesses. The company's board is currently reviewing its business strategy in light of the upcoming up-front payment and plans to provide further guidance after the board meeting in March 2011 and no later than the annual general meeting on May 11, 2011. Management noted that while there are no current projects to which PNG could apply the funds, the board is reviewing potential options that could include a share repurchase, a special dividend, acquisitions and a sale of the company. Due to the company's small size, we do not expect share repurchases or a special dividend to be meaningful components of the use of proceeds.

Price Target Increased to Reflect the Sale

We have increased our price target to $33.00 (from $28.00) to reflect the sale of PNG's interest in the KSL Project. The price target increase of $5/share includes the immediate value crystallization from the up-front payment of roughly $5/share, and about half of the additional payment of $5/share when Apache and EOG decide to proceed with the construction of Kitimat LNG (i.e., assuming roughly a 50% probability factor that the project moves forward on the anticipated timing). In comparison, our previous price target already included about $2/share of value based on the estimated present value of roughly $6.00/share to $7.00/share when the KSL pipeline would be commissioned in 2014 or 2015 (at a 12% levered equity discount rate) and assuming a 50% probability factor that the project would move forward.

Pending additional colour on the use of proceeds, we have left our estimates unchanged. Our financial forecast is set out in Exhibit 2.

Exhibit 2: Financial Forecast (In $MM except per share figures)

	2008	2009	Q1/10	Q2/10	Q3/10	Q4/10E	2010E	2011E	2012E
Gas Sales and Transportation Services	$39.7	$40.5	$17.8	$8.4	$6.2	$15.3	$47.7	$47.1	$47.7
Hydro	0.0	0.0	0.0	0.6	0.2	0.5	1.3	2.0	2.0
Other	7.0	6.4	0	2	0	0	2.2	2.2	2.2
Total Operating Margin	46.7	46.9	17.9	10.5	6.6	16.1	51.2	51.3	51.9
Operating and Maintenance	(12.0)	(12.3)	(3.0)	(3.1)	(3.0)	(3.1)	(12.2)	(13.0)	(13.2)
Administrative and General	(6.5)	(7.3)	(2.3)	(2.5)	(1.9)	(2.0)	(8.7)	(8.0)	(8.0)
Municipal and Other Taxes	(4.7)	(4.6)	(1.2)	(1.2)	(1.2)	(1.2)	(4.8)	(4.9)	(5.0)
Investment and Other Income	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
EBITDA	23.6	22.7	11.4	3.7	0.5	9.8	25.4	25.4	25.8
Depreciation and Amortization	(8.6)	(8.1)	(2.1)	(2.2)	(2.2)	(2.2)	(8.7)	(8.7)	(8.7)
Interest Expense, Net	(7.0)	(5.6)	(1.4)	(1.6)	(1.7)	(1.6)	(6.4)	(6.4)	(6.4)
Project Development Expenditures	(0.8)	(0.2)	(0.3)	(0.3)	(0.0)	(0.0)	(0.6)	0.0	0.0
Current Taxes	(0.9)	(2.2)	(1.3)	1.6	1.2	(2.8)	(1.2)	(1.3)	(1.3)
Future Taxes	(0.3)	(0.1)	(0.8)	(1.5)	(0.0)	1.1	(1.2)	(1.3)	(1.3)
Non-Controlling Interest	0.0	0.0	0.0	0.0	0.0	(0.0)	0.0	0.0	0.0
Net Income	5.9	6.5	5.5	(0.1)	(2.2)	4.3	7.4	7.7	8.0
Less: Dividends on Preferred Shares	(0.3)	(0.3)	(0.1)	(0.1)	(0.1)	(0.1)	(0.3)	(0.3)	(0.3)
Net Income to Common	**$5.6**	**$6.2**	**$5.4**	**($0.2)**	**($2.3)**	**$4.2**	**$7.1**	**$7.4**	**$7.7**
Average Shares (Diluted)	3.7	3.6	3.7	3.6	3.6	3.7	3.7	3.8	3.8
Normalized EPS (Basic)	**$1.53**	**$1.72**	$1.51	($0.06)	($0.64)	$1.16	**$1.96**	**$2.02**	**$2.06**
Normalized EPS (Diluted)	**$1.52**	**$1.71**	$1.48	($0.06)	($0.64)	$1.13	**$1.91**	**$1.97**	**$2.01**

Source: Company reports; RBC Capital Markets estimates

Valuation

Our $33.00/share price target is based on a 12.5x forward P/E for the existing assets plus a $5/share value for the up front payment for the KSL Project sale and about a $2/share (50% risked) for the payment contingent upon the KSL project going forward. The 12.5x multiple used in our valuation is a discount to the other Canadian regulated utility companies that we cover. We believe a discount is reasonable given small size of the company, the low trading liquidity and the mature utility assets that have very modest organic growth potential.

Price Target Impediment

Impediments to our price target include the KSL project proceeding on previously guided timelines (i.e. the receipt of the remaining $20 million payment), regulatory decisions, the economy in the company's service territories, investments or acquisitions that fail to gain the confidence of investors and the level of long-term interest rates.

Company Description

Pacific Northern Gas owns and operates two systems: the Western system, which is a regulated natural gas transmission and distribution utility operating within the west-central portion of northern B.C.; and the Northeast system, which is a regulated gas distribution utility in northeast B.C. Collectively operating over 3,500 kilometres of transmission and distribution pipeline, the company serves residential, commercial and industrial customers in the two resource-based areas. In addition to the regulated utility business, the company owns a 9.8 MW run-of-river hydro plant. PNG is focused on enhancing value from its regulated business and evaluating other opportunities.

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			Investment Banking Serv./Past 12 Mos.	
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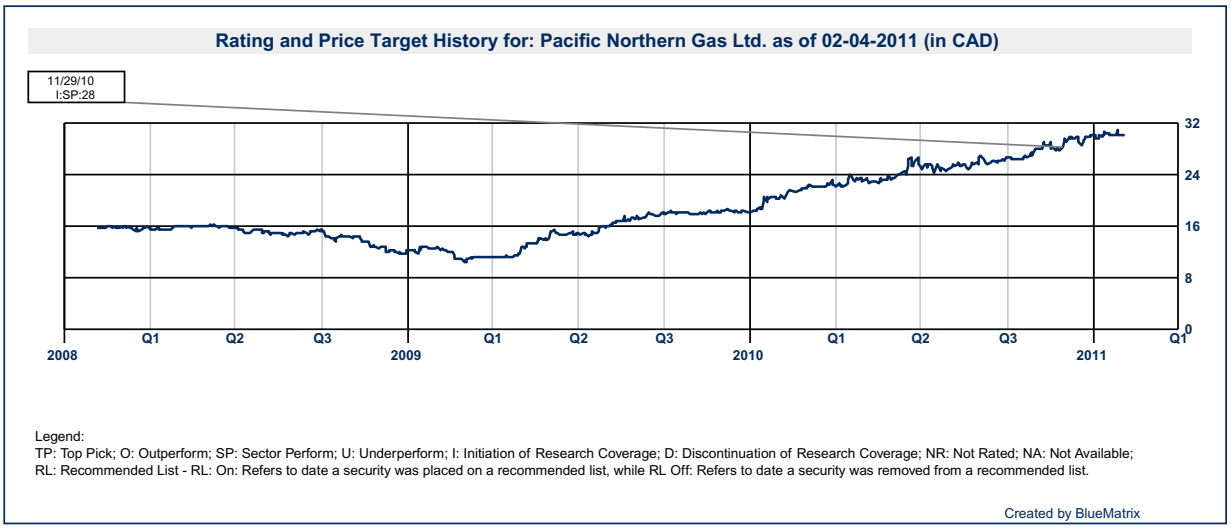

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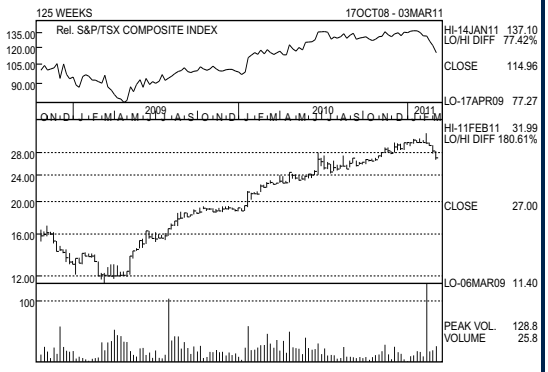

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All values in CAD unless otherwise noted.

FIRST GLANCE | COMMENT

MARCH 4, 2011

Pacific Northern Gas Ltd. (TSX: PNG; 27.00)

Announces $3/Share Special Dividend; Q4/10 Results In Line

Sector Perform
Average Risk

Impact

Neutral

First Impression

- **$3/Share Special Dividend Represents Roughly Half of the First Payment from the KSL Sale.** Pacific Northern Gas announced that it would make a $3/share special dividend payment on March 24, 2011 (March 15, 2011 record date) in addition to the regular $0.30/share quarterly dividend. The $11 million payment represents roughly half of the net proceeds from the first payment from the KSL sale after taxes and transaction costs. Should the Kitimat LNG project move forward, PNG will receive another $20 million (pre-tax) in cash from the buyers.
- **Q4/10 Results In Line.** Q4/10 EPS was $1.10 compared to our estimate of $1.16 and $0.95 in Q4/09. The per share comparison is magnified by the small share count, with reported Q4/10 net income of $3.9 million comparing with our estimate of $4.2 million. Detailed results were not available at the time of publishing although it appears that operating margin of $16.0 million was also in line with our forecast of $16.1 million.
- **We Will Further Assess the Quarter and the Outlook Following the Release of Detailed Results.** We expect the detailed results to be released shortly, after which we will further assess the quarter, our financial forecast, and our overall outlook.

Priced as of prior trading day's market close, EST (unless otherwise noted).

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Company Description

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Ratings

Top Pick (TP): Represents best in Outperform category; analyst's best ideas; expected to significantly outperform the sector over 12 months; provides best risk-reward ratio; approximately 10% of analyst's recommendations.

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Sector Perform (SP): Returns expected to be in line with sector average over 12 months.

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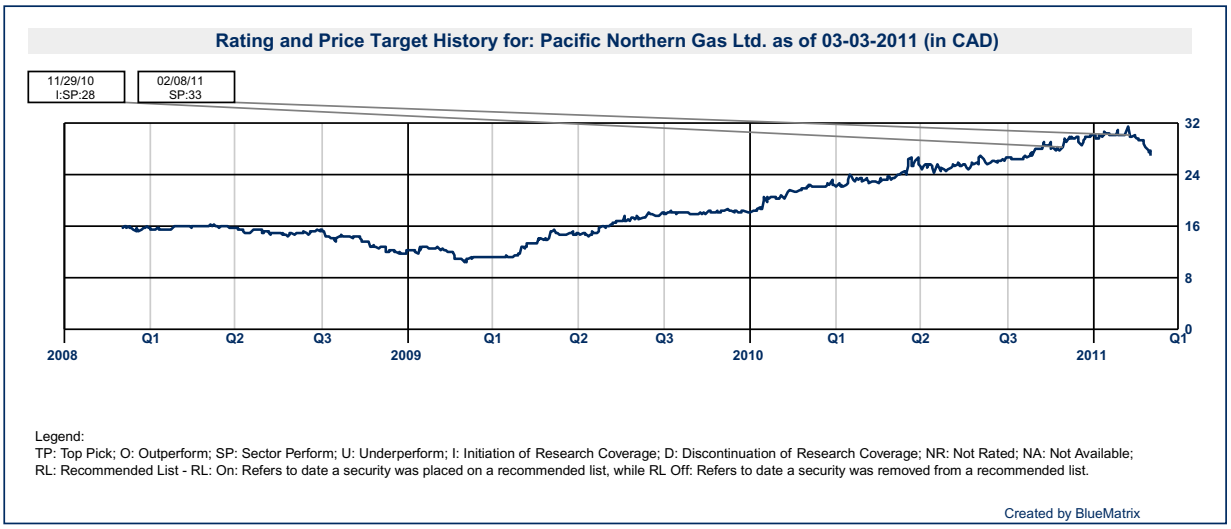
RBC Capital Markets, Equity Research

			Investment Banking Serv./Past 12 Mos.	
Rating	Count	Percent	Count	Percent
BUY[TP/O]	699	51.50	197	28.18
HOLD[SP]	594	43.80	136	22.90
SELL[U]	63	4.60	10	15.87



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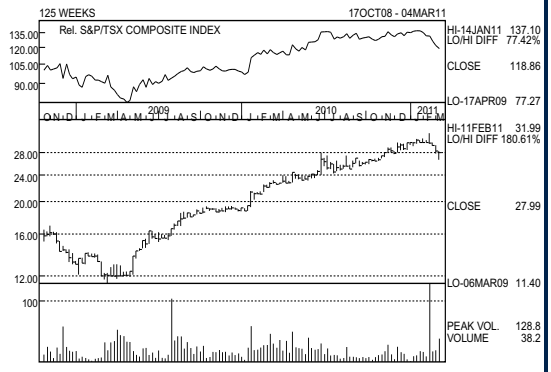

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FY Dec	2009A	2010A	2011E	2012E
EPS (Op) - Basic	1.72	1.88	2.02	2.09
Prev.		1.96		2.06
Div. Yield	3.4	4.1	4.4	4.6
P/E	16.3x	14.9x	13.9x	13.4x
EPS (Op) - FD	1.71	1.83	1.96	2.03
Prev.		1.91	1.97	2.01
Annual Div.	0.96	1.14	1.22	1.30

EPS (Op) - Basic	Q1	Q2	Q3	Q4
2009	1.39A	(0.13)A	(0.49)A	0.95A
2010	1.51A	(0.06)A	(0.64)A	1.10A
Prev.				1.16E
2011	1.77E	(0.13)E	(0.72)E	1.10E
Prev.		(0.12)E	(0.71)E	1.09E

Annual Div.: Dividends for 2011 do not include the $3./share special dividend declared in March 2011.

All values in CAD unless otherwise noted.

PRICE TARGET REVISION | COMMENT

MARCH 7, 2011

Pacific Northern Gas Ltd. (TSX: PNG)

Looking for Additional Clarity on the Strategy

Sector Perform
Average Risk

Price:	28.00	**Price Target:**	30.00 ↓ 33.00
		Implied All-In Return:	11%
Shares O/S (MM):	3.6	**Market Cap (MM):**	101
Dividend:	1.20	**Yield:**	4.3%

Large Holder: 15% interest

Event

Pacific Northern Gas (PNG) reported Q4/10 results; special dividend of $3/share results in reduced price target of $30/share.

Investment Opinion

- **Looking for More Clarity on the Strategy.** Although the stock appears to represent some value, we remain neutral on the shares pending clarity on the strategy. For a small company that was looking to grow, we were surprised by the size of the special dividend.
- **What to Do with the Stock?** At current levels, we would hold the stock, at least until the $3/share special dividend is paid. If there is weakness in the share price due to a recycling of the shareholder base, income-oriented investors should consider adding to positions.
- **$3/Share Special Dividend Represents Roughly Half of the First Payment from the KSL Sale.** PNG announced that it would make a $3/share special dividend payment on March 24, 2011 (March 15, 2011 record date) in addition to the regular $0.30/share quarterly dividend. The $11 million special dividend payment represents roughly half of the net proceeds from the initial payment from the KSL sale after taxes and transaction costs. Should the Kitimat LNG project move forward, PNG will receive another $20 million (pre-tax) in cash from the buyers.
- **Q4/10 Results In-Line.** Q4/10 EPS was $1.10 compared to our estimate of $1.16 and $0.95 in Q4/09. The per share comparison is magnified by the small share count, with reported Q4/10 net income of $3.9 million comparing with our estimate of $4.2 million.
- **2012 Estimate Modestly Increased.** For 2012, we have modestly bumped up our EPS estimate to $2.09 (from $2.06) to reflect lower net interest expense, partially offset by higher depreciation. For clarity, our estimates do not factor in any acquisitions.
- **Valuation: Price Target Reduced to $30/share (from $33.00) to Reflect the $3/share Special Dividend.** Our price target continues to be based on a 12.5x forward P/E for the existing assets, but our previous $33/share target is reduced by the $3/share special dividend payment.

Priced as of prior trading day's market close, EST (unless otherwise noted).

For Required Non-U.S. Analyst and Conflicts Disclosures, see page 5.

Looking for Clarity on the Strategy

During the conference call to discuss the KSL sale on February 7, 2011, management stated that the board was reviewing a number of options for the proceeds, which has resulted in the special dividend of $3/share representing about half of the net proceeds that have been received. In terms of the remaining proceeds, we expect growth projects/acquisitions to be the likely use of the funds although no transactions appear to be imminent. There continues to be a lot of optimism with respect to the potential for LNG exports from B.C.'s northern coast. Upside for shareholders could be driven by the Kitimat LNG facility proceeding (which would result in an incremental $20 million payment to the company) in addition to the potential for other LNG projects that could possibly drive a new pipeline. Following the conference call in February, it was clarified that the sale of the company was not being contemplated. On that topic, the acquisition of utility businesses can be tricky as regulators usually ensure that most synergies are for the benefit of rate payers and often acquired businesses are subject to ring-fencing, which could limit financial structuring of a transaction.

Q4/10 Results in Line with Expectations

Q4/10 EPS was $1.10 compared to our estimate of $1.16 and $0.95 in Q4/09. The per share comparison is magnified by the small share count, with reported Q4/10 net income of $3.9 million comparing with our estimate of $4.2 million. A table showing the Q4/10 results compared to our estimate is set out in Exhibit 1.

Exhibit 1: Q4/10 Results (In $MM except per share figures)

	Q4/10	RBC CM Q4/10E	Q4/09	2010E	2009	Comments
Gas Sales and Transportation Services	$14.8	$15.3	$12.8	$47.2	$40.5	Offset by higher Other margin
Hydro	0.5	0.5	0.0	1.3	0.0	
Other	0.7	0.3	1.2	2.5	6.4	Offset by lower Gas Sales & Transportation margin
Total Operating Margin	16.0	16.1	13.9	51.1	46.9	
Operating and Maintenance	(3.4)	(3.1)	(3.0)	(12.6)	(12.3)	Higher-than-expected maintenance activities
General & Administrative	(2.3)	(2.0)	(1.8)	(9.0)	(7.3)	Restructuring costs related to tax structuring (offset by cash tax recoveries)
Municipal and Other Taxes	(1.2)	(1.2)	(1.1)	(4.8)	(4.6)	
Investment and Other Income	0.0	0.0	0.0	0.0	0.0	
EBITDA	9.1	9.8	7.9	24.7	22.7	
Depreciation and Amortization	(2.3)	(2.2)	(2.1)	(8.8)	(8.1)	
Interest Expense, Net	(1.7)	(1.6)	(1.4)	(6.4)	(5.6)	
Project Development Expenditures	(0.0)	(0.0)	(0.1)	(0.6)	(0.2)	
Current Taxes	(1.8)	(2.8)	(0.4)	(0.2)	(2.2)	Related to the restructuring costs booked in G&A
Future Taxes	0.7	1.1	(0.6)	(1.6)	(0.1)	
Non-Controlling Interest	(0.0)	(0.0)	0.0	0.0	0.0	
Net Income	4.0	4.3	3.4	7.1	6.5	
Less: Dividends on Preferred Shares	(0.1)	(0.1)	(0.1)	(0.3)	(0.3)	
Net Income to Common	**$3.9**	**$4.2**	**$3.4**	**$6.8**	**$6.2**	
Average Shares (Diluted)	3.7	3.7	3.6	3.7	3.6	
Normalized EPS (Basic)	**$1.10**	**$1.16**	**$0.95**	**$1.88**	**$1.72**	
Normalized EPS (Diluted)	**$1.06**	**$1.13**	**$0.93**	**$1.83**	**$1.71**	

Source: Company reports; RBC Capital Markets estimates

Estimate Changes

Our 2011 EPS estimate remains unchanged with lower net interest expense due to the remaining KSL proceeds offsetting higher assumed depreciation. For 2012, we have modestly bumped up our EPS estimate to $2.09 (from $2.06) to reflect lower net interest expense, partially offset by higher depreciation. For clarity, our estimates do not factor in any acquisitions and are normalized for the KSL sale. Our revised financial forecast is set out in Exhibit 2.

Exhibit 2: Financial Forecast (In $MM except per share figures)

	2009	2010	Q1/11E	Q2/11E	Q3/11E	Q4/11E	2011E	2012E	Old 2011E	Old 2012E
Gas Sales and Transportation Services	$40.5	$47.2	$17.9	$8.5	$6.1	$14.6	$47.1	$47.7	*$47.1*	*$47.7*
Hydro	0.0	1.3	0.5	0.7	0.2	0.5	2.0	2.0	*2.0*	*2.0*
Other	6.4	2.5	0.6	0.6	0.6	0.6	2.2	2.2	*2.2*	*2.2*
Total Operating Margin	46.9	51.1	18.9	9.8	6.9	15.7	51.3	51.9	*51.3*	*51.9*
Operating and Maintenance	(12.3)	(12.6)	(3.2)	(3.2)	(3.2)	(3.2)	(13.0)	(13.2)	*(13.0)*	*(13.2)*
General & Administrative	(7.3)	(9.0)	(2.0)	(2.0)	(2.0)	(2.0)	(8.0)	(8.0)	*(8.0)*	*(8.0)*
Municipal and Other Taxes	(4.6)	(4.8)	(1.2)	(1.2)	(1.2)	(1.2)	(4.9)	(5.0)	*(4.9)*	*(5.0)*
Investment and Other Income	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	*0.0*	*0.0*
EBITDA	22.7	24.7	12.5	3.3	0.4	9.2	25.4	25.8	*25.4*	*25.8*
Depreciation and Amortization	(8.1)	(8.8)	(2.3)	(2.3)	(2.3)	(2.3)	(9.0)	(9.0)	*(8.7)*	*(8.7)*
Interest Expense, Net	(5.6)	(6.4)	(1.6)	(1.5)	(1.5)	(1.5)	(6.2)	(6.1)	*(6.4)*	*(6.4)*
Project Development Expenditures	(0.2)	(0.6)	0.0	0.0	0.0	0.0	0.0	0.0	*0.0*	*0.0*
Current Taxes	(2.2)	(0.2)	(0.9)	0.1	0.3	(0.5)	(1.0)	(1.1)	*(1.3)*	*(1.3)*
Future Taxes	(0.1)	(1.6)	(1.3)	0.1	0.5	(0.8)	(1.5)	(1.6)	*(1.3)*	*(1.3)*
Non-Controlling Interest	0.0	0.0	0.0	(0.0)	0.0	0.0	0.0	0.0	*0.0*	*0.0*
Net Income	6.5	7.1	6.5	(0.4)	(2.5)	4.1	7.7	8.0	*7.7*	*8.0*
Less: Dividends on Preferred Shares	(0.3)	(0.3)	(0.1)	(0.1)	(0.1)	(0.1)	(0.3)	(0.3)	*(0.3)*	*(0.3)*
Net Income to Common	**$6.2**	**$6.8**	**$6.4**	**($0.5)**	**($2.6)**	**$4.0**	**$7.3**	**$7.6**	***$7.4***	***$7.7***
Average Shares (Diluted)	3.6	3.7	3.7	3.6	3.6	3.7	3.7	3.7	*3.8*	*3.8*
Normalized EPS (Basic)	**$1.72**	**$1.88**	$1.77	($0.13)	($0.72)	$1.10	**$2.02**	**$2.09**	***$2.02***	***$2.06***
Normalized EPS (Diluted)	**$1.71**	**$1.83**	$1.72	($0.13)	($0.72)	$1.07	**$1.96**	**$2.03**	***$1.97***	***$2.01***

Source: Company reports; RBC Capital Markets estimates

Valuation

Our $30.00/share price target is based on a 12.5x forward P/E for the existing assets plus a $2/share value for the up front payment for the KSL Project sale (net of the $3/share special dividend payment) and about $2/share (50% risked) for the payment contingent upon the KSL project going forward. The 12.5x multiple used in our valuation is a discount to the other Canadian regulated utility companies that we cover. We believe a discount is reasonable given small size of the company, the low trading liquidity, and the mature utility assets that have very modest organic growth potential.

Price Target Impediment

Impediments to our price target include the KSL project proceeding on previously guided timelines (i.e., the receipt of the remaining $20 million payment), regulatory decisions, the economy in the company's service territories, investments or acquisitions that fail to gain the confidence of investors, and the level of long-term interest rates.

Company Description

Pacific Northern Gas owns and operates two systems: the Western system, which is a regulated natural gas transmission and distribution utility operating within the west-central portion of northern B.C.; and the Northeast system, which is a regulated gas distribution utility in northeast B.C. Collectively operating over 3,500 kilometres of transmission and distribution pipeline, the company serves residential, commercial and industrial customers in the two resource-based areas. In addition to the regulated utility business, the company owns a 9.8 MW run-of-river hydro plant. PNG is focused on enhancing value from its regulated business and evaluating other opportunities.

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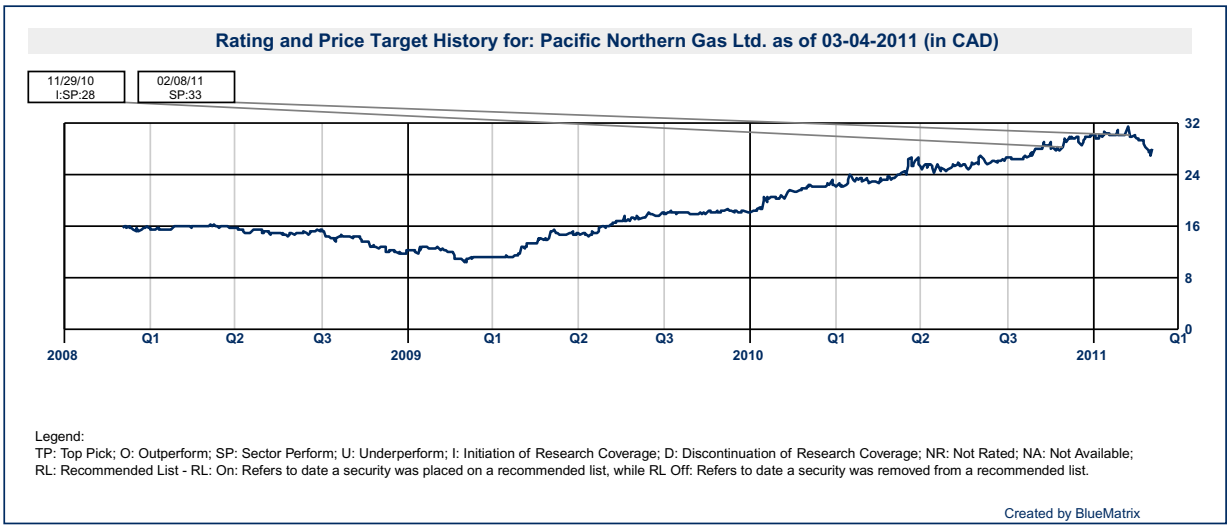
HOLD[SP]	594	43.80	133	22.39
SELL[U]	63	4.60	10	15.87



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