

CANADIAN PACIFIC RAILWAY LTD/CN
Form 6-K
July 28, 2010

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 6-K
Report of Foreign Issuer
Pursuant to Rule 13a-16 or 15d-16 of
the Securities Exchange Act of 1934
For the month of July, 2010

CANADIAN PACIFIC RAILWAY LIMITED

(Commission File No. 1-01342)

CANADIAN PACIFIC RAILWAY COMPANY

(Commission File No. 1-15272)

(translation of each Registrant's name into English)

Suite 500, Gulf Canada Square, 401 9th Avenue, S.W., Calgary, Alberta, Canada, T2P 4Z4

(address of principal executive offices)

Indicate by check mark whether the registrants file or will file annual reports under cover Form 20-F or Form 40-F.

Form 20-F Form 40-F

Indicate by check mark if the registrants are submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(1):

Indicate by check mark if the registrants are submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(7):

Indicate by check mark whether the registrants by furnishing the information contained in this Form are also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934.

Yes No

If Yes is marked, indicate below the file number assigned to the registrant in connection with Rule 12g3-2(b):
82-_____

This Report furnished on Form 6-K shall be incorporated by reference into each of the following Registration Statements under the Securities Act of 1933 of the registrant: Form S-8 No. 333-140955 (Canadian Pacific Railway Limited), Form S-8 No. 333-127943 (Canadian Pacific Railway Limited) and Form S-8 No. 333-13962 (Canadian Pacific Railway Limited).

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, each registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

CANADIAN PACIFIC RAILWAY LIMITED
(Registrant)

Date: July 28, 2010

By: Signed: Karen L. Fleming
Name: Karen L. Fleming
Title: Corporate Secretary

CANADIAN PACIFIC RAILWAY COMPANY
(Registrant)

Date: July 28, 2010

By: Signed: Karen L. Fleming
Name: Karen L. Fleming
Title: Corporate Secretary

CANADIAN PACIFIC ANNOUNCES SECOND-QUARTER RESULTS

CALGARY Canadian Pacific Railway Limited (TSX/NYSE: CP) today announced second-quarter net income of \$166.6 million. Diluted earnings per share were \$0.98, up 23 per cent from \$0.80 in the second-quarter 2009 which included a \$0.41 per share gain from an asset sale.

We leveraged volume growth in the quarter to deliver a solid financial performance through a keen focus on cost management, said Fred Green, President and CEO. Our emphasis on safety, productivity and asset velocity is improving service reliability for our customers.

SECOND-QUARTER 2010 COMPARED WITH SECOND-QUARTER 2009

Adjusted diluted earnings per share increased 96 per cent to \$0.92

Total revenues were up 20 per cent to \$1.23 billion

Operating income increased 48 per cent to \$274.1 million

Adjusted earnings increased 97 per cent to \$156.2 million

Operating ratio improved 430 basis points to 77.8 per cent

Markets are likely to remain volatile, added Green. Our proven track record of quickly adjusting our resources to meet changing volume demands position us well for the second half.

Presentation of non-GAAP earnings measures

CP presents non-GAAP earnings measures in this news release to provide an additional basis for evaluating underlying earnings and liquidity trends in its business that can be compared with prior periods' results of operations. When foreign exchange gains and losses on long-term debt and other specified items are excluded from diluted earnings per share, income and income tax expense, these are non-GAAP measures.

These non-GAAP earnings measures exclude foreign currency translation effects on long-term debt and related income taxes, which can be volatile and short term. The impact of volatile short-term rate fluctuations on foreign-denominated debt is only realized when long-term debt matures or is settled. A reconciliation of income, excluding foreign exchange gains and losses on long-term debt and other specified items, to net income as presented in the financial statements is detailed in the attached Summary of Rail Data. In addition, these non-GAAP measures exclude other specified items (described below) that are not a part of CP's normal ongoing revenues and operating expenses.

Net income and diluted earnings per share, excluding foreign exchange gains and losses on long-term debt and other specified items, are referred to in this news release as Adjusted earnings and Adjusted diluted earnings per share.

Other specified items are material transactions that may include, but are not limited to, restructuring and asset impairment charges, gains and losses on non-routine sales of assets, unusual income tax adjustments, and other items that do not typify normal business activities.

The non-GAAP earnings measures described in this news release have no standardized meanings and are not defined by accounting principles generally accepted in the United States and, therefore, are unlikely to be comparable to similar measures presented by other companies.

FOREIGN EXCHANGE GAIN AND LOSS ON LONG-TERM DEBT AND OTHER SPECIFIED ITEMS

CP had a net foreign exchange gain on long-term debt of \$9.4 million after tax in the second-quarter of 2010, compared with a loss of \$15.7 million after tax in second-quarter of 2009.

As part of a consolidated financing strategy, CP structures its U.S. dollar long-term debt in different taxing jurisdictions. As well, a portion of this debt is designated as a net investment hedge against the net investment in foreign subsidiaries. Although the taxes on foreign exchange gains and losses on long-term debt generally offset one another, because they may be in different tax jurisdictions, the resulting net tax can vary significantly.

In the second quarter of 2010 the Company recorded an unrealized gain of \$1.0 million after tax as a result of the change in the market assumptions used to estimate the fair value of our investment in long-term floating rate notes. Other specified items in the second-quarter of 2009 included an after tax gain on the sale of a portion of CP's interest in the Detroit River Tunnel Partnership of \$68.7 million. There was also a gain in 2009 in the fair value of long-term floating rates of \$3.2 million after tax as a result of the change in the market assumptions.

For the first six months of 2010, CP had a foreign exchange gain on long-term debt of \$6.3 million after tax, compared to a loss of \$9.2 million after tax in the first half of 2009. CP also had a gain on long-term floating rate notes of \$1.9 million after tax, down from \$3.2 million after tax in the first half of 2009.

CP began reporting its financial results in accordance with U.S. GAAP as of January 1, 2010. All prior period comparative numbers contained in this release are to U.S. GAAP. Additional historical U.S. GAAP financial reports can be found at www.cpr.ca.

Note on forward-looking information

This news release contains certain forward-looking statements relating but not limited to our operations, anticipated financial performance and business prospects. Undue reliance should not be placed on forward-looking information as actual results may differ materially.

By its nature, CP's forward-looking information involves numerous assumptions, inherent risks and uncertainties, including but not limited to the following factors: changes in business strategies; general North American and global economic, credit and business conditions; risks in agricultural production such as weather conditions and insect populations; the availability and price of energy commodities; the effects of competition and pricing pressures; industry capacity; shifts in market demand; changes in laws and

regulations, including regulation of rates; changes in taxes and tax rates; potential increases in maintenance and operating costs; uncertainties of litigation; labour disputes; risks and liabilities arising from derailments; transportation of dangerous goods, timing of completion of capital and maintenance projects; currency and interest rate fluctuations; effects of changes in market conditions and discount rates on the financial position of pension plans and investments, including long-term floating rate notes; and various events that could disrupt operations, including severe weather conditions, security threats and governmental response to them, and technological changes.

There are factors that could cause actual results to differ from those described in the forward-looking statements contained in this news release. These more specific factors are identified and discussed elsewhere in this news release with the particular forward-looking statement in question.

Except as required by law, CP undertakes no obligation to update publicly or otherwise revise any forward-looking information, whether as a result of new information, future events or otherwise.

About Canadian Pacific:

Canadian Pacific, through the ingenuity of its employees located across Canada and in the United States, remains committed to being the safest, most fluid railway in North America. Our people are the key to delivering innovative transportation solutions to our customers and to ensuring the safe operation of our trains through the more than 1,100 communities where we operate. Our combined ingenuity makes Canadian Pacific a better place to work, rail a better way to ship, and North America a better place to live. Come and visit us at www.cpr.ca to see how we can put our ingenuity to work for you.

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CANADIAN PACIFIC RAILWAY LIMITED
CONSOLIDATED STATEMENT OF INCOME
(in millions of Canadian dollars, except per share data)
(unaudited)

	For the three months ended June 30		For the six months ended June 30	
		2009		2009
	2010	Restated (see Note 2)	2010	Restated (see Note 2)
Revenues				
Freight	\$ 1,202.2	\$ 1,001.4	\$ 2,340.4	\$ 2,077.4
Other	32.0	29.9	60.6	63.5
	1,234.2	1,031.3	2,401.0	2,140.9
Operating expenses				
Compensation and benefits	349.7	324.5	703.5	667.5
Fuel	177.9	117.7	359.6	288.7
Materials	51.0	53.5	115.0	130.2
Equipment rents	54.9	55.1	103.9	121.5
Depreciation and amortization	123.3	123.2	244.5	239.4
Purchased services and other	203.3	172.4	393.8	373.9
	960.1	846.4	1,920.3	1,821.2
Operating income	274.1	184.9	480.7	319.7
Gain on sale of partnership interest (<i>Note 4</i>)		81.2		81.2
Less:				
Other (income) and charges	(3.4)	9.6	(8.3)	18.1
Interest expense	64.8	72.6	131.5	144.2
Income before income tax expense	212.7	183.9	357.5	238.6
Income tax expense (<i>Note 5</i>)	46.1	48.4	89.9	44.1
Net income	\$ 166.6	\$ 135.5	\$ 267.6	\$ 194.5
Earnings per share (<i>Note 6</i>)				
Basic earnings per share	\$ 0.99	\$ 0.81	\$ 1.59	\$ 1.18

Diluted earnings per share	\$ 0.98	\$ 0.80	\$ 1.58	\$ 1.18
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**Weighted average number of shares
(millions)**

Basic	168.6	168.0	168.6	164.5
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Diluted	169.2	168.4	169.0	164.7
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Dividends declared per share	\$ 0.2700	\$ 0.2475	\$ 0.5175	\$ 0.4950
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See notes to consolidated financial statements.

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CANADIAN PACIFIC RAILWAY LIMITED
CONSOLIDATED BALANCE SHEET
(in millions of Canadian dollars)
(unaudited)

	June 30 2010	December 31 2009 Restated (see Note 2)
Assets		
Current assets		
Cash and cash equivalents	\$ 373.6	\$ 679.1
Accounts receivable, net	441.2	655.1
Materials and supplies	136.8	132.7
Deferred income taxes	137.6	128.1
Other current assets	62.2	46.5
	1,151.4	1,641.5
Investments	167.9	156.7
Net properties	12,044.5	11,978.5
Goodwill and intangible assets	204.0	202.3
Other assets	171.2	175.8
Total assets	\$13,739.0	\$14,154.8
Liabilities and shareholders equity		
Current liabilities		
Accounts payable and accrued liabilities	\$ 897.7	\$ 927.1
Income and other taxes payable	36.1	31.9
Dividends payable	45.5	41.7
Long-term debt maturing within one year	40.2	605.3
	1,019.5	1,606.0
Pension and other benefits liabilities	1,252.2	1,453.9
Other long-term liabilities	486.8	479.9
Long-term debt	4,160.4	4,138.2
Deferred income taxes	1,938.1	1,818.7
Total liabilities	8,857.0	9,496.7
Shareholders equity		
Share capital	1,780.8	1,771.1
Additional paid-in capital	29.4	30.8
Accumulated other comprehensive loss	(1,709.5)	(1,744.7)

Retained earnings	4,781.3	4,600.9
	4,882.0	4,658.1
<i>Total liabilities and shareholders equity</i>	\$13,739.0	\$14,154.8

Commitments and contingencies (*Note 12*)
See notes to consolidated financial statements.

CANADIAN PACIFIC RAILWAY LIMITED
CONSOLIDATED STATEMENT OF CASH FLOWS
(in millions of Canadian dollars)
(unaudited)

	For the three months ended June 30		For the six months ended June 30	
	2010	2009 Restated (see Note 2)	2010	2009 Restated (see Note 2)
Operating activities				
Net income	\$ 166.6	\$ 135.5	\$ 267.6	\$ 194.5
Reconciliation of net income to cash provided by operating activities:				
Depreciation and amortization	123.3	123.2	244.5	239.4
Deferred income taxes (Note 5)	43.5	53.3	85.1	43.8
Gain on sale of partnership interest		(81.2)		(81.2)
Restructuring and environmental payments	(6.0)	(10.5)	(11.6)	(19.0)
Pension funding in excess of expense	(150.7)	(17.3)	(160.0)	(32.6)
Other operating activities, net	0.4	(16.7)	17.8	(12.4)
Change in non-cash working capital balances related to operations	10.0	(51.2)	(72.0)	(63.1)
Cash provided by operating activities	187.1	135.1	371.4	269.4
Investing activities				
Additions to properties	(168.0)	(246.4)	(258.8)	(368.6)
Proceeds from the sale of properties and other assets	17.4	144.3	26.4	152.3
Proceeds from sale of long-term floating rate notes		12.3		12.3
Cash used in investing activities	(150.6)	(89.8)	(232.4)	(204.0)
Financing activities				
Dividends paid	(41.7)	(41.7)	(83.4)	(79.7)
Issuance of CP Common Shares	3.9	3.4	6.9	499.2
Collection of receivable from financial institution	219.8		219.8	
Net decrease in short-term borrowing		(76.4)		(94.5)
Issuance of long-term debt		409.5		409.5
Repayment of long-term debt	(581.2)	(593.3)	(590.3)	(606.5)
Other financing activities	0.2	29.2	0.2	29.2

Cash (used in) provided by financing activities	(399.0)	(269.3)	(446.8)	157.2
Effect of foreign exchange fluctuations on U.S.dollar -denominated cash and cash equivalents	12.3	(8.2)	2.3	(5.8)
Cash position				
(Decrease) increase in cash and cash equivalents	(350.2)	(232.2)	(305.5)	216.8
Cash and cash equivalents at beginning of period	723.8	566.5	679.1	117.5
Cash and cash equivalents at end of period	\$ 373.6	\$ 334.3	\$ 373.6	\$ 334.3
Supplemental disclosures of cash flow information				
Income taxes paid	\$ 3.2	\$ 0.3	\$ 5.0	\$ 3.7
Interest paid (<i>Note 10</i>)	\$ 174.0	\$ 101.7	\$ 219.1	\$ 160.3

See notes to consolidated financial statements.

CANADIAN PACIFIC RAILWAY LIMITED
CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
(in millions of Canadian dollars, except common share amounts)
(unaudited)

	Common shares (in millions)	Share capital	Additional paid-in capital	Accumulated other comprehensive loss	Retained earnings	Total shareholders equity
Balance at December 31, 2009, as previously reported	168.5	\$1,771.1	\$30.8	\$(1,746.3)	\$4,665.2	\$4,720.8
Cumulative adjustment for change in accounting policy (see Note 2)				1.6	(64.3)	(62.7)
Balance at December 31, 2009, as restated	168.5	1,771.1	30.8	(1,744.7)	4,600.9	4,658.1
Net income					267.6	267.6
Other comprehensive income				35.2		35.2
Comprehensive income				35.2	267.6	302.8
Dividends declared					(87.2)	(87.2)
Stock compensation expense			0.8			0.8
Shares issued under stock option plans	0.2	9.7	(2.2)			7.5
Balance at June 30, 2010	168.7	\$1,780.8	\$29.4	\$(1,709.5)	\$4,781.3	\$4,882.0
Comprehensive income three months ended June 30, 2010				\$ 25.1	\$ 167.8	\$ 192.9

See notes to consolidated financial statements.

CANADIAN PACIFIC RAILWAY LIMITED
NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2010

(unaudited)

1 Basis of presentation

These unaudited consolidated financial statements of Canadian Pacific Railway Limited (CP , the Company or Canadian Pacific Railway) reflect management 's estimates and assumptions that are necessary for their fair presentation in conformity with accounting principles generally accepted in the United States (GAAP). They do not include all disclosures required under GAAP for annual financial statements and should be read in conjunction with the 2009 U.S. GAAP consolidated financial statements. The policies used are consistent with the policies used in preparing the 2009 U.S. GAAP consolidated financial statements, except as discussed in Note 2. The Company 's investments in which CP has significant influence, which are not consolidated, are accounted for using the equity method.

CP 's operations can be affected by seasonal fluctuations such as changes in customer demand and weather-related issues. This seasonality could impact quarter-over-quarter comparisons. The 2009 global recession has affected financial results such that seasonal fluctuations may not be consistent with those in prior years. The timing of a return to seasonal trends consistent with prior years will depend on the continued recovery of the economy and the related impact on the Company 's customers.

2 Accounting changes

Consolidations

In June 2009, the Financial Accounting Standards Board (FASB) issued Amendments to Consolidation of Variable Interest Entities. The guidance retains the scope of the previous guidance and removes the exemption of entities previously considered qualifying special purpose entities. In addition, it replaces the previous quantitative approach with a qualitative analysis approach for determining whether the enterprise 's variable interest or interests give it a controlling financial interest in a variable interest entity. The guidance is further amended to require ongoing reassessments of whether an enterprise is the primary beneficiary of a variable interest entity and requires enhanced disclosures about an enterprise 's involvement in a variable interest entity. The guidance is applicable to all variable interest entities that existed at January 1, 2010, the date of adoption, or are created thereafter. The Company has variable interests in variable interest entities, however, the adoption of the new guidance did not change the previous assessment that the Company is not the primary beneficiary and as such does not consolidate the variable interest entities. Additional note disclosure regarding the nature of the Company 's variable interests and where judgment was required to assess the primary beneficiary of these variable interest entities has been provided in Note 11.

Accounting for transfers of financial assets

The FASB has released additional guidance with respect to the accounting and disclosure of transfers of financial assets such as securitized accounts receivable. Although the Company currently does not have an accounts receivable securitization program, the guidance, which includes revisions to the derecognition criteria in a transfer and the treatment of qualifying special purpose entities, would be applicable to any future securitization. The new guidance is effective for the Company from January 1, 2010. The adoption of this guidance had no impact to the Company 's financial statements.

Fair value measurement and disclosure

In January 2010, the FASB amended the disclosure requirements related to fair value measurements. The update provides for new disclosures regarding transfers in and out of Level 1 and Level 2 financial asset and liability categories and expanded disclosures in the Level 3 reconciliation. The update also provides clarification that the level of disaggregation should be at the class level and that disclosures about inputs and valuation techniques are required for both recurring and nonrecurring fair value measurements that fall in either Level 2 or Level 3. New disclosures and clarifications of existing disclosures are effective for interim and annual reporting periods beginning after December 15, 2009, except for the expanded disclosures in the Level 3 reconciliation, which are effective for fiscal years beginning after December 15, 2010. The Company has adopted this guidance resulting in expanded note disclosure (Note 7).

CANADIAN PACIFIC RAILWAY LIMITED
NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2010

(unaudited)

2 Accounting changes (continued)

Rail Grinding

During the second quarter of 2010, the Company changed its accounting policy for the treatment of rail grinding costs. In prior periods, CP had capitalized such costs and depreciated them over the expected economic life of the rail grinding. The Company concluded that, although the accounting treatment was within acceptable accounting standards, it is preferable to expense the costs as incurred, given the subjectivity in determining the expected economic life and the associated depreciation methodology. The accounting policy change has been accounted for on a retrospective basis. The effects of the adjustment to January 1, 2010 resulted in an adjustment to decrease net properties by \$89.0 million, deferred income taxes by \$26.3 million, and shareholders equity by \$62.7 million. As a result of the change the following increases (decreases) to financial statement line items occurred:

(in millions of Canadian dollars, except per share data)

	For the three months ended June 30		For the six months ended June 30		For the year ended December 31		
	2010	2009	2010	2009	2009	2008	2007
Changes to Consolidated Statement of Income and Comprehensive Income							
Depreciation and amortization	\$ (3.8)	\$ (3.5)	\$ (7.6)	\$ (7.0)	\$ (14.0)	\$ (8.9)	\$ (9.5)
Compensation and benefits	0.3	0.7	0.6	0.8	2.8	2.7	2.0
Fuel					0.1	0.1	0.1
Materials	0.1	0.4	0.2	0.5	1.8	1.7	1.3
Purchased services and other	2.1	4.1	3.9	4.8	15.9	15.4	11.3
Total operating expenses	(1.3)	1.7	(2.9)	(0.9)	6.6	11.0	5.2
Income tax expense	0.2	(0.6)	0.6	0.3	(1.2)	(3.2)	0.4
Net income	\$ 1.1	\$ (1.1)	\$ 2.3	\$ 0.6	\$ (5.4)	\$ (7.8)	\$ (5.6)
	\$0.01	\$ (0.01)	\$0.01	\$	\$ (0.03)	\$ (0.05)	\$ (0.04)

Basic earnings per share							
Diluted earnings per share	\$0.01	\$(0.01)	\$0.01	\$	\$(0.03)	\$(0.05)	\$(0.04)
Other comprehensive income (loss)	(0.8)	1.3	(0.3)	0.7	2.4	(2.8)	2.0
Comprehensive income	\$ 0.3	\$ 0.2	\$ 2.0	\$ 1.3	\$ (3.0)	\$ (10.6)	\$ (3.6)

**Changes to
Consolidated
Statement of Cash
Flows**

Cash provided by operating activities (decrease)	\$ (2.5)	\$ (5.2)	\$ (4.7)	\$(6.1)	\$(20.6)	\$(19.9)	\$(14.7)
Cash used in investing activities (decrease)	\$ (2.5)	\$ (5.2)	\$ (4.7)	\$(6.1)	\$(20.6)	\$(19.9)	\$(14.7)

CANADIAN PACIFIC RAILWAY LIMITED
NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2010

(unaudited)

2 Accounting changes (continued)

Changes to Consolidated Balance Sheet

	As at June 30 2010	As at December 31 2009	As at December 31 2008
Net properties	\$(86.4)	\$ (89.0)	\$ (86.2)
Deferred income tax liability	(25.7)	(26.3)	(26.5)
Accumulated other comprehensive loss (income)	1.3	1.6	(0.8)
Retained earnings	(62.0)	(64.3)	(58.9)

3 Future accounting changes

There have been no new accounting pronouncements issued that are expected to have a significant impact to the Company's financial statements.

4 Gain on sale of partnership interest

During the second quarter of 2009, the Company completed a sale of a portion of its investment in the Detroit River Tunnel Partnership (DRTP) to its existing partner, reducing the Company's ownership from 50% to 16.5%. The proceeds received in the quarter from the transaction were \$110 million. Additional proceeds of \$22 million are contingent on achieving certain future freight volumes through the tunnel, and have not been recognized. The gain on this transaction was \$81.2 million (\$68.7 million after tax).

5 Income taxes

(in millions of Canadian dollars)	For the three months ended June 30 2009	For the six months ended June 30 2009
	2010	2010
	Restated (see Note 2)	Restated (see Note 2)
Current income tax expense	\$ 2.6	\$ 4.8
Deferred income tax expense	43.5	85.1
Income tax expense	\$46.1	\$89.9
	\$ (4.9)	\$ 0.3
	53.3	43.8
	\$ 48.4	\$ 44.1

During the first quarter of 2009, legislation was enacted to reduce British Columbia provincial income tax rates. As a result, the Company recorded in the first quarter of 2009 a \$6.2 million income tax benefit related to the revaluation of its deferred income tax balances as at December 31, 2008. In addition, during the three and six months ended June 30, 2009, the tax impact of foreign exchange losses increased expected income tax expense, based on the expected annual

effective tax rate, by approximately \$17 million and \$9 million, respectively. Also, for the three and six months ended June 30, 2009, the tax impact of a gain on sale of partnership interest reduced expected income tax expense by approximately \$9 million. In the three and six months ended June 30, 2010, the tax impact of foreign exchange gains decreased expected income tax expense by approximately \$9 million and \$3 million, respectively.

CANADIAN PACIFIC RAILWAY LIMITED
NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2010

(unaudited)

6 Earnings per share

At June 30, 2010, the number of shares outstanding was 168.7 million (June 30, 2009 168.1 million).

Basic earnings per share have been calculated using net income for the period divided by the weighted average number of Canadian Pacific Railway Limited shares outstanding during the period.

Diluted earnings per share have been calculated using the treasury stock method, which assumes that any proceeds received from the exercise of in-the-money options would be used to purchase Common Shares at the average market price for the period.

The number of shares used in earnings per share calculations is reconciled as follows:

(in millions)	For the three months ended June 30		For the six months ended June 30	
	2010	2009	2010	2009
Weighted average shares outstanding	168.6	168.0	168.6	164.5
Dilutive effect of stock options	0.6	0.4	0.4	0.2
Weighted average diluted shares outstanding	169.2	168.4	169.0	164.7

For the three and six months ended June 30, 2010, 1,711,200 and 2,120,421 options, respectively, were excluded from the computation of diluted earnings per share because their effects were not dilutive (three and six months ended June 30, 2009 2,809,967 and 3,101,592, respectively).

7 Financial instruments

A. Fair values of financial instruments

The Company categorizes its financial assets and liabilities measured at fair value into one of three different levels depending on the observability of the inputs employed in the measurement.

Level 1: Unadjusted quoted prices for identical assets and liabilities in active markets that are accessible at the measurement date.

Level 2: Directly or indirectly observable inputs other than quoted prices included within Level 1 or quoted prices for similar assets and liabilities. Derivative instruments in this category are valued using models or other industry standard valuation techniques derived from observable market data.

Level 3: Valuations based on inputs which are less observable, unavailable or where the observable data does not support a significant portion of the instruments' fair value. Generally, Level 3 valuations are longer dated transactions, occur in less active markets, occur at locations where pricing information is not available or have no binding broker quote to support Level 2 classifications.

When possible, the estimated fair value is based on quoted market prices and, if not available, estimates from third party brokers. For non exchange traded derivatives classified in Level 2, the Company uses standard valuation

techniques to calculate fair value. These methods include discounted mark to market for forwards, futures and swaps. Primary inputs to these techniques include observable market prices (interest, foreign exchange and commodity) and volatility, depending on the type of derivative and nature of the underlying risk. The Company uses inputs and data used by willing market participants when valuing derivatives and considers its own credit default swap spread as well as those of its counterparties in its determination of fair value. Wherever possible the Company uses observable inputs. All derivatives are classified as Level 2. A detailed analysis of the techniques used to value long-term floating rate notes, which are classified as Level 3, is discussed below.

CANADIAN PACIFIC RAILWAY LIMITED
NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2010

(unaudited)

7 Financial instruments (continued)

Gain/loss in fair value of long-term floating rate notes

At June 30, 2010 and December 31, 2009, the Company held long-term floating rate notes with a total settlement value of \$129.0 million and \$129.1 million, respectively, and carrying values of \$74.9 million and \$69.3 million, respectively. The carrying values, being the estimated fair values, are reported in Investments .

During the three and six months ended June 30, 2010, the Company received \$nil and \$0.1 million, respectively, in partial redemption of certain of the notes held. At June 30, 2010, the Company held long-term floating rate notes with settlement value, as follows:

\$116.7 million Master Asset Vehicle (MAV) 2 notes with eligible assets;

\$12.1 million MAV 2 Ineligible Asset (IA) Tracking notes; and

\$0.2 million MAV 3 Class 9 Traditional Asset (TA) Tracking notes.

The MAV 2 Class A-1 notes have received a rating of A Under Review with Positive Implications from DBRS.

The MAV 2 Class A-2 notes have received a BBB (low) rating from DBRS.

The valuation technique used by the Company to estimate the fair value of its investment in long-term floating rate notes at June 30, 2010 and December 31, 2009 incorporates probability weighted discounted cash flows considering the best available public information regarding market conditions and other factors that a market participant would consider for such investments. The above noted redemption of notes, accretion and other minor changes in assumptions have resulted in gains of \$3.1 million and \$5.6 million in the three and six months ended June 30, 2010, respectively (three and six months ended June 30, 2009 \$5.3 million and \$5.3 million, respectively). The interest rates and maturities of the various long-term floating rate notes, discount rates and credit losses modelled at June 30, 2010 and December 31, 2009, respectively, are:

	June 30, 2010	December 31, 2009
Probability weighted average coupon interest rate	0.4%	Nil
Weighted average discount rate	7.5%	7.9%
Expected repayments of long-term floating rate notes	Three to 19 years	Three and a half to 19 years
Credit losses	MAV 2 eligible asset notes: nil to 100%	MAV 2 eligible asset notes: nil to 100%
	MAV 2 IA Tracking notes: 25%	MAV 2 IA Tracking notes: 25%
	MAV 3 Class 9 TA Tracking notes: nil	MAV 3 Class 9 TA Tracking notes: nil

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(unaudited)

7 Financial instruments (continued)

The probability weighted discounted cash flows resulted in an estimated fair value of the Company's long-term floating rate notes of \$74.9 million at June 30, 2010 (December 31, 2009 \$69.3 million). The change in the original cost and estimated fair value of the Company's long-term floating rate notes is as follows (representing a roll-forward of assets measured at fair value using Level 3 inputs):

(in millions of Canadian dollars)	Original cost	Estimated fair value
As at January 1, 2010	\$ 129.1	\$ 69.3
Redemption of notes	(0.1)	
Accretion		2.9
Change in market assumptions		2.7
As at June 30, 2010	\$ 129.0	\$ 74.9

Accretion and gains and losses from the redemption of notes and change in market assumptions are reported in Other income and charges .

B. Financial risk management

The Company's policy with respect to using derivative financial instruments is to selectively reduce volatility associated with fluctuations in interest rates, foreign exchange (FX) rates, and the price of fuel and stock-based compensation expense. Where derivatives are designated as hedging instruments, the relationship between the hedging instruments and their associated hedged items is documented, as well as the risk management objective and strategy for the use of the hedging instruments. This documentation includes linking the derivatives that are designated as fair value or cash flow hedges to specific assets or liabilities on the Consolidated Balance Sheet, commitments or forecasted transactions. At the time a derivative contract is entered into, and at least quarterly thereafter, an assessment is made whether the derivative item is effective in offsetting the changes in fair value or cash flows of the hedged items. The derivative qualifies for hedge accounting treatment if it is effective in substantially mitigating the risk it was designed to address.

Financial derivatives or commodity instruments are used to mitigate financial risk and are not for trading or speculative purposes.

Foreign exchange management

The Company is exposed to fluctuations of financial commitments, assets, liabilities, income or cash flows due to changes in FX rates. The Company conducts business transactions and owns assets in Canada, the United States and other countries; as a result, revenues and expenses are incurred in both Canadian and U.S. dollars. The Company enters into foreign exchange risk management transactions primarily to manage fluctuations in the exchange rate between Canadian and U.S. currencies. In terms of net income, excluding FX on long-term debt, mitigation of U.S. dollar FX exposure is provided primarily through offsets created by revenues and expenses incurred in the same currency.

The FX gains and losses on long-term debt are mainly unrealized and can only be realized when U.S. dollar denominated long-term debt matures or is settled. The Company also has long-term FX exposure on its investment in U.S. affiliates. A portion of the Company's U.S. dollar denominated long-term debt has been designated as a hedge of the net investment in foreign subsidiaries. This designation has the effect of mitigating volatility on net income by offsetting long-term FX gains and losses on long-term debt against gains and losses on its net investment. In addition, the Company may enter into FX forward contracts to lock in the amount of Canadian dollars it has to pay on its U.S. denominated debt maturities.

Occasionally the Company will enter into short-term FX forward contracts as part of its cash management strategy.

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(unaudited)

7 Financial instruments (continued)

Foreign exchange forward contracts

In 2007, the Company entered into a FX forward contract to fix the exchange rate on US\$400 million 6.250% Notes due 2011. This derivative guaranteed the amount of Canadian dollars that the Company will repay when its US\$400 million 6.250% Notes mature in October 2011. This derivative was not designated as a hedge and changes in fair value are recognized in net income in the period in which the change occurs. During the first quarter of 2009, CP unwound and settled US\$25 million of the US\$400 million currency forward for total proceeds of \$4.5 million received in the second quarter. In the second quarter of 2009, a further US\$275 million of the currency forward was unwound and settled for total proceeds of \$26.6 million. During the remainder of 2009, CP unwound a further US\$30 million for total proceeds of \$3.0 million. During the three months ended June 30, 2010, CP unwound the remaining US\$70 million for total proceeds of \$0.2 million.

During the three months ended June 30, 2010, the Company recognized a foreign exchange gain on long-term debt of \$1.9 million recorded to *Other income and charges* related to the currency forward comprised of unrealized and realized gains. For the six months ended June 30, 2010, no gain or loss was reported. For the same periods in 2009, the Company recorded a net loss of \$30.9 million and \$16.8 million, respectively, inclusive of both realized and unrealized losses.

Interest rate management

The Company is exposed to interest rate risk, which is the risk that the fair value or future cash flows of a financial instrument will vary as a result of changes in market interest rates. In order to manage funding needs or capital structure goals, the Company enters into debt or capital lease agreements that are subject to either fixed market interest rates set at the time of issue or floating rates determined by on-going market conditions. Debt subject to variable interest rates exposes the Company to variability in interest expense, while debt subject to fixed interest rates exposes the Company to variability in the fair value of debt.

To manage interest rate exposure, the Company accesses diverse sources of financing and manages borrowings in line with a targeted range of capital structure, debt ratings, liquidity needs, maturity schedule, and currency and interest rate profiles. In anticipation of future debt issuances, the Company may enter into forward rate agreements such as treasury rate locks, bond forwards or forward starting swaps, designated as cash flow hedges, to substantially lock in all or a portion of the effective future interest expense. The Company may also enter into swap agreements to manage the mix of fixed and floating rate debt.

Interest rate swaps

During the three months ended June 30, 2010, the Company entered into interest rate swaps, classified as fair value hedges, for a notional amount of US\$101.4 million. The swap agreements converted the Company's outstanding fixed interest rate liability into variable rate liability for the 5.75% Notes due in May 2013. During the three months ended June 30, 2010, accounting for the associated debt at the floating interest rate decreased *Interest expense* by \$0.1 million. At June 30, 2010, the unrealized gain derived from the fair value of these swap agreements was \$1.6 million of which \$0.5 million was reflected in *Other current assets* and \$1.1 million in *Other assets* with an offset reflected in *Long-term debt*. At December 31, 2009, the Company had no outstanding interest

rate swaps.

During the second quarter of 2009, CP unwound its outstanding fixed-to-floating interest rate swap, which converted a portion of its US\$400 million 6.250% Notes to floating-rate debt, for a gain of \$16.8 million. The gain was deferred as a fair value adjustment to the underlying debt that was hedged and will be amortized to Interest expense until such time the 6.250% Notes are repaid. Subsequently, in the second quarter of 2009, CP repurchased a portion of the underlying debt as part of a tender offer and recognized \$6.5 million of the deferred gain to Other income and charges offsetting part of the loss on repurchase of debt recognized in the second quarter of 2009. During the three and six months ended June 30, 2010, the Company amortized \$1.1 million and \$2.1 million, respectively, of the remaining deferred gain to Interest expense. Prior to the unwind, accounting for the associated debt at the floating interest rate decreased Interest expense by \$1.7 million and \$3.1 million for the three and six months ended June 30, 2009, respectively.

The combined impact of current and previously settled interest rate swaps reduced interest expense in the three months ended June 30, 2010 by \$1.2 million and \$2.2 million for the six months ended June 30, 2010 (three and six months ended June 30, 2009 \$1.7 million and \$3.1 million, respectively).

CANADIAN PACIFIC RAILWAY LIMITED

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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(unaudited)

7 Financial instruments (continued)

Treasury rate locks

At June 30, 2010, the Company had net unamortized losses related to interest rate locks, which are accounted for as cash flow hedges, settled in previous years totalling \$22.2 million (December 31, 2009 \$23.9 million). This amount is composed of various unamortized gains and losses related to specific debts which are reflected in

Accumulated other comprehensive loss and are amortized to Interest expense in the period that interest on the related debt is charged. The amortization of these gains and losses resulted in an increase in Interest expense and

Other comprehensive income of \$1.8 million and \$1.7 million for the three and six months ended June 30, 2010, respectively (three and six months ended June 30, 2009 \$1.9 million and \$1.8 million, respectively).

Stock-based compensation expense management

The Company is exposed to stock-based compensation risk, which is the probability of increased compensation expense due to the increase in the Company's share price.

The Company's compensation expense is subject to volatility due to the movement of CP's share price and its impact on the value of certain management and director stock-based compensation programs. These programs include tandem share appreciation rights (TSARs), deferred share units (DSUs), restricted share units (RSUs), and performance share units (PSUs). As the share price appreciates, these instruments create increased compensation expense.

The Company entered into a Total Return Swap (TRS) to reduce the volatility to the Company over time on three types of stock-based compensation programs: TSARs, DSUs and RSUs. The TRS is a derivative that provides price appreciation and dividends, in return for a charge by the counterparty. The swaps were intended to minimize volatility to Compensation and benefits expense by providing a gain to offset increased compensation expense as the share price increased and a loss to offset reduced compensation expense when the share price falls. If stock-based compensation share units fall out of the money after entering the program, the loss associated with the swap would no longer be fully offset by compensation expense reductions, which would reduce the effectiveness of the swap. During 2009, the Company decided not to expand its TRS program.

Compensation and benefits expense included an unrealized loss on these swaps of \$0.4 million for the three months ended June 30, 2010, and an unrealized gain of \$0.4 million for the six months ended June 30, 2010. For the same periods in 2009, the Company recorded an unrealized gain of \$13.6 million and a net gain of \$2.9 million which was inclusive of both realized losses and unrealized gains, respectively. During the first quarter of 2009, in order to improve the effectiveness of the TRS in mitigating the volatility of stock-based compensation programs, CP unwound a portion of the program for a total cost of \$31.1 million. This cost had previously been recognized in

Compensation and benefits expense and was settled in the second quarter of 2009. At June 30, 2010, the unrealized loss on the TRS of \$17.8 million was included in Accounts payable and accrued liabilities (December 31, 2009 \$18.2 million).

Fuel price management

The Company is exposed to potential volatility in net income due to increases or decreases in the price of diesel. Volatility in diesel fuel prices can have a significant impact on the Company's income.

The impact of variable fuel expense is mitigated substantially through fuel cost recovery programs. While these programs provide effective and meaningful coverage, residual exposure remains as the fuel expense risk cannot be completely recovered from shippers due to timing and volatility in the market. The Company continually monitors residual exposure, and where appropriate, may enter into derivative instruments.

Derivative instruments used by the Company to manage fuel expense risk may include, but are not limited to, swaps and options for diesel and crude oil. In addition, the Company may combine FX forward contracts with fuel derivatives to effectively hedge the risk associated with FX variability on fuel purchases and commodity hedges.

CANADIAN PACIFIC RAILWAY LIMITED**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS****JUNE 30, 2010***(unaudited)***7 Financial instruments (continued)**

At June 30, 2010, the Company had diesel futures contracts, which are accounted for as cash flow hedges, to purchase approximately 14.7 million US gallons during the period July 2010 to June 2011 at an average price of US\$2.16 per US gallon. This represents approximately 5% of estimated fuel purchases for this period. At June 30, 2010, the unrealized loss on these futures contracts was \$0.9 million and was reflected in Accounts payable and accrued liabilities with the offset, net of tax, reflected in Accumulated other comprehensive loss. At December 31, 2009, the unrealized gain on these futures contracts was \$2.5 million and was reflected in Other current assets with the offset, net of tax, reflected in Accumulated other comprehensive loss.

At June 30, 2010 and December 31, 2009, the Company had no remaining crude futures and associated FX forward contracts.

During the three and six months ended June 30, 2010, the impact of settled commodity swaps benefited Fuel expense by \$0.7 million and \$1.6 million, respectively, as a result of realized gains on diesel swaps. For the three months ended June 30, 2009, the net impact of settled commodity swaps decreased Fuel expense by \$0.9 million as a result of realized gains on diesel swaps and crude oil swaps. For the six months ended June 30, 2009, the net impact of settled commodity swaps increased Fuel expense by \$4.8 million, as a result of realized losses on diesel swaps, offset in part by gains on crude oil swaps.

The following table summarizes information on the location and amounts of gains and losses, before tax, related to derivatives on the Consolidated Statement of Income and in comprehensive income for the three and six months ended June 30, 2010 and 2009:

	Location of gain (loss) recognized in income on derivatives	Amount of gain (loss)			
		Amount of gain (loss)		recognized in other	
		recognized in income		comprehensive	
		on derivatives		income on derivatives	
		For the three months ended June 30		For the three months ended June 30	
		2010	2009	2010	2009
(in millions of Canadian dollars)					
Derivatives designated as hedging instruments					
<i>Effective portion</i>					
Crude oil swaps	Fuel expense	\$ 0.7	\$ 0.8	\$ (3.7)	\$ 0.9
Diesel future contracts			0.1		1.6

	Fuel expense				
FX contracts on fuel	Fuel expense				(0.4)
Interest rate swap	Interest expense	1.2	1.7		
	Other income and charges		6.5		
Treasury rate locks	Interest expense	(1.8)	(1.9)	1.8	1.9
Derivatives not designated as hedging instruments					
Total return swap	Compensation and benefits	(0.4)	13.6		
FX forward contracts	Other income and charges	1.9	(30.9)		
Treasury rate locks	Interest expense		(0.7)		
		\$ 1.6	\$(10.8)	\$(1.9)	\$ 4.0

CANADIAN PACIFIC RAILWAY LIMITED
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7 Financial instruments (continued)

	Location of gain (loss) recognized in income on derivatives	Amount of gain (loss) recognized in income on derivatives For the six months ended June 30		Amount of gain (loss) recognized in other comprehensive income on derivatives For the six months ended June 30	
		2010	2009	2010	2009
(in millions of Canadian dollars)					
Derivatives designated as hedging instruments					
<i>Effective portion</i>					
Crude oil swaps	Fuel expense	\$	\$ 1.0	\$	\$ 0.3
Diesel future contracts	Fuel expense	1.6	(5.8)	(3.4)	6.0
FX contracts on fuel	Fuel expense				(0.2)
Interest rate swap	Interest expense	2.2	3.1		
	Other income and charges		6.5		
Treasury rate locks	Interest expense	(1.7)	(1.8)	1.7	1.8
Derivatives not designated as hedging instruments					
Total return swap	Compensation and benefits	0.4	2.9		
FX forward contracts	Other income and charges		(16.8)		
Treasury rate locks	Interest expense		(0.7)		
		\$ 2.5	\$(11.6)	\$(1.7)	\$ 7.9

At June 30, 2010, the Company expected that, during the next 12 months, \$0.9 million of unrealized holding losses on diesel future contracts will be realized and recognized in the consolidated statement of income, reported in Fuel expense as a result of these derivatives being settled.

The following table summarizes information on the effective and ineffective portions, before tax, of the Company's net investment hedge on the Consolidated Statement of Income and in comprehensive income for the three and six months ended June 30, 2010 and 2009:

	Location of ineffective	Effective portion recognized in other
--	----------------------------	--

	portion recognized in income	Ineffective portion recognized in income For the three months ended June 30		comprehensive income For the three months ended June 30	
(in millions of Canadian dollars)		2010	2009	2010	2009
FX on LTD within net investment hedge	Other income and charges	\$ 0.6	\$ (1.3)	\$ (75.4)	\$ 143.5

	Location of ineffective portion recognized in income	Ineffective portion recognized in income For the six months ended June 30		Effective portion recognized in other comprehensive income For the six months ended June 30	
(in millions of Canadian dollars)		2010	2009	2010	2009
FX on LTD within net investment hedge	Other income and charges	\$ 2.6	\$ (4.9)	\$ (25.2)	\$ 85.6

CANADIAN PACIFIC RAILWAY LIMITED
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8 Stock-based compensation

At June 30, 2010, the Company had several stock-based compensation plans, including stock option plans, various cash settled liability plans and an employee stock savings plan. These plans resulted in an expense for the three and six months ended June 30, 2010 of \$12.9 million and \$30.8 million, respectively (three and six months ended June 30, 2009 \$41.8 million and \$37.8 million, respectively).

Tandem stock appreciation rights (TSARs)

In the first six months of 2010, under CP's stock option plans, the Company issued 812,900 TSARs at the weighted average exercise price of \$51.81 per share, based on the closing price on the grant date.

Pursuant to the employee plan, these TSARs may be exercised upon vesting, which is between 24 months and 36 months after the grant date, and will expire after 10 years.

Under the fair value method, the fair value at the grant date was \$11.6 million for TSARs issued in the first six months of 2010 (first six months of 2009 \$5.4 million). The weighted average fair value assumptions were approximately:

	For the six months ended June 30	
	2010	2009
Grant price	\$ 51.81	\$ 36.29
Expected life (years) ⁽¹⁾	6.25	5.00
Risk-free interest rate ⁽²⁾	2.74%	2.14%
Expected stock price volatility ⁽³⁾	30%	30%
Expected annual dividends per share ⁽⁴⁾	\$ 0.99	\$ 0.99
Weighted average fair value of TSARs granted during the period	\$ 14.27	\$ 7.24

(1) Represents the period of time that awards are expected to be outstanding. Historical data on exercise behaviour was used to estimate the expected life of the option.

(2) Based on the implied yield

available on zero-coupon government issues with an equivalent remaining term at the time of the grant.

- (3) Based on the historical stock price volatility of the Company's stock over a period commensurate with the expected term of the option.

- (4) Based on the annualized dividend rate on the date of grant.

Regular options

In the first six months of 2010, under CP's stock option plans, the Company issued 29,800 regular options at the weighted average exercise price of \$56.69 per share, based on the closing price on the grant date.

Under the fair value method, the fair value at the grant date was \$0.5 million for options issued in the first six months of 2010 (first six months of 2009 - \$nil).

Performance share unit (PSU) plan

In the first six months of 2010, the Company issued 328,020 PSUs with a grant date fair value of \$15.4 million. These units attract dividend equivalents in the form of additional units based on the dividends paid on the Company's Common Shares. PSUs vest and are settled in cash approximately three years after the grant date contingent upon CP's performance (performance factor). The fair value of PSUs are measured, both on the grant date and each subsequent quarter until settlement, using a Monte Carlo simulation model. The model utilizes multiple input variables that determine the probability of satisfying the performance and market condition stipulated in the grant.

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9 Pensions and other benefits

At June 30, the elements of net periodic benefit cost for defined benefit pension plans and other benefits recognized in the three and six months ended June 30, 2010, included the following components:

(in millions of Canadian dollars)	For the three months ended June 30			
	Pensions		Other benefits	
	2010	2009	2010	2009
Current service cost (benefits earned by employees in the period)	\$ 21.6	\$ 16.8	\$ 3.9	\$ 3.1
Interest cost on benefit obligation	116.1	120.6	7.0	6.8
Expected return on fund assets	(149.6)	(139.4)	(0.2)	(0.2)
Recognized net actuarial loss	17.8	1.9	1.3	0.9
Amortization of prior service costs	3.3	5.7	(0.4)	(0.4)
Settlement gain ⁽¹⁾				(8.7)
Net periodic benefit cost	\$ 9.2	\$ 5.6	\$ 11.6	\$ 1.5

(in millions of Canadian dollars)	For the six months ended June 30			
	Pensions		Other benefits	
	2010	2009	2010	2009
Current service cost (benefits earned by employees in the period)	\$ 43.2	\$ 33.7	\$ 7.8	\$ 7.3
Interest cost on benefit obligation	232.2	241.3	14.0	14.7
Expected return on fund assets	(299.2)	(278.9)	(0.4)	(0.5)
Recognized net actuarial loss	35.6	3.8	2.6	1.9
Amortization of prior service costs	6.6	11.4	(0.8)	(0.8)
Settlement gain ⁽¹⁾				(8.7)
Net periodic benefit cost	\$ 18.4	\$ 11.3	\$ 23.2	\$ 13.9

⁽¹⁾ Settlement gains resulted from certain post-retirement benefit obligations being assumed by a U.S.

national
multi-employer
benefit plan.

In the three months and six months ended June 30, 2010, the Company made contributions of \$159.7 million and \$178.4 million, respectively (2009 \$21.4 million and \$43.7 million, respectively) to its defined benefit pension plans. The contributions made in the second quarter of 2010 included, at the Company's option, amounts equivalent to the estimated current and past service contribution requirements for the Company's main Canadian defined benefit plan for the balance of 2010.

10 Interest paid

Interest paid in the three and six months ended June 30, 2010, included an amount of \$71.7 million of accrued interest in relation to a long-term debt that matured in June 2010.

11 Variable interest entities

The Company leases equipment from certain trusts, which have been determined to be variable interest entities financed by a combination of debt and equity provided by unrelated third parties. The lease agreements, which are classified as operating leases, have a fixed price purchase option which create the Company's variable interest and result in the trusts being considered variable interest entities. These fixed price purchase options are set at the estimated fair market value as determined at the inception of the lease and could provide the Company with potential gains. These options are considered variable interests, however, they are not expected to provide a significant benefit to the Company.

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11 Variable interest entities (continued)

The Company is responsible for maintaining and operating the leased assets according to specific contractual obligations outlined in the terms of the lease agreements and industry standards. The rigor of the contractual terms of the lease agreements and industry standards are such that the Company has limited discretion over the maintenance activities associated with these assets. As such the Company concluded these terms do not provide the Company with the power to direct the activities of the variable interest entities in a way that has a significant impact on the entities' economic performance.

The Company's financial exposure as a result of its involvement with the variable interest entities is equal to the fixed lease payments due to the trusts. In 2010 lease payments after tax will amount to \$9.3 million. Future minimum lease payments, before tax, of \$256.2 million will be payable over the next 20 years (Note 12).

The Company does not guarantee the residual value of the assets to the lessor, however, it must deliver to the lessor the assets in good operating condition, subject to normal wear and tear, at the end of the lease term.

As the Company's actions and decisions do not significantly effect the variable interest entities' performance, and the Company's fixed purchase price option is not considered to be potentially significant to the variable interest entities, the Company is not considered to be the primary beneficiary, and does not consolidate these variable interest entities. As the leases are considered to be operating leases, the Company does not recognize any balances in the Consolidated Balance Sheet in relation to the variable interest entities.

12 Commitments and contingencies

In the normal course of its operations, the Company becomes involved in various legal actions, including claims relating to injuries and damage to property. The Company maintains provisions it considers to be adequate for such actions. While the final outcome with respect to actions outstanding or pending at June 30, 2010, cannot be predicted with certainty, it is the opinion of management that their resolution will not have a material adverse effect on the Company's financial position or results of operations.

At June 30, 2010, the Company had committed to total future capital expenditures amounting to \$177.7 million and operating expenditures amounting to \$1,750.1 million for the years 2010-2028.

Operating lease commitments

At June 30, 2010, minimum payments under operating leases were estimated at \$876.8 million in aggregate, with annual payments in each of the next five years of: balance of 2010 \$72.7 million; 2011 \$131.9 million; 2012 \$121.0 million; 2013 \$106.4 million; 2014 \$79.9 million.

Environmental remediation accruals

Environmental remediation accruals cover site-specific remediation programs. Environmental remediation accruals are measured on an undiscounted basis and are recorded when the costs to remediate are probable and reasonably estimable. The estimate of the probable costs to be incurred in the remediation of properties contaminated by past railway use reflects the nature of contamination at individual sites according to typical activities and scale of operations conducted. CP has developed remediation strategies for each property based on the nature and extent of the contamination, as well as the location of the property and surrounding areas that may

be adversely affected by the presence of contaminants, considering available technologies, treatment and disposal facilities and the acceptability of site-specific plans based on the local regulatory environment. Site-specific plans range from containment and risk management of the contaminants through to the removal and treatment of the contaminants and affected soils and ground water. The details of the estimates reflect the environmental liability at each property. Provisions for environmental remediation costs are recorded in *Other long-term liabilities*, except for the current portion which is recorded in *Accounts payable and accrued liabilities*. Payments are expected to be made over 10 years to 2020.

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12 Commitments and contingencies (continued)

The accruals for environmental remediation represent CP's best estimate of its probable future obligation and includes both asserted and unasserted claims, without reduction for anticipated recoveries from third parties. Although the recorded accruals include CP's best estimate of all probable costs, CP's total environmental remediation costs cannot be predicted with certainty. Accruals for environmental remediation may change from time to time as new information about previously untested sites becomes known, environmental laws and regulations evolve and advances are made in environmental remediation technology. The accruals may also vary as the courts decide legal proceedings against outside parties responsible for contamination. These potential charges, which cannot be quantified at this time, are not expected to be material to CP's financial position, but may materially affect income in the particular period in which a charge is recognized. Costs related to existing, but as yet unknown, or future contamination will be accrued in the period in which they become probable and reasonably estimable. Changes to costs are reflected as changes to Other long-term liabilities or Accounts payable and accrued liabilities and to Purchased services and other within operating expenses. The amount credited to income in the three months ended June 30, 2010 was \$0.1 million and charged to income in the six months ended June 30, 2010 was \$1.5 million (three and six months ended June 30, 2009 charges of \$0.6 million and \$1.6 million, respectively).

Guarantees

At June 30, 2010, the Company had residual value guarantees on operating lease commitments of \$169.9 million. The maximum amount that could be payable under these and all of the Company's other guarantees cannot be reasonably estimated due to the nature of certain of the guarantees. All or a portion of amounts paid under certain guarantees could be recoverable from other parties or through insurance. The Company accrues for all guarantees that it expects to pay. At June 30, 2010, these accruals amounted to \$9.4 million.

13 Reconciliation of U.S. GAAP to Canadian GAAP

The unaudited consolidated financial statements of the Company have been prepared in accordance with U.S. GAAP. The material differences between U.S. GAAP and Canadian generally accepted accounting principles (Canadian GAAP) as they relate to the Company are explained and quantified below, along with their effect on the Company's Consolidated Statement of Income and Consolidated Balance Sheet.

- (a) **Accounting for derivative instruments and hedging:** The measurement and recognition rules for derivative instruments and hedging under Canadian GAAP are largely harmonized with U.S. GAAP. However, under Canadian GAAP, only the ineffective portion of a net investment hedge that represents an over hedge is recognized in income, whereas under U.S. GAAP, any ineffective portion is recognized in income immediately.
- (b) **Pensions and post-retirement benefits:** The Company is required to recognize the over or under funded status of defined benefit pension and other post-retirement benefit plans on the balance sheet under U.S. GAAP. The over or under funded status is measured as the difference between the fair value of the plan assets and the benefit obligation, being the projected benefit obligation for pension plans and the accumulated benefit obligation for other post-retirement benefit plans. In addition, any previously unrecognized actuarial gains and losses and prior service costs and credits that arise during the period will be recognized as a component of other comprehensive income (OCI), net of tax. Under Canadian GAAP the over or under funded status of defined benefit pension and

post-retirement benefit plans is not recognized in the balance sheet. Canadian GAAP recognizes an asset for contributions made in excess of amounts recognized as expense in the Consolidated Statement of Income and a liability when contributions are less than amounts recognized as expense.

Prior service costs are amortized under Canadian GAAP and U.S. GAAP. However, the period over which costs related to events before 2000 are amortized differs between Canadian GAAP and U.S. GAAP.

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13 Reconciliation of U.S. GAAP to Canadian GAAP (continued)

- (c) **Post-employment benefits:** Post-employment benefits are covered by the CICA Section 3461 Employee Future Benefits . Consistent with accounting for post-retirement benefits, the policy permits amortization of actuarial gains and losses if they fall outside of the corridor. Under U.S. GAAP, such gains and losses on post-employment benefits that do not vest or accumulate are included immediately in income.
- (d) **Termination and severance benefits:** Termination and severance benefits are covered by the CICA Section 3461 Employee Future Benefits and the CICA Emerging Issues Committee Abstract 134 Accounting for Severance and Termination Benefits (EIC 134). Upon transition to the CICA Section 3461 effective January 1, 2000, a net transitional asset was created and was being amortized to income. During the first quarter of 2009 this transitional asset was fully amortized. Under U.S. GAAP, the expected benefits were not accrued and are expensed when paid.
- (e) **Stock-based compensation:** U.S. GAAP requires the use of an option-pricing model to fair value, at the grant date, share-based awards issued to employees, including stock options, TSARs, PSUs, RSUs, and DSUs. TSARs, PSUs, RSUs, and DSUs are subsequently re-measured at fair value each reporting period. Under Canadian GAAP, liability awards that are settled, such as TSARs, PSUs, RSUs and DSUs, are accounted for using the intrinsic method. U.S. GAAP also requires that CP accounts for forfeitures on an estimated basis. Under Canadian GAAP, CP has elected to account for forfeitures on an actual basis as they occur.
- (f) **Internal use software:** Under U.S. GAAP certain costs, including preliminary project phase costs, are expensed as incurred. These costs are capitalized and depreciated under Canadian GAAP.
- (g) **Capitalization of interest:** U.S. GAAP requires interest costs to be capitalized for all qualifying capital programs. Under Canadian GAAP capitalization of interest is a policy choice and the Company expenses interest related to capital projects undertaken during the year unless specific debt is attributed to a capital program. Differences in GAAP result in additional capitalization of interest under U.S. GAAP and subsequent related depreciation.
- (h) **Joint venture:** The CICA Section 3055 Interest in Joint Ventures requires the proportionate consolidation method to be applied to the recognition of interests in joint ventures in consolidated financial statements. Until April 1, 2009, the Company accounted for its joint-venture interest in the DRTP under Canadian GAAP using the proportionate consolidation method. During the second quarter of 2009, the Company completed a sale of a portion of its investment in the DRTP to its existing partner, reducing the Company's ownership from 50% to 16.5%. Effective April 1, 2009, the Company discontinued proportionate consolidation and accounts for its remaining investment in the DRTP under the equity method of accounting. U.S. GAAP requires the equity method of accounting to be applied to interests in joint ventures. This had no effect on net income as it represents a classification difference within the Consolidated Statement of Income and Consolidated Balance Sheet for periods prior to April, 2009.
- (i) **Long-term debt:** Under Canadian GAAP, offsetting amounts with the same party and with a legal right to offset are netted against each other. U.S. GAAP does not allow netting of assets and liabilities among three parties. In 2003, the Company and one of its subsidiaries entered into a contracts with a financial institution resulting in a receivable amount and long-term debt payable. In the second quarter of 2010, these contracts were unwound

eliminating this difference.

As well, transaction costs have been added to the fair value of the Long-term debt under Canadian GAAP whereas under U.S. GAAP such costs are recorded separately with Other assets .

- (j) **Capital leases:** Under U.S. GAAP, certain leases, which are recorded as capital leases under Canadian GAAP, do not meet the criteria for capital leases and are recorded as operating leases. These relate to equipment leases, previously recorded as operating leases under Canadian and U.S. GAAP, which were renewed within the last 25 percent of the equipment's useful life.

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13 Reconciliation of U.S. GAAP to Canadian GAAP (continued)

(k) **Investment tax credits:** Under U.S. GAAP investment tax credits are credited against income tax expense whereas under Canadian GAAP these tax credits are offset against the related operating expense. There is no impact to net income as a result of this GAAP difference.

(l) **Cash flows:** There are no material differences between cash flows under U.S. GAAP and Canadian GAAP.

Comparative income statement

Consolidated net income is reconciled from Canadian to U.S. GAAP below:

	Three months ended June 30					
	Canadian	2010 U.S. GAAP	U.S.	Canadian	2009 U.S. GAAP	U.S.
(in millions of Canadian dollars, except per share data)	GAAP	adjustments	GAAP	GAAP⁽¹⁾	adjustments	GAAP
Revenues						
Freight (h)	\$ 1,202.2	\$	\$ 1,202.2	\$ 1,000.8	\$ 0.6	\$ 1,001.4
Other (h)	32.0		32.0	56.3	(26.4)	29.9
	1,234.2		1,234.2	1,057.1	(25.8)	1,031.3
Operating expenses						
Compensation and benefits (b, c, d, e, f)	349.1	0.6	349.7	302.5	22.0	324.5
Fuel	177.9		177.9	117.7		117.7
Materials (f)	48.5	2.5	51.0	52.4	1.1	53.5
Equipment rents (j)	54.6	0.3	54.9	54.7	0.4	55.1
Depreciation and amortization (f, g, h, j, k)	122.7	0.6	123.3	120.8	2.4	123.2
Purchased services and other (c, f, h, k)	207.7	(4.4)	203.3	183.3	(10.9)	172.4
	960.5	(0.4)	960.1	831.4	15.0	846.4
Operating income	273.7	0.4	274.1	225.7	(40.8)	184.9
Gain on sale of partnership interest				81.2		81.2
Less:						
Other (income) and charges (a)	(2.6)	(0.8)	(3.4)	14.0	(4.4)	9.6
Interest expense (g, j)	67.3	(2.5)	64.8	73.4	(0.8)	72.6
	209.0	3.7	212.7	219.5	(35.6)	183.9

Income before income tax expense

Income tax expense (recovery) (k) ⁽²⁾	46.0	0.1	46.1	64.3	(15.9)	48.4
Net income	\$ 163.0	\$ 3.6	\$ 166.6	\$ 155.2	\$ (19.7)	\$ 135.5
Basic earnings per share	\$ 0.97	\$ 0.02	\$ 0.99	\$ 0.92	\$ (0.11)	\$ 0.81
Diluted earnings per share	\$ 0.96	\$ 0.02	\$ 0.98	\$ 0.92	\$ (0.12)	\$ 0.80

(1) Restated for the Company's changes in accounting policies in relation to the accounting for rail grinding, discussed in Note 2 to these consolidated financial statements, and for locomotive overhauls and amortization of pension plan amendments for unionized employees, discussed in Note 2 of the Company's 2009 annual consolidated financial statements. In addition, certain revenue and operating expense items have been reclassified in order to be consistent with U.S. GAAP presentation.

(2) Adjustment for income tax expense (recovery) includes the tax effect of other U.S. to

Canadian GAAP
differences, in
addition to the
impact of
difference
(k) Investment tax
credits.

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13 Reconciliation of U.S. GAAP to Canadian GAAP (continued)

Comparative income statement

Consolidated net income is reconciled from Canadian to U.S. GAAP below:

	Six months ended June 30					
	2010			2009		
	Canadian	GAAP	U.S.	Canadian	GAAP	U.S.
(in millions of Canadian dollars, except per share data)	GAAP	adjustments	GAAP	GAAP	adjustments	GAAP
Revenues						
Freight (h)	\$ 2,340.4	\$	\$ 2,340.4	\$ 2,079.9	\$ (2.5)	\$ 2,077.4
Other (h)	60.6		60.6	86.3	(22.8)	63.5
	2,401.0		2,401.0	2,166.2	(25.3)	2,140.9
Operating expenses						
Compensation and benefits (b, c, d, e, f)	694.4	9.1	703.5	643.8	23.7	667.5
Fuel	359.6		359.6	288.7		288.7
Materials (f)	110.6	4.4	115.0	128.6	1.6	130.2
Equipment rents (j)	103.3	0.6	103.9	120.8	0.7	121.5
Depreciation and amortization (f, g, h, j, k)	243.2	1.3	244.5	238.8	0.6	239.4
Purchased services and other (c, f, h, k)	402.8	(9.0)	393.8	380.3	(6.4)	373.9
	1,913.9	6.4	1,920.3	1,801.0	20.2	1,821.2
Operating income	487.1	(6.4)	480.7	365.2	(45.5)	319.7
Gain on sale of partnership interest				81.2		81.2
Less:						
Other (income) and charges (a)	(5.6)	(2.7)	(8.3)	21.7	(3.6)	18.1
Interest expense (g, j)	136.5	(5.0)	131.5	145.7	(1.5)	144.2
Income before income tax expense	356.2	1.3	357.5	279.0	(40.4)	238.6
Income tax expense (recovery) (k) ⁽²⁾	88.3	1.6	89.9	62.0	(17.9)	44.1
Net income	\$ 267.9	\$ (0.3)	\$ 267.6	\$ 217.0	\$ (22.5)	\$ 194.5
Basic earnings per share	\$ 1.59	\$	\$ 1.59	\$ 1.32	\$ (0.14)	\$ 1.18
Diluted earnings per share	\$ 1.59	\$ (0.01)	\$ 1.58	\$ 1.32	\$ (0.14)	\$ 1.18

- (1) Restated for the Company's changes in accounting policies in relation to the accounting for rail grinding, discussed in Note 2 to these consolidated financial statements, and for locomotive overhauls and amortization of pension plan amendments for unionized employees, discussed in Note 2 of the Company's 2009 annual consolidated financial statements. In addition, certain revenue and operating expense items have been reclassified in order to be consistent with U.S. GAAP presentation.

- (2) Adjustment for income tax expense (recovery) includes the tax effect of other U.S. to Canadian GAAP differences, in addition to the impact of difference
(k) Investment tax credits.

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13 Reconciliation of U.S. GAAP to Canadian GAAP (continued)

Consolidated balance sheet

The Consolidated Balance Sheet is reconciled from Canadian to U.S. GAAP below:

	June 30, 2010			December 31, 2009		
	Canadian	U.S.	U.S.	Canadian	U.S.	U.S.
(in millions of Canadian dollars)	GAAP	adjustments	GAAP	GAAP ⁽¹⁾	adjustments	GAAP
Assets						
Current assets						
Cash and cash equivalents	\$ 373.6	\$	\$ 373.6	\$ 679.1	\$	\$ 679.1
Accounts receivable, net (i)	441.2		441.2	441.0	214.1	655.1
Materials and supplies	136.8		136.8	132.7		132.7
Deferred income taxes	137.6		137.6	128.1		128.1
Other current assets	62.2		62.2	46.5		46.5
	1,151.4		1,151.4	1,427.4	214.1	1,641.5
Investments	167.9		167.9	156.7		156.7
Net properties (e, f, g, j)	11,946.0	98.5	12,044.5	11,878.8	99.7	11,978.5
Goodwill and intangible assets	204.0		204.0	202.3		202.3
Other assets (b, i)	2,013.2	(1,842.0)	171.2	1,777.2	(1,601.4)	175.8
Total assets	\$ 15,482.5	\$ (1,743.5)	\$ 13,739.0	\$ 15,442.4	\$ (1,287.6)	\$ 14,154.8
Liabilities and shareholders equity						
Current liabilities						
Accounts payable and accrued liabilities (e)	\$ 882.6	\$ 15.1	\$ 897.7	\$ 917.3	\$ 9.8	\$ 927.1
Income and other taxes payable	36.1		36.1	31.9		31.9
Dividends payable	45.5		45.5	41.7		41.7
Long-term debt maturing within one year (i, j)	41.1	(0.9)	40.2	392.1	213.2	605.3
	1,005.3	14.2	1,019.5	1,383.0	223.0	1,606.0
Pension and other benefit liabilities (b, c)		1,252.2	1,252.2		1,453.9	1,453.9
Other long-term liabilities (b, c, e)	803.9	(317.1)	486.8	790.2	(310.3)	479.9
Long-term debt (i, j)	4,210.5	(50.1)	4,160.4	4,102.7	35.5	4,138.2
	2,628.6	(690.5)	1,938.1	2,523.2	(704.5)	1,818.7

Future / deferred income taxes
(b, c, e, f, g, j)

Total liabilities	8,648.3	208.7	8,857.0	8,799.1	697.6	9,496.7
Shareholders equity						
Share capital (e)	1,755.0	25.8	1,780.8	1,746.4	24.7	1,771.1
Contributed surplus / Additional paid-in capital (e)	33.4	(4.0)	29.4	33.5	(2.7)	30.8
Accumulated other comprehensive income (loss) (a, b)	52.9	(1,762.4)	(1,709.5)	51.1	(1,795.8)	(1,744.7)
Retained income / earnings (a, b, c, e, f, g, j)	4,992.9	(211.6)	4,781.3	4,812.3	(211.4)	4,600.9
	6,834.2	(1,952.2)	4,882.0	6,643.3	(1,985.2)	4,658.1
Total liabilities and shareholders equity	\$ 15,482.5	\$ (1,743.5)	\$ 13,739.0	\$ 15,442.4	\$ (1,287.6)	\$ 14,154.8

CANADIAN PACIFIC RAILWAY LIMITED
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13 Reconciliation of U.S. GAAP to Canadian GAAP (continued)

(1) Restated for the Company's changes in accounting policies in relation to the accounting for rail grinding, discussed in Note 2 to these consolidated financial statements, and for locomotive overhauls and amortization of pension plan amendments for unionized employees, discussed in Note 2 of the Company's 2009 annual consolidated financial statements. In addition, certain revenue and operating expense items have been reclassified in order to be consistent with U.S. GAAP presentation.

Disclosures required by Canadian GAAP

Future accounting changes

U.S. GAAP / International Financial Reporting Standards (IFRS)

On February 13, 2008, the Canadian Accounting Standards Board (AcSB) confirmed that publicly accountable enterprises will be required to adopt IFRS in place of Canadian GAAP for interim and annual reporting purposes for fiscal years beginning on or after January 1, 2011, unless, as permitted by Canadian securities regulations, SEC registrants were to adopt U.S. GAAP on or before this date. Commencing on January 1, 2010, CP adopted U.S. GAAP for its financial reporting, which is consistent with the reporting of other North American Class I railways. As a result, CP will not be adopting IFRS in 2011.

Business combinations, consolidated financial statements and non-controlling interests

In January 2009, the CICA issued three new standards:

Business Combinations, Section 1582

This section which replaces the former Section 1581 Business Combinations and provides the Canadian equivalent to IFRS 3 Business Combinations (January 2008). The new standard requires the acquiring entity in a business combination to recognize most of the assets acquired and liabilities assumed in the transaction at fair value including contingent assets and liabilities; and to recognize and measure the goodwill acquired in the business combination or a gain from a bargain purchase. Acquisition-related costs are also to be expensed.

Consolidated Financial Statements, Section 1601 and Non-controlling Interests, Section 1602

These two sections replace Section 1600 Consolidated Financial Statements . Section 1601 Consolidated Financial Statements carries forward guidance from Section 1600 Consolidated Financial Statements with the exception of non-controlling interests which are addressed in a separate section. Section 1602 Non-controlling Interests , requires the Company to report non-controlling interests within equity, separately from the equity of the owners of the parent, and transactions between an entity and non-controlling interests as equity transactions.

All three standards are effective January 1, 2011 and therefore will not impact the Company as it has adopted U.S. GAAP for financial reporting.

Capital disclosures

The Company's objectives when managing its capital are:

to maintain a flexible capital structure which optimizes the cost of capital at acceptable risk while providing an appropriate return to its shareholders;

to manage capital in a manner which balances the interests of equity and debt holders;

to manage capital in a manner that will maintain compliance with its financial covenants;

to manage its long-term financing structure to maintain its investment grade rating; and

to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business.

The Company defines its capital as follows:

shareholders' equity;

long-term debt, including the current portion thereof; and

short-term borrowing.

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13 Reconciliation of U.S. GAAP to Canadian GAAP (continued)

The Company manages its capital structure and makes adjustments to it in accordance with the aforementioned objectives, as well as in light of changes in economic conditions and the risk characteristics of the underlying assets. In order to maintain or adjust its capital structure, the Company may, among other things, adjust the amount of dividends paid to shareholders, purchase shares for cancellation pursuant to normal course issuer bids, issue new shares, issue new debt, and/or issue new debt to replace existing debt with different characteristics.

The Company monitors capital using a number of key financial metrics, including:
debt to total capitalization; and

interest coverage ratio.

The calculations for the aforementioned key financial metrics are as follows:

Debt to total capitalization

Debt is the sum of long-term debt, long-term debt maturing within one year and short-term borrowing. This sum is divided by debt plus total shareholders' equity as presented on our Consolidated Balance Sheet.

Interest coverage ratio

Interest coverage ratio is measured, on a twelve month rolling basis, as adjusted EBIT divided by interest expense. Adjusted EBIT excludes changes in the estimated fair value of the Company's investment in long-term floating rate notes/asset-backed commercial paper (ABCP), the gains on sales of partnership interest and significant properties and the loss on termination of a lease with a shortline railway as these are not in the normal course of business and foreign exchange gains and losses on long-term debt, which can be volatile and short term. The interest coverage ratio and adjusted EBIT are non-GAAP measures and do not have standardized meanings prescribed by GAAP and, therefore, are unlikely to be comparable to similar measures of other companies.

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13 Reconciliation of U.S. GAAP to Canadian GAAP (continued)

The following table illustrates the financial metrics and their corresponding guidelines currently in place:

(in millions of Canadian dollars, U.S. GAAP)	Guidelines	June 30, 2010	June 30, 2009 Restated (See Note 2)
Long-term debt		\$ 4,160.4	\$ 4,218.1
Long-term debt maturing within one year		40.2	385.7
Short-term borrowing			55.6
Total debt		\$ 4,200.6	\$ 4,659.4
Shareholders' equity		\$ 4,882.0	\$ 4,887.5
Total debt		4,200.6	4,659.4
Total debt plus equity		\$ 9,082.6	\$ 9,546.9
Operating income for the twelve months ended June 30		\$ 966.5	\$ 910.6
Other income and charges		1.2	(30.5)
(Gain) loss in long-term floating rate notes/ABCP		(4.3)	23.4
Foreign exchange (gain) loss on long-term debt		(8.5)	(3.1)
Equity income in DM&E			26.8
Gain on sales of significant properties		(79.1)	
Loss on termination of lease with shortline railway		54.5	
Adjusted EBIT⁽¹⁾⁽²⁾ for the twelve months ended June 30		\$ 930.3	\$ 927.2
Total debt		\$ 4,200.6	\$ 4,659.4
Total debt plus equity		\$ 9,082.6	\$ 9,546.9
Total debt to total capitalization⁽¹⁾	No more than 50.0%	46.2%	48.8%
Adjusted EBIT ⁽¹⁾⁽²⁾		\$ 930.3	\$ 927.2
Interest expense ⁽²⁾		\$ 254.9	\$ 272.7
Interest coverage ratio⁽¹⁾⁽²⁾	No less than 4.0	3.6	3.4

(1) These earnings measures have no standardized meanings prescribed by GAAP and, therefore, are unlikely to be comparable to similar measures of other companies.

(2) The amount is calculated on a twelve month rolling basis.

The Company's financial objectives and strategy as described above have remained substantially unchanged over the last two fiscal years. The objectives are reviewed on an annual basis and financial metrics and their management targets are monitored on a quarterly basis. The interest coverage ratio has improved during the twelve-month period ended June 30, 2010 due to an increase in year-over-year adjusting earnings and a reduction in year-over-year interest expense. The interest coverage ratio for the period is below the management target provided in the above table, due to lower volumes as a result of the global recession that occurred during the period.

The Company is subject to a financial covenant of funded debt to total capitalization in the revolver loan agreement. Performance to this financial covenant is well within permitted limits.

Summary of Rail Data
(Reconciliation of GAAP earnings to non-GAAP earnings on pages 2 and 3)

2010	Second Quarter				2010	Year-to-date		
	2009 ⁽¹⁾	Fav/(Unfav)	%			2009 ⁽¹⁾	Fav/(Unfav)	%
<u>Financial (millions, except per share data)</u>								
<u>Revenues</u>								
\$ 1,202.2	\$ 1,001.4	\$ 200.8	20.1	Freight revenue	\$ 2,340.4	\$ 2,077.4	\$ 263.0	12.7
32.0	29.9	2.1	7.0	Other revenue	60.6	63.5	(2.9)	(4.6)
1,234.2	1,031.3	202.9	19.7		2,401.0	2,140.9	260.1	12.1
<u>Operating expenses</u>								
Compensation and								
349.7	324.5	(25.2)	(7.8)	benefits	703.5	667.5	(36.0)	(5.4)
177.9	117.7	(60.2)	(51.1)	Fuel	359.6	288.7	(70.9)	(24.6)
51.0	53.5	2.5	4.7	Materials	115.0	130.2	15.2	11.7
54.9	55.1	0.2	0.4	Equipment rents	103.9	121.5	17.6	14.5
Depreciation and								
123.3	123.2	(0.1)	(0.1)	amortization	244.5	239.4	(5.1)	(2.1)
Purchased services								
203.3	172.4	(30.9)	(17.9)	and other	393.8	373.9	(19.9)	(5.3)
960.1	846.4	(113.7)	(13.4)		1,920.3	1,821.2	(99.1)	(5.4)
274.1	184.9	89.2	48.2	Operating income	480.7	319.7	161.0	50.4
	81.2	(81.2)	(100.0)	Gain on sale of partnership interest		81.2	(81.2)	(100.0)
Less:								
(3.4)	9.6	13.0	135.4	Other (income) and charges	(8.3)	18.1	26.4	145.9
64.8	72.6	7.8	10.7	Interest expense	131.5	144.2	12.7	8.8
Income before								
212.7	183.9	28.8	15.7	income tax expense	357.5	238.6	118.9	49.8
46.1	48.4	2.3	4.8	Income tax expense	89.9	44.1	(45.8)	(103.9)
\$ 166.6	\$ 135.5	\$ 31.1	23.0	Net income	\$ 267.6	\$ 194.5	\$ 73.1	37.6
\$ 0.99	\$ 0.81	\$ 0.18	22.2	Basic earnings per share	\$ 1.59	\$ 1.18	\$ 0.41	34.7
Diluted earnings per								
\$ 0.98	\$ 0.80	\$ 0.18	22.5	share	\$ 1.58	\$ 1.18	\$ 0.40	33.9
77.8	82.1	4.3		Operating ratio (%)	80.0	85.1	5.1	

**Shares
Outstanding**

168.6	168.0	0.6	0.4	Weighted average (avg) number of shares outstanding (millions)	168.6	164.5	4.1	2.5
169.2	168.4	0.8	0.5	Weighted avg number of diluted shares outstanding (millions)	169.0	164.7	4.3	2.6

Foreign Exchange

0.98	0.85	(0.13)	(15.3)	Average foreign exchange rate (US\$/Canadian\$)	0.97	0.83	(0.14)	(16.9)
1.02	1.18	(0.16)	(13.6)	Average foreign exchange rate (Canadian\$/US\$)	1.03	1.21	(0.18)	(14.9)

(1) Restated for the Company's change in accounting policy in relation to the accounting for rail grinding.

Summary of Rail Data (Page 2)
Adjusted Earnings Performance - Quarter
Non-GAAP Measures

	Second Quarter 2010			Second Quarter 2009 ⁽¹⁾			% Adjusted (Non-GAAP) ⁽²⁾
	Reported (GAAP)	Adjustments Fav/(Unfav)	Adjusted (Non-GAAP) ⁽²⁾	Reported (GAAP)	Adjustments Fav/(Unfav)	Adjusted (Non-GAAP) ⁽²⁾	
In millions, except per share data							
Operating income	\$ 274.1	\$	\$ 274.1	\$ 184.9	\$	\$ 184.9	48.2
Gain on sale of partnership interest				81.2	(81.2) ⁽⁵⁾		
Less:							
Other (income) and charges	(3.4)	(1.8) ⁽³⁾	(1.6)	9.6	(6.4) ⁽⁶⁾	16.0	110.0
Interest expense	64.8		64.8	72.6		72.6	10.7
Income before tax	\$ 212.7	\$ (1.8)	\$ 210.9	\$ 183.9	\$ (87.6)	\$ 96.3	119.0
Income tax expense	46.1	(8.6) ⁽⁴⁾	54.7	48.4	31.4 ⁽⁷⁾	17.0	(221.8)
Net income	\$ 166.6	\$ (10.4)	\$ 156.2 ⁽⁸⁾	\$ 135.5	\$ (56.2)	\$ 79.3 ⁽⁸⁾	97.0
Basic earnings per share	\$ 0.99	\$ (0.06)	\$ 0.93	\$ 0.81	\$ (0.34)	\$ 0.47	97.9
Diluted earnings per share	\$ 0.98	\$ (0.06)	\$ 0.92	\$ 0.80	\$ (0.33)	\$ 0.47	95.7

2010:

(2) These earnings measures have no standardized meanings prescribed by GAAP and may not be comparable to similar measures of other companies.

(3) To exclude the gain in fair value of long-term floating rate notes of \$1.7 million and a gain in foreign exchange on long-term debt (FX on LTD) of

\$0.1 million in order to eliminate the impact of volatile short-term exchange rate fluctuations.

- (4) A tax adjustment to exclude the tax expense associated with the gain in fair value of long-term floating rate notes of \$0.7 million and the tax recovery on FX on LTD of \$9.3 million.

- (8) These adjusted figures are also referred to as Income, before FX on LTD and other specified items .

2009:

- (1) Restated for the Company s change in accounting policy in relation to the accounting for rail grinding.
- (2) These earnings measures have no standardized meanings prescribed by GAAP and may not be comparable to similar measures of

other
companies.

- (5) To exclude the gain of \$81.2 million before tax which arose from the partial sale of the investment in the Detroit River Tunnel Partnership.
- (6) To exclude the gain in fair value of long-term floating rate notes of \$4.7 million and a gain in FX on LTD of \$1.7 million in order to eliminate the impact of volatile short-term exchange rate fluctuations.
- (7) A tax adjustment to exclude the tax expense of the sale of the partnership interest of \$12.5 million, the tax expense associated with the gain in fair value of long-term floating rate notes of \$1.5 million and the tax expense on FX on LTD

of
\$17.4 million.

- (8) These adjusted figures are also referred to as Income, before FX on LTD and other specified items .

Summary of Rail Data (Page 3)
Adjusted Earnings Performance Year-to-date
Non-GAAP Measures

	Year-to-date 2010			Year-to-date 2009 ⁽¹⁾			% Adjusted (Non-GAAP) ⁽²⁾
	Reported (GAAP)	Adjustments Fav/(Unfav)	Adjusted (Non-GAAP) ⁽²⁾	Reported (GAAP)	Adjustments Fav/(Unfav)	Adjusted (Non-GAAP) ⁽²⁾	
In millions, except per share data							
Operating income	\$ 480.7	\$	\$ 480.7	\$ 319.7	\$	\$ 319.7	50.4
Gain on sale of partnership interest				81.2	(81.2) ⁽⁵⁾		
Less:							
Other (income) and charges	(8.3)	(6.9) ⁽³⁾	(1.4)	18.1	(4.0) ⁽⁶⁾	22.1	106.3
Interest expense	131.5		131.5	144.2		144.2	8.8
Income before tax	\$ 357.5	\$ (6.9)	\$ 350.6	\$ 238.6	\$ (85.2)	\$ 153.4	128.6
Income tax expense	89.9	(1.3) ⁽⁴⁾	91.2	44.1	22.5 ⁽⁷⁾	21.6	(322.2)
Net income	\$ 267.6	\$ (8.2)	\$ 259.4 ⁽⁸⁾	\$ 194.5	\$ (62.7)	\$ 131.8 ⁽⁸⁾	96.8
Basic earnings per share	\$ 1.59	\$ (0.05)	\$ 1.54	\$ 1.18	\$ (0.38)	\$ 0.80	92.5
Diluted earnings per share	\$ 1.58	\$ (0.05)	\$ 1.53	\$ 1.18	\$ (0.38)	\$ 0.80	91.3

2010:

(2) These earnings measures have no standardized meanings prescribed by GAAP and may not be comparable to similar measures of other companies.

(3) To exclude the gain in fair value of long-term floating rate notes of \$2.7 million and a gain in foreign exchange on long-term debt (FX on LTD) of

\$4.2 million in order to eliminate the impact of volatile short-term exchange rate fluctuations.

- (4) A tax adjustment to exclude the tax expense associated with the gain in fair value of long-term floating rate notes of \$0.8 million and the tax recovery on FX on LTD of \$2.1 million.

- (8) These adjusted figures are also referred to as Income, before FX on LTD and other specified items .

2009:

- (1) Restated for the Company s change in accounting policy in relation to the accounting for rail grinding.
- (2) These earnings measures have no standardized meanings prescribed by GAAP and may not be comparable to similar measures of

other
companies.

- (5) To exclude the gain of \$81.2 million before tax which arose from the partial sale of the investment in the Detroit River Tunnel Partnership.
- (6) To exclude the gain in fair value of long-term floating rate notes of \$4.7 million and a loss in FX on LTD of \$0.7 million in order to eliminate the impact of volatile short-term exchange rate fluctuations.
- (7) A tax adjustment to exclude the tax expense of the sale of the partnership interest of \$12.5 million, the tax expense associated with the gain in fair value of long-term floating rate notes of \$1.5 million and the tax expense on FX on LTD of \$8.5 million.

- (8) These adjusted figures are also referred to as Income, before FX on LTD and other specified items .

Summary of Rail Data (Page 4)

2010	Second Quarter				2010	Year-to-date		
	2009	Fav/(Unfav)	%			2009	Fav/(Unfav)	%
Commodity Data								
Freight Revenues (millions)								
\$ 264.4	\$ 274.6	\$ (10.2)	(3.7)	- Grain	\$ 535.7	\$ 562.3	\$ (26.6)	(4.7)
136.7	95.3	41.4	43.4	- Coal	247.2	211.8	35.4	16.7
114.9	66.6	48.3	72.5	- Sulphur and fertilizers	232.7	142.8	89.9	63.0
44.4	42.1	2.3	5.5	- Forest products	87.6	87.5	0.1	0.1
217.0	179.6	37.4	20.8	- Industrial and consumer products	422.5	385.4	37.1	9.6
89.0	49.9	39.1	78.4	- Automotive	166.6	101.8	64.8	63.7
335.8	293.3	42.5	14.5	- Intermodal	648.1	585.8	62.3	10.6
\$ 1,202.2	\$ 1,001.4	\$ 200.8	20.1	Total Freight Revenues	\$ 2,340.4	\$ 2,077.4	\$ 263.0	12.7
Millions of Revenue Ton-Miles (RTM)								
8,303	8,696	(393)	(4.5)	- Grain	16,939	17,224	(285)	(1.7)
5,268	3,888	1,380	35.5	- Coal	9,576	7,720	1,856	24.0
4,335	1,719	2,616	152.2	- Sulphur and fertilizers	8,727	3,899	4,828	123.8
1,275	1,092	183	16.8	- Forest products	2,653	2,156	497	23.1
5,166	3,971	1,195	30.1	- Industrial and consumer products	10,053	8,321	1,732	20.8
560	347	213	61.4	- Automotive	1,105	710	395	55.6
6,518	5,819	699	12.0	- Intermodal	12,575	11,427	1,148	10.0
31,425	25,532	5,893	23.1	Total RTMs	61,628	51,457	10,171	19.8
Freight Revenue per RTM (cents)								
3.18	3.16	0.02	0.6	- Grain	3.16	3.26	(0.10)	(3.1)
2.59	2.45	0.14	5.7	- Coal	2.58	2.74	(0.16)	(5.8)
2.65	3.87	(1.22)	(31.5)	- Sulphur and fertilizers	2.67	3.66	(0.99)	(27.0)
3.48	3.86	(0.38)	(9.8)	- Forest products	3.30	4.06	(0.76)	(18.7)
4.20	4.52	(0.32)	(7.1)	- Industrial and consumer products	4.20	4.63	(0.43)	(9.3)
15.89	14.38	1.51	10.5	- Automotive	15.08	14.34	0.74	5.2

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5.15	5.04	0.11	2.2	- Intermodal	5.15	5.13	0.02	0.4
				Total Freight				
3.83	3.92	(0.09)	(2.3)	Revenue per RTM	3.80	4.04	(0.24)	(5.9)
Carloads								
(thousands)								
115.9	119.3	(3.4)	(2.8)	- Grain	229.1	230.8	(1.7)	(0.7)
94.6	66.2	28.4	42.9	- Coal	170.6	137.0	33.6	24.5
43.2	22.3	20.9	93.7	- Sulphur and fertilizers	87.5	47.2	40.3	85.4
17.2	15.5	1.7	11.0	- Forest products	34.8	33.0	1.8	5.5
				- Industrial and consumer products	188.4	166.7	21.7	13.0
96.6	80.1	16.5	20.6	- Automotive	71.0	43.6	27.4	62.8
37.5	22.6	14.9	65.9	- Intermodal	520.0	482.2	37.8	7.8
271.4	238.2	33.2	13.9					
676.4	564.2	112.2	19.9	Total Carloads	1,301.4	1,140.5	160.9	14.1
Freight Revenue								
per Carload								
\$ 2,281	\$ 2,302	\$ (21)	(0.9)	- Grain	\$ 2,338	\$ 2,436	\$ (98)	(4.0)
1,445	1,440	5	0.3	- Coal	1,449	1,546	(97)	(6.3)
2,660	2,987	(327)	(10.9)	- Sulphur and fertilizers	2,659	3,025	(366)	(12.1)
2,581	2,716	(135)	(5.0)	- Forest products	2,517	2,652	(135)	(5.1)
				- Industrial and consumer products	2,243	2,312	(69)	(3.0)
2,246	2,242	4	0.2	- Automotive	2,346	2,335	11	0.5
2,373	2,208	165	7.5	- Intermodal	1,246	1,215	31	2.6
1,237	1,231	6	0.5					
				Total Freight Revenue per Carload	\$ 1,798	\$ 1,821	\$ (23)	(1.3)

Summary of Rail Data (Page 5)

2010	Second Quarter				2010	Year-to-date		
	2009 ⁽¹⁾	Fav/(Unfav)	%			2009 ⁽¹⁾	Fav/(Unfav)	%
<u>Operations Performance</u>								
1.58	1.71	0.13	7.6	Total operating expenses per GTM (cents) ⁽²⁾	1.61	1.81	0.20	11.0
1.58	1.75	0.17	9.7	Operating expenses exclusive of land sales per GTM (cents) ⁽²⁾⁽³⁾	1.61	1.84	0.23	12.5
60,766	49,635	11,131	22.4	Freight gross ton-miles (GTM) (millions)	119,290	100,568	18,722	18.6
9,920	8,391	1,529	18.2	Train miles (000)	19,477	17,298	2,179	12.6
15,726	15,156	(570)	(3.8)	Average number of active employees Total	15,079	15,103	24	0.2
13,813	13,270	(543)	(4.1)	Average number of active employees Expense	13,818	13,827	9	0.1
15,975	15,178	(797)	(5.3)	Number of employees at end of period Total	15,975	15,178	(797)	(5.3)
13,887	13,120	(767)	(5.8)	Number of employees at end of period Expense	13,887	13,120	(767)	(5.8)
1.13	1.14	0.01	0.9	U.S. gallons of locomotive fuel per 1,000 GTMs freight & yard	1.18	1.24	0.06	4.8
68.3	56.1	(12.2)	(21.7)	U.S. gallons of locomotive fuel consumed total (millions) ⁽⁴⁾	139.8	123.8	(16.0)	(12.9)
2.55	1.78	(0.77)	(43.3)	Average fuel price (U.S. dollars per U.S. gallon)	2.49	1.93	(0.56)	(29.0)
<u>Fluidity Data (including DM&E)</u>								
19.9	n/a			Average terminal dwell AAR definition (hours)	21.9	n/a		
23.2	n/a			Average train speed AAR definition (mph)	23.1	n/a		
147.0	n/a			Car miles per car day	139.2	n/a		
55.3	n/a			Average daily active cars on-line (000)	57.8	n/a		
1,013	n/a			Average daily active road locomotives on-line	1,006	n/a		
<u>Fluidity Data (excluding DM&E)</u>								
19.9	20.4	0.5	2.5	Average terminal dwell AAR definition (hours)	21.9	21.8	(0.1)	(0.5)
24.6	26.4	(1.8)	(6.8)	Average train speed AAR definition (mph)	24.4	25.7	(1.3)	(5.1)
160.6	144.6	16.0	11.1	Car miles per car day	152.1	142.2	9.9	7.0

48.1	42.5	(5.6)	(13.2)	Average daily active cars on-line (000)	50.3	45.6	(4.7)	(10.3)
901	723	(178)	(24.6)	Average daily active road locomotives on-line	886	777	(109)	(14.0)
<u>Safety</u>								
1.36	1.60	0.24	15.0	FRA personal injuries per 200,000 employee-hours	1.64	1.71	0.07	4.1
1.46	1.92	0.46	24.0	FRA train accidents per million train-miles	1.36	1.94	0.58	29.9

- (1) Certain prior period figures have been revised to conform with current presentation or have been updated to reflect new information.
- (2) Restated for the Company's change in accounting policy in relation to the accounting for rail grinding.
- (3) These earnings measures have no standardized meanings prescribed by GAAP and may not be comparable to similar measures of other companies. Operating expenses exclusive of land sales per GTM is calculated consistently

with total operating expenses per GTM except for the exclusion of net gains on land sales of \$0.8 million and \$22.9 million for the three months ended June 30, 2010 and 2009, and \$3.2 million and \$24.5 million for the six months ended June 30, 2010 and 2009 respectively. Please refer to pages 2 and 3, Adjusted Earnings Performance, Quarter and Year-to-date, Non-GAAP measures.

- (4) Includes gallons of fuel consumed from freight, yard and commuter service but excludes fuel used in capital projects and other non-freight activities.

n/a not available