

# Growing responsibly.



NW NATURAL ANNUAL REPORT 2007 • GROWING RESPONSIBLY



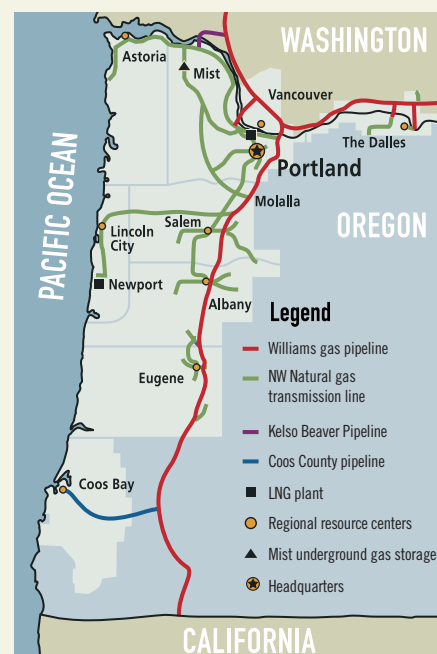
**NW Natural**<sup>®</sup>

2007 ANNUAL REPORT

## Corporate Profile

NW Natural (NYSE: NWN) is a 149-year-old natural gas local distribution and storage company headquartered in Portland, Oregon, with a customer growth rate well above the national average. NW Natural serves more than 652,000 customers in Oregon and southwest Washington, including the Portland-Vancouver metropolitan area, the Willamette Valley, the Oregon coast and the Columbia River Gorge. In keeping with its steady growth, the company has increased dividends paid to shareholders for 52 consecutive years, a feat matched by few publicly traded companies. NW Natural purchases natural gas for its core market from a variety of suppliers in the western United States and Canada. The company operates gas storage facilities in its service territory, contracts for additional gas storage outside its service territory, and provides gas storage services to other energy companies in the Northwest. NW Natural is developing a new gas storage facility at Gill Ranch near Fresno, California, and plans to develop a new natural gas transmission pipeline from central Oregon to northwest Oregon providing enhanced gas deliverability and reliability for the region.

## Utility Service Territory



## Financial Overview

	2007	2006	PERCENT INCREASE (DECREASE)
<b>EARNINGS</b>			
Financial facts (\$000):			
Gross operating revenues	1,033,193	1,013,172	2
Net operating revenues	369,042	340,176	8
Net income	74,497	63,415	17
Financial ratios (%):			
Return on average common equity	12.5	10.7	17
Capital structure at year-end:			
Long-term debt	46.3	46.3	—
Common stock equity	53.7	53.7	—

## COMMON STOCK

Shareholder data (000):			
Average shares outstanding	26,821	27,540	(3)
Year-end shares outstanding	26,407	27,284	(3)
Per share data (\$):			
Basic earnings	2.78	2.30	21
Diluted earnings	2.76	2.29	21
Dividends paid	1.44	1.39	4
Dividend rate at year-end	1.50	1.42	6
Book value at year-end	22.52	21.97	2
Market value at year-end	48.66	42.44	15

## OPERATING HIGHLIGHTS

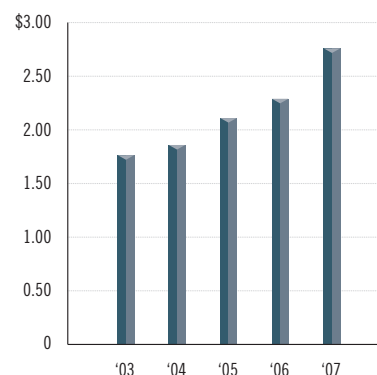
Gas sales and transportation deliveries (000 therms)	1,214,969	1,192,649	2
Degree days (25-year average, 4,265)	4,374	4,089	7
Customers at year-end	652,012	636,584	2
Employees at year-end	1,141	1,211	(6)

## DIVIDENDS PAID ON COMMON STOCK (per share)

### PAYMENT DATE

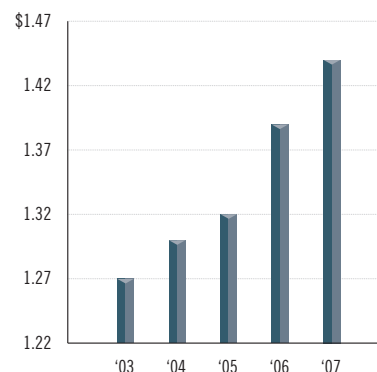
February 15	\$ 0.355	\$ 0.345
May 15	0.355	0.345
August 15	0.355	0.345
November 15	0.375	0.355
<b>Total dividends paid</b>	<b>\$ 1.440</b>	<b>\$ 1.390</b>

## Diluted Earnings Per Share (IN DOLLARS)



Diluted earnings per share were \$2.76 in 2007, up 21 percent over 2006.

## Dividends Paid Per Share (IN DOLLARS)



Annual dividends paid per share in 2007 increased for the 52nd consecutive year. The indicated dividend rate at year-end was \$1.50 per share.



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## Letter to Shareholders

*Front:* Mark Dodson,  
Chief Executive Officer,

*Back:* Gregg Kantor,  
President and Chief  
Operating Officer

### **A foundation for sustainable success**

NW Natural has always taken a long-term view of its commitments to customers, employees, shareholders and the communities it serves. This stewardship ethic has helped us grow and thrive for 149 years. And in today's world of new economic and environmental realities, it has never been more important or more valued by those who rely on us.

In 2007, we ramped up our efforts on behalf of sustainability – for both our company and our planet – and we're proud of what we accomplished. We reorganized to better compete and to improve customer service. We planned strategic investments in gas storage and transmission pipelines – necessary infrastructure as the nation increasingly relies on natural gas to help reduce carbon emissions. And we were among the first gas utilities in the nation to give its customers options to combat global warming.

By year's end, it was clear not only that we'd made responsible decisions, but also that we'd executed well. Our financial results show that responsible growth can drive sustained high performance.

### **Much ventured, much gained**

The year 2007 was exceptional both in terms of the company's accomplishments and its financial results.

Earnings were up more than 17 percent, with earnings per share increasing by nearly 21 percent.

Gas cost savings allowed us to lower customer rates for 2008 and brought NW Natural customers and shareholders significant financial benefits. Oregon and Washington residential customers saw rates drop by 8 and 10 percent, respectively. Oregon's incentive cost-sharing mechanism refunds to customers two-thirds of the money saved on gas purchases while allowing

shareholders to keep one-third of the savings. NW Natural's portion of these savings totaled \$12 million, equivalent to 27 cents a share.

A regulatory surcharge resulting from Oregon legislation passed in 2005 also added to 2007 earnings. Legislators sought to ensure that the taxes utilities paid equaled the amount of taxes collected from rate-payers. Because we paid more taxes than we collected in rates in 2006 and 2007 tax years, we expect to collect \$6 million from customers for these periods, equivalent to 13 cents a share.

Despite a slowdown in housing starts, NW Natural continued to grow at a rate well above the national average. The Northwest's relatively strong economy helped us maintain a customer growth rate of 2.4 percent, compared to a national average of 1.2 percent.

Last year, we shared with you the changes we were making in our operations to become more efficient. Our timing could not have been better. The improvements initiated in 2006 contributed to 2007 results and position us well to ride out the current economic slowdown. For example, our newly reorganized sales team reversed a trend of declining residential conversions to gas, producing the first annual increase in eight years.

Since implementing these changes, the company is operating with more than 10 percent fewer employees. We are proud to say we accomplished these reductions almost entirely through attrition and voluntary separations – an uncommon feat in today's business environment.

Our strong financial performance in 2007 allowed us to invest ahead of schedule on a number of projects designed to reinforce the safety and reliability of our gas system. These investments totaled approximately \$5 million for the year. Excluding these accelerated expenditures, core O&M was up only 1 percent, thus meeting one of our main objectives: keeping increases in our operating costs lower than customer growth.

Cash provided by operations in 2007 reached \$184 million compared to \$149 million in 2006. These record results reflected the effects of our improved operations and higher deferred gas cost benefits. And for the second consecutive year, we produced positive free cash flow – a rare achievement for a fast-growing natural gas utility.

Overall, 2007 was a remarkable year. The company's total shareholder return was 18 percent, and the end-of-year share price was \$48.66, up \$6.22.

### New business opportunities

The year 2007 saw a tipping point for public perception about climate

change, making carbon reduction legislation likely in the near future. It also became clear to us that the only short-term practical option for large-scale electric generation is natural gas – so the nation must begin thinking more seriously about its gas supplies.

This recognition reinforced our earlier interest in new business development related to gas transportation and storage. It also encouraged us to build on the expertise acquired from managing and operating our Mist storage field and its connecting pipelines.

In August, we announced the creation of Palomar Gas Transmission LLC, a joint venture formed with TransCanada Corporation. The partnership plans to build a new transmission pipeline connecting TransCanada's interstate system with NW Natural's distribution system. A second Palomar segment could connect to a liquefied natural gas import terminal if one is built on the Columbia River.

In September, we also announced the formation of Gill Ranch Storage, LLC. This NW Natural subsidiary plans to build and operate a 20 billion cubic feet (Bcf) underground gas storage facility near Fresno, California. We are working on this project jointly with Pacific Gas & Electric, which brings experience with storage and pipelines in California as well as with the state's regulatory environment.

### Rewarded for responsible actions

In business, as in the natural world, sustainability requires balance. For a utility, that means balancing and aligning the interests of all those who rely on us – customers, employees, shareholders and communities in Oregon and Washington.

Without raising rates we found new ways to align the interests of all our

constituencies. We streamlined our operations to improve customer service while increasing shareholder value. We kept our commitments to employees. And we strengthened relationships with Northwest communities through our local philanthropic efforts and involvement with civic and national policy issues.

## Highlights

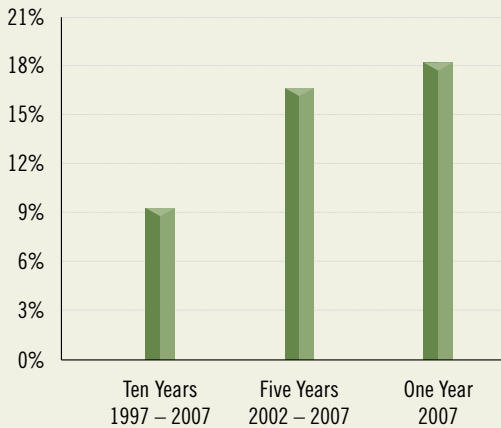
In 2007, NW Natural:

- Earned a record \$2.76 per diluted share, up 21 percent over 2006, and provided a total shareholder return of 18 percent.
- Ranked first in the West and second nationally in the annual J.D. Power & Associates customer satisfaction survey.
- Produced record cash flow from operations of \$184 million, resulting in positive free cash flow for the year.
- Increased our Mist gas storage capacity by 1.8 Bcf to approximately 16 Bcf.
- Formed a joint venture with TransCanada to build Palomar Pipeline, and formed Gill Ranch Storage, LLC to develop a gas storage facility in California with Pacific Gas & Electric Company.
- Extended our weather normalization and decoupling rate mechanisms in Oregon into 2012.
- Was named to the list of the 10 "Most Admired Companies" in the "Across All Industries" category by the Portland Business Journal.
- Ranked as one of the 100 top corporate citizens in the nation by CRO Magazine (formerly Business Ethics) for the seventh year in a row.
- Was honored with the RecycleWorks Award by the City of Portland for our sustainability efforts.
- Was confirmed by Standard and Poor's at a secured debt rating of AA- with the top business risk profile ranking.
- Was confirmed by Moody's at a secured debt rating of A2 with low business risk, and rating outlook was changed to positive from stable.
- Raised the quarterly dividend rate by 6 percent, making this the 52nd consecutive year of increasing dividends per share.

### Environmental stewardship

Our Northwest customers are known for their environmental concern and savvy. When surveyed, they said they expected us to play a leading role in fighting climate change. So in 2007, we launched our Smart Energy program and became the nation's first stand-alone gas utility to help customers offset carbon dioxide emissions associated with their natural gas use.

## Total Shareholder Return (ANNUALIZED AS A PERCENT)



Our annualized total return (dividends plus stock appreciation) was 18.2 percent in 2007, 16.7 percent over the past five years, and 9.3 percent over 10 years.

We're also taking a close look at the effects climate change could have on the gas industry. As chair of the American Gas Association's Climate Change Task Force, I spoke at numerous public forums to help the gas industry focus on the challenge of climate change, and to articulate the important role natural gas must play in future carbon legislation. And recently, Governor Ted Kulongoski appointed NW Natural's Gregg Kantor, to be one of 11 members of his new Oregon Global Warming Commission.

While there may be questions about what climate change will mean for the future energy picture, we believe there will be greater demand for natural gas. And to anticipate and respond to the impacts on our business, we will continue to be actively involved in local and national climate change policy discussions.

We will also continue to aggressively support the efficient and direct use of natural gas. Using highly efficient natural gas water heaters, furnaces and other appliances can help cut carbon

emissions by thousands of pounds per year. Natural gas will be a critical resource in a carbon-constrained world, and we intend to stay focused on making sure it is used wisely.

### Toward sustaining our success

In 2007, we took bold steps – toward greater operational efficiencies, toward a leadership role in climate change discussions, and toward becoming a larger presence in West Coast gas storage and transportation.

The year 2008 is about follow through – with the organizational changes we started in 2006 and 2007, and with the new business development plans we set in motion last year. At the same time, we'll be keeping an eye on the horizon.

Our ongoing process improvement efforts will apply new technology to our retooled organization. After a year of planning, we completed on time and on budget the implementation of a new technology system that will strengthen our business procedures, from supply change management to data analysis. As our work continues this year, we will also be installing new dispatching and global positioning software that will help us make better use of field resources.

When we announced plans for Palomar and Gill Ranch last year, we knew we were just at the beginning of two long development and permitting processes.

In 2008, we are busy showing communities and regulators that the Palomar Pipeline can be built safely, with utmost respect for the environment, agricultural land and communities along the transmission line route. We expect to file for a siting permit with the Federal Energy Regulatory Commission in 2008.

The Gill Ranch project will require an environmental assessment, a

permit from the California Public Utilities Commission and other regulatory approvals. We will also follow up on our successful open season by pursuing agreements with parties that expressed interest in the project.

This will be a busy regulatory year for our core utility as well. First, we have filed a general rate case in Washington, where we serve about 10 percent of our customers.

In Oregon, the commission will be reviewing the gas cost sharing mechanisms for utilities across the state. As part of that proceeding, the commissioners will be looking at how well NW Natural's gas cost sharing mechanism performs for customers and the company. Our current sharing mechanism is more than a decade old and was created at a time when natural gas prices were more stable. Given the volatility of prices today, we believe updating the mechanism to create a more appropriate risk/reward balance for customers and shareholders makes sense.

We will also continue to be active in issues that affect our shareholders on the national front. Federal legislation passed in 2006 that reduced the tax rate on dividends and capital gains to 15 percent for individual taxpayers is due to expire in 2010. We have been working with the American Gas Association and other member companies to advocate this tax relief be made permanent. We believe this legislation addressed an inequitable double taxation on dividends. Maintaining a lower tax on dividends has been one of our industry's top priorities for years, and we will continue to work to make this provision permanent.

### Governance for the future

Over our 149-year history, NW Natural's management and board have believed the key to our success is making sure this company

In 2007 we ramped up our efforts to ensure the

## *sustainability of our company and our planet*

– and we're proud of what we accomplished.



has the talent to lead it into the future. Last year, the company took action on several fronts to carry on that legacy.

First, two new directors joined the board. Jane Peverett, President and CEO of British Columbia Transmission Corporation, and George Puentes, President of Don Pancho Authentic Mexican Foods, add new expertise and skills to a board that is already remarkable for its diverse and extensive business experience.

Second, in 2007, the board elected Gregg Kantor, President and Chief Operating Officer. He has served as our Executive Vice President since late 2006 and previously held positions as Senior Vice President and Vice President of Public and Regulatory Affairs. Gregg's move to President and COO provides additional leadership to help drive operational improvements.

### **Working responsibly, growing sustainably**

NW Natural is a company with tremendous commitment and talent at every level.

You can see it in the results produced by our gas supply team's smart purchases or in the gas storage income generated by the employees who operate and market our Mist storage field. You can see it in the safety and system reliability numbers resulting from our field employees' work. You can see it in the customer satisfaction ratings received by our call center representatives and service technicians. And the list goes on.

This is a company of very special employees who believe deeply that they are stewards of a great company and of a critical piece of the Northwest's infrastructure. NW Natural is lucky to have them, and we are proud to serve with them.

As we approach our 150th anniversary, NW Natural continues to grow – and grow responsibly. We understand the obligations we have, and we appreciate the trust that our customers and shareholders have placed in us. We want you to know we intend to be relentless in our efforts to honor that trust and to meet the new challenges and expectations that lie ahead.

Sincerely,

Mark S. Dodson  
Chief Executive Officer



## Interview with Gregg Kantor, President and Chief Operating Officer

### **What does sustainability mean for NW Natural?**

We approach sustainability from several different angles. We think about sustaining the company long term – for the benefit of our customers, employees, shareholders and local communities. For example, over the last 24 months we restructured our operations to be more efficient and more competitive, so we can remain a healthy company for many years into the future.

We also think about sustainability the way it's more commonly used today, in the sense of preserving resources for future generations.

In that regard we have to use natural gas wisely, so that it can remain affordable and accessible for our customers to heat their homes and to fuel the Northwest's economy. As a company, we're also committed

to using and throwing away less paper, using less fuel and reducing emissions in all our operations.

Here at NW Natural, we started the Smart Energy carbon emissions offset program and, under Mark Dodson's leadership, we're helping the national gas industry take on issues related to climate change.

We are focused on making sure this company can compete for another 150 years. We are also mindful that we're stewards of valuable natural gas supplies, and we want to ensure this resource is used efficiently. Finally, we want to make sure adequate gas storage and pipelines are in place so that as the nation becomes more aggressive about addressing climate change, natural gas is available for direct use by consumers, and for power generation.

### **What were the main accomplishments of NW Natural's utility operations in 2007?**

We made great advances toward implementing the new operating model we described in last year's annual report. We've reorganized our work along process lines, centralized many work groups, and standardized more of our daily tasks and procedures. We outsourced functions that aren't central to the gas business and improved the remaining processes to provide better customer service.

We also began to move our business processes into a unified software system. On Jan. 7 of this year, we completed the first phase of this effort, converting our accounting and purchasing processes to this new system.

Today we are operating more efficiently and effectively, and we are providing our customers better



We have to use natural gas wisely, so that it can remain

*affordable and accessible for our customers*

to heat their homes and to fuel the Northwest's economy.



service than we were just a year ago. In 2008, the focus on improving our operations will continue with the addition of even more technology.

With a new integrated work management system, vehicle locating devices and new computers in our trucks, we'll be able to respond more quickly to customer and emergency calls. We'll also be able to dispatch employees and equipment more efficiently system wide, eliminating artificial boundaries between resource centers.

#### **How did your relationship with your employees hold up through these changes?**

The union leadership was a full partner in last year's efforts.

By centralizing and redesigning many work functions, we are operating effectively with fewer

employees. By January 2008, we had approximately 10 percent fewer positions than we had 12 months earlier.

We made a commitment that we'd do everything possible to reduce positions using attrition, and we lived up to that promise. Virtually all reductions were made through attrition, or voluntary severance. And because we kept employees informed of pending changes, a number of them took the initiative to find positions with other companies before the changes took place.

While we restructured our operations, we committed ourselves to hiring from within the company whenever possible. Since the time we announced the reorganization, we filled more than 80 percent of our open positions with existing employees.

That's not to say it's been easy. Our union/management team worked hard over many months to make sure employees had plenty of options and that they would be treated equitably if their positions were eliminated. Yet some employees still had to make tough choices, moving into new positions or in some cases even relocating their families to remain with us.

It's been a challenge for all of us to learn new ways of doing our jobs, operating with fewer managers and employees, and looking at our work differently. However, I'm very proud to say that everyone in the company – from managers to our human resources team to the union leadership and individual employees – acted with respect and integrity throughout the process.

# A strategic and lasting foundation.

A business that's been operating for 149 years gets in the habit of thinking long term. For NW Natural, it's not enough to meet earnings targets. We're always planning ways to sustain the financial health of our business far into the future. In 2007, the result was a major overhaul of the company's structure, making us more responsive and competitive.

## *We have roots in the Northwest,*

and we plan to keep serving communities for a long time.

## *It's our home.*

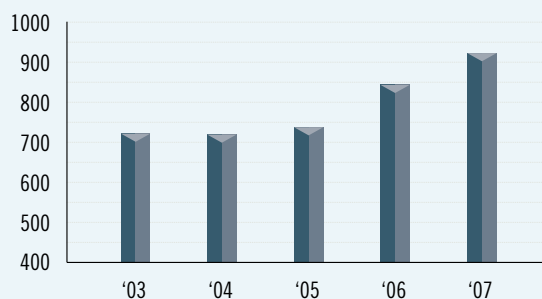


But home towns change, and so do the forces that affect a utility's success. To remain a leader in the natural gas industry as well as a respected corporate citizen, our business model has to be flexible and dynamic.

In 2006, we took a hard look at ourselves to see if we were meeting our own expectations – as well as those of our customers, our employees and our shareholders. In response to what we learned, we spent 2007 restructuring large parts of NW Natural. By centralizing key functions, integrating our work into a process-driven model, and identifying areas to improve our business practices, we are prepared to take on future competitive challenges.

We know we're on the right track by looking at 2007 results. In addition to controlling our operational expenses, we reversed a trend of declining conversions and found new ways to better serve our customers.

**CUSTOMERS SERVED BY EACH OPERATING EMPLOYEE**



The number of customers served by operating employees continued to increase in 2007, as we have improved operational effectiveness.

For example, we've worked hard to make our Web site convenient and easy to use, and customers are taking notice. With more than 215,000 customers registered to use our site's self-service area, visits to our online service features increased by 34 percent last year to more than 2 million. We've also improved our call center's response time by 13 percent through a series of technology enhancements and contracting for peak-season help.

Today we are a more fluid and responsive company and we intend to keep growing and evolving. It's what we've all come to expect from NW Natural.

# Purpose, prosperity, sustainability.

There are utilities – and there's the larger energy industry. NW Natural is ready to expand its role beyond local gas distribution to participate more fully in the regional energy business. We are making investments that are positioned to add shareholder value as natural gas becomes even more important to the nation's energy portfolio.

It may not seem that a small, independent natural gas utility based in Oregon

*can influence the regional energy picture.*

But that's exactly what we plan to do. And here's how.



First, we know what we're good at. We're great at building and operating storage facilities. We do an excellent job of building and managing pipelines. Secondly, we know how to read the writing on the wall.

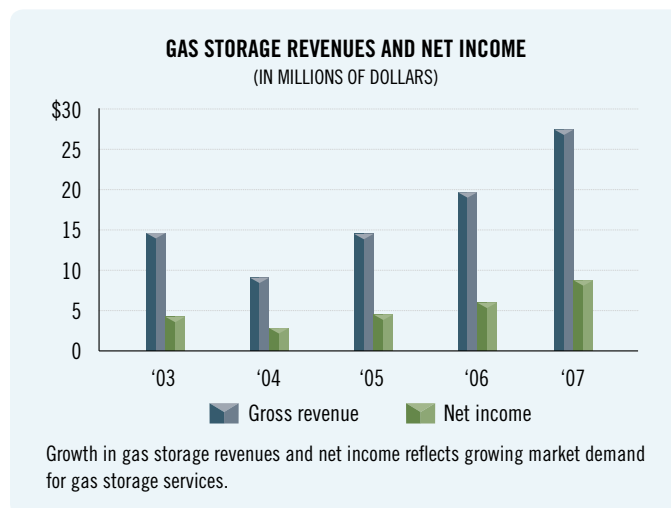
Today, that writing says the U.S. is going to be relying on natural gas to reduce greenhouse gas emissions causing climate change. In the Northwest alone, demand for natural gas is projected to increase by nearly 7.5 percent over the next four years, and could grow as high as 30 percent over the next two decades.\*

While we're not in the gas exploration business, we can build on what we know to help West Coast gas customers access the supplies they need at a price they can afford.

That's why in 2007 we expanded our own underground storage facilities in Oregon. We also took the first steps to develop storage in California and a new major pipeline, called Palomar, connecting our system to the TransCanada interstate system.

From our vantage point, we see changes coming in the nation's energy policy and in our region's energy needs. Our storage and transportation projects will support the West Coast's energy-dependent economy as carbon constraints limit fuel options. These investments will also strengthen the foundation of NW Natural for future customers, employees and shareholders.

\* NWGA, *Natural Gas & Climate Change in the Pacific Northwest, 2007.*





# Accountable to future generations.

As climate change becomes a growing concern, customers are looking to NW Natural for help reducing greenhouse gas emissions. We're using a variety of strategies, tools and programs to meet our customers' needs at the same time we're modifying our own practices to reduce the environmental impacts of our operations.

In the Pacific Northwest,

*we have a strong connection to nature*

and value the gifts it provides.



Natural resources are the backbone of a healthy, vibrant and prosperous society. These resources must be used wisely to allow future generations the same opportunities and quality of life enjoyed today.

We have listened to our customers' concerns about climate change and consider it an opportunity and obligation to develop strategies that reduce greenhouse gas emissions. Our pioneering rate structure encourages energy efficiency and supports programs that help customers reduce their gas use. Last year, these programs\* saved enough gas to heat 4,300 homes. This model has been adopted by many natural gas utilities throughout the United States.

**81 percent of customers surveyed**

said they supported our development of a voluntary program

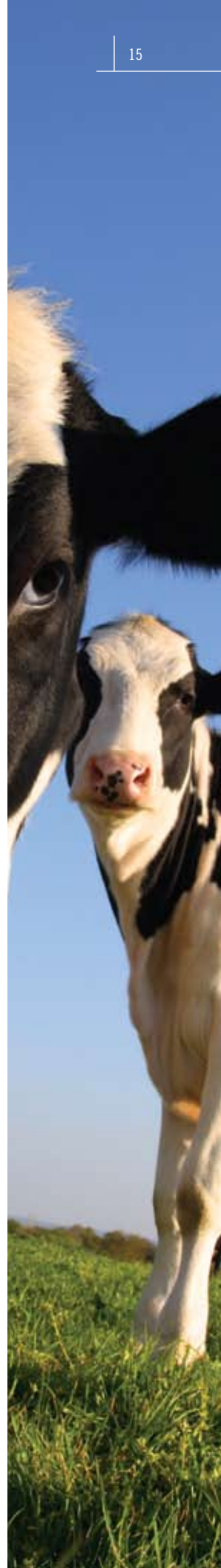
**to help reduce carbon emissions.**

Last year, we expanded our low-income weatherization program to help Oregonians earning 60 to 80 percent of the state's median income, making us one of the first utilities in the nation to reach out to this group. Our goal is to help the working poor and seniors make simple home improvements that reduce their energy use. We also became the first stand-alone gas utility in the country to offer customers a carbon offset program. These progressive solutions protect the environment while supporting the economy.

We recognize that we cannot ask others to do something that we wouldn't do ourselves. Across our company, we are rethinking our work and discovering new ways to reduce our environmental footprint. A team of engineers and gas supply staff developed an innovative operating procedure that prevents methane from being released into the atmosphere during pipeline projects. The first time this new method was used, it reduced the greenhouse gas equivalent of taking 118 cars off the road for one year.

We're also putting technology and processes in place to measure our own carbon output and using socially responsible vendors and purchasing ecologically friendly products to lessen our impact on the planet. Protecting this beautiful place we call home isn't just another business goal for us, it's a passion we share with our customers.

\* Offered by Energy Trust of Oregon.



# Comparative Consolidated INCOME STATEMENTS



Thousands, except per share amounts (year ended December 31)	2007	2006	2005	2004	2003
<b>Operating revenues:</b>					
Gross operating revenues	\$ 1,033,193	\$ 1,013,172	\$ 910,486	\$ 707,604	\$ 611,256
Cost of sales	639,150	648,156	563,860	399,244	323,190
Revenue taxes	25,001	24,840	21,633	16,865	14,650
Net operating revenues	369,042	340,176	324,993	291,495	273,416
<b>Operating expenses:</b>					
Operations and maintenance	120,488	114,560	113,216	102,155	96,420
General taxes	25,288	24,419	23,185	21,943	20,475
Depreciation and amortization	68,343	64,435	61,645	57,371	54,249
Total operating expenses	214,119	203,414	198,046	181,469	171,144
<b>Income from operations</b>	154,923	136,762	126,947	110,026	102,272
<b>Other income and expense - net</b>	1,445	2,134	1,205	2,828	2,150
<b>Interest charges - net</b>	37,811	39,247	37,283	35,751	35,099
<b>Income before income taxes</b>	118,557	99,649	90,869	77,103	69,323
<b>Income taxes</b>	44,060	36,234	32,720	26,531	23,340
<b>Net income</b>	74,497	63,415	58,149	50,572	45,983
Redeemable preferred stock dividend requirements	—	—	—	—	294
<b>Earnings applicable to common stock</b>	\$ 74,497	\$ 63,415	\$ 58,149	\$ 50,572	\$ 45,689
<b>Average common shares outstanding:</b>					
Basic	26,821	27,540	27,564	27,016	25,741
Diluted	26,995	27,657	27,621	27,283	26,061
<b>Earnings per share of common stock:</b>					
Basic	\$ 2.78	\$ 2.30	\$ 2.11	\$ 1.87	\$ 1.77
Diluted	\$ 2.76	\$ 2.29	\$ 2.11	\$ 1.86	\$ 1.76
<b>Dividends per share of common stock</b>	\$ 1.44	\$ 1.39	\$ 1.32	\$ 1.30	\$ 1.27

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





## Comparative Consolidated BALANCE SHEETS

Thousands (December 31)	2007	2006	2005	2004	2003
<b>Assets:</b>					
<b>Plant and property:</b>					
Utility plant	\$ 2,052,161	\$ 1,963,498	\$ 1,875,444	\$ 1,794,972	\$ 1,657,589
Less accumulated depreciation	615,533	574,093	536,867	505,286	471,716
Utility plant - net	1,436,628	1,389,405	1,338,577	1,289,686	1,185,873
Non-utility property	67,149	42,652	40,836	33,963	23,395
Less accumulated depreciation and amortization	7,904	6,916	5,990	5,244	4,855
Non-utility property - net	59,245	35,736	34,846	28,719	18,540
Total plant and property	1,495,873	1,425,141	1,373,423	1,318,405	1,204,413
<b>Current assets:</b>					
Cash and cash equivalents	6,107	5,767	7,143	5,248	4,706
Accounts receivable	69,442	82,070	84,418	60,634	48,369
Accrued unbilled revenue	78,004	87,548	81,512	64,401	59,109
Allowance for uncollectible accounts	(2,890)	(3,033)	(3,067)	(2,434)	(1,763)
Inventories of gas, materials and supplies	79,944	78,128	86,161	66,477	50,859
Prepayments and other current assets	25,691	21,695	67,543	42,791	34,554
Total current assets <sup>1</sup>	256,298	272,175	323,710	237,117	195,834
<b>Regulatory assets<sup>1</sup></b>	193,536	196,280	98,851	91,263	77,272
<b>Fair value of non-trading derivatives<sup>1</sup></b>	3,227	6,557	178,653	16,399	23,885
<b>Other investments</b>	54,070	47,985	58,451	60,618	73,845
<b>Other assets</b>	11,179	8,718	9,216	8,393	10,130
<b>Total assets</b>	<b>\$ 2,014,183</b>	<b>\$ 1,956,856</b>	<b>\$ 2,042,304</b>	<b>\$ 1,732,195</b>	<b>\$ 1,585,379</b>
<b>Capitalization and liabilities:</b>					
<b>Capitalization:</b>					
Common stock equity	\$ 594,751	\$ 599,545	\$ 586,931	\$ 568,517	\$ 506,316
Long-term debt	512,000	517,000	521,500	479,500	494,500
Total capitalization	1,106,751	1,116,545	1,108,431	1,052,544	1,006,635
<b>Current liabilities:</b>					
Notes payable	143,100	100,100	126,700	102,500	85,200
Accounts payable	119,731	113,579	135,287	102,478	86,029
Long-term debt due within one year	5,000	29,500	8,000	15,000	—
Taxes accrued	13,259	21,230	12,725	10,242	8,605
Interest accrued	2,827	2,924	2,918	2,897	2,998
Other current and accrued liabilities	29,794	21,455	29,916	34,168	31,589
Total current liabilities <sup>1</sup>	313,711	288,788	315,546	267,285	214,421
<b>Regulatory liabilities<sup>1</sup></b>	275,090	214,901	344,487	165,699	166,714
<b>Deferred income taxes and investment tax credits</b>	206,340	210,084	227,400	216,740	178,742
<b>Fair value of non-trading derivatives<sup>1</sup></b>	18,587	49,803	6,876	5,487	—
<b>Other liabilities</b>	93,704	76,735	39,564	24,440	18,867
<b>Total capitalization and liabilities</b>	<b>\$ 2,014,183</b>	<b>\$ 1,956,856</b>	<b>\$ 2,042,304</b>	<b>\$ 1,732,195</b>	<b>\$ 1,585,379</b>

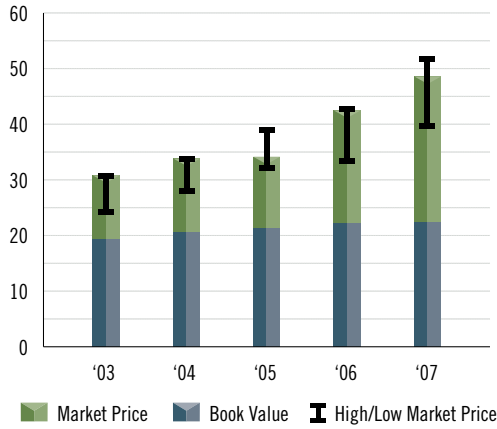
<sup>1</sup> Current and long-term portions of regulatory assets, regulatory liabilities and fair value of non-trading derivatives are combined for presentation above.

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

# Comparative Financial STATISTICS

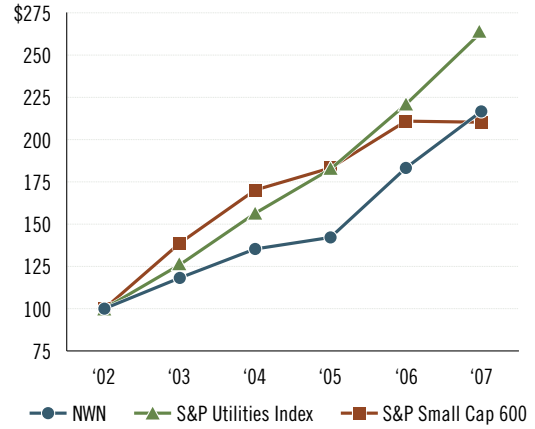


**Year-End Market Price & Book Value Per Share**  
(IN DOLLARS)



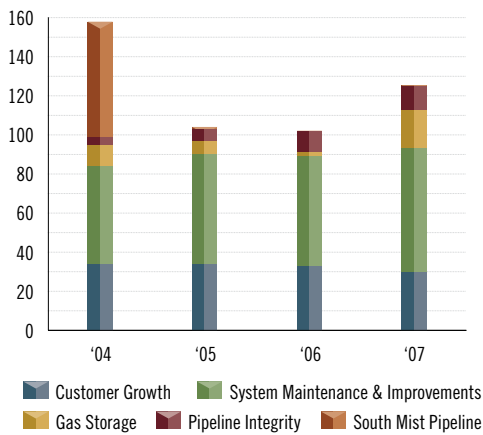
The year-end market-to-book ratio averaged 1.78x over the past five years. Total annualized return to shareholders (dividends paid plus market appreciation) was 16.7 percent for the five-year period ending December 31, 2007.

**Comparison of Five-Year Cumulative Total Return**  
(BASED ON \$100 INVESTED ON 12/31/02)



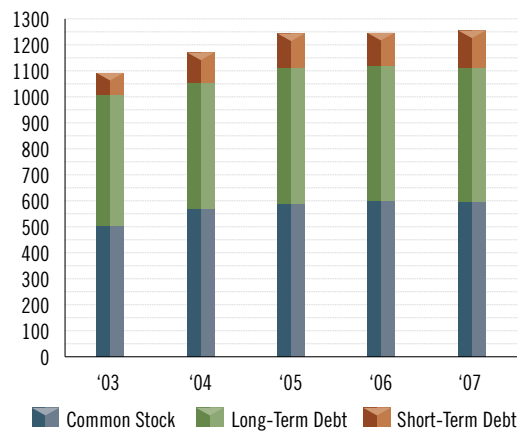
Our total annualized return over the five-years ending December 31, 2007 was 16.7 percent, compared to the Standard & Poor's (S&P) Small Cap 600 Index rate of 16.0 percent and the S&P Electric & Gas Utilities Index rate of 21.4 percent.

**Capital Expenditures**  
(IN MILLIONS OF DOLLARS)



Focusing on profitable capital expenditures improved earnings and cash flows. Our capital expenditures for gas storage increased in 2007 due to strong market demand for storage services.

**Capitalization**  
(IN MILLIONS OF DOLLARS)



In 2007, \$38.6 million in cash dividends were paid to common shareholders, \$44.6 million was used for share repurchases and \$29.5 million of long-term debt was retired.



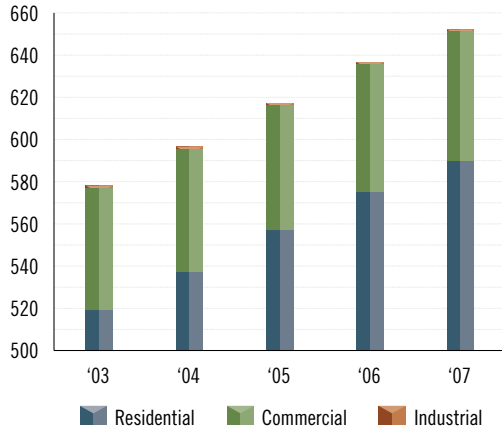
## Comparative Financial STATISTICS

	2007	2006	2005	2004	2003
<b>Common stock</b>					
<b>Ratios at year-end:</b>					
Price/earnings ratio	17.5	18.5	16.2	18.0	17.3
Dividend yield at year-end rate - %	3.1	3.3	4.0	3.9	4.1
Dividend payout - %	51.8	60.4	62.6	69.5	71.8
Return on average common equity - %	12.5	10.7	10.1	9.4	9.3
<b>Per share data - (\$):</b>					
Basic earnings	2.78	2.30	2.11	1.87	1.77
Diluted earnings	2.76	2.29	2.11	1.86	1.76
Dividends paid	1.44	1.39	1.32	1.30	1.27
Dividend rate at year-end	1.50	1.42	1.38	1.30	1.30
Book value at year-end	22.52	21.97	21.28	20.64	19.52
<b>Market price:</b>					
High	52.85	43.69	39.63	34.13	31.30
Low	39.79	32.83	32.42	27.46	24.05
Year-end	48.66	42.44	34.18	33.74	30.75
Average	46.20	36.98	35.92	31.06	27.72
<b>Number of shares of common stock outstanding (000):</b>					
Year-end	26,407	27,284	27,579	27,547	25,938
Average	26,821	27,540	27,564	27,016	25,741
<b>Coverage data (ratio of earnings to)</b>					
Fixed charges - Securities and Exchange Commission method	3.92	3.40	3.32	3.02	2.84
<b>Cash flow data (\$000)</b>					
Cash provided by operating activities	183,640	148,566	79,066	104,899	105,254
Cash used in investing activities	(117,479)	(90,567)	(92,008)	(132,631)	(124,801)
<b>Utility plant</b>					
Capital expenditures (\$000)	93,785	95,307	89,259	138,347	121,411
Depreciation - % of average depreciable utility plant	3.4	3.4	3.4	3.4	3.5
Accumulated depreciation - % of depreciable utility plant	40.8	39.6	38.4	37.2	38.0
<b>Capital structure at year-end (%)</b>					
<b>(Exclusive of current portion of long-term debt)</b>					
First mortgage bonds	46.3	46.3	47.0	45.6	49.0
Unsecured debt	0.0	0.0	0.0	0.4	0.7
Total long-term debt	46.3	46.3	47.0	46.0	49.7
Common stock equity	53.7	53.7	53.0	54.0	50.3
Total capital structure	100.0	100.0	100.0	100.0	100.0
<b>Effective tax rate</b>					
Effective tax rate - % of pretax income	37	36	36	34	34

# Comparative Operating STATISTICS

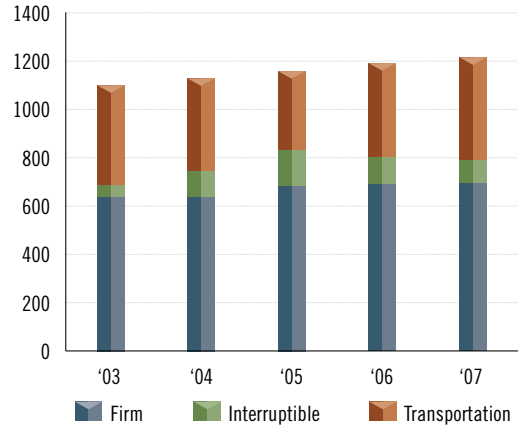


**Total Customers**  
(IN THOUSANDS)



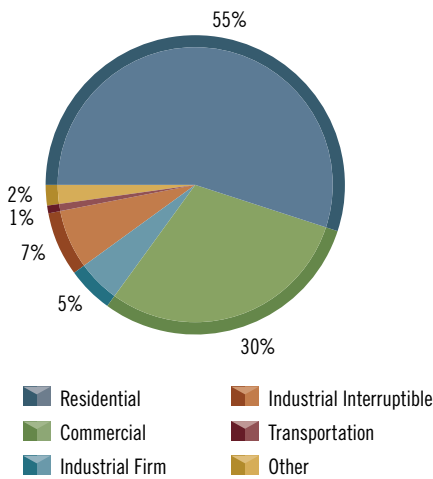
We added 15,428 new customers in 2007, expanding our customer base by 2.4 percent. In the past five years, we have added over 91,000 new customers.

**Gas Sales and Transportation Deliveries**  
(IN MILLIONS OF THERMS)



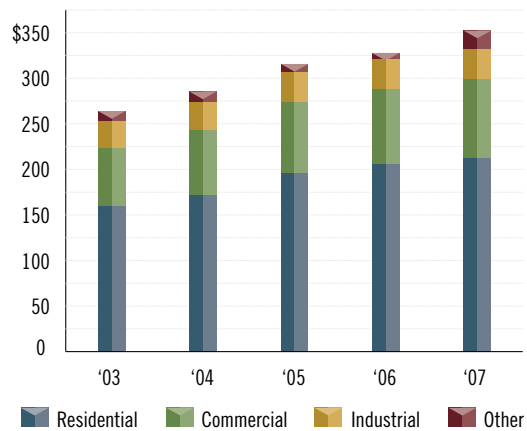
Gas sales and transportation deliveries in 2007 were 2 percent higher at over 1.2 billion therms, due primarily to strong customer growth in residential and commercial segments.

**Utility Gas Revenues**  
(BY CLASS)



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

**Utility Net Operating Revenues (Margin)**  
(IN MILLIONS OF DOLLARS)



We continue to see growth in utility margin, with an increase of 33 percent over the past five years.



## Comparative Operating STATISTICS

Selected Utility Data	2007	2006	2005	2004	2003
<b>Gas sales and transportation deliveries (000 therms)</b>					
Residential	398,960	382,665	371,538	352,356	343,534
Commercial	249,659	242,683	233,987	222,875	226,257
Industrial firm	52,340	66,971	74,880	62,843	55,314
Industrial interruptible	89,128	112,736	149,106	104,278	47,994
Unbilled therms *	—	—	—	—	12,099
Total gas sales	790,087	805,055	829,511	742,352	685,198
Transportation	424,882	387,594	328,056	389,514	414,554
Total volumes delivered	1,214,969	1,192,649	1,157,567	1,131,866	1,099,752
<b>Operating revenues and cost of sales (000)</b>					
Utility operating revenues:					
Residential	\$ 555,312	\$ 536,468	\$ 471,502	\$ 383,067	\$ 328,346
Commercial	298,800	290,666	250,287	200,424	176,336
Industrial firm	54,567	66,986	64,507	45,259	33,578
Industrial interruptible	74,876	93,107	100,740	55,380	23,661
Total gas sales revenues	983,555	987,227	887,036	684,130	561,921
Transportation	14,191	12,800	10,755	12,655	17,962
Unbilled revenues *	—	—	—	—	14,474
Regulatory adjustment for income taxes paid **	5,996	—	—	—	—
Other	12,228	161	2,862	4,160	7,627
Total utility operating revenues	1,015,970	1,000,188	900,653	700,945	601,984
Cost of gas sold	639,094	648,081	563,772	399,176	323,128
Revenue taxes	25,001	24,840	21,633	16,865	14,650
Utility net operating revenues	\$ 351,875	\$ 327,267	\$ 315,248	\$ 284,904	\$ 264,206
<b>Customer and weather data</b>					
Total customers	652,012	636,584	617,163	596,635	578,150
Actual degree days	4,374	4,089	4,178	3,853	3,952
Percent colder (warmer) than average	3%	(4)%	(2)%	(10)%	(7)%
Average use per customer in therms:					
Residential	687	678	673	677	673
Commercial	4,110	4,052	3,936	3,907	4,004
<b>Gas purchases (000 therms)</b>					
Gas purchased cost per therm - net (cents)	75.00	75.37	71.42	56.60	46.99
Average sendout cost of gas (cents)	80.89	80.50	67.96	53.77	47.16
Maximum day firm sendout (000 therms)	5,845	5,672	5,649	7,177	4,851
Maximum day total sendout (000 therms)	7,344	7,401	6,966	8,913	6,310
<b>Utility employees</b>					
Number of customers served by each operating employee	924	845	738	721	724

\* Unbilled therms and revenues have been allocated by customer class for the years 2004 through 2007.

\*\* Regulatory adjustment for income taxes paid is the result of the implementation in 2007 of utility regulation as described in our Annual Report on Form 10-K.



## Corporate Officers

*From left to right:*

Grant Yoshihara, Gregg Kantor,  
Margaret Kirkpatrick, Richelle Luther,  
David Anderson, C. J. Rue, Steve Feltz,  
Mark Dodson, Keith White,  
Lea Anne Doolittle, Dave Williams

*Photographed at the Crystal Springs  
Rhododendron Garden - Portland, Oregon.*

**DAVID H. ANDERSON, 46 [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)

**MARK S. DODSON, 63 [1997]**

**Chief Executive Officer (2007-present)**

President and Chief Executive  
Officer (2003-2007)  
President and Chief Operating  
Officer (2001-2002)  
General Counsel (1997-2002)  
Senior Vice President, Public Affairs  
(1997-2001)

**LEA ANNE DOOLITTLE, 53 [2000]**

**Senior Vice President (2008-present)**

Vice President, Human Resources  
(2000-2007)  
Director of Compensation, PacifiCorp  
(1993-2000)

**STEPHEN P. FELTZ, 52 [1982]**

**Treasurer and Controller (1999-present)**

Assistant Treasurer and Manager,  
General Accounting (1996-1999)

**GREGG S. KANTOR, 50 [1996]**

**President and Chief Operating Officer (2007-present)**

Executive Vice President (2006-2007)  
Senior Vice President, Public and  
Regulatory Affairs (2003-2006)  
Vice President, Public Affairs and  
Communications (1998-2002)

**MARGARET D. KIRKPATRICK, 53 [2005]**

**Vice President and General Counsel (2005-present)**

Partner, Stoel Rives LLP (1990-2005)

**RICHELLE T. LUTHER, 39 [2002]**

**Chief Governance Officer and Corporate Secretary (2008-present)**

Assistant Secretary (2002-2007)  
Associate, Stoel Rives LLP (1997-2002)

**C. J. RUE, 62 [1974]**

**Secretary (1982-2007)\***

Assistant Treasurer (1987-2007)

**J. KEITH WHITE, 55 [1996]**

**Vice President Business Development and Energy Supply and Chief Strategic Officer (2007-present)**

Managing Director, Gas Operations and  
Wholesale Services and Chief Strategic  
Officer (2005-2007)  
Managing Director, Chief Strategic  
Officer (2003-2005)

**DAVID R. WILLIAMS, 55 [1978]**

**Vice President Utility Services (2007-present)**

Director, Utility Operations  
and Labor Relations (2005-2006)  
General Manager, Utility Operations  
(1999-2005)

**GRANT M. YOSHIHARA, 53 [1991]**

**Vice President Utility Operations (2007-present)**

Managing Director, Utility Services  
(2005-2006)  
General Manager, Consumer Services  
(2003-2005)

[Date joined NW Natural]

\*Mr. Rue retired December 31, 2007.

# Board of Directors



**TIMOTHY P. BOYLE, 58**

President and Chief Executive Officer  
Columbia Sportswear Company  
Portland, Oregon  
[2003] (3) (5) (6)



**MARTHA L. "STORMY" BYORUM, 59**

Senior Managing Director  
Stephens Cori Capital Advisors  
New York, New York  
[2004] (2) (6)



**JOHN D. CARTER, 62**

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



**MARK S. DODSON, 63**

Chief Executive Officer  
NW Natural  
Portland, Oregon  
[2003]



**C. SCOTT GIBSON, 55**

President  
Gibson Enterprises  
Portland, Oregon  
[2002] (3) (4) (5)



**TOD R. HAMACHEK, 55**

Former Chairman and Chief  
Executive Officer  
Penwest Pharmaceuticals Company  
Seattle, Washington  
[1986] (1) (2) (5)



**RANDALL C. PAPÉ, 57**

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



**JANE L. PEVERETT, 49**

President and Chief Executive Officer  
British Columbia  
Transmission Corporation  
Vancouver, British Columbia  
[2007] (2) (5)



**GEORGE J. PUENTES, 60**

President  
Don Pancho Authentic  
Mexican Foods, Inc.  
Salem, Oregon  
[2007] (4) (6)



**RICHARD G. REITEN, 68**

Chairman of the Board  
NW Natural  
Portland, Oregon  
[1996] (1) (4) (5) (6)



**KENNETH THRASHER, 58**

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



**RUSSELL F. TROMLEY, 68**

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

# Quarterly FINANCIAL INFORMATION



## Quarterly Financial Information (unaudited)

Dollars (thousands except per share amounts)

	March 31	June 30	Sept. 30	Dec. 31	Total
<b>2007</b>					
Operating revenues	\$394,091	\$183,249	\$124,245	\$331,608	\$1,033,193
Net operating revenues	139,008	64,118	49,663	116,253	369,042
Net income (loss)	48,075	2,617	(5,908)	29,713	74,497
Basic earnings (loss) per share	1.77	0.10	(0.22)	1.12	2.78*
Diluted earnings (loss) per share	1.76	0.10	(0.22)	1.11	2.76*
<b>2006</b>					
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*

\* 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 our business.

## 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 2006 and 2007 was:

### 2007

Quarter Ended	High	Low
March 31	\$46.34	\$39.79
June 30	52.85	44.05
September 30	49.37	40.98
December 31	50.89	44.28

### 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

The closing quotations for the common stock on Dec. 31, 2007 and Dec. 29, 2006 were \$48.66 and \$42.44, respectively.



## Quarterly FINANCIAL INFORMATION

### Notice of Annual Meeting

The 2008 Annual Meeting will be held at 2 p.m., Thursday, May 22, 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.

### Scheduled Payment Dates

February 15, 2008  
 May 15, 2008  
 August 15, 2008  
 November 14, 2008

### Certifications

The Chief Executive Officer certified to the NYSE on June 1, 2007 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 (SEC), as exhibits 31.1 and 31.2 to its Annual Report on Form 10-K for the year ended December 31, 2006, 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, 2007, 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 SEC on Forms 10-K and 10-Q.

### Shareholder Information



Robert S. Hess  
 Investor Relations  
 (503) 220-2388  
 (800) 422-4012 Ext. 2388  
 rsh@nwnatural.com



Kimberlee V. Anderson  
 Shareholder Services  
 (503) 226-4211 Ext. 3412  
 (800) 422-4012 Ext. 3412  
 kva@nwnatural.com

### Request for Publications

The following publications may be obtained without charge by contacting the Corporate Secretary at NW Natural's address. 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 SEC, also are available on NW Natural's Web site at nwnatural.com. Our SEC filings are also available in the public reference room of the SEC at 100 F Street NE, Washington, DC 20549, by calling (800) 732-0330 or by accessing the SEC website at www.sec.gov.

### Stock Transfer Agent and Registrar

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

### 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  
 (800) 735-7777



### NW Natural®

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 nwnatural.com  
 NYSE: NWN

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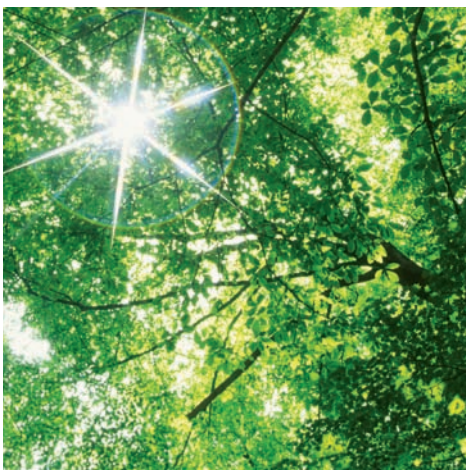
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Portland, Oregon 97209  
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NYSE: NWN

