

NW Natural reports strong results for quarter, 2006

by Bend_Weekly_News_Sources

Fourth Quarter & Full-Year Financial & Operating Highlights

Achieved 2006 earnings per share of \$2.29 on net income of \$63.4 million, a 9 percent increase over 2005
Realized fourth quarter net income of \$30.1 million or \$1.09 per share, up 17 percent from fourth quarter results in 2005

Produced cash flow from operations in 2006 of \$149 million, which resulted in positive free cash flow for the year

Improved overall customer service rating to 3rd best gas utility in the nation, including 1st nationally for customer ease and satisfaction with billing and payment

Increased the quarterly dividend by 3 percent in October 2006, achieving 51 consecutive years of increasing dividends paid to shareholders

Achieved customer growth of over 3 percent, or twice the national average, for 20 consecutive years

Established earnings guidance for 2007 of \$2.30-\$2.45 per share, an 8 percent increase over 2006 guidance

Company credit rating was upgraded to AA-, and the company's commercial paper rating was raised to A-1 by Standard & Poors

Continued to study and evaluate the development of a new natural gas transmission pipeline in Oregon

Recognized as one of America's 100 Best Corporate Citizens for the seventh year in a row

Northwest Natural Gas Company today reported net income for the 12 months ended Dec. 31, 2006 of \$63.4 million, or \$2.29 per share, a 9 percent increase for the year, compared to \$58.1 million, or \$2.11 per share, in 2005. Results were driven by continued strong customer growth, which helped produce margin (net operating revenues) of \$340.2 million on \$1.0 billion of sales, gas commodity savings and continued cost controls.

Earnings for the fourth quarter of 2006 were \$30.1 million, compared to net income of \$25.8 million in the fourth quarter of 2005. Earnings per share in the quarter increased by 17 percent to \$1.09 per share, compared to 93 cents per share in the same quarter of 2005.

According to Mark Dodson, president and chief executive officer, "We achieved excellent results in 2006 during a time of volatile gas prices, while making important operational enhancements inside our company. In large part, our results were driven by continued customer growth, cost controls and our purchased gas adjustment mechanism, which allows savings in our gas buying to be shared between customers and shareholders.

"I am very proud of our employees, who remained focused on providing excellent customer service as evidenced by this year's J.D. Power & Associates residential customer survey, where we ranked third in the nation among gas utilities and second in the West for overall customer satisfaction, and first in the nation for customer ease and satisfaction with billing and payment."

Fourth quarter financial and operating highlights

Net income and earnings per share rise 17 percent

Results of operations produced net income for the quarter of \$30.1 million (\$1.09 per share), compared to net income of \$25.8 million (93 cents per share) in 2005. The company's utility operations contributed earnings of \$28.4 million (\$1.03 per share), compared to \$24.4 million (88 cents per share) last year. Gas storage contributed net income of \$1.2 million (4 cents per share) in the fourth quarters of 2006 and 2005. Other non-utility activities resulted in net income of \$0.5 million (2 cents per share) in the quarter, including a \$0.4 million net gain from real estate sales, compared to net income of \$0.2 million in 2005 (1 cent per share). Fourth quarter 2005 results reflected a pre-tax charge of \$2.8 million related to a billing dispute with a number of industrial customers.

Customer growth remains twice the national average

NW Natural's customer growth continued at a rate more than double the national average and exceeded 3 percent for the 20th consecutive year. Growth in the company's service territory is driven by single- and multi-family new construction, as well as conversions of existing homes to natural gas from other fuel sources. Gas sales to residential and commercial customers produced 88 percent of the company's 2006 utility margin. At Dec. 31, 2006, the company had 636,584 customers, for a growth rate of 3.1 percent over the past 12 months.

Operational results remain on target

NW Natural's total gas sales and transportation deliveries in the fourth quarter of 2006, excluding deliveries of gas stored for others, were 369 million therms compared to 367 million therms in the same 2005 period. The increase was due mainly to customer growth, offset by slightly warmer weather. Margin from utility operations in the period was \$108.8 million, up from \$101.9 million in 2005, due primarily to customer growth and commodity cost savings, somewhat offset by a \$2.9 million temporary mark to market charge.

Volumes sold to residential and commercial customers in the fourth quarter of 2006 were 221 million therms, slightly lower than last year's 223 million therms, primarily due to weather that was 2 percent warmer than last year and 1 percent warmer than average. Residential and commercial sales contributed \$99.4 million to margin, up 6.4 percent from \$93.4 million in 2005. The company's weather and decoupling mechanisms in Oregon recovered a net \$0.4 million to margin in the quarter compared to a margin refund of \$2.9 million in 2005.

Gas deliveries to industrial customers in the fourth quarter were 148 million therms, up 2.3 percent from 144

million therms last year, and margin in the sector increased by \$1.5 million in 2006 to \$8.5 million.

NW Natural continues to provide gas storage services to customers in the interstate and intrastate gas market. Earnings from the company's gas storage segment in the fourth quarters of 2006 and 2005 were \$1.2 million, or 4 cents per share. These results include income from the optimization of our assets by an independent third party, primarily through the use of commodity and capacity release transactions.

NW Natural has an annual Purchased Gas Adjustment (PGA) tariff in Oregon and Washington that reflects projected gas costs in customer rates. In Oregon, the company absorbs 33 percent of any excess cost of gas, or retains 33 percent of any gas cost savings, both as compared to the projected gas commodity prices built into rates. The company also retains 33 percent of the margin when it sells surplus gas commodity off-system, and credits 67 percent to customers. In Washington, 100 percent of all gas costs are passed through to customers.

In October 2006, the Oregon Public Utility Commission (OPUC) approved a modification to the company's PGA tariff, effective Nov. 1, 2006, which provides for a comparison of actual gas cost recovery included in revenues to actual gas purchase costs incurred, instead of using estimated expenses versus actual costs incurred. Consistent with the company's prior PGA sharing mechanism, 67 percent of any cost differences in Oregon will be deferred for refund or recovery in customer rates in subsequent periods. The change in the PGA renewal date was also moved from Oct. 1 to Nov. 1. As a consequence of the change in renewal date, the company's weather normalization mechanism in Oregon was modified to begin on Dec. 1, and the company's decoupling mechanism was modified to provide complete coverage through Nov. 30, which provides Oregon customers and the company better protection from the effects of usage differences in October and November.

Operations and maintenance expenses in the fourth quarter of 2006 decreased about 1 percent from last year. The decrease resulted primarily from ongoing cost control initiatives, as well as the charge related to the industrial customer settlement in the fourth quarter of 2005, partially offset by higher payroll-related expenses and severance costs.

As reported in August 2006, the company expected implementation of its new operational redesign to result in employee reductions, mainly through attrition and voluntary incentive programs offered to employees. As a result, the company incurred severance costs in the fourth quarter of 2006 of approximately \$1.9 million related to workforce reductions of approximately 80 employees as part of the organizational redesign. These costs were offset by expense reductions, gains from gas commodity savings and gains from sales of various non-core assets. The company had 1,211 employees at Dec. 31, 2006.

Full-year (12 months) financial and operating highlights

Net income and earnings per share increase 9 percent

For the 12-month-period ended Dec. 31, 2006, net income increased 9 percent to \$63.4 million, or \$2.29 per share, compared to \$58.1 million, or \$2.11 per share, in 2005. Utility operations contributed \$56.7 million in earnings or \$2.05 per share, in 2006, compared to \$52.8 million or \$1.91 per share, in 2005. Gas storage contributed \$6.0 million for the year, or 21 cents per share, compared to \$4.5 million, or 17 cents per share, in 2005. Other non-utility activities resulted in net income of \$0.8 million, or 3 cents per share, in both 2006 and 2005.

Operating results reflect strong customer growth and higher volumes

NW Natural's total gas sales and transportation deliveries in 2006, excluding deliveries of gas stored for others, were 1.19 billion therms, up 3 percent from 2005, due primarily to strong customer growth.

Gas sales to residential and commercial customers in 2006 were 625 million therms, up from 606 million therms in 2005, despite weather that was 4 percent warmer than average and 2 percent warmer than last year.

Residential and commercial sales contributed \$288.3 million to margin, up 5 percent from \$274.0 million in 2005, due mainly to customer growth and commodity savings from the PGA incentive sharing. The company's weather normalization and decoupling mechanisms reduced margin by \$0.3 million for 2006. This compares to a combined margin recovery of \$1.6 million from these mechanisms in 2005.

Gas deliveries to industrial sales and transportation customers in 2006 were 567.3 million therms, up about 3 percent from the same period last year. The contribution to margin from these customers was \$32.4 million, up about 2 percent from last year.

Operations and maintenance expenses for the full-year increased less than 1 percent, compared to an 11 percent increase in 2005. The lower rate of expense increase in 2006 was largely due to cost control initiatives, as well as the charge related to the industrial customer settlement in 2005. Bad debt expense as a percent of revenues billed remained well below 1 percent at 0.30 percent for the 12 months ended Dec. 31, 2006.

For the year, Oregon customers saved \$16.4 million in lower gas costs due to the company's commodity cost sharing mechanisms. NW Natural's share of the commodity savings and off-system sales in 2006 contributed \$8.1 million to margin for the year, equivalent to 18 cents per share of earnings. Last year these factors contributed \$4.3 million of margin to the company, equivalent to 9 cents per share of earnings.

Cash flows, credit ratings & capital structure

Cash provided by operations in 2006 was \$148.6 million, compared to \$79.1 million in 2005 that included a \$31 million cash contribution to the company's pension plan in the year. Cash flows reflect the improved results for the quarter and full year. For the first time in many years, NW Natural produced free cash flow (cash provided by operating activities less cash used in investing activities less common dividends paid) of \$19.7 million in 2006.

NW Natural's capitalization at Dec. 31, 2006, reflected 48 percent common equity, 42 percent long-term debt, and 10 percent short-term debt, compared to 47 percent common equity, 42 percent long-term debt, and 11 percent short-term debt at Dec. 31, 2005.

During the year, the company purchased 395,500 shares of common stock as part of the company's authorized repurchase program, and had a total of 27.3 million shares of common stock outstanding at the end of 2006. Since the program's inception in 2000, the company has repurchased 1.2 million shares at a total cost of \$39.1 million, out of the authorized level of 2.6 million shares or \$85 million.

On February 28, 2006, Standard & Poor's raised the credit ratings on the company's senior secured long-term debt to AA- from A and our senior unsecured long-term debt to A from A- . S&P also raised the credit ratings on commercial paper to A-1 from A-1 . Standard & Poor's also reconfirmed the company's business risk profile of 1 their lowest risk profile rating. Moody's currently rates the company's senior secured long-term debt A2, senior unsecured long-term debt A3 and commercial paper P-1. Both agencies have assigned a stable ratings outlook.

Other developments

J.D. Power ranks NW Natural in top tier for customer service

NW Natural placed third in a national residential customer satisfaction survey conducted by J.D. Power and Associates in 2006, which was an increase from fifth-best the year before. The company rated second-best in the western region for overall customer service and ranked first in the nation for customer ease and satisfaction with billing and payment. The survey was based on 12,000 telephone interviews with customers of the nation's top 56 natural gas utilities.

Proposed construction of new Oregon pipeline with TransCanada's Gas Transmission Northwest (GTN) system

NW Natural and TransCanada Corporation's GTN are continuing to study and evaluate customer interest in a proposed transmission pipeline that would connect GTN's interstate gas line near Madras, Oregon, to NW Natural's high-pressure system near Molalla, Ore., southeast of Portland, and to other NW Natural facilities in northwest Oregon. A decision regarding whether or not to proceed with the development of the project is expected to be made later in this year. If constructed, commercial operation of the pipeline could commence by late 2011.

NW Natural ranked #37 on list of "100 Best Corporate Citizens" in America

For the seventh year in a row, NW Natural has been named to the "100 Best Corporate Citizens" list, first developed by Business Ethics magazine. The ranking is issued by The CRO (Corporate Responsibility Officer) organization and included a third-party review of more than 1,100 public companies, who were rated on their financial performance over the past three years, as well as various measures of corporate social performance. NW Natural is the highest ranked utility or energy company on the list.

Outlook for 2007

The company's 2007 outlook assumes normal weather conditions, continued strong customer growth, ongoing benefits from improvements to our cost structure, and no significant changes in prevailing regulatory policies. The company also does not forecast gains (or losses) that may occur from the company's commodity cost sharing mechanisms.

NW Natural expects full-year earnings per share to be within the range of \$2.30-\$2.45, an approximate 8 percent increase over 2006 EPS guidance. The company continues to target long-term earnings per share growth of 5 percent or more and to maintain a dividend payout ratio of 60 to 70 percent of earnings.

Senior Vice President and Chief Financial Officer David Anderson said, "While encouraged with our results in 2006, including being free cash flow positive for the first time in many years, we continue to take actions to ensure our financial condition remains strong in 2007 and into the future. The operational changes now underway are focused on keeping cost increases below customer growth levels and making improvements to our entire organizational design. In addition to operational changes, we remain focused on maintaining strong investment grade credit ratings, which currently are at A or above. We have had a good start to 2007 given the benefit of our commodity sharing mechanism in Oregon as well as expected cost savings from our operational redesign, and colder than average weather in January."

Dividend Declaration

On Jan. 4, 2007, the company declared a quarterly dividend of 35.5 cents per share, payable Feb. 15, 2007, to shareholders of record on Jan. 31, 2007. The annual indicated dividend rate is \$1.42 per share. The company modified its dividend policy in October 2006 to include annual increases, raising the dividend 3 percent at that time and 9 percent over the past two years.

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