

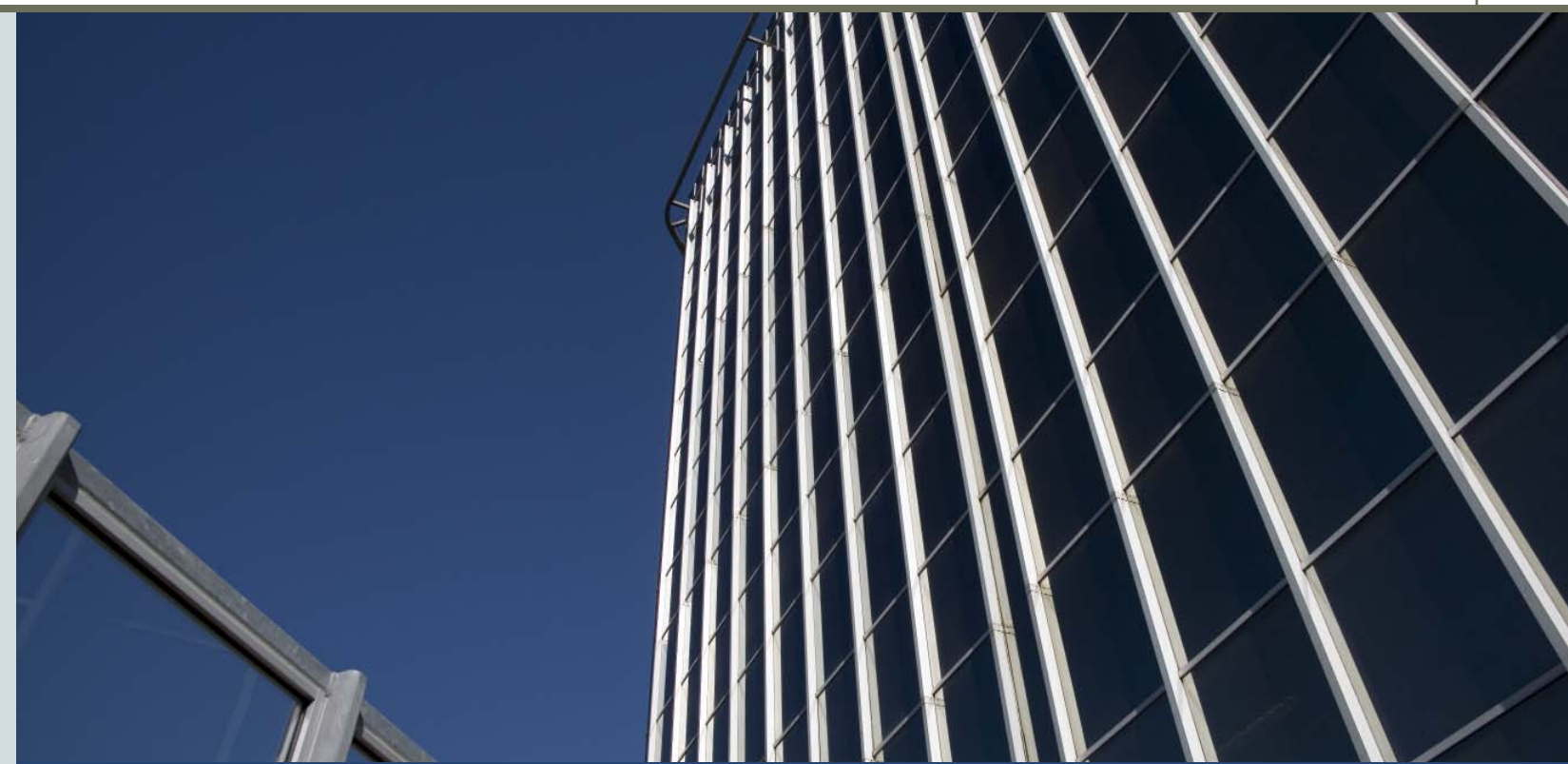
 **NW Natural**[®]
220 NW Second Avenue
Portland, Oregon 97209
nwnatural.com

STRONGER

by design

Mount Hood serves as a backdrop for new residential developments in the cities of Gresham and Damascus near Portland. The fast-growing area is a key growth opportunity for NW Natural.

 **NW Natural**[®]
2006 ANNUAL REPORT



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President & Chief Executive Officer,
Mark S. Dodson

Letter to Shareholders

Last year in my letter to shareholders I wrote that, after a strong financial performance in 2005, NW Natural had no intention of resting on its laurels. We were more determined than ever to improve our core operations and better position the company for the future.

I am pleased to report that in 2006 NW Natural delivered solidly on this commitment. It was a year in which we shifted our thinking about fundamental processes, introduced key operational improvements and successfully managed important external challenges.

In the end, we realigned our operations, and still – through the focus, discipline and hard work of our employees – provided excellent customer service and a 29 percent total shareholder return. We met our pledge to make NW Natural stronger by design and those efforts are already producing results.

Highlights

In 2006, NW Natural:

- Earned \$2.29 per share, a 9 percent increase over 2005;
- Produced a total shareholder return of 29 percent;
- Marked the 51st consecutive year of increasing dividends paid;
- Added 19,421 customers, growing by more than 3 percent – twice the national average – for the 20th consecutive year;
- Rose to third highest for customer satisfaction among the nation's 56 gas utilities and first in billing and payment services, according to the latest J.D. Power & Associates survey;
- Had its corporate credit rating upgraded to AA- and commercial paper rating to A-1+ by Standard & Poor's;
- Continued to expand the Mist underground gas storage facility;
- Joined with TransCanada to explore the feasibility of building a new transmission pipeline in Oregon;
- Held operating and maintenance (O&M) expenses to a 1 percent increase over 2005 levels; and
- Was recognized as one of America's top 100 corporate citizens for the sixth consecutive year.

An Outstanding Year

In 2006, NW Natural delivered excellent financial results and took important steps to enhance its operational efficiency. Earnings were \$2.29 per share, a 9 percent increase over last year. Revenues exceeded \$1 billion resulting in net operating revenues of \$340 million – both the highest in company history. Earnings and cash provided by operations also reached record levels. These solid results also allowed the company to produce free cash flow (cash from operations less capital expenditures and common dividends) for the first time in many years.

Total shareholder return was 29 percent. The share price increased by 24 percent, from \$34.18 to \$42.44, and shareholders enjoyed the 51st consecutive year of increasing dividends paid.

Strong customer growth continued to drive earnings. NW Natural again added customers at a pace more than double the national average. Many companies talk about growth, but what makes NW Natural stand out is its ability to bring that growth to the bottom line while still providing exceptional customer service. The latest J.D. Power survey is strong proof. This year NW Natural rose to third in the nation (second in the West) in overall customer satisfaction and was ranked number one in billing and payment services.

Last year there was solid evidence of our strong balance sheet and sharp focus on cost management. Standard & Poor's upgraded both our long- and short-term credit ratings. And last year we held O&M expenditures to a 1 percent increase over 2005 levels, meeting our objective to keep annual cost increases below the customer growth rate.

What makes NW Natural stand out is its ability to bring growth to the bottom line while still providing exceptional customer service. The latest J.D. Power survey is strong proof. NW Natural rose to third in the nation in customer satisfaction.

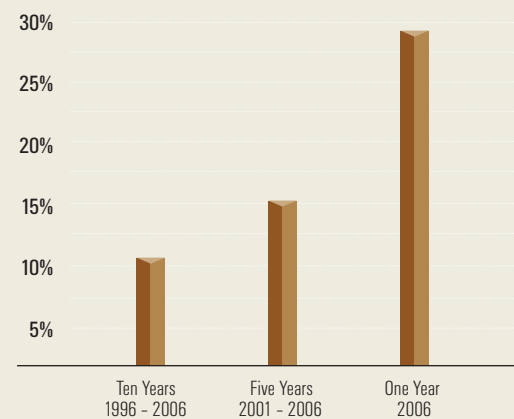
NW Natural kept another important commitment in 2006. We took key steps to leverage our expertise and grow the company in ways that complement and benefit our core business. First, we completed another phase in the development of our Mist underground gas storage facility, expanding its capacity to serve the interstate market. This segment continues to deliver excellent results. Gas storage revenues last year increased by 33 percent and contributed 21 cents per share to earnings.

On another front, we partnered with TransCanada to explore the feasibility of constructing a new pipeline across Oregon. If built, the Palomar pipeline will increase the reliability of the region's gas infrastructure and could be extended to serve any liquefied natural gas terminal that may be built on the Columbia River. We see the pipeline as an important new link in the transmission system serving our customers, one that offers NW Natural a new avenue for earnings growth.

Designing Around the Core

Though we've continued to deliver excellent results in the face of volatile gas prices, we know that higher gas costs are hard on customers. As a utility we can't control commodity prices, but we do have an obligation to customers and shareholders to manage capital and operating costs. That means accepting nothing less than operational excellence in every part of our business. Last year, we made significant progress toward that goal.

Total Shareholder Return ANNUALIZED AS A PERCENT



The company's annualized total return (dividends plus stock appreciation) was 28.91 percent in 2006, 15.42 percent over the past five years, and 10.83 percent over 10 years.

In our drive to improve, we started the year by benchmarking our operational practices against other high-performing peer utilities. NW Natural is good at many things, but we also knew others were doing some things better. In evaluating our operating model and comparing best practices, we confirmed that NW Natural's core business is defined by three key processes: acquiring customers, serving customers and delivering gas. Our review examined in detail how specific functions are interrelated and could be performed more efficiently.

Redesigning our operations was not simply about cost cutting, nor asking people to do more with less. Budgets can be cut to meet short-term goals, but that by itself is seldom effective over the long term. What we needed was a better way to deliver services – a model that would position NW Natural to be competitive in the marketplace in the years ahead, provide the greatest value possible to customers, and deliver the stability and growth shareholders expect. I believe our redesign delivers on all counts, and the results of 2006 are the first indications of our progress.

Redesigning our operations around core processes better aligns accountabilities, creates greater centralization and ensures increased standardization – all of which lead to greater efficiency. Using our resources and personnel more efficiently

means significant changes in such areas as new construction, where we will outsource work to contractors to a greater degree over the next few years. Our own crews will continue to perform construction work that requires more customization and other special needs.

Over the next several years, our restructuring should allow us to reduce the number of positions at NW Natural by about 15 percent. We believe we can achieve this reduction largely through attrition and a voluntary severance program.

None of this has been easy, but we're a company that believes in shaping its own future, and in the long term that serves the best interests of our employees as well as customers and shareholders. We pledged from the start to communicate changes openly, clearly and respectfully – and we have.

Challenges and Opportunities Ahead

Our new model will better position NW Natural to face the challenges and opportunities ahead. Given the ongoing tight balance between supply and demand, we expect natural gas prices to remain an issue in the near term. But we have continued to help mitigate volatility by adapting our gas purchasing and hedging strategies to respond to market fluctuations.

For example, our Mist storage facilities and our gas purchasing strategies allowed us to take advantage of falling prices at summer's end, locking in a substantial portion of our gas supplies at lower prices. The move captured millions in savings, allowed us to cut projected customer rate increases in half and – under Oregon's purchased-gas adjustment incentives – delivered one-third of the savings to our bottom line.

Sometimes challenges can provide new opportunities. As long as price volatility continues, gas storage and pipeline infrastructure expansion become even more highly valued. That's part of our incentive to further grow underground gas storage capacity at Mist. It's also why we're exploring the opportunity with TransCanada to build the proposed Palomar pipeline.

Increasingly, global warming is taking center stage as a key challenge for our industry. Even before last year's change in control of Congress, new legislation regulating greenhouse gases was receiving serious consideration. Now the drive to reduce emissions will likely increase.

On this issue we have not been bystanders; we've already taken steps to embrace the challenge. In 2004, I was appointed co-chair of Oregon's Global Warming Task Force. I also currently chair the American Gas Association's Committee on Climate Change. And as a company, we have begun to position ourselves for coming changes.

Five years ago we began to address the challenges of a carbon-constrained world by introducing the Conservation Tariff. Its immediate purpose was to break the link between our earnings and gas usage. It effectively put shareholders on the same side of the table as customers, paving the way for us to aggressively promote conservation. It worked. Customers have used less natural gas without harming the company financially. A recognized success, it was renewed by Oregon regulators and has been emulated by utilities in at least 11 other states.

In the future, you will see NW Natural bring a sustainability focus to its own operations, promote direct use of natural gas and combined heat and power, and continue to help our customers use our product with greater efficiency.

Last year we took another important step in our efforts to address growing environmental concerns by creating an office of environmental policy and sustainability, a rarity among gas utilities. The new director, Bill Edmonds, will help focus and guide our efforts to reduce our company's environmental footprint and meet the expectations of our environmentally conscious customer base. In the future, you will see NW Natural bring a sustainability focus to its own operations, promote direct use of natural gas and combined heat and power, and continue to help our customers use our product with greater efficiency.

Looking to the Future

Making fundamental shifts in the operating model of a 148-year-old company is a complex task, one that requires extensive knowledge of the company, its operations and its people.

Fortunately, we were able to take advantage of the experience of our Executive Vice President, Mike McCoy, before he retired at the end of 2006. Mike devoted 37 years of his professional life to NW Natural, helped to mentor a new generation of company leaders, and in his final assignment, played a central role in redesigning our operations.

With the implementation of our new operating model, the board approved several executive promotions. In December, Gregg Kantor, Senior Vice President for Public and Regulatory Affairs, was named Executive Vice President. Gregg will now help coordinate the work of the officer team in addition to his other assignments.

The board also made three other appointments. Grant Yoshihara was promoted to Vice President of Utility Operations, Dave Williams became our Vice President of Utility Services, and Keith White will serve as Vice President of Business Development and Energy Supply. These four executives represent more than 70 years of combined operations and leadership experience at NW Natural and are well qualified, along with the other members of the executive team, to lead our company into the future.

While the passing of 2006 added depth to our executive team, the year also, sadly, marked the passage of two respected leaders and friends. Dick Woolworth, our Chairman of the Board, passed away in August. Wayne Kuni, who retired from the board in 2003 after 23 years of service, passed away in February. Both were outstanding directors who contributed much to the company's success. We will miss their wisdom and experience.

Finally, I would be remiss if I didn't finish this letter by underscoring that last year's outstanding performance was without question the product of great employees. During a year of tough changes, they remained focused on the job at hand, displaying the discipline and dedication of a world-class work force. Month after month they executed on our business plan and, at the same time, helped implement changes to make NW Natural a stronger company for the long haul. They deserve enormous credit.

Going forward, we realize that becoming stronger by design is a process, not an event – a journey, not a destination. We will continue to adapt our operations to meet the challenges ahead and to fulfill our commitment to delivering the greatest possible value to our customers, and to you, our shareholders.

Thank you for your continuing investment in NW Natural.

Sincerely,

Mark S. Dodson
President & Chief Executive Officer



Five key managers oversaw the plan to redesign NW Natural's operations model. Left, Grace Merchant, Manager of Organizational Development, Charlie Stinson, Director of Project Development, and Grant Yoshihara, Vice President of Utility Operations confer about the new model's implementation. Right, Lea Anne Doolittle, Vice President of Human Resources, and Dave Williams, Vice President of Utility Services, also helped to develop the plan.

Q & A: Redesigning our PROCESSES

Changing NW Natural's operating model and beginning to shift the culture of a 148-year-old company was a complex process that took more than a year of study, planning, and decision making. NW Natural's management team knew the goal: realign company operations for greater efficiency to keep costs down and strengthen the company for the future. To draw up plans for change, NW Natural benchmarked its own model against high-performing peer utilities to glean ideas for best practices. Out of that exercise emerged a blueprint – dozens of improvements designed to support greater efficiency and enhance customer service.

Five key managers at NW Natural led the effort – Dave Williams, Vice President of Utility Services; Grant Yoshihara, Vice President of Utility Operations; Charlie Stinson, Director of Project Development; and Grace Merchant, Manager of Organizational Development. At the same time, Lea Anne Doolittle, Vice President of Human Resources, coordinated an efficiency review of the company's corporate functions. Improvements were identified and combined with the operational changes. Here are some excerpts from a recent discussion about the "ops model review."

NW Natural has been performing well and producing excellent results. Why change its operating model now?

Williams: Even though NW Natural has been disciplined about costs, when we looked farther down the road, our analysis showed we needed to become even more efficient. Some costs, such as health care, pensions and insurance were increasing faster than our customer growth rate. That trend couldn't be sustained – not if we wanted to continue to produce the kind of returns that shareholders expect or the level of service that customers need.

Yoshihara: Since 2000, the industry has gone through a series of gas price increases and it hurt our customers. We don't control gas prices but we are obligated to do what we can to avoid putting further costs on the backs of our customers. It was time to take a hard look within and evaluate what we could do to control costs even more. To some degree, we can mitigate gas price volatility in the marketplace with effective purchasing and hedging strategies, but we also need to achieve still greater operational excellence.



"Our reorganization has focused NW Natural on three core areas – acquiring customers, serving customers and delivering gas. We are putting our renewed focus into action with dozens of initiatives that drive these ideas into daily operations."

– Lori Russell, Process Director – Project Implementation

What did your benchmarking against other companies show?

Williams: As expected, NW Natural fundamentally operates very well, but in some areas, other companies had developed better practices. We used the data to take a fresh look at all our practices. We picked up different ideas and structures as we went along and adapted the best of them to fit our specific needs.

Merchant: It gave us an opportunity to step back and look at things differently. Seeing other companies' best practices at work gave us great ideas for improvements in our own operations.

Doolittle: Benchmarking gave us license to re-examine all our basic processes and realign them in more efficient, productive ways. We did keep many practices that were working well, but we found we could improve some things – such as how we go about acquiring customers. All our stakeholders will see benefits from these changes.

Was NW Natural doing some things better than others?

Stinson: In some areas we are the leader. We've worked hard over the years to develop productive regulatory relationships and that has helped. We're fortunate to have regulators who grasp the complexities of the utility business. Among other things, this has led to approval of several innovative tariffs. Also, in pipeline safety and other compliance issues, we're already ahead of the curve.

What are some of the changes being implemented and how will they improve operations long term?

Yoshihara: We have a culture that has always valued its commitment to customers. The attitude is, 'we're not going to let the customer down.' That spirit and commitment will never change. But how we respond to customer requests is changing – for the better. If you design your response around every possible variable, you can actually be underserving the majority of customers. By better standardizing our practices and responses, we gain efficiencies that will allow us to better serve more customers.

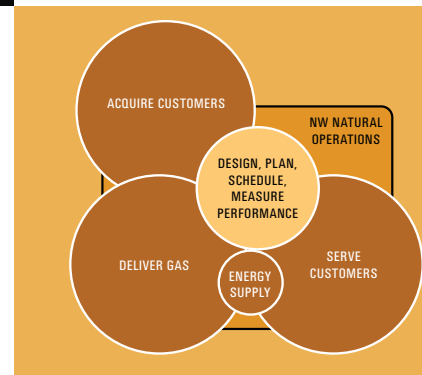
Will customers notice anything different?

Yoshihara: Service will continue to improve and customers will have more choices. New options will continue to evolve such as Web self-service. It's low cost and can serve a broader customer base, which frees us up to concentrate on other service issues. By being more efficient, we will be able to keep our product and service competitive in the marketplace.

How are employees responding to change?

Williams: They've done very well. It's been a tough adjustment for some employees who worked here for many years and were accustomed to the existing processes. We knew we had to approach it right, and we spent a good deal of time communicating with employees, identifying the core values as a company we needed to preserve. Change is never easy, but we have smart employees who can see that the marketplace is changing and we need to adapt.

Doolittle: Of course, change is most difficult when you're directly impacted. But many employees also realized fundamental changes were necessary if NW Natural was to thrive, not just survive. Building a stronger company that can provide good jobs, competitive salaries and a dependable retirement into the future is something people can understand.



NW Natural's redesign required identifying core processes—acquiring customers, serving customers, delivering gas and managing supply. The changes will improve efficiency while enhancing customer service. The redesign also identified the work best performed by employees.



Phil Damiano, Customer Acquisition Engineer, right, discusses gas service issues with Jim Chapman, General Manager of Legend Homes, which will build 600 homes at Villebois, a housing development southwest of Portland, by 2010. "We look forward to working with NW Natural at Villebois," said Chapman. "We've always worked well together on our projects and Villebois should demonstrate the value that comes from being truly synchronized with a utility."

New model to **ACQUIRE** *business*

Strong customer growth is at the heart of NW Natural's story. Our communities continue to expand and the company continues to capture the bulk of the residential new construction heating load. Overall, the Portland area is expected to grow by 500,000 people in the next 20 years. In Portland's fast-growing Pearl District, an area of mid-rises and lofts that appeal to urban-minded professionals, 5,000 new housing units have gone up in the last five years. Another 6,750 units are planned within the next five years. South of downtown on the Willamette River, the innovative South Waterfront development is adding 4,000 housing units and an expected 10,000 jobs in buildings using natural gas.

Suburban areas in our territory are also becoming more densely developed, creating traditional communities centered on a commercial core that is surrounded by stylish, energy-efficient homes served by mass transit. An excellent example of these modern villages is Villebois, located about 20 miles southwest of Portland in Wilsonville. When completed, Villebois will have more than 2,300 homes and will increase Wilsonville's current population by nearly 50 percent.

In addition to Villebois, approximately 12,000 acres of land in the Damascus and Gresham areas east of Portland are now primed for new development. Damascus, Oregon's newest ZIP code, is projected to add 25,000 residents by 2026. While most of the state's growth is concentrated in the Portland metropolitan area, growth is also occurring in other parts of NW Natural's service territory.

Population growth makes adding customers easier, but adding profitable customers at the right time takes savvy, attention to detail and expertise. NW Natural has developed a proprietary software program



"Long-term land use planning has been part of the Oregon landscape for 30 years. It guides development into more dense corridors, making it easier to expand our mains efficiently. We have created committed partnerships with building associations and major individual developers to ensure continued success in this area."

- Tamy Linver, Process Director - Customer Acquisition

called Prospector to track prospects based on demographics, home size, and location. A NW Natural representative can immediately tell a potential conversion customer whether natural gas is readily available or will be available soon, helping the prospect decide if he or she is a good candidate to convert to gas. The two key considerations are the propensity of a customer to convert and the customer's potential profitability. Having this data helps NW Natural create effective incentives to attract new customers.



Consumer Research Analyst Jorge Moncayo crunches the numbers using the Prospector program, which helps guide the location of new mains. Jorge's work is especially valuable in analyzing the potential for conversion customers.

One of the innovations to come out of this work is our Good Neighbor Services, a program that allows the company to add a new residential service from an existing gas line running to a home next door. Not only does the program save installation time and cost for NW Natural, but it also allows prospective customers to gain gas service for less expense. In its first partial year of operation in 2006, Good Neighbor Services connected 613 customers, saving the company more than \$300,000.

More focused industry partnerships, strategic new gas main development and Good Neighbor Services all fit into the realignment of NW Natural's sales and construction processes. By placing construction and sales together, this portion of the gas company becomes very similar in structure to the development firms with which we work. Uniting management of construction and marketing makes the process of bringing gas to new and existing homes work more smoothly.

"It will allow for a noticeable increase in services to the builder community and a renewed commitment to strengthen our relationships with those who make our product available to their customers," said Phil Damiano, Customer Acquisition Engineer.



Marilyn Williamson, Project Manager of Service Solutions, right, talks over details of the program with Jeremy Harmon of Tri-Tech Heating. The Vancouver, Washington-based provider has been one of the program's most successful referral partners.

Better ways to SERVE customers

At its core, great service is about problem solving. During 2006, NW Natural launched several initiatives to improve relationships with customers. Sometimes this meant leveraging technology to serve customers at lower cost. Other times it simply involved redesigning processes to serve the largest number of customers in the most efficient way.

Service Solutions. This program directly connects customers who have equipment repair needs to highly qualified third party providers. In the past, service technicians would inspect a customer's equipment, but might find a problem that required the services of an independent service contractor. A customer then had to go through the inconvenience of finding a contractor and worrying about work quality. With Service Solutions, NW Natural screens and certifies providers to ensure their qualifications. Customers are promised an appointment-scheduling call within two hours and a service call within 24 hours. NW Natural staff also follows up with customers to make sure the work is satisfactory. This approach has improved customer satisfaction and allowed service technicians to work more efficiently. Our criteria for provider participation also raise the bar for all gas equipment service work in the territory by encouraging certification and ongoing technician training.

Service Order Scheduling. In examining how we responded to customer requests for field service, NW Natural found that sometimes bending over backward to serve a few customers came at the expense of others. Each day, NW Natural schedules and routes service calls in order to meet service priority requirements in an efficient manner. But customer service representatives had the ability to override this schedule and insert new appointments at the customer's request. These late additions to the schedule weren't always priorities or emergencies. As a result, scheduled appointments were sometimes delayed in



"Dedication to customer service is a tradition at NW Natural. Person-to-person service will always be an important part of our service commitment, but with technology we are finding new ways to help add value for customers. And they had already voted us No. 1 in the nation in billing and payment services, according to J.D. Power."

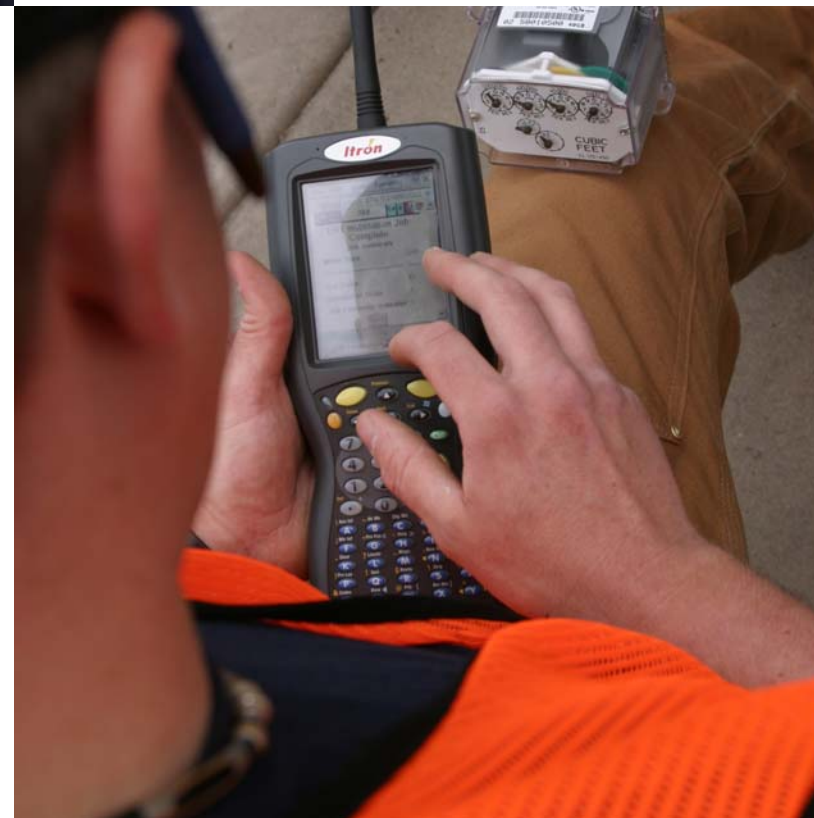
- Susan Dodge, Process Director - Customer Service

order to do all the promised work, and service technicians often worked extensive overtime as a result. By more clearly defining scheduling guidelines, request types and limiting the volume of exceptions, customers are being served more efficiently. Emergencies still receive top priority, while the majority of customers received better service and the company saved significantly with less overtime costs during 2006.

Automated Meter Reading (AMR). Meter readers have long been a familiar sight in neighborhoods. But improvements in technology have made automated meter reading a virtual necessity for fiscally responsible utilities. Throughout 2006 and into 2007, NW Natural has been converting customer meters so they can be read by a vehicle traveling through the streets. A single vehicle can accurately read up to 9,000 meters per day – about a tenfold increase over even the most efficient meter reader.

Online Billing & Payment. NW Natural has become a leader in billing and payment services – rated in 2006 as the best energy utility, gas or electric, in the nation by J.D. Power & Associates. Customer surveys showed that a large number of consumers generally are moving to paperless billing and payment. Among gas utilities nationwide, NW Natural has the fourth highest percentage of customers paying bills online – nearly 16 percent, compared to the industry average of 10 percent.

¿Habla Español? NW Natural has also developed a program to use its internal resources to better serve Spanish-speaking customers. For years, the company used an outside vendor to translate during service calls with non-English-speaking customers. But many call center employees now are fluent in Spanish. By formalizing the training needed and creating special positions, customer service is now able to provide Spanish language service without the need for a third-party translator.



Overall, NW Natural is converting 240,000 meters by investing around \$15 million over two years. Once the upgrades are in place, the company expects to save about \$2.7 million annually and further increase meter reading accuracy and timeliness. Here, a technician calibrates a new automated meter before installation.



Joe Karney, Pipeline Integrity Engineer, inspects a "smart pig" before it is inserted into a 20-inch diameter pipe to test for any anomalies. NW Natural uses such devices to detect, locate and document corrosion, dents, scratches and any other pipeline irregularities.

DELIVERING *gas safely and reliably*

It's 7 a.m. on a foggy Northwest morning and Joe Karney has a date with a very smart pig. Karney, a NW Natural pipeline integrity engineer, is managing a project to detect any possible weak spots in a 20-inch diameter pipe that runs beneath Portland. This October morning he is supervising the placement of a High Resolution MFL Inline Inspection Tool, known in the pipeline vernacular as a "smart pig."

The high-tech device will travel about seven miles inside the pipe, scanning for any anomalies that could spell trouble down the road. High-resolution smart pigs can accurately detect, locate and document any corrosion, dents, scratches and other irregularities in pipelines. Once a problem is identified, the information can be used to develop a repair or replacement program, determine if reinspection is necessary and evaluate effectiveness of a corrosion inhibitor program.

This is just one of more than a dozen projects undertaken during 2006 to ensure the safety and integrity of NW Natural's pipeline system. Overall, the company spent \$11 million on similar projects in 2006 as part of a program that will maintain and extend the life of more than 13,500 miles of pipeline. This pipeline work is essential to the current and long-term viability of the transmission system.

About 60 miles west of Portland in the Oregon Coast Range, our pipeline work was more visible. There along the Nehalem River, one of the region's premier salmon and steelhead streams, NW Natural moved 850 feet of 24-inch diameter pipe and 660 feet of 16-inch diameter pipe. The pipes, which allow natural gas to flow from NW Natural's Mist underground gas storage facility nearby, were moved to a new location beneath Battle Creek, a tributary of the Nehalem. The reason for the move was simple: the highway department planned on realigning the road in the area to straighten out a curve and replace a bridge. NW Natural took the opportunity to move the pipeline into a safer location, away from the road and the new bridge.



"Getting gas to the mains down your street should be invisible to you. That's our goal: when you need gas, it's there safely and reliably, and you don't ever worry about the 13,500 miles of pipe. That's our job and we love to do it well."

- George Gent, Process Director - Deliver Gas

The company used special boring equipment to relocate the pipe well beneath the creek bed. This commonly used technology causes the least disruption to streamside habitat.

"We've done this on many projects involving stream crossings," said Charlie Stinson, NW Natural's Director of Project Development. "We are very careful to not damage sensitive streamside areas during the work, and afterward the pipe is a safe depth underground."

NW Natural works continually on several fronts to enhance the safety and reliability of the system.

Pipeline Services Team. A specialized team focuses on high pressure steel pipes. While most of the company's pipeline system now uses polyethylene pipes, the main backbone of the delivery system is steel. Maintaining it requires highly trained work teams with extensive steel experience.

Geo-hazard. A full-time geologist keeps tabs on the rainfall in areas of geologic interest. Working with Pipeline Services staff, geologist Jack Meyer analyzes the stability of our system and recommends adjustments to ensure safety. NW Natural is working proactively to avert damage from landslides and ground movements of all kinds.

Corrosion and Leakage Control. Experienced teams work on both of these issues. The company prevents corrosion-induced leakage on steel systems by protecting them with low-level electrical current. This counteracts the effects of electrolysis, a chemical reaction that causes corrosion in metal placed underground. The entire gas system is routinely surveyed for leakage and repair work to be planned and completed when needed.

The goal of all this work is to make sure NW Natural's gas transmission system is safe, reliable and flexible enough to serve customers today and in the future.



Welders work on 24-inch diameter pipe as part of the Battle Creek project. Working in a sensitive streamside area, crews moved and replaced two essential sections of pipe serving the Mist underground gas storage facility.



Randy Friedman, left, Director of Gas Supply, and gas buyer Mike Mott, monitor the markets, gathering information needed to plan and execute a successful natural gas purchasing strategy.

Managing gas **SUPPLY** efficiently

Gas Supply

Before we can deliver natural gas to homes and businesses, we need to ship it to the Northwest. That's the role of Gas Supply and the professionals who purchase and move our supplies.

NW Natural has developed a strong reputation for its gas acquisition and storage strategies. A cornerstone of this strategy has been the development of the Mist underground gas storage facility and the South Mist Pipeline. Working together, these two investments give NW Natural enough capacity to store about 14 billion cubic feet of natural gas and help manage peak winter demand and gas market price volatility.

By leveraging this infrastructure and following a disciplined financial hedging strategy, Gas Supply works to keep ahead of market volatility, as amply demonstrated over the past two winters. For the winter of 2005-06, NW Natural had already purchased and locked in prices on most all of its winter gas supply by the end of summer. As a result, the company and its customers had only modest exposure to the sharp price spike created by hurricanes later that fall. For the winter of 2006-07, early prices were unusually high. Throughout last year Gas Supply hedged at times when prices fell enough to once again be within our target hedging range. Consequently, buyers were able to lock in better prices at that time and NW Natural cut its initial rate change request in half.

A team of gas buyers in Portland, headed by Randy Friedman, Director of Gas Supply, keeps a constant eye on the market. They purchase the company's gas supplies, schedule the daily flow of gas on upstream pipelines, optimize pipeline capacity, and perform other activities. They also coordinate the receipt of customer-owned gas into NW Natural's system. The team studies the markets and keeps abreast of everything from long-term weather reports to the plans of Canadian gas producers, to the repair schedules for major transmission lines. As a result, NW Natural customers receive the supplies they need at reasonable cost.



"We have a strong record of acquiring gas supply at good prices. Effective storage facility management, knowledge of markets and strategic investments over time mean we can consistently supply gas to our customers at reasonable rates."

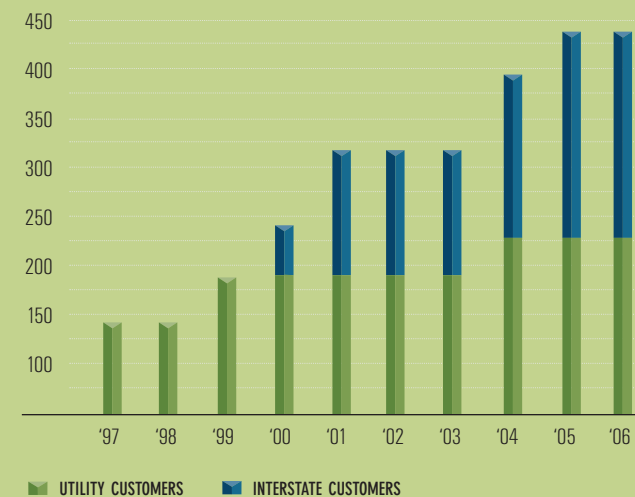
- Keith White, Vice President of Business Development and Energy Supply

The company's supply strategies are paying off for customers and shareholders alike. NW Natural has an annual Purchased Gas Adjustment (PGA) tariff in Oregon and Washington to true up actual versus projected gas costs in rates. In Oregon, the company absorbs 33 percent of any excess cost of gas, or retains 33 percent of any gas cost savings, as compared to commodity prices in rates. The other 67 percent is deferred and credited (or collected) from customers.

For 2006, NW Natural's one-third share of gas cost savings added 18 cents per share to earnings. For our customers, the share of benefits over recent years is even more impressive: more than \$60 million returned in the form of rate relief or bill credits.

Historic Mist Integrated Development

DELIVERABILITY/DTHERMS IN THOUSANDS AT YEAR-END



NW Natural began expanding the Mist underground storage field to serve not only the company's core utility customers, but to also provide interstate storage services to non-core customers in the region. The chart shows how the company developed incremental capacity ahead of what was needed for utility customers. NW Natural also contracts with an independent third-party vendor for assistance in optimizing the value of the company's gas storage assets.

Further Supply Development

In 2001, we began providing storage services to interstate customers using incremental Mist capacity developed outside of core customer rates. This business segment continues to be a significant element of our growth strategy. For example, NW Natural has in place a 10-year contract with Portland General Electric beginning this year to provide storage services for gas to fuel two electricity generating plants located in northwest Oregon. One of the two, Port Westward, is a new 400-megawatt base-load facility just commencing operation this spring.

NW Natural plans to continue adding storage capacity at Mist to accommodate utility customer growth and serve the expanding regional gas storage market. An expansion is under way for 2007 that would increase Mist's withdrawal capability by about 15 percent.

In addition to storage, NW Natural and TransCanada Corporation's GTN Systems are continuing to study and evaluate customer interest in a proposed transmission pipeline. The Palomar pipeline would connect GTN's

interstate gas line in central Oregon to NW Natural's high-pressure system southeast of Portland, and to other NW Natural facilities in northwest Oregon. A decision whether or not to proceed with the project is expected to be made later this year. If constructed, commercial operation of the pipeline could commence by late 2011.

Comparative Condensed Consolidated Income Statements

Thousands, except per share amounts (year ended December 31)	2006	2005	2004	2003	2002*
Operating revenues:					
Gross operating revenues	\$ 1,013,172	\$ 910,486	\$ 707,604	\$ 611,256	\$ 641,376
Cost of sales	648,156	563,860	399,244	323,190	353,832
Revenue taxes	24,840	21,633	16,865	14,650	14,743
Net operating revenues	340,176	324,993	291,495	273,416	272,801
Operating expenses:					
Operations and maintenance	114,560	113,216	102,155	96,420	85,120
Other taxes	24,419	23,185	21,943	20,475	19,333
Depreciation, depletion and amortization	64,435	61,645	57,371	54,249	52,090
Total operating expenses	203,414	198,046	181,469	171,144	156,543
Income from operations	136,762	126,947	110,026	102,272	116,258
Other income (expense)	2,134	1,205	2,828	2,150	(14,890)
Interest charges – net	39,247	37,283	35,751	35,099	34,132
Income before income taxes	99,649	90,869	77,103	69,323	67,236
Income taxes	36,234	32,720	26,531	23,340	23,444
Net income	63,415	58,149	50,572	45,983	43,792
Redeemable preferred and preference stock dividend requirements	-	-	-	294	2,280
Earnings applicable to common stock	\$ 63,415	\$ 58,149	\$ 50,572	\$ 45,689	\$ 41,512
Average common shares outstanding:					
Basic	27,540	27,564	27,016	25,741	25,431
Diluted	27,657	27,621	27,283	26,061	25,814
Earnings per share of common stock:					
Basic	\$ 2.30	\$ 2.11	\$ 1.87	\$ 1.77	\$ 1.63
Diluted	\$ 2.29	\$ 2.11	\$ 1.86	\$ 1.76	\$ 1.62
Dividends paid per share of common stock	\$ 1.39	\$ 1.32	\$ 1.30	\$ 1.27	\$ 1.26

See Notes to Consolidated Financial Statements in the Company's Annual Report on Form 10-K.

* Includes a loss of \$13.9 million, or \$.33 per share, in 2002 for charges related to a terminated acquisition.

Comparative Condensed Consolidated Balance Sheets

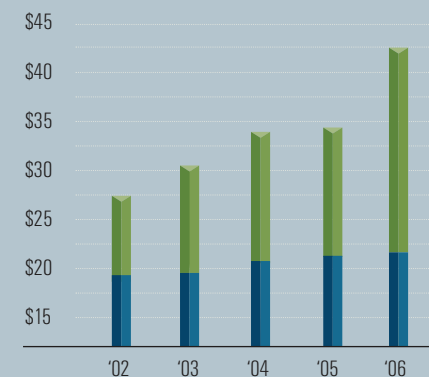
Thousands of dollars (December 31)	2006	2005	2004	2003	2002
Assets:					
Plant and property:					
Utility plant	\$ 1,963,498	\$ 1,875,444	\$ 1,794,972	\$ 1,657,589	\$ 1,539,965
Less accumulated depreciation	574,093	536,867	505,286	471,716	435,601
Utility plant – net	1,389,405	1,338,577	1,289,686	1,185,873	1,104,364
Non-utility property	42,652	40,836	33,963	23,395	20,832
Less accumulated depreciation and depletion	6,916	5,990	5,244	4,855	4,404
Non-utility property – net	35,736	34,846	28,719	18,540	16,428
Total plant and property	1,425,141	1,373,423	1,318,405	1,204,413	1,120,792
Current assets:					
Cash and cash equivalents	5,767	7,143	5,248	4,706	7,328
Accounts receivable	82,070	84,418	60,634	48,369	48,751
Accrued unbilled revenue	87,548	81,512	64,401	59,109	44,069
Allowance for uncollectible accounts	(3,033)	(3,067)	(2,434)	(1,763)	(1,815)
Inventories of gas, materials and supplies	78,128	86,161	66,477	50,859	58,030
Prepayments and other current assets	21,695	67,543	42,791	34,554	36,934
Total current assets	272,175	323,710	237,117	195,834	193,297
Regulatory assets	196,280	98,851	91,263	77,272	61,523
Fair value of non-trading derivatives	6,557	178,653	16,399	23,885	12,426
Other investments	47,985	58,451	60,618	73,845	67,619
Other assets	8,718	9,216	8,393	10,130	11,620
Total assets	\$ 1,956,856	\$ 2,042,304	\$ 1,732,195	\$ 1,585,379	\$ 1,467,277
Capitalization and liabilities:					
Capitalization:					
Common stock equity	\$ 599,545	\$ 586,931	\$ 568,517	\$ 506,316	\$ 482,392
Redeemable preferred stock	-	-	-	-	8,250
Total capital stock	599,545	586,931	568,517	506,316	490,642
First mortgage bonds	517,000	521,500	479,500	494,500	439,500
Unsecured debt	-	-	4,527	5,819	6,445
Total long-term debt	517,000	521,500	484,027	500,319	445,945
Total capitalization	1,116,545	1,108,431	1,052,544	1,006,635	936,587
Current liabilities:					
Notes payable	100,100	126,700	102,500	85,200	69,802
Accounts payable	113,579	135,287	102,478	86,029	74,436
Long-term debt due within one year	29,500	8,000	15,000	-	20,000
Taxes accrued	21,230	12,725	10,242	8,605	7,822
Interest accrued	2,924	2,918	2,897	2,998	2,902
Other current and accrued liabilities	21,455	29,916	34,168	31,589	30,045
Total current liabilities	288,788	315,546	267,285	214,421	205,007
Regulatory liabilities	214,901	344,487	165,699	166,714	150,049
Deferred income taxes and investment tax credits	210,084	227,400	216,740	178,742	149,556
Fair value of non-trading derivatives	49,803	6,876	5,487	-	-
Other liabilities	76,735	39,564	24,440	18,867	26,078
Total capitalization and liabilities	\$ 1,956,856	\$ 2,042,304	\$ 1,732,195	\$ 1,585,379	\$ 1,467,277

These Financial Statements are condensed. See Consolidated Financial Statements and Notes to Consolidated Financial Statements in the company's Annual Report on Form 10-K.

Certain amounts from prior years have been reclassified to conform with the current financial statement presentation.

Selected Financial Statistics

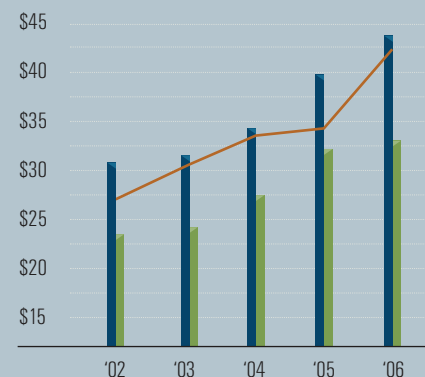
Year-End Market Price & Book Value Per Share
IN DOLLARS



BOOK VALUE PER SHARE
EXCESS OF MARKET PRICE OVER BOOK VALUE PER SHARE

The year-end market-to-book ratio averaged 1.64x over the past five years. Total return to shareholders from dividends paid and market appreciation was 15.4 percent for this period.

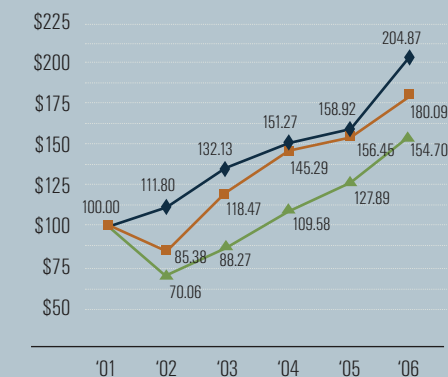
High/Low Market Price Per Share
IN DOLLARS



HIGH LOW YEAR-END

Price per share at year-end increased 57 percent in five years, including a 24 percent increase in 2006.

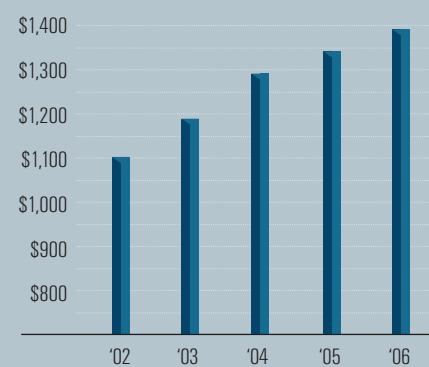
Comparison of Five-Year Cumulative Total Return
BASED ON \$100 INVESTED ON 12/31/2001



NWN
S&P UTILITIES INDEX
S&P SMALLCAP 600

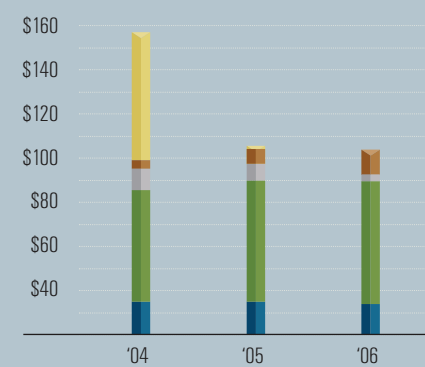
Our annualized return rate over the five years ending December 31, 2006 was 15.42%, compared to the Standard & Poor's (S&P) SmallCap 600 Index rate of 12.49% and the S&P Utilities Index rate of 9.12%.

Net Utility Plant
IN MILLIONS OF DOLLARS



Utility plant continued to increase in 2006 as a result of customer growth and investments in infrastructure and gas storage.

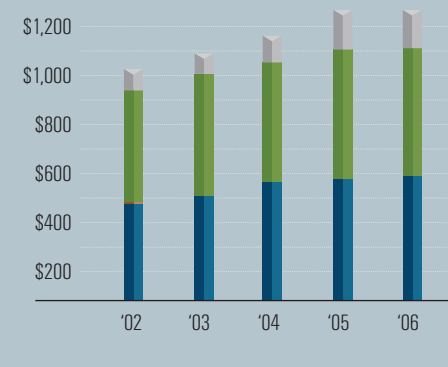
Capital Expenditures
IN MILLIONS OF DOLLARS



CUSTOMER GROWTH SYSTEM MAINTENANCE GAS STORAGE PIPELINE INTEGRITY SOUTH MIST PIPELINE EXTENSION

Focusing on profitable capital expenditures improved earnings and cash flows in 2006. NW Natural internally generated \$20 million of free cash flow in 2006 (cash from operations minus cap-ex and dividends), the highest level in over 10 years.

Capitalization
IN MILLIONS OF DOLLARS



COMMON EQUITY PREFERRED AND PREFERENCE STOCK LONG-TERM DEBT SHORT-TERM DEBT

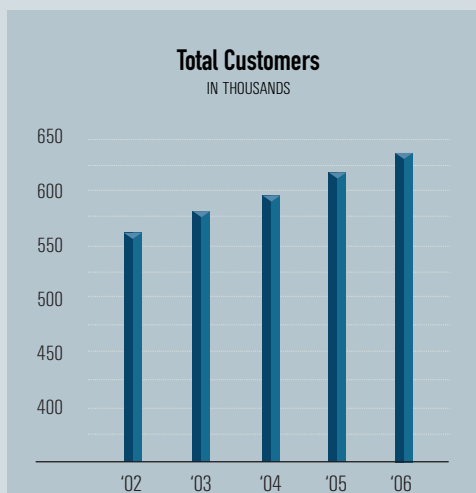
\$38.2 million in cash dividends were paid to common shareholders in 2006; \$8 million in Medium-Term Notes were retired, and \$25 million in Medium-Term Notes were issued.

Comparative Financial Statistics

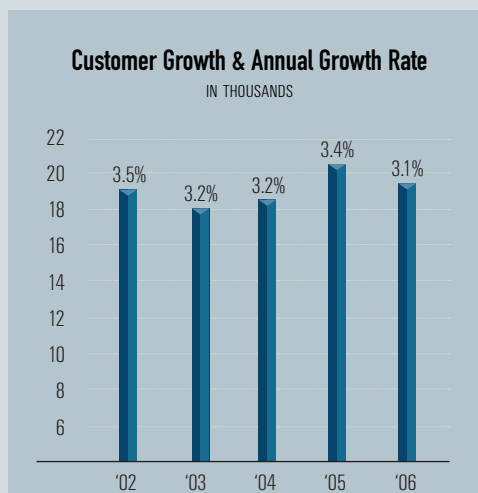
	2006	2005	2004	2003	2002*
Common stock					
Ratios at year-end:					
Price/earnings ratio	18.5	16.2	18.0	17.3	16.6
Dividend yield at year-end rate - %	3.3	4.0	3.9	4.1	4.7
Dividend payout - %	60.4	62.6	69.5	71.8	77.3
Return on average common equity - %	10.7	10.1	9.4	9.3	8.7
Per share data - (\$):					
Basic earnings	2.30	2.11	1.87	1.77	1.63
Diluted earnings	2.29	2.11	1.86	1.76	1.62
Dividends paid	1.39	1.32	1.30	1.27	1.26
Dividend rate at year-end	1.42	1.38	1.30	1.30	1.26
Book value at year-end	21.97	21.28	20.64	19.52	18.85
Market price:					
High	43.69	39.63	34.13	31.30	30.70
Low	32.83	32.42	27.46	24.05	23.46
Year-end	42.44	34.18	33.74	30.75	27.06
Average	36.98	35.92	31.06	27.72	27.58
Number of shares of common stock outstanding (000):					
Year-end	27,284	27,579	27,547	25,938	25,586
Average	27,540	27,564	27,016	25,741	25,431
Coverage data - times earned					
Fixed charges - Securities and Exchange Commission	3.40	3.32	3.02	2.84	2.85
Utility plant					
Capital expenditures (000)	\$ 95,307	\$ 89,259	\$ 138,347	\$ 121,411	\$ 78,156
Depreciation - % of average depreciable utility plant	3.4	3.4	3.4	3.5	3.5
Accumulated depreciation - % of depreciable utility plant	39.6	38.4	37.2	38.0	37.3
Capital structure at year-end (%)					
(Exclusive of current portion of long-term debt)					
First mortgage bonds	46.3	47.0	45.6	49.0	46.9
Unsecured debt	-	-	0.4	0.7	0.7
Total long-term debt	46.3	47.0	46.0	49.7	47.6
Redeemable preferred stock	-	-	-	-	0.9
Common stock equity	53.7	53.0	54.0	50.3	51.5
Total capital stock	53.7	53.0	54.0	50.3	52.4
Total capital structure	100.0	100.0	100.0	100.0	100.0
Effective tax rate					
Effective tax rate - % of pretax income	36%	36%	34%	34%	35%

*Includes loss of \$0.33 per share in 2002 for charges related to a terminated acquisition.

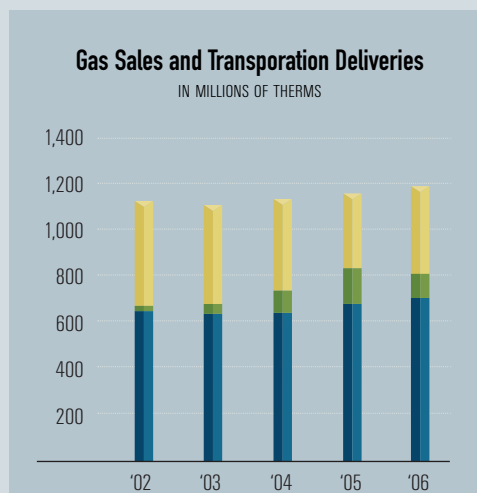
Selected Operating Statistics



The company added 19,421 new customers in 2006, expanding our customer base by 3.1 percent. In the past five years, the company has added over 95,000 new customers.

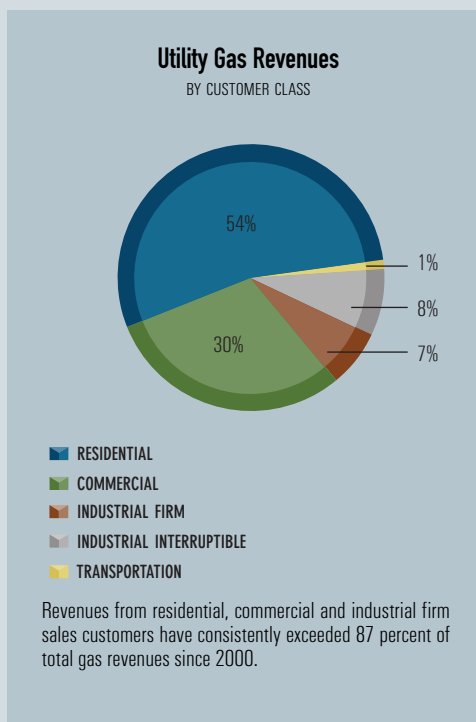


NW Natural has consistently added new customers and grown at a rate greater than the national average for the past 20 years, including 2006 when the company's annual growth rate was 3.1 percent, compared to the national gas distribution industry average of approximately 1.5 percent annually.

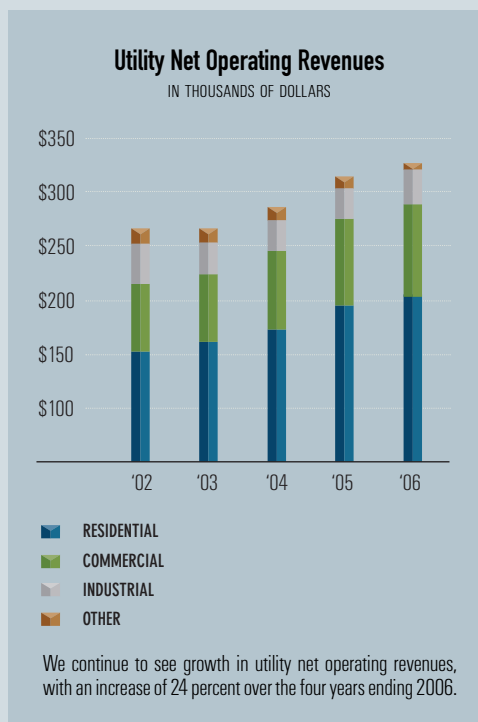


■ FIRM SALES
■ INTERRUPTIBLE SALES
■ TRANSPORTATION

Gas sales and transportation deliveries in 2006 were 3 percent higher at nearly 1.2 billion therms, due primarily to strong customer growth in residential and commercial segments.

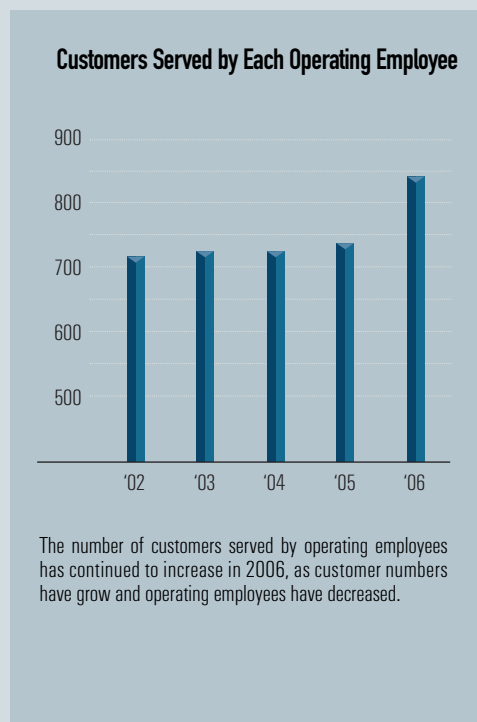


Revenues from residential, commercial and industrial firm sales customers have consistently exceeded 87 percent of total gas revenues since 2000.



■ RESIDENTIAL
■ COMMERCIAL
■ INDUSTRIAL
■ OTHER

We continue to see growth in utility net operating revenues, with an increase of 24 percent over the four years ending 2006.



The number of customers served by operating employees has continued to increase in 2006, as customer numbers have grown and operating employees have decreased.

Comparative Operating Statistics

Selected Utility Data	2006	2005	2004	2003	2002
Customers at year-end					
Residential	575,116	556,667	537,152	519,427	503,402
Commercial	60,523	59,543	58,548	57,969	56,087
Industrial firm	637	667	658	478	306
Industrial interruptible	187	214	193	165	31
Total sales customers	636,463	617,091	596,551	578,039	559,826
Transportation customers	121	72	84	111	241
Total customers	636,584	617,163	596,635	578,150	560,067
Gas sales and transportation deliveries (000 therms)					
Residential	382,665	371,538	352,356	343,534	357,091
Commercial	242,683	233,987	222,875	226,257	240,155
Industrial firm	66,971	74,880	62,843	55,314	63,215
Industrial interruptible	112,736	149,106	104,278	47,994	26,241
Unbilled therms *	-	-	-	12,099	(6,617)
Total gas sales	805,055	829,511	742,352	685,198	680,085
Transportation	387,594	328,056	389,514	414,554	445,999
Total volumes delivered	1,192,649	1,157,567	1,131,866	1,099,752	1,126,084
Operating revenues and cost of sales (000)					
Utility operating revenues:					
Residential	\$ 536,468	\$ 471,502	\$ 383,067	\$ 328,346	\$ 354,735
Commercial	290,666	250,287	200,424	176,336	201,475
Industrial firm	66,986	64,507	45,259	33,578	42,965
Industrial interruptible	93,107	100,740	55,380	23,661	15,937
Total gas sales revenues	987,227	887,036	684,130	561,921	615,112
Transportation	12,800	10,755	12,655	17,962	26,020
Unbilled revenues *	-	-	-	14,474	(12,702)
Other	161	2,862	4,160	7,627	4,018
Total utility operating revenues	1,000,188	900,653	700,945	601,984	632,448
Cost of gas sold	648,081	563,772	399,176	323,128	353,034
Revenue taxes	24,840	21,633	16,865	14,650	14,743
Utility net operating revenues	\$ 327,267	\$ 315,248	\$ 284,904	\$ 264,206	\$ 264,671
Customer data					
Heat requirements:					
Actual degree days	4,089	4,178	3,853	3,952	4,232
Percent colder (warmer) than average	(1)	(7)	(10)	(2)	(4)
Average use per customer in therms:					
Residential	678	673	677	673	725
Commercial	4,052	3,936	3,907	4,004	4,334
Average sales rate per therm (cents):					
Residential	139.8	125.2	107.1	95.6	99.3
Commercial	119.4	105.4	88.2	78.0	83.9
Industrial firm	99.5	85.7	70.7	60.7	68.0
Industrial interruptible	82.6	67.6	53.1	49.3	61.7
Total sales	122.3	105.6	90.8	83.5	89.6
Gas purchases (000 therms)	820,542	815,334	756,672	683,331	708,796
Gas purchased cost per therm — net (cents)	75.37	71.42	56.60	46.99	51.07
Average sendout cost of gas (cents)	80.50	67.96	53.77	47.16	51.91
Maximum day firm sendout (000 therms)	5,672	5,649	7,177	4,851	4,249
Maximum day total sendout (000 therms)	7,401	6,966	8,913	6,310	6,172
Utility employees	1,211	1,305	1,288	1,291	1,261
Number of customers served by each operating employee	845	738	721	724	714

*Unbilled therms and revenues have been allocated by revenue class for 2006, 2005 and 2004.



Corporate Officers

NW Natural officers gather on a condominium balcony in Portland's energy-efficient South Waterfront development. When finished, the development will provide 4,000 gas-fueled housing units.

Back row from left to right: Michael McCoy, C. J. Rue, Gregg Kantor, Stephen Feltz. Front row from left to right: David Anderson, Margaret Kirkpatrick, Richelle Luther, Lea Anne Doolittle, Mark Dodson

David H. Anderson, 45 [2004]
Senior Vice President and Chief Financial Officer (2004-present)
 Senior VP and CFO, TXU Gas (2004)
 Senior VP, Corporate Controller and Principal Accounting Officer, TXU Corp. (2003-2004)
 VP, Investor Relations and Shareholder Services, TXU Corp. (1997-2003)

Stephen P. Feltz, 51 [1982]
Treasurer and Controller (1999-present)
 Assistant Treasurer and Manager, General Accounting (1996-1999)

Richelle T. Luther, 38 [2002]
Assistant Secretary (2002-present)
 Associate, Stoel Rives LLP (1997-2002)

Mark S. Dodson, 62 [1997]
President and Chief Executive Officer (2003-present)
 President and Chief Operating Officer (2001-2002)
 General Counsel (1997-2002)
 Senior Vice President, Public Affairs (1997-2001)

Gregg S. Kantor, 49 [1996]
Executive Vice President (2006-present)
 Senior Vice President, Public and Regulatory Affairs (2003-2006)
 Vice President, Public Affairs and Communications (1998-2002)

Michael S. McCoy, 63 [1969]
Executive Vice President, Customer and Utility Operations (2000-2006)*
 Senior Vice President, Customer and Utility Operations (1999-2000)

Lea Anne Doolittle, 52 [2000]
Vice President, Human Resources (2000-present)
 Director of Compensation, PacifiCorp (1993-2000)

Margaret D. Kirkpatrick, 52 [2005]
Vice President and General Counsel (2005-present)
 Partner, Stoel Rives LLP (1990-2005)

C. J. Rue, 61 [1974]
Secretary (1982-present)
 Assistant Treasurer (1987-present)

Board of Directors



Timothy P. Boyle, 57
 President and Chief Executive Officer, Columbia Sportswear Company
 Portland, Oregon
 [2003] (3) (5) (6)



Martha L. "Stormy" Byorum, 58
 Senior Managing Director, Stephens Cori Capital Advisors
 New York, New York
 [2004] (2) (6)



John D. Carter, 61
 President and Chief Executive Officer, Schnitzer Steel Industries, Inc.
 Portland, Oregon
 [2002] (1) (2) (6)



Mark S. Dodson, 62
 President and Chief Executive Officer, NW Natural
 Portland, Oregon
 [2003]



C. Scott Gibson, 54
 President, Gibson Enterprises
 Portland, Oregon
 [2002] (3) (4) (5)



Tod R. Hamachek, 61
 Former Chairman and Chief Executive Officer of Penwest Pharmaceuticals Company
 Seattle, Washington
 [1986] (1) (2) (5)



Randall C. Papé, 56
 President and Chief Executive Officer, The Papé Group, Inc.
 Eugene, Oregon
 [1996] (1) (4) (6)



Richard G. Reiten, 67
 Chairman of the Board, NW Natural
 Portland, Oregon
 [1996] (1) (4) (5) (6)



Kenneth Thrasher, 57
 Chairman and Chief Executive Officer, Compli Corporation
 Portland, Oregon
 [2005] (2) (3) (4)



Russell F. Tromley, 67
 Chairman and Chief Executive Officer, Tromley Industrial Holdings, Inc.
 Tualatin, Oregon
 [1994] (1) (2) (3)

In Memoriam

The NW Natural team lost two long-time friends and advisors in 2006.



Richard L. Woolworth
 1941-2006
 Director (2000-2005)
 Chairman of the Board (2005-2006)



Wayne D. Kuni
 1930-2006
 Director (1980-2003)

Key: [Year elected to the Board], (1) Governance Committee, (2) Audit Committee, (3) Organization and Executive Compensation Committee, (4) Public Affairs and Environmental Policy Committee, (5) Strategic Planning Committee, (6) Finance Committee

*McCoy retired Dec. 31, 2006.

[Date joined NW Natural]

Corporate Profile

NW Natural (NYSE: NWN) is a 148-year-old natural gas local distribution company headquartered in Portland, Oregon. The company has added customers at a rate of 3 percent or more per year for 20 consecutive years. NW Natural serves more than 636,000 customers in Oregon and southwest Washington, including the Portland-Vancouver metropolitan area, the Willamette Valley, the Oregon coast and the Columbia River Gorge. More than 200,000 customers have been added to NW Natural's distribution system in the past 10 years. In keeping with its steady growth, the company has increased dividends paid to shareholders for 51 consecutive years. NW Natural purchases natural gas for its core market from a variety of suppliers in the western United States and Canada. The company also operates an underground gas storage facility and contracts for additional gas storage outside its service territory. NW Natural operates two liquefied natural gas plants in its service area. The company also provides gas storage services to other energy companies in the Northwest interstate market.

Service Territory

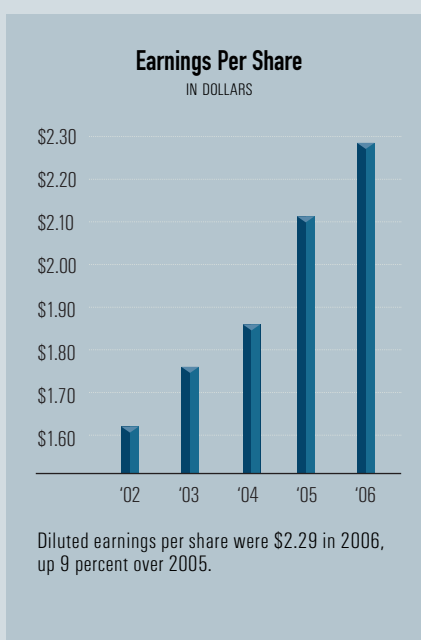


Financial Overview

	2006	2005	Percent increase (decrease)
Earnings			
Financial facts (\$000):			
Gross operating revenues	1,013,172	910,486	11
Net operating revenues	340,176	324,993	5
Net income	63,415	58,149	9
Financial ratios (%):			
Return on average common equity	10.7	10.1	6
Capital structure at year-end:			
Long-term debt	46.3	47.0	(1)
Common stock equity	53.7	53.0	1
Common stock			
Shareholder data:			
Common shareholders	8,753	9,136	(4)
Average shares outstanding (000)	27,540	27,564	
Per share data (\$):			
Basic earnings	2.30	2.11	9
Diluted earnings	2.29	2.11	9
Dividends paid on common stock	1.39	1.32	5
Book value at year-end	21.97	21.28	3
Market value at year-end	42.44	34.18	24
Operating highlights			
Gas sales and transportation deliveries (000 therms)	1,192,649	1,157,567	3
Degree days (25-year average, 4,265)	4,089	4,178	(2)
Customers at year-end	636,584	617,163	3
Number of utility employees	1,211	1,305	(7)

Dividends paid on common stock (per share)

Payment date	2006	2005
February 15	\$ 0.345	\$ 0.325
May 15	\$ 0.345	\$ 0.325
August 15	\$ 0.345	\$ 0.325
November 15	\$ 0.355	\$ 0.345
Total dividends paid	\$ 1.390	\$ 1.320



Quarterly Financial Information (unaudited)

Dollars (thousands except per share amounts)	Quarter ended				
	March 31	June 30	Sept. 30	Dec. 31	Total
2006					
Operating revenues	\$ 390,391	\$ 170,979	\$ 114,914	\$ 336,888	\$ 1,013,172
Net operating revenues	125,464	61,747	41,341	111,624	340,176
Net income (loss)	41,033	1,994	(9,724)	30,112	63,415
Basic earnings (loss) per share	1.49	0.07	(0.35)	1.10	2.30*
Diluted earnings (loss) per share	1.48	0.07	(0.35)	1.09	2.29*
2005					
Operating revenues	\$ 308,777	\$ 153,667	\$ 106,667	\$ 341,375	\$ 910,486
Net operating revenues	120,986	57,649	41,940	104,418	324,993
Net income (loss)	39,887	1,140	(8,671)	25,793	58,149
Basic earnings (loss) per share	1.45	0.04	(0.31)	0.94	2.11*
Diluted earnings (loss) per share	1.43	0.04	(0.31)	0.93	2.11*

* Quarterly earnings per share are based upon the average number of common shares outstanding during each quarter. Because the average number of shares outstanding has changed in each quarter shown, the sum of quarterly earnings may not equal earnings per share for the year. Variations in earnings between quarterly periods are due primarily to the seasonal nature of the company's business.

Notice of Annual Meeting

The 2007 Annual Meeting will be held at 2 p.m., Thursday, May 24, in the Hospitality Suite on the fourth floor of NW Natural's offices, 220 NW Second Avenue, Portland, Oregon. A meeting notice and proxy statement will be sent to all shareholders in mid-April.

Dividend Reinvestment and Direct Stock Purchase Plan

Participants may make an initial investment in company stock and common shareholders of record may reinvest all or part of their dividends in additional shares under the company's plan. Cash purchases may also be made. Participants in the Plan bear the cost of brokerage fees and commissions for shares purchased on the open market to fulfill purchases under the Plan. A prospectus will be sent upon request.

Dividend Payment Dates

February 15, 2007
May 15, 2007
August 15, 2007
November 15, 2007

Certifications

The Chief Executive Officer certified to the NYSE on June 13, 2006 that, as of that date, he was not aware of any violation by the company of NYSE's corporate

governance listing standards, and the company had filed with the Securities and Exchange Commission, as exhibits 31.1 and 31.2 to its Annual Report on Form 10-K for the year ended December 31, 2005, the certificates of the Chief Executive Officer and the Chief Financial Officer of the company certifying the quality of the company's public disclosure. For the year ended December 31, 2006, the certificates of the Chief Executive Officer and Chief Financial Officer are attached as exhibits 31.1 and 31.2 to the Form 10-K included in this Annual Report.

Contact the NW Natural Board

Concerns may be directed to the non-management directors as follows:

- Call 800-541-9967, or
- Write to NW Natural Board of Directors, c/o Corporate Secretary, or
- E-mail Directors@nwnatural.com

Forward-looking Statements

NW Natural's future operating results will be affected by various uncertainties and risk factors, many of which are beyond the company's control, including governmental policy and regulatory action, the competitive environment, economic factors and weather conditions. Some statements in this annual report may be forward-looking, and actual results may differ materially as a result of these uncertainties. For a more complete description of these uncertainties and risk

factors, please refer to the company's filings with the Securities and Exchange Commission on Forms 10-K and 10-Q.

Shareholder Information

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Investor Relations
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(800) 422-4012
Ext. 2388
rsh@nwnatural.com

Carol M. Frary
Shareholder Services
(503) 226-4211
(800) 422-4012
Ext. 3412
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Request for Publications

The following publications may be obtained without charge by contacting the Corporate Secretary at the NW Natural address shown to the right:

Annual Report; Form 10-K; Form 10-Q; Corporate Governance Standards; Director Independence Standards; Code of Ethics; and Board Committee Charters.

These publications, as well as other filings made with the Securities and Exchange Commission, also are available on NW Natural's Web site at nwnatural.com.

Common Stock Prices

NW Natural's common stock is listed and trades on the New York Stock Exchange under the symbol "NWN." The quarterly high and low trading range during 2005 and 2006 was:

2006 Quarter Ended	High	Low
March 31	\$ 36.57	\$ 32.83
June 30	37.04	33.30
September 30	40.08	35.81
December 31	43.69	38.53

2005 Quarter Ended	High	Low
March 31	\$ 37.24	\$ 32.42
June 30	38.67	34.36
September 30	39.63	35.60
December 31	37.77	33.25

The closing quotations for the common stock on Dec. 29, 2006 and Dec. 30, 2005 were \$42.44 and \$34.18, respectively.

Trustee and Bond Paying Agent

For all bond issues:
Deutsche Bank Trust Company Americas
60 Wall Street
27th Floor - MS NYC60-2710
New York, NY 10005
Telephone: (800) 735-7777

Stock Transfer Agent and Registrar

For the Common Stock:
American Stock Transfer & Trust Company
59 Maiden Lane, Plaza Level
New York, NY 10038
Telephone: (888) 777-0321
Internet: amstock.com
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