

CANADIAN PACIFIC RAILWAY LTD/CN
Form 6-K
July 23, 2008

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, 2008

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 whether the registrants by furnishing the information contained in this Form is 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-_____

The interim financial statements, Management's Discussion and Analysis, and updated earnings coverage calculations included in this Report furnished on Form 6-K shall be incorporated by reference into, or as an exhibit to, as applicable, 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), Form S-8 No. 333-13962 (Canadian Pacific Railway Limited), and Form F-9 No. 333-142347 (Canadian Pacific Railway Company).

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
CANADIAN PACIFIC RAILWAY
COMPANY
(Registrants)

Date: July 22, 2008

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

Canadian Pacific
Management's Discussion and Analysis
Second Quarter Report 2008

Release: Immediate, July 22nd, 2008

CANADIAN PACIFIC ANNOUNCES ITS SECOND-QUARTER RESULTS

CALGARY Canadian Pacific Railway Limited (TSX/NYSE: CP) announced its second-quarter results today. Net income in the second quarter was \$155 million, a decrease of 40 per cent from \$257 million in 2007, and diluted earnings per share was \$1.00, a decrease from \$1.64 in the second quarter of 2007.

SUMMARY OF SECOND-QUARTER 2008 COMPARED WITH SECOND-QUARTER 2007

Total revenues were essentially flat at \$1.22 billion

Income before foreign exchange gains and losses on long-term debt and other specified items decreased to \$150 million from \$175 million

Adjusted diluted earnings per share decreased to \$0.97 from \$1.12

Operating ratio was 79.4 per cent compared with 74.7 per cent

This was a tough quarter with the unprecedented rise in fuel prices, the North American economic downturn, and prolonged flooding on our US mainline, said Fred Green, President and CEO. Combined, these had a significant impact on CP's earnings.

We see the current economic conditions continuing, and CP is taking aggressive steps which should position us well for 2009, continued Mr. Green. I have accelerated a rigorous process to improve our productivity, efficiency, and yield.

Freight revenues increased almost two per cent despite a decrease in traffic. This was mainly due to pricing, inclusive of fuel recoveries. CP experienced strong growth in industrial and consumer products of 17 per cent, intermodal of nine per cent and coal of six per cent. This was offset by decreases in forest products of 21 per cent, grain of nine per cent, sulphur and fertilizers of five per cent, and automotive of two per cent.

Operating expenses increased seven per cent with fuel up 34 per cent and purchased services and other, depreciation and amortization and materials up from two to nine per cent. This was offset by a decrease in equipment rents of 20 per cent and compensation and benefits of four per cent.

SUMMARY OF FIRST-HALF 2008 COMPARED WITH FIRST-HALF 2007

Net income for the first half of 2008 was \$246 million compared with \$385 million in 2007, a decrease of 36 per cent. Diluted earnings per share was \$1.59 down from \$2.46.

Freight revenues increased two per cent to \$2.3 billion and operating expenses were up seven per cent to \$1.9 billion.

EXCLUDING FOREIGN EXCHANGE GAINS AND LOSSES ON LONG-TERM DEBT AND OTHER SPECIFIED ITEMS

Income decreased to \$267 million from \$297 million.

Diluted earnings per share were \$1.72 down from \$1.90.

Operating ratio deteriorated 400 basis points to 81.0 per cent from 77.0 per cent.

2008 OUTLOOK

We continue to focus on driving positive pricing gains and strengthening our fuel recovery and cost management programs, said Mike Lambert, Chief Financial Officer. However, these will not be enough to offset the challenges we are facing with the higher price of fuel and the slowing North American economy. We are updating our guidance to reflect our substantially higher fuel assumptions and the deteriorating economic conditions. We now expect our full-year adjusted diluted earnings per share to be in the range of \$4.00 to \$4.20, down from our previous guidance of \$4.40 to \$4.60.

The 2008 estimate assumes an average currency exchange rate of the U.S. dollar at par with the Canadian dollar. Crude oil prices are expected to average US \$121 per barrel for the year (versus the previous assumption of US \$98 per barrel) with the second half averaging roughly US \$140 per barrel. Crack spreads are expected to average US \$23 per barrel for the year (versus the previous assumption of US \$20 per barrel) with the second half averaging US \$27 per barrel. The estimated average all-in fuel price is expected to be between US \$3.80 and \$3.90 per U.S. gallon for the year.

CP strives to mitigate the impact of any changes in WTI and crack margins through fuel recovery programs. However, these programs do not completely offset the changes in expense caused by changes in WTI and crack margins.

The approximate net annual impact on EPS of changes in WTI and crack margins given CP's current portfolio of freight contracts is as follows:

A change in WTI of US \$2 per barrel impacts EPS by \$0.01

A change in crack margins of US \$1 per barrel impacts EPS by \$0.02

These sensitivities do not consider the impact of the lagged implementation of changes in fuel surcharges from the timing of actual expenses incurred. This lag is due to regulatory notice requirements for rail price adjustments.

CP expects to grow total revenue by six to eight per cent in 2008, up from previous guidance of four to six per cent due mostly to increased fuel recovery, offset somewhat by volume declines. Total operating expenses are expected to increase by 11 to 13 per cent, revised from the previous guidance of six to eight per cent due principally to higher fuel cost.

CP expects its normalized tax rate to be between 26 per cent and 27 per cent, excluding the impact of the Dakota Minnesota & Eastern Railroad (DM&E) equity pick-up, a change from the previous outlook of 27 per cent to 29 per cent as a result of decreasing Canadian provincial tax rates.

CP expects free cash to be approximately \$150 million, adjusted downwards from the previous outlook of approximately \$200 million in 2008, due to lower projected earnings.

The 2008 outlook includes the projected after tax earnings of the DM&E on an equity accounting basis for the full year.

FOREIGN EXCHANGE GAINS AND LOSSES ON LONG-TERM DEBT AND OTHER SPECIFIED ITEMS

CP had a foreign exchange gain on long-term debt of \$7 million (\$5 million after tax) in the second quarter of 2008, compared with a foreign exchange gain on long-term debt of \$89 million (\$65 million after tax) in the second quarter of 2007. There were no other specified items in the

second quarter of 2008. There was a future income tax benefit of \$17 million in the second quarter of 2007 resulting from a reduction in the Canadian federal income tax rate.

For the first six months of 2008, CP had a foreign exchange loss on long-term debt of \$10 million (\$6 million after tax) compared with a foreign exchange gain of \$97 million (\$71 million after tax) in the first half of 2007.

At June 30, 2008 CP held investments in Canadian Non-Bank Asset Backed Commercial Paper (ABCP) with an original cost of approximately \$144 million. In the third-quarter of 2007, CP adjusted the estimated fair value of the investment and took a charge of \$21 million (\$15 million after tax) and classified the investments as long-term investments. In the first quarter of 2008, in recognition of current market conditions impacting these investments, CP further adjusted the estimated fair value of the investments and took an additional charge of \$21 million (\$15 million after tax). The estimated fair value of the investments as at June 30, 2008 was unchanged from the estimated fair value at March 31, 2008.

Continuing uncertainties regarding the value of the assets which underlie the ABCP, the amount and timing of cash flows and the outcome of the restructuring process could give rise to a material change in the value of the Company's investments in ABCP which would impact the Company's near-term earnings.

In the first quarter of 2008, the company recorded a \$21 million (\$15 million after tax) impairment of the company's investment in ABCP. Other than the future income tax benefit of \$17 million mentioned above, there were no additional other specified items in the first half of 2007.

Presentation of non-GAAP earnings

CP presents non-GAAP earnings in this news release to provide a basis for evaluating underlying earnings and liquidity trends in its business that can be compared with prior periods' results of operations. These non-GAAP earnings exclude foreign currency translation impacts on long-term debt, which can be volatile and short term, and other specified items, which are not among CP's normal ongoing revenues and operating expenses. 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. Diluted EPS, excluding foreign exchange gains and losses on long-term debt and other specified items, is also referred to in this news release as adjusted diluted EPS.

Free cash is calculated as cash provided by operating activities, less cash used in investing activities and dividends paid, adjusted for the acquisition of the DM&E, and now excluding changes in the accounts receivable securitization program, which was terminated in the second quarter. Free cash is adjusted for the DM&E acquisition, as it is not indicative of normal day-to-day investments in the Company's asset base. The securitization of accounts receivable is a financing-type transaction, which is excluded to clarify the nature of the use of free cash.

Earnings that exclude the foreign exchange currency translation impact on long-term debt and other specified items, and free cash after dividends, as described in this news release, have no standardized meanings and are not defined by Canadian generally accepted accounting principles and, therefore, are unlikely to be comparable to similar measures presented by other companies.

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.

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 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; timing of completion of capital and maintenance projects; currency and interest rate fluctuations; effects of changes in market conditions on the financial position of pension plans and investments; 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 in the Outlook section and 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.

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 900 communities where we operate. Our combined ingenuity makes CPR 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. Canadian Pacific is proud to be the official rail freight services provider for the Vancouver 2010 Olympic and Paralympic Winter Games.

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STATEMENT OF CONSOLIDATED INCOME

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

| | For the three months ended June 30 | |
|--|---|-----------------|
| | 2008 | 2007 |
| | (unaudited) | |
| Revenues | | |
| Freight | \$ 1,193.1 | \$ 1,174.1 |
| Other | 27.2 | 41.4 |
| | 1,220.3 | 1,215.5 |
| Operating expenses | | |
| Compensation and benefits | 315.5 | 329.8 |
| Fuel | 260.3 | 193.7 |
| Materials | 56.5 | 55.6 |
| Equipment rents | 46.1 | 57.3 |
| Depreciation and amortization | 124.7 | 119.1 |
| Purchased services and other | 166.1 | 152.3 |
| | 969.2 | 907.8 |
| Revenues less operating expenses | 251.1 | 307.7 |
| Other charges <i>(Note 4)</i> | 4.9 | 8.2 |
| Equity income in Dakota, Minnesota & Eastern Railroad Corporation <i>(Note 10)</i> | (13.4) | |
| Foreign exchange gains on long-term debt | (6.8) | (88.6) |
| Interest expense <i>(Note 5)</i> | 62.9 | 49.2 |
| Income tax expense <i>(Note 6)</i> | 48.6 | 82.2 |
| Net income | \$ 154.9 | \$ 256.7 |
| Basic earnings per share <i>(Note 7)</i> | \$ 1.01 | \$ 1.66 |
| Diluted earnings per share <i>(Note 7)</i> | \$ 1.00 | \$ 1.64 |

See notes to interim consolidated financial statements.

STATEMENT OF CONSOLIDATED INCOME
(in millions of Canadian dollars, except per share data)

| | For the six months ended June 30 | |
|--|---|-----------------|
| | 2008 | 2007 |
| | (unaudited) | |
| Revenues | | |
| Freight | \$ 2,317.5 | \$ 2,265.0 |
| Other | 49.7 | 66.4 |
| | 2,367.2 | 2,331.4 |
| Operating expenses | | |
| Compensation and benefits | 643.8 | 662.3 |
| Fuel | 490.5 | 364.9 |
| Materials | 122.0 | 118.0 |
| Equipment rents | 92.0 | 112.8 |
| Depreciation and amortization | 244.6 | 237.7 |
| Purchased services and other | 325.0 | 298.7 |
| | 1,917.9 | 1,794.4 |
| Revenues less operating expenses | 449.3 | 537.0 |
| Other charges (Note 4) | 11.6 | 13.0 |
| Equity income in Dakota, Minnesota & Eastern Railroad Corporation (Note 10) | (24.4) | |
| Change in estimated fair value of Canadian third party asset-backed commercial paper (Note 10) | 21.3 | |
| Foreign exchange losses (gains) on long-term debt | 9.5 | (97.2) |
| Interest expense (Note 5) | 122.8 | 96.0 |
| Income tax expense (Note 6) | 62.8 | 139.9 |
| Net income | \$ 245.7 | \$ 385.3 |
| Basic earnings per share (Note 7) | \$ 1.60 | \$ 2.49 |
| Diluted earnings per share (Note 7) | \$ 1.59 | \$ 2.46 |

See notes to interim consolidated financial statements.

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CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
(in millions of Canadian dollars)

| | For the three months ended June 30 | |
|---|---|-------------|
| | 2008 | 2007 |
| | (unaudited) | |
| Comprehensive income | | |
| Net income | \$ 154.9 | \$ 256.7 |
| Other comprehensive income | | |
| Net change in foreign currency translation adjustments, net of hedging activities | (1.1) | (2.9) |
| Net change in gains on derivatives designated as cash flow hedges | 16.7 | (9.8) |
| Other comprehensive income (loss) before income taxes | 15.6 | (12.7) |
| Income tax expense | (5.3) | (2.0) |
| Other comprehensive income (loss) (Note 13) | 10.3 | (14.7) |
| Comprehensive income | \$ 165.2 | \$ 242.0 |
| | | |
| | For the six months ended June 30 | |
| | 2008 | 2007 |
| | (unaudited) | |
| Comprehensive income | | |
| Net income | \$ 245.7 | \$ 385.3 |
| Other comprehensive income | | |
| Net change in foreign currency translation adjustments, net of hedging activities | 2.2 | (3.2) |
| Net change in gains on derivatives designated as cash flow hedges | 7.9 | (13.0) |
| Other comprehensive income (loss) before income taxes | 10.1 | (16.2) |
| Income tax recovery (expense) | 2.7 | (1.3) |

| | | |
|--|----------|----------|
| Other comprehensive income (loss) (<i>Note 13</i>) | 12.8 | (17.5) |
| Comprehensive income | \$ 258.5 | \$ 367.8 |

See notes to interim consolidated financial statements.

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CONSOLIDATED BALANCE SHEET
(in millions of Canadian dollars)

| | June 30 | December |
|---|--------------------|--------------------|
| | 2008 | 31 |
| | (unaudited) | |
| Assets | | |
| Current assets | | |
| Cash and cash equivalents | \$ 80.9 | \$ 378.1 |
| Accounts receivable and other current assets (Note 9) | 681.3 | 542.8 |
| Materials and supplies | 199.5 | 179.5 |
| Future income taxes | 66.7 | 67.3 |
| | 1,028.4 | 1,167.7 |
| Investments (Note 10) | 1,717.6 | 1,668.6 |
| Net properties | 9,464.2 | 9,293.1 |
| Other assets and deferred charges (Note 15) | 1,468.0 | 1,235.6 |
| Total assets | \$ 13,678.2 | \$ 13,365.0 |
| Liabilities and shareholders equity | | |
| Current liabilities | | |
| Short-term borrowing | \$ 255.0 | \$ 229.7 |
| Accounts payable and accrued liabilities | 954.2 | 980.8 |
| Income and other taxes payable | 50.7 | 68.8 |
| Dividends payable | 38.1 | 34.5 |
| Long-term debt maturing within one year | 238.4 | 31.0 |
| | 1,536.4 | 1,344.8 |
| Deferred liabilities | 717.2 | 714.6 |
| Long-term debt (Note 11) | 4,016.8 | 4,146.2 |
| Future income taxes | 1,741.8 | 1,701.5 |
| Shareholders equity | | |
| Share capital (Note 12) | 1,216.9 | 1,188.6 |
| Contributed surplus | 39.8 | 42.4 |
| Accumulated other comprehensive income (Note 13) | 52.4 | 39.6 |
| Retained income | 4,356.9 | 4,187.3 |

| | | |
|---|--------------------|--------------------|
| | 5,666.0 | 5,457.9 |
| <i>Total liabilities and shareholders equity</i> | \$ 13,678.2 | \$ 13,365.0 |

Commitments and contingencies (*Note 19*).
See notes to interim consolidated financial statements.

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STATEMENT OF CONSOLIDATED CASH FLOWS
(in millions of Canadian dollars)

| | For the three months ended June 30 | |
|--|---|----------------|
| | 2008 | 2007 |
| | (unaudited) | |
| Operating activities | | |
| Net income | \$ 154.9 | \$ 256.7 |
| Add (deduct) items not affecting cash: | | |
| Depreciation and amortization | 124.7 | 119.1 |
| Future income taxes | 32.4 | 57.7 |
| Foreign exchange gains on long-term debt | (6.8) | (88.6) |
| Amortization of deferred charges | 2.6 | 3.1 |
| Equity income, net of cash received | (11.4) | |
| Restructuring and environmental remediation payments <i>(Note 8)</i> | (10.8) | (12.0) |
| Other operating activities, net | 29.9 | 0.9 |
| Change in non-cash working capital balances related to operations <i>(Note 9)</i> | (132.5) | 27.6 |
| Cash provided by operating activities | 183.0 | 364.5 |
| Investing activities | | |
| Additions to properties | (237.3) | (158.4) |
| Additions to investments and other assets <i>(Note 15)</i> | (57.8) | (11.4) |
| Additions to investment in Dakota, Minnesota & Eastern Railroad Corporation <i>(Note 10)</i> | (1.2) | |
| Net (cost) proceeds from disposal of transportation properties | (0.1) | (0.4) |
| Cash used in investing activities | (296.4) | (170.2) |
| Financing activities | | |
| Dividends paid | (38.0) | (34.7) |
| Issuance of CP Common Shares | 4.8 | 15.0 |
| Purchase of CP Common Shares | | (212.0) |
| Net (decrease) increase in short-term borrowing | 188.3 | (77.7) |
| Issuance of long-term debt <i>(Note 11)</i> | 1,068.7 | 485.1 |
| Repayment of long-term debt | (1,069.9) | (3.5) |
| Settlement of treasury rate lock <i>(Note 14)</i> | (30.9) | |
| Cash provided by financing activities | 123.0 | 172.2 |

Cash position

| | | |
|--|---------|----------|
| Increase in cash and cash equivalents | 9.6 | 366.5 |
| Cash and cash equivalents at beginning of period | 71.3 | 25.6 |
| Cash and cash equivalents at end of period | \$ 80.9 | \$ 392.1 |

See notes to interim consolidated financial statements.

STATEMENT OF CONSOLIDATED CASH FLOWS
(in millions of Canadian dollars)

| | For the six months ended June 30 | |
|---|---|----------------|
| | 2008 | 2007 |
| | (unaudited) | |
| Operating activities | | |
| Net income | \$ 245.7 | \$ 385.3 |
| Add (deduct) items not affecting cash: | | |
| Depreciation and amortization | 244.6 | 237.7 |
| Future income taxes | 27.9 | 96.2 |
| Change in estimated fair value of Canadian third party asset-backed commercial paper (Note 10) | 21.3 | |
| Foreign exchange losses (gains) on long-term debt | 9.5 | (97.2) |
| Amortization of deferred charges | 5.1 | 6.2 |
| Equity income, net of cash received | (20.8) | |
| Restructuring and environmental remediation payments (Note 8) | (24.5) | (25.2) |
| Other operating activities, net | 4.4 | (1.8) |
| Change in non-cash working capital balances related to operations (Note 9) | (170.2) | (9.0) |
| Cash provided by operating activities | 343.0 | 592.2 |
| Investing activities | | |
| Additions to properties | (364.7) | (362.6) |
| Additions to investments and other assets (Note 15) | (192.5) | (11.7) |
| Additions to investment in Dakota, Minnesota & Eastern Railroad Corporation (Note 10) | (7.5) | |
| Net (cost) proceeds from disposal of transportation properties | (2.6) | 8.5 |
| Cash used in investing activities | (567.3) | (365.8) |
| Financing activities | | |
| Dividends paid | (72.5) | (63.8) |
| Issuance of CP Common Shares | 17.0 | 25.1 |
| Purchase of CP Common Shares | | (228.1) |
| Net (decrease) increase in short-term borrowing | 25.3 | |
| Issuance of long-term debt (Note 11) | 1,068.7 | 485.1 |
| Repayment of long-term debt | (1,080.5) | (176.9) |
| Settlement of treasury rate lock (Note 14) | (30.9) | |
| Cash (used in) provided by financing activities | (72.9) | 41.4 |

Cash position

| | | |
|--|---------|----------|
| Increase (decrease) in cash and cash equivalents | (297.2) | 267.8 |
| Cash and cash equivalents at beginning of period | 378.1 | 124.3 |
| Cash and cash equivalents at end of period | \$ 80.9 | \$ 392.1 |

See notes to interim consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
(in millions of Canadian dollars)

| | For the three months ended June 30 | |
|--|---|-------------|
| | 2008 | 2007 |
| | (unaudited) | |
| Share capital | | |
| Balance, beginning of period | \$ 1,210.4 | \$ 1,182.9 |
| Shares issued under stock option plans | 6.5 | 18.5 |
| Shares purchased | | (19.4) |
| Balance, end of period | 1,216.9 | 1,182.0 |
| Contributed surplus | | |
| Balance, beginning of period | 38.5 | 37.1 |
| Stock compensation expense | 2.3 | 2.1 |
| Stock compensation expense related to shares issued under stock option plans | (1.0) | (0.5) |
| Balance, end of period | 39.8 | 38.7 |
| Accumulated other comprehensive income | | |
| Balance, beginning of period | 42.1 | 77.6 |
| Other comprehensive income (loss) (<i>Note 13</i>) | 10.3 | (14.7) |
| Balance, end of period | 52.4 | 62.9 |
| Retained income | | |
| Balance, beginning of period | 4,240.1 | 3,641.7 |
| Net income for the period | 154.9 | 256.7 |

| | | |
|---|------------|------------|
| Shares purchased | | (168.6) |
| Dividends | (38.1) | (34.9) |
| Balance, end of period | 4,356.9 | 3,694.9 |
| Total accumulated other comprehensive income and retained income | 4,409.3 | 3,757.8 |
| Shareholders' equity, end of period | \$ 5,666.0 | \$ 4,978.5 |

See notes to interim consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
(in millions of Canadian dollars)

| | For the six months ended June 30 | |
|--|---|-------------|
| | 2008 | 2007 |
| | (unaudited) | |
| Share capital | | |
| Balance, beginning of period | \$ 1,188.6 | \$ 1,175.7 |
| Shares issued under stock option plans | 28.3 | 30.8 |
| Shares purchased | | (24.5) |
| Balance, end of period | 1,216.9 | 1,182.0 |
| Contributed surplus | | |
| Balance, beginning of period | 42.4 | 32.3 |
| Stock compensation expense | 6.8 | 7.4 |
| Stock compensation expense related to shares issued under stock option plans | (9.4) | (1.0) |
| Balance, end of period | 39.8 | 38.7 |
| Accumulated other comprehensive income | | |
| Balance, beginning of period | 39.6 | 66.4 |
| Adjustment for change in accounting policy | | 14.0 |
| Adjusted balance, beginning of period | 39.6 | 80.4 |
| Other comprehensive income (loss) (Note 13) | 12.8 | (17.5) |
| Balance, end of period | 52.4 | 62.9 |
| Retained income | | |

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| | | |
|---|------------|------------|
| Balance, beginning of period | 4,187.3 | 3,582.1 |
| Adjustment for change in accounting policy | | 4.0 |
| Adjusted balance, beginning of period | 4,187.3 | 3,586.1 |
| Net income for the period | 245.7 | 385.3 |
| Shares purchased | | (206.6) |
| Dividends | (76.1) | (69.9) |
| Balance, end of period | 4,356.9 | 3,694.9 |
| Total accumulated other comprehensive income and retained income | 4,409.3 | 3,757.8 |
| Shareholders' equity, end of period | \$ 5,666.0 | \$ 4,978.5 |

See notes to interim consolidated financial statements.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2008

(unaudited)

1 Basis of presentation

These unaudited interim consolidated financial statements and notes have been prepared using accounting policies that are consistent with the policies used in preparing Canadian Pacific Railway Limited's (CP, the Company or Canadian Pacific Railway) 2007 annual consolidated financial statements, except as discussed below and in Note 2 for the adoption of new accounting standards. They do not include all disclosures required under Generally Accepted Accounting Principles for annual financial statements and should be read in conjunction with the annual consolidated financial statements.

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.

2 New accounting changes

Financial Instrument and Capital Disclosures

The CICA has issued the following accounting standards effective for fiscal years beginning on or after January 1, 2008: Section 3862 Financial Instruments Disclosures, Section 3863 Financial Instruments Presentation, and Section 1535 Capital Disclosures.

Section 3862 Financial Instruments Disclosures and Section 3863 Financial Instruments Presentation replace Section 3861 Financial Instruments Disclosure and Presentation, revising disclosures related to financial instruments, including hedging instruments, and carrying forward unchanged presentation requirements.

Section 1535 Capital Disclosures requires the Company to provide disclosures about the Company's capital and how it is managed.

The adoption of these new accounting standards did not impact the amounts reported in the Company's financial statements; however, it did result in expanded note disclosure (see Note 14 and Note 20).

Inventories

Effective January 1, 2008, the CICA has issued accounting standard Section 3031 Inventories. Section 3031 Inventories provides guidance on the method of determining the cost of the Company's materials and supplies. The new accounting standard specifies that inventories are to be valued at the lower of cost and net realizable value. The standard requires the reversal of previously recorded write downs to realizable value when there is clear evidence that net realizable value has increased. The adoption of Section 3031 Inventories did not impact the Company's financial statements.

3 Future accounting changes

In February 2008, the CICA issued accounting standard Section 3064 Goodwill and intangible assets, replacing accounting standard Section 3062 Goodwill and other intangible assets and accounting standard Section 3450 Research and development costs. The new Section will be applicable on a retrospective basis with restatement to financial statements relating to fiscal years beginning on or after October 1, 2008. Accordingly, the Company will adopt the new standards for its fiscal year beginning January 1, 2009. Section 3064 establishes standards for the

recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets by profit-oriented enterprises. Standards concerning goodwill are unchanged from the standards included in the previous Section 3062. The Company is currently evaluating the impact of the adoption of this new Section.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**JUNE 30, 2008***(unaudited)***4 Other charges**

| (in millions) | For the three months ended June 30 | | For the six months ended June 30 | |
|--|---|---------------|---|----------------|
| | 2008 | 2007 | 2008 | 2007 |
| Amortization of discount on accruals recorded at present value | \$ 1.6 | \$ 2.2 | \$ 3.1 | \$ 4.2 |
| Other exchange losses | 0.6 | 2.5 | 1.9 | 2.0 |
| Loss on sale of accounts receivable | 1.1 | 1.4 | 2.7 | 2.7 |
| Gains on non-hedging derivative instruments | (0.9) | (0.1) | (0.9) | (0.4) |
| Other | 2.5 | 2.2 | 4.8 | 4.5 |
| Total other charges | \$ 4.9 | \$ 8.2 | \$ 11.6 | \$ 13.0 |

5 Interest expense

| (in millions) | For the three months ended June 30 | | For the six months ended June 30 | |
|-------------------------------|---|----------------|---|----------------|
| | 2008 | 2007 | 2008 | 2007 |
| Interest expense | \$ 64.8 | \$ 52.3 | \$ 129.5 | \$ 101.1 |
| Interest income | (1.9) | (3.1) | (6.7) | (5.1) |
| Total interest expense | \$ 62.9 | \$ 49.2 | \$ 122.8 | \$ 96.0 |

6 Income taxes

During the six months ended June 30, 2008, legislation was substantively enacted to reduce provincial income tax rates. As a result of these changes, the Company recorded a \$15.7 million benefit in future tax liability and income tax expense for the six months ended June 30, 2008, related to the revaluation of its future income tax balances as at December 31, 2007. For the three months ended June 30, 2008, the Company recorded a \$5.1 million benefit in future income tax liability and income tax expenses.

Cash taxes paid for the quarter ended June 30, 2008, was \$13.2 million (three months ended June 30, 2007 cash taxes refunded was \$1.1 million). Cash taxes paid in the six months ended June 30, 2008 was \$57.9 million (six months ended June 30, 2007 \$8.1 million).

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**JUNE 30, 2008***(unaudited)***7 Earnings per share**

At June 30, 2008, the number of shares outstanding was 153.8 million (June 30, 2007 153.1 million).

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

Diluted earnings per share have been calculated using the treasury stock method, which gives effect to the dilutive value of outstanding options.

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 | |
|---|---|-------------|---|-------------|
| | 2008 | 2007 | 2008 | 2007 |
| Weighted average shares outstanding | 153.7 | 154.3 | 153.6 | 154.9 |
| Dilutive effect of stock options | 1.4 | 1.8 | 1.4 | 1.5 |
| | | | | |
| Weighted average diluted shares outstanding | 155.1 | 156.1 | 155.0 | 156.4 |
| | | | | |
| (in dollars) | | | | |
| Basic earnings per share | \$ 1.01 | \$ 1.66 | \$ 1.60 | \$ 2.49 |
| Diluted earnings per share | \$ 1.00 | \$ 1.64 | \$ 1.59 | \$ 2.46 |

For the three and six months ended June 30, 2008, 613,933 and 617,825 options were excluded from the computation of diluted earnings per share because their effects were not dilutive (three and six months ended June 30, 2007 nil and 2,425).

8 Restructuring and environmental remediation

At June, 2008, the provision for restructuring and environmental remediation was \$217.2 million (December 31, 2007 \$234.0 million). This provision primarily includes labour liabilities for restructuring plans. Payments are expected to continue in diminishing amounts until 2025. The environmental remediation liability includes the cost of a multi-year soil remediation program.

Set out below is a reconciliation of CP's liabilities associated with restructuring and environmental remediation programs:

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**JUNE 30, 2008***(unaudited)***8 Restructuring and environmental remediation (continued)****Three months ended June 30, 2008**

| | Opening Balance Apr. 1 | | | Amortization of | Foreign Exchange | Closing Balance June 30 |
|--|---------------------------------------|----------------|-----------------|----------------------------|-----------------------------|--|
| (in millions) | 2008 | Accrued | Payments | Discount | Impact | 2008 |
| Labour liability for terminations and severances | \$ 118.9 | 1.5 | (8.3) | 1.1 | (0.3) | \$ 112.9 |
| Other non-labour liabilities for exit plans | 0.6 | | | | | 0.6 |
| Total restructuring liability | 119.5 | 1.5 | (8.3) | 1.1 | (0.3) | 113.5 |
| Environmental remediation program | 105.5 | 1.0 | (2.5) | | (0.3) | 103.7 |
| Total restructuring and environmental remediation liability | \$ 225.0 | 2.5 | (10.8) | 1.1 | (0.6) | \$ 217.2 |

Three months ended June 30, 2007

| | Opening Balance April 1 | | | Amortization of | Foreign Exchange | Closing Balance June 30 |
|--|--|------------------|-----------------|----------------------------|-----------------------------|--|
| (in millions) | 2007 | (reduced) | Payments | Discount | Impact | 2007 |
| Labour liability for terminations and severances | \$ 176.1 | (2.1) | (9.6) | 1.7 | (2.5) | \$ 163.6 |
| Other non-labour liabilities for exit plans | 1.3 | | | | (0.2) | 1.1 |
| Total restructuring liability | 177.4 | (2.1) | (9.6) | 1.7 | (2.7) | 164.7 |

| | | | | | | |
|---|-----------------|--------------|---------------|------------|--------------|-----------------|
| Environmental remediation program | 119.2 | 1.1 | (2.4) | | (5.2) | 112.7 |
| Total restructuring and environmental remediation liability | \$ 296.6 | (1.0) | (12.0) | 1.7 | (7.9) | \$ 277.4 |

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**JUNE 30, 2008***(unaudited)***8 Restructuring and environmental remediation (continued)****Six months ended June 30, 2008**

| (in millions) | Opening Balance Jan. 1 2008 | Accrued | Payments | Amortization of Discount | Foreign Exchange Impact | Closing Balance June 30 2008 |
|--|--|------------|---------------|--------------------------------|-------------------------------|---|
| Labour liability for terminations and severances | \$ 129.2 | 1.5 | (20.6) | 2.2 | 0.6 | \$ 112.9 |
| Other non-labour liabilities for exit plans | 0.8 | | (0.2) | | | 0.6 |
| Total restructuring liability | 130.0 | 1.5 | (20.8) | 2.2 | 0.6 | 113.5 |
| Environmental remediation program | 104.0 | 1.9 | (3.7) | | 1.5 | 103.7 |
| Total restructuring and environmental remediation liability | \$ 234.0 | 3.4 | (24.5) | 2.2 | 2.1 | \$ 217.2 |

Six months ended June 30, 2007

| (in millions) | Opening Balance Jan. 1 2007 | Accrued (reduced) | Payments | Amortization of Discount | Foreign Exchange Impact | Closing Balance June 30 2007 |
|--|--|--------------------------|---------------|--------------------------------|-------------------------------|---|
| Labour liability for terminations and severances | \$ 187.4 | (2.1) | (22.1) | 3.2 | (2.8) | \$ 163.6 |
| Other non-labour liabilities for exit plans | 1.4 | | (0.1) | | (0.2) | 1.1 |
| Total restructuring liability | 188.8 | (2.1) | (22.2) | 3.2 | (3.0) | 164.7 |

| | | | | | | |
|---|-----------------|--------------|---------------|------------|--------------|-----------------|
| Environmental remediation program | 120.2 | 1.3 | (3.0) | | (5.8) | 112.7 |
| Total restructuring and environmental remediation liability | \$ 309.0 | (0.8) | (25.2) | 3.2 | (8.8) | \$ 277.4 |

Amortization of Discount is charged to income as Other Charges , Compensation and Benefits and Purchased Services and Other as applicable. New accruals and adjustments to previous accruals are reflected in Compensation and Benefits and Purchased Services and Other as applicable.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2008

(unaudited)

9 Accounts Receivable

As at March 31, 2008, the Company had an accounts receivable securitization program. Under the terms of the program, the Company sold an undivided co-ownership interest in \$120.0 million of eligible freight receivables to an unrelated trust. In the second quarter of 2008, the Company's accounts receivable securitization program was terminated. As a result of this termination, in the Company's Consolidated balance sheet, Accounts receivable and other current assets increased by \$120.0 million and in the Statement of consolidated cash flows the Change in non-cash working capital balances related to operations reflected an outflow of \$120.0 million. As well, the related servicing asset and liability which had previously been recognized are no longer required to be maintained and were settled as part of the termination.

10 Investments

Dakota, Minnesota & Eastern Railroad Corporation (DM&E)

Effective October 4, 2007, the Company acquired all of the issued and outstanding shares of DM&E. The Company is currently accounting for the purchase by the equity method until such time as the acquisition has been approved by the United States Surface Transportation Board. The purchase price was \$1.499 billion cash payment, including a \$6 million post closing adjustment in the first quarter of 2008, and transaction costs of \$22 million incurred to June 30, 2008. Future contingent payments of up to approximately US\$1.05 billion may become payable up to December 31, 2025 upon achievement of certain milestones.

The equity income from the Company's investment in DM&E, which is recorded net of tax, was \$13.4 million during the three months ended June 30, 2008 and \$24.4 million during the six months ended June 30, 2008. The difference between cost and the underlying net book value of DM&E at the date of acquisition was US\$983.5 million. For the three months ended June 30, 2008 the equity income from the Company's investment in DM&E was reduced by \$3.4 million to recognize additional depreciation expense based on the assigned cost using fair values at that date of acquisition and \$0.5 million to recognize amortization of the fair value of intangible assets acquired. For the six months ended June 30, 2008, the additional depreciation expense was \$6.8 million and the amortization of intangible assets was \$0.9 million.

Canadian Third Party Asset-backed Commercial Paper (ABCP)

At June 30, 2008, the Company held ABCP issued by a number of trusts with an original cost of \$143.6 million. At the dates the Company acquired these investments they were rated R1 (High) by DBRS Limited (DBRS), the highest credit rating issued for commercial paper, and backed by R1 (High) rated assets and liquidity agreements. These investments matured during the third quarter of 2007 but, as a result of liquidity issues in the ABCP market, did not settle on maturity. As a result, the Company has classified its ABCP as long-term investments after initially classifying them as Cash and cash equivalents.

On August 16, 2007, an announcement was made by a group representing banks, asset providers and major investors on an agreement in principle to a long-term proposal and interim agreement to convert the ABCP into long-term floating rate notes maturing no earlier than the scheduled maturity of the underlying assets. On September 6, 2007, a pan-Canadian restructuring committee consisting of major investors was formed. The committee was created to propose a solution to the liquidity problem affecting the ABCP and has retained legal and financial advisors to oversee the proposed restructuring process.

The ABCP in which the Company has invested has not traded in an active market since mid-August 2007 and there are currently no market quotations available.

On March 17, 2008, a court order was obtained which commenced the process of restructuring the ABCP under the protection of the Companies Creditors Arrangement Act (CCAA). A vote of the holders of the ABCP approving the restructuring occurred on April 25, 2008, and on June 25, 2008 a court order sanctioning the restructuring of the ABCP was made pursuant to the CCAA. The sanction order remains subject to appeals by certain of the holders of ABCP, and the restructuring is not expected to be implemented until all appeals have been finally resolved.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2008

(unaudited)

10 Investments (continued)

Canadian Third Party Asset-backed Commercial Paper (ABCP) (continued)

On March 20, 2008, the pan-Canadian restructuring committee issued an Information Statement containing details about the proposed restructuring. Based on this and other public information it is estimated that, of the \$143.6 million of ABCP in which the Company has invested:

\$12.5 million is represented by traditional securitized assets and the Company will, on restructuring, receive replacement TA Tracking long-term floating rate notes with a maturity of approximately eight and one half years. As the underlying assets are primarily comprised of cash and Canadian Lines of Credit which are subject to an offer to repurchase at par value, the Company has assumed that these notes will be repaid in full significantly in advance of maturity;

\$117.7 million is represented by a combination of leveraged collateralized debt, synthetic assets and traditional securitized assets and the Company will, on restructuring, receive replacement senior Class A-1 and Class A-2 and subordinated Class B and Class C long-term floating rate notes with maturities of approximately eight years and nine months. The Company expects to receive replacement notes with par values as follows:

Class A-1: \$59.7 million

Class A-2: \$46.5 million

Class B: \$8.0 million

Class C: \$3.5 million

The replacement senior notes are expected to obtain a AA rating while the replacement subordinated notes are likely to be unrated; and

\$13.4 million is represented by assets that have an exposure to US mortgages and sub-prime mortgages. On restructuring, the Company is likely to receive IA Tracking long-term floating rate notes with maturities of approximately between five years and three months and eight years and seven months. These notes may be rated, although at this time the pan-Canadian restructuring committee has provided no indication of the rating these notes may receive.

The valuation technique used by the Company to estimate the fair value of its investment in ABCP at June 30, 2008, 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 assumptions used in determining the estimated fair value reflect the details included in the Information Statement issued by the pan-Canadian restructuring committee and the risks associated with the long-term floating rate notes. The interest rates and maturities of the various long-term floating rate notes, discount rates and credit losses modelled are:

| | |
|--|--|
| Probability weighted average interest rate | 3.2 per cent |
| Weighted average discount rate | 7.4 per cent |
| Maturity of long-term floating rate notes | five to nine years |
| Credit losses | rated notes ⁽¹⁾ : nil to 25 percent unrated notes ⁽²⁾ : 15 to 100 percent |

(1)

TA Tracking,
Class A-1 and
Class A-2 senior
notes and IA
Tracking notes.

- (2) Class B and
Class C
subordinated
notes.

Interest rates and credit losses vary by each of the different replacement long-term floating rate notes to be issued as each has different credit ratings and risks. Interest rates and credit losses also vary by the different probable cash flow scenarios that have been modelled.

Discount rates vary dependent upon the credit rating of the replacement long-term floating rate notes. Discount rates have been estimated using Government of Canada benchmark rates plus expected spreads for similarly rated instruments with similar maturities and structure. An increase in the estimated discount rates of 1 percent would reduce the estimated fair value of the Company's investment in ABCP by approximately \$5 million.

Maturities vary by different replacement long-term floating rate notes as a result of the expected maturity of the underlying assets.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**JUNE 30, 2008***(unaudited)***10 Investments (continued)****Canadian Third Party Asset-backed Commercial Paper (ABCP) (continued)**

One of the cash flow scenarios modelled is a liquidation scenario whereby, if the restructuring is not successfully completed, recovery of the Company's investment is through the liquidation of the underlying assets of the ABCP trusts. In addition, while the likelihood is remote, there remains a possibility that a liquidation scenario may occur even with a successful approval of the restructuring plan.

In addition, assumptions have also been made as to the amount of restructuring costs that the Company will bear.

The probability weighted discounted cash flows resulted in an estimated fair value of the Company's ABCP of \$100.8 million at June 30, 2008. This was unchanged from the estimated fair value at March 31, 2008. However, it represents a reduction from the estimated fair value at December 31, 2007 of \$122.1 million. A charge to income of \$21.3 million before tax (\$15.0 million after tax) was recorded in the first quarter of 2008. This first quarter charge represents 15 percent of the original value, bringing the aggregate write-down to a total of approximately 30 percent of the original value. Sensitivity analysis is presented below for key assumptions:

| (in millions) | Change in fair value of ABCP | |
|---|---|-------|
| Probability of successful restructuring | | |
| 1 percent increase | \$ | 0.4 |
| 1 percent decrease | \$ | (0.4) |
| Interest rate | | |
| 50 basis point increase | \$ | 2.9 |
| 50 basis point decrease | \$ | (2.9) |
| Discount rate | | |
| 50 basis point increase | \$ | (2.4) |
| 50 basis point decrease | \$ | 2.5 |

Continuing uncertainties regarding the value of the assets which underlie the ABCP, the amount and timing of cash flows and the outcome of the restructuring process could give rise to a further material change in the value of the Company's investment in ABCP which could impact the Company's near term earnings.

11 Long-term debt

During the second quarter of 2008, the Company issued US\$400 million 5.75% 5-year notes, US\$300 million 6.50% 10-year notes and CDN\$375 million 6.25% 10-year notes. Net proceeds from these offerings were CDN\$1,068.7 million. The notes are unsecured, but carry a negative pledge. The proceeds from these offerings were used to partially repay the bridge financing.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**JUNE 30, 2008***(unaudited)***12 Shareholders equity**

An analysis of Common Share balances is as follows:

| (in millions) | For the three months ended June 30 | | For the six months ended June 30 | |
|--|---|-------------|---|-------------|
| | 2008 | 2007 | 2008 | 2007 |
| Share capital, beginning of period | 153.6 | 155.2 | 153.3 | 155.5 |
| Shares issued under stock option plans | 0.2 | 0.4 | 0.5 | 0.8 |
| Shares purchased | | (2.5) | | (3.2) |
| Share capital, end of period | 153.8 | 153.1 | 153.8 | 153.1 |

For the six months ended June 30, 2008, there were no shares purchased (2.5 million shares were purchased during the three months ended June 30, 2007 at an average price per share of \$74.16 and for the six months ended June 30, 2007 3.2 million shares were purchased at an average price per share of \$73.64).

Purchases are made at the market price on the day of purchase, with consideration allocated to share capital up to the average carrying amount of the shares, and any excess allocated to retained earnings. When shares are purchased, it takes three days before the transaction is settled and the shares are cancelled. The cost of shares purchased in a given month and settled in the following month is accrued in the month of purchase.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**JUNE 30, 2008***(unaudited)***13 Other comprehensive income and accumulated other comprehensive income**

Components of other comprehensive income and the related tax effects are as follows:

| (in millions) | For the three months ended June 30 | | |
|--|---|---|------------------------------|
| | Before tax amount | 2008 Income tax (expense) recovery | Net of tax amount |
| Unrealized foreign exchange gain on translation of U.S. dollar-denominated long-term debt designated as a hedge of the net investment in U.S. subsidiaries | \$ 8.0 | \$ (1.1) | \$ 6.9 |
| Unrealized foreign exchange loss on translation of the net investment in U.S. subsidiaries | (9.1) | | (9.1) |
| Realized gain on cash flow hedges settled in the period | (6.0) | 1.9 | (4.1) |
| Decrease in unrealized holding losses on cash flow hedges | 21.0 | (6.6) | 14.4 |
| Realized loss on cash flow hedges settled in prior periods | 1.7 | 0.5 | 2.2 |
| Other comprehensive income (loss) | \$ 15.6 | \$ (5.3) | \$ 10.3 |

| (in millions) | For the three months ended June 30 | | |
|--|---|---|------------------------------|
| | Before tax amount | 2007 Income tax (expense) recovery | Net of tax amount |
| Unrealized foreign exchange gain on translation of U.S. dollar-denominated long-term debt designated as a hedge of the net investment in U.S. subsidiaries | \$ 33.8 | \$ (5.2) | \$ 28.6 |
| Unrealized foreign exchange loss on translation of the net investment in U.S. subsidiaries | (36.7) | | (36.7) |
| Realized gain on cash flow hedges settled in the period | (4.8) | 1.5 | (3.3) |

| | | | |
|--|-----------|----------|-----------|
| Decrease in unrealized holding gains on cash flow hedges | (6.6) | 2.2 | (4.4) |
| Realized loss on cash flow hedges settled in prior periods | 1.6 | (0.5) | 1.1 |
| Other comprehensive loss | \$ (12.7) | \$ (2.0) | \$ (14.7) |

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**JUNE 30, 2008***(unaudited)***13 Other comprehensive income and accumulated other comprehensive income (continued)**

| (in millions) | For the six months ended June 30 | | |
|--|----------------------------------|--|----------------------|
| | Before tax amount | 2008 Income tax (expense) recovery | Net of tax amount |
| Unrealized foreign exchange loss on translation of U.S. dollar-denominated long-term debt designated as a hedge of the net investment in U.S. subsidiaries | \$ (35.0) | \$ 4.7 | \$ (30.3) |
| Unrealized foreign exchange gain on translation of the net investment in U.S. subsidiaries | 37.2 | | 37.2 |
| Realized gain on cash flow hedges settled in the period | (8.9) | 3.6 | (5.3) |
| Decrease in unrealized holding losses on cash flow hedges | 15.2 | (6.1) | 9.1 |
| Realized loss on cash flow hedges settled in prior periods | 1.6 | 0.5 | 2.1 |
| Other comprehensive income | \$ 10.1 | \$ 2.7 | \$ 12.8 |

| (in millions) | For the six months ended June 30 | | |
|--|----------------------------------|--|----------------------|
| | Before tax amount | 2007 Income tax (expense) recovery | Net of tax amount |
| Unrealized foreign exchange gain on translation of U.S. dollar-denominated long-term debt designated as a hedge of the net investment in U.S. subsidiaries | \$ 37.7 | \$ (5.8) | \$ 31.9 |
| Unrealized foreign exchange loss on translation of the net investment in U.S. subsidiaries | (40.9) | | (40.9) |
| Realized gain on cash flow hedges settled in the period | (8.1) | 2.8 | (5.3) |
| Decrease in unrealized holding gains on cash flow hedges | (6.5) | 2.2 | (4.3) |

| | | | |
|--|-----------|----------|-----------|
| Realized loss on cash flow hedges settled in prior periods | 1.6 | (0.5) | 1.1 |
| Other comprehensive loss | \$ (16.2) | \$ (1.3) | \$ (17.5) |

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**JUNE 30, 2008***(unaudited)***13 Other comprehensive income and accumulated other comprehensive income (continued)**

Changes in the balances of each classification within Accumulated other comprehensive income are as follows:

Three months ended June 30, 2008

| (in millions) | Opening Balance, Apr. 1, 2008 | Period change | Closing Balance, June 30, 2008 |
|--|--|--------------------------|---|
| Foreign exchange gain on U.S. dollar debt designated as a hedge of the net investment in U.S. subsidiaries | \$ 259.4 | \$ 6.9 | \$ 266.3 |
| Foreign exchange loss on net investment in U.S. subsidiaries | (200.6) | (9.1) | (209.7) |
| Unrealized effective losses on cash flow hedges | (12.7) | 10.3 | (2.4) |
| Deferred loss on settled hedge instruments | (4.0) | 2.2 | (1.8) |
| Accumulated other comprehensive income | \$ 42.1 | \$ 10.3 | \$ 52.4 |

Three months ended June 30, 2007

| (in millions) | Opening Balance, Apr. 1, 2007 | Period change | Closing Balance, June 30, 2007 |
|--|--|--------------------------|---|
| Foreign exchange gain on U.S. dollar debt designated as a hedge of the net investment in U.S. subsidiaries | \$ 238.6 | \$ 28.6 | \$ 267.2 |
| Foreign exchange loss on net investment in U.S. subsidiaries | (172.7) | (36.7) | (209.4) |
| Unrealized effective gains on cash flow hedges | 17.0 | (7.7) | 9.3 |
| Deferred loss on settled hedge instruments | (5.3) | 1.1 | (4.2) |
| Accumulated other comprehensive income | \$ 77.6 | \$ (14.7) | \$ 62.9 |

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**JUNE 30, 2008***(unaudited)***13 Other comprehensive income and accumulated other comprehensive income (continued)****Six months ended June 30, 2008**

| (in millions) | Opening Balance, Jan. 1, 2008 | Period change | Closing Balance, June 30, 2008 |
|--|--|--------------------------|---|
| Foreign exchange gain on U.S. dollar debt designated as a hedge of the net investment in U.S. subsidiaries | \$ 296.6 | \$ (30.3) | \$ 266.3 |
| Foreign exchange loss on net investment in U.S. subsidiaries | (246.9) | 37.2 | (209.7) |
| Unrealized effective losses on cash flow hedges | (6.2) | 3.8 | (2.4) |
| Deferred loss on settled hedge instruments | (3.9) | 2.1 | (1.8) |
| Accumulated other comprehensive income | \$ 39.6 | \$ 12.8 | \$ 52.4 |

Six months ended June 30, 2007

| (in millions) | Opening Balance, Jan. 1, 2007 | Adjustment for change in accounting policy | Adjusted Opening Balance, Jan. 1, 2007 | Period change | Closing Balance, June 30, 2007 |
|--|--|---|---|--------------------------|---|
| Foreign exchange gain on U.S. dollar debt designated as a hedge of the net investment in U.S. subsidiaries | \$ 234.9 | \$ 0.4 | \$ 235.3 | \$ 31.9 | \$ 267.2 |
| Foreign exchange loss on net investment in U.S. subsidiaries | (168.5) | | (168.5) | (40.9) | (209.4) |
| Unrealized effective gains of cash flow hedges | | 18.9 | 18.9 | (9.6) | 9.3 |
| Deferred loss on settled hedge instruments | | (5.3) | (5.3) | 1.1 | (4.2) |
| Accumulated other comprehensive income | \$ 66.4 | \$ 14.0 | \$ 80.4 | \$ (17.5) | \$ 62.9 |

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2008

(unaudited)

13 Other comprehensive income and accumulated other comprehensive income (continued)

During the next twelve months, the Company expects \$15.9 million of unrealized holding gains on derivative instruments to be realized and recognized in the Statement of Consolidated Income. Existing derivative instruments designated as cash flow hedges will be fully matured by December 31, 2009.

14 Financial instruments

The fair value of a financial instrument is the amount of consideration that would be agreed upon in an arms length transaction between willing parties. The Company uses the following methods and assumptions to estimate fair value of each class of financial instruments for which carrying amounts are included in the Consolidated Balance Sheet as follows:

Loans and receivables

Accounts receivable and other current assets The carrying amounts approximate fair value because of the short maturity of these instruments.

Investments Long-term receivable balances are carried at amortized cost based on an initial fair value as determined at the time using discounted cash flow analysis and observable market based inputs.

Financial liabilities

Accounts payable and accrued liabilities, short-term borrowings, and deferred liabilities The carrying amounts approximate fair value because of the short maturity of these instruments.

Long-term debt The carrying amount of long-term debt is at amortized cost based on an initial fair value as determined at the time using the quoted market prices for the same or similar debt instruments.

Available for sale

Investments Certain equity investments which are recorded on a cost basis have a carrying value that equals cost as fair value cannot be reliably established as there are no quoted prices in an active market for these investments.

Held for trading

Derivative instruments that are designated as hedging instruments are measured at fair value determined using the quoted market prices for the same or similar instruments. Derivative instruments that are not designated in hedging relationships are classified as held for trading and measured at fair value determined by using quoted market prices for similar instruments and changes in fair values of such derivatives are recognized in net income as they arise.

Cash and cash equivalents The carrying amounts approximate fair value because of the short maturity of these instruments.

Investments Canadian third party asset-backed commercial paper (ABCP) is carried at fair value, which has been determined using valuation techniques that incorporate probability weighted discounted future cash flows reflecting market conditions and other factors that a market participant would consider (see Note 10).

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**JUNE 30, 2008***(unaudited)***14 Financial instruments (continued)**

The table below reconciles carrying value positions of the Company's financial instruments with Consolidated Balance Sheet categories:

| | June 30, 2008 | | | December 31, 2007 | | |
|---|--|--|----------------------|--|-------------------------------------|----------------------|
| | Carrying Value of Financial Assets / Liabilities | Carrying Value of Other Assets / Liabilities | Balance Sheet Amount | Carrying Value of Financial Assets / Liabilities | Value of Other Assets / Liabilities | Balance Sheet Amount |
| (in millions) | | | | | | |
| Assets | | | | | | |
| Cash and cash equivalents | \$ 80.9 | \$ | \$ 80.9 | \$ 378.1 | \$ | \$ 378.1 |
| Accounts receivable and other current assets | | | | | | |
| <i>Accounts receivable</i> | 603.5 | | | 483.0 | | |
| <i>Current portion of crude oil swaps</i> | 17.5 | | | 12.9 | | |
| <i>Current portion of interest rate swaps</i> | 2.6 | | | | | |
| <i>Total return swap</i> | 2.3 | | | | | |
| <i>Other</i> | | 55.4 | | | 46.9 | |
| | 625.9 | 55.4 | 681.3 | 495.9 | 46.9 | 542.8 |
| Investments | | | | | | |
| <i>Equity investments at cost</i> | 1.2 | | | 1.3 | | |
| <i>Long-term receivables at amortized cost</i> | 11.3 | | | 17.5 | | |
| <i>ABCP</i> | 100.8 | | | 122.1 | | |
| <i>Other</i> | | 1,604.3 | | | 1,527.7 | |
| | 113.3 | 1,604.3 | 1,717.6 | 140.9 | 1,527.7 | 1,668.6 |
| Other assets and deferred charges | | | | | | |
| <i>Long-term portion of crude oil swaps</i> | 9.0 | | | 8.5 | | |
| <i>Long-term portion of interest rate swaps</i> | 3.5 | | | | | |
| <i>Other</i> | | 1,455.5 | | | 1,227.1 | |
| | 12.5 | 1,455.5 | 1,468.0 | 8.5 | 1,227.1 | 1,235.6 |

Liabilities

| | | | | | | |
|--|-------|-------|-------|-------|-------|-------|
| Short-term borrowings | 255.0 | | 255.0 | 229.7 | | 229.7 |
| Accounts payable and accrued liabilities | | | | | | |
| <i>Accounts payable and accrued liabilities</i> | 782.9 | | | 750.6 | | |
| <i>Current portion of foreign exchange contracts on fuel</i> | 1.3 | | | 2.1 | | |
| <i>Current portion of treasury rate lock</i> | | | | 30.6 | | |
| <i>Current portion of interest rate swaps</i> | | | | (1.0) | | |
| <i>Other</i> | | 170.0 | | | 198.5 | |
| | 784.2 | 170.0 | 954.2 | 782.3 | 198.5 | 980.8 |

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**JUNE 30, 2008***(unaudited)***14 Financial instruments (continued)**

| (in millions) | June 30, 2008 | | | December 31, 2007 | | |
|---|--|--|----------------------|--|--|----------------------|
| | Carrying Value of Financial Assets / Liabilities | Carrying Value of Other Assets / Liabilities | Balance Sheet Amount | Carrying Value of Financial Assets / Liabilities | Carrying Value of Other Assets / Liabilities | Balance Sheet Amount |
| Liabilities | | | | | | |
| Long-term debt maturing within one year | \$ 238.4 | \$ | \$ 238.4 | \$ 31.0 | \$ | \$ 31.0 |
| Deferred liabilities | | | | | | |
| Long-term portion of foreign exchange contracts on fuel | 0.7 | | | 1.5 | | |
| Long-term portion of currency forward | 11.5 | | | 15.7 | | |
| Long-term portion of interest rate swaps | | | | (4.5) | | |
| Total return swap | | | | 3.8 | | |
| Long-term portion of Accounts payable and accrued liabilities | 42.6 | | | 41.9 | | |
| Other | | 662.4 | | | 656.2 | |
| | 54.8 | 662.4 | 717.2 | 58.4 | 656.2 | 714.6 |
| Long-term debt | 4,016.8 | | 4,016.8 | 4,146.2 | | 4,146.2 |

Carrying value and fair value of financial instruments

The carrying values of financial instruments equal or approximate their fair values with the exception of long-term debt which has a carrying value of approximately \$4,255.2 million (December 31, 2007 \$4,177.2 million) and a fair value of approximately \$4,240.0 million at June 30, 2008 (December 31, 2007 \$4,302.6 million). The fair value of publicly traded long-term debt is determined based on market prices at June 30, 2008 and December 31, 2007, respectively. The fair value of other long-term debt is estimated based on rates currently available to the Company for long-term borrowings, with terms and conditions similar to those borrowings in place at the applicable Consolidated Balance Sheet date.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2008

(unaudited)

14 Financial instruments (continued)

Financial risk management

In the normal course of operations, the Company is exposed to various market risks such as foreign exchange risk, interest rate risk, other price risk, as well as credit risk and liquidity risk. To manage these risks, the Company utilizes a Financial Risk Management (FRM) framework. The FRM goals and strategy are outlined below:

FRM objectives:

Maintaining sound financial condition as an ongoing entity;

Optimizing earnings per share and cash flow;

Financing operations of the group of CP companies at the optimal cost of capital; and

Ensuring liquidity to all Canadian and U.S. operations.

In order to satisfy the objectives above, the Company has adopted the following strategies:

Prepare multi-year planning and budget documents at prevailing market rates to ensure clear, corporate alignment to performance management and achievement of targets;

Measure the extent of operating risk within the business;

Identify the magnitude of the impact of market risk factors on the overall risk of the business and take advantage of natural risk reductions that arise from these relationships; and

Utilize financial instruments, including derivatives to manage the remaining residual risk to levels that fall within the risk tolerance of the Company.

Under the governance structure established by the Company and approved by the Audit, Finance and Financial Risk Management Committee (Audit Committee), the Board of Directors has the authority to approve the Financial Risk Management Policies of the Company. The Board has delegated to the Audit Committee the accountability for ensuring a structure is in place to ensure compliance with the individual Corporate Risk Management Policies across the Company's operations.

The policy objective with respect to the utilization of derivative financial instruments is to selectively mitigate the impact of fluctuations in foreign exchange (FX) rates, interest rates, fuel price, and share price. The use of any derivative instruments is carried out in accordance with approved trading limits and authorized counterparties as specified in the policy and/or mandate. It is not the Company's intent to use financial derivatives or commodity instruments for trading or speculative purposes.

Risk factors

The following is a discussion of market, credit and liquidity risks and related mitigation strategies that have been identified through the FRM framework. This is not an exhaustive list of all risks, nor will the mitigation strategies

eliminate all risks listed. Risks related to the Company's investment in ABCP are discussed in more detail in Note 10.

Foreign exchange risk

This risk refers to the fluctuation of financial commitments, assets, liabilities, income or cash flows due to changes in FX rates. The Company conducts business transactions and owns assets in both Canada and the United States; as a result, revenues and expenses are incurred in both Canadian dollars and U.S. dollars. The Company's income is exposed to FX risk largely in the following ways:

Translation of U.S. dollar denominated revenues and expenses into Canadian dollars When the Canadian dollar changes relative to the U.S. dollar, income reported in Canadian dollars will change. The impact of a strengthening Canadian dollar on U.S. dollar revenues and expenses will reduce net income because the Company has more U.S. dollar revenues than expenses. This impact is excluded from the sensitivity in the table below; and

Translation of U.S. dollar denominated debt and other monetary items A strengthening Canadian dollar will reduce the Company's U.S. dollar denominated debt in Canadian dollar terms and generate a FX gain on long-term debt, which is recorded in income. The Company calculates FX on long-term debt using the difference in FX rates at the beginning and at the end of each reporting period. Other U.S. dollar denominated monetary items will also be impacted by changes in FX rates.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**JUNE 30, 2008***(unaudited)***14 Financial instruments (continued)****Foreign exchange management**

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. Where appropriate the Company negotiates with U.S. customers and suppliers to reduce the net exposure. The Company may from time to time reduce residual exposure by hedging revenues through FX forward contracts. The Company had no revenue forward sales of U.S. dollars outstanding at June 30, 2008.

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 self-sustaining 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. In addition, for long-term debt denominated in U.S. dollars in Canada, the Company may enter into currency forwards to hedge debt that is denominated in U.S. dollars.

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

The table below depicts the quarterly impact to net income and other comprehensive income of long-term debt had the exchange rate increased or decreased by one cent. The impact on other U.S. dollar denominated monetary items is not considered to be material.

| (in millions) | Three months ended June 30, 2008 | |
|---|---|---|
| | Impact to Net income | Impact to Other comprehensive income |
| 1 cent strengthening in Canadian dollar | \$ (1.1) | \$ (2.1) |
| 1 cent weakening in Canadian dollar | 1.1 | 2.1 |

Note: All variables excluding FX are held constant. Impact to net income would be decreased by \$10.9 million and to other comprehensive income would be increased by \$10.9 million if the net investment hedge was not included in the above table.

Foreign exchange forward contracts

In June 2007, the Company entered into a currency forward to fix the exchange rate on US\$400 million 6.250% Notes due 2011. This derivative guarantees the amount of Canadian dollars that the Company will repay when its US\$400 million 6.25% note matures in October 2011. During the three months

ended June 30, 2008, the Company recorded a loss of \$9.7 million and a gain of \$4.2 million for the first half of 2008 to Foreign exchange (gain) loss on long-term debt . For the same periods in 2007, the Company recorded a loss of \$2.0 million. At June 30, 2008, the unrealized loss on the forward was \$11.5 million (December 31, 2007 \$15.7 million).

Interest rate risk

This refers to the risk that the fair value or income and 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 the debt.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**JUNE 30, 2008***(unaudited)***14 Financial instruments (continued)**

The table below depicts the floating and fixed maturities for all financial assets and liabilities:

| (in millions) | June 30, 2008 | |
|---------------------------------|---|--|
| | At floating interest rates | At fixed interest rates |
| Financial assets | | |
| Cash and short-term investments | \$ 80.9 | \$ |
| ABCP | 100.8 | |
| Financial liabilities | | |
| Short-term borrowings | 255.0 | |
| Long-term debt ⁽¹⁾ | 553.9 | 3,701.3 |

- (1) Includes impact
of interest rate
swaps

Interest rate management

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 issuance, the Company may enter into forward rate agreements such as treasury rate locks, bond forwards or forward starting swaps 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.

The table below depicts the quarterly impact to net income and other comprehensive income had interest rates increased or decreased by 50 basis points. Typically, as rates increase, net income decreases.

| (in millions) | Three months ended June 30, 2008 | |
|----------------------------------|---|-------|
| | Impact to Net income | |
| 50 basis point increase in rates | \$ | (0.5) |
| 50 basis point decrease in rates | | 0.5 |

Note: All variables excluding interest rates are held constant.

At June 30, 2008, the Company had outstanding interest rate swap agreements, classified as a fair value hedge, for a notional amount of US\$200 million or \$203.9 million. The swap agreements convert a portion of the Company's fixed-interest-rate liability into a variable-rate liability for the 6.250% Notes. During the three months ended June 30, 2008, the Company recorded a gain of \$0.9 million (three months ended June 30, 2007 losses of \$0.3 million) to Interest expense. For the six months ended June 30, 2008 this gain was \$1.1 million (six months ended June 30, 2007 losses of \$0.8 million). At June 30, 2008, the unrealized gain, derived from the fair value of the swap, was \$6.1 million (December 31, 2007 \$5.5 million).

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**JUNE 30, 2008****(unaudited)****14 Financial instruments (continued)**

The following table discloses the terms of the swap agreements at June 30, 2008:

| | |
|--|---------------------|
| Expiration | October 15, 2011 |
| Notional amount of principal (in CDN\$ millions) | \$ 203.9 |
| Fixed receiving rate | 6.250% |
| Variable paying rate YTD | 4.859% |

Based on U.S. three-month LIBOR.

During 2007, the Company entered into derivative agreements, which were designated as cash flow hedges, that established the benchmark rate on \$350.0 million of 30 year debt that was expected to be issued. These hedges were de-designated on May 13, 2008 when it was no longer probable that the Company would issue 30 year debt. On May 23, 2008, the fair value of these instruments was a loss of \$30.9 million at the time of the issuance of the debt and the settlement of the derivative instrument. A gain of \$1.3 million from the date of de-designation to the date of settlement of the derivative instrument was recorded in net income. Losses of \$0.2 and \$1.1 million due to some ineffectiveness were recognized and recorded in net income during the 3 months and six months ended June 30, 2008, respectively. Effective hedge losses of \$28.7 million will be deferred in accumulated other comprehensive income and will be amortized in earnings as an adjustment to interest expense.

Stock-based compensation risk

This risk refers to 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 share price and its impact on the value of certain management and director stock-based compensation programs. These programs, as described in the management proxy circular, include deferred share units, restricted share units, performance share units and share appreciation rights. As the share price appreciates, these instruments are marked to market increasing compensation expense.

Stock-based compensation expense management

To minimize the volatility to compensation expense created by changes in share price, the Company entered into a Total Return Swap (TRS) to reduce the volatility and total cost to the Company over time of the four types of stock-based compensation programs noted above. These are derivatives that provide price appreciation and dividends, in return for a charge by the counterparty. The swaps minimize volatility to compensation expense by providing a gain to substantially offset increased compensation expense as the share price increases 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 offset by any compensation expense reductions.

The table below depicts the quarterly impact to net income as a result of the TRS had the share price increased or decreased \$1 from the closing share price on June 30, 2008.

| (in millions) | Three months ended June 30, 2008 Impact to Net income |
|-----------------------------|--|
| \$1 increase in share price | \$ 1.7 |
| \$1 decrease in share price | (1.7) |

Note: All variables excluding share price are held constant.

During the three months ended June 30, 2008, Compensation and benefits expense decreased by \$3.3 million (three months ended June 30, 2007 \$16.5 million) and \$6.0 million for the six months ended June 30, 2008 (six months ended June 30, 2007 \$22.8 million) due to unrealized gains for these swaps. At June 30, 2008, the unrealized gain on the swap was \$2.3 million (December 31, 2007 unrealized loss of \$3.8 million).

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**JUNE 30, 2008***(unaudited)***14 Financial instruments (continued)****Commodity risk**

The Company is exposed to commodity risk related to purchases of diesel fuel and the potential reduction in net income due to increases in the price of diesel. Because fuel expense constitutes a large portion of the Company's operating costs, volatility in diesel fuel prices can have a significant impact on the Company's income. Items affecting volatility in diesel prices include, but are not limited to, fluctuations in world markets for crude oil and distillate fuels, which can be affected by supply disruptions and geopolitical events.

Fuel price management

The impact of variable fuel expense is mitigated substantially through fuel recovery programs which apportion incremental changes in fuel prices to shippers through price indices, tariffs, and, by contract, within agreed upon guidelines. 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 crude oil and diesel. 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.

The table below depicts the quarterly impact to net income (excluding recoveries through pricing mechanisms) and other comprehensive income as a result of our crude forward contracts had the price of West Texas Intermediate (WTI) changed by \$1 for the three months ended June 30, 2008:

| (in millions) | Three months ended June 30, 2008 | |
|----------------------------------|-------------------------------------|---|
| | Impact to Net income | Impact to Other Comprehensive income |
| \$1 increase in price per barrel | \$ 0.1 | \$ 0.2 |
| \$1 decrease in price per barrel | (0.1) | (0.2) |

Note: All variables excluding WTI per barrel are held constant.

At June 30, 2008, the Company had crude forwards contracts, which are accounted for as cash flow hedges, to purchase approximately 258,000 barrels over the 2008-2009 period at average quarterly prices ranging from US\$35.17 to US\$38.19 per barrel. This represents approximately 2% of estimated fuel purchases in 2008 and 2009. At June 30, 2008, the unrealized gain on these forward contracts was \$26.6 million (December 31, 2007 \$21.4 million).

At June 30, 2008, the Company had FX forward contracts (in conjunction with the crude purchases above), which are accounted for as cash flow hedges, totalling US\$9.4 million over the 2008-2009 period at exchange rates ranging from 1.2276 to 1.2611. At June 30, 2008, the unrealized loss on these forward contracts was \$1.9 million (December 31, 2007 \$3.5 million).

For the three months ended June 30, 2008, fuel expense was reduced by \$5.2 million (three months ended June 30, 2007 \$4.8 million) as a result of \$5.8 million in realized gains (three months ended June 30, 2007 \$5.6 million) arising from settled swaps, partially offset by \$0.7 million in realized losses (three months ended June 30, 2007 \$0.8 million) arising from the settled FX forward contracts. For the six months ended June 30, 2008, fuel expense was reduced by \$8.8 million (six months ended June 30, 2007 \$9.4 million) as a result of \$10.1 million in realized gains (six months ended June 30, 2007 \$10.5 million) arising from settled swaps, partially offset by \$1.3 million in realized losses (six months ended June 30, 2007 \$1.1 million) arising from settled FX forward contracts.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**JUNE 30, 2008***(unaudited)***14 Financial instruments (continued)****Credit risk**

Credit risk refers to the possibility that a customer or counterparty will fail to fulfil its obligations under a contract and as a result, create a financial loss for the Company. The Company's credit risk regarding its investment in ABCP are discussed in more detail in Note 10.

Credit risk management

The railway industry services predominantly financially established customers and the Company has experienced limited financial loss with respect to credit risk. The credit worthiness of customers is assessed using credit scores supplied by a third party, and through direct monitoring of their financial well-being on a continual basis. The Company establishes guidelines for customer credit limits and should thresholds in these areas be reached, appropriate precautions are taken to improve collectibility. Pursuant to their respective terms, accounts receivable are aged as follows at June 30, 2008:

| | |
|------------------------|----------|
| (in millions) | |
| Up to date | \$ 463.7 |
| Under 30 days past due | 81.0 |
| 30-60 days past due | 22.3 |
| 61-90 days past due | 8.6 |
| Over 91 days past due | 27.9 |
| | \$ 603.5 |

Counterparties to financial instruments expose the Company to credit losses in the event of non-performance. Counterparties for derivative and cash transactions are limited to high credit quality financial institutions, which are monitored on an ongoing basis. Counterparty credit assessments are based on the financial health of the institutions and their credit ratings from external agencies. With exception of ABCP, the Company does not anticipate non-performance that would materially impact the Company's financial statements.

With the exception of ABCP, the Company believes there are no significant concentrations of credit risk. The maximum exposure to credit risk can be taken from our financial assets values reported in the table reconciling the carrying value positions of the Company's financial instruments with Consolidated Balance Sheet categories and as discussed in Note 19 under guarantees.

Liquidity risk

The Company monitors and manages its liquidity risk to ensure access to sufficient funds to meet operational and investing requirements.

Liquidity risk management

The Company has long-term debt ratings of Baa3, BBB, and BBB from Moody's Investors Service, Inc. (Moody's), Standard and Poor's Corporation (S&P), and DBRS respectively. The S&P rating has a negative outlook, while the ratings of Moody's and DBRS have a stable outlook. The Company intends to manage its capital structure and

liquidity at levels that sustain an investment grade rating.

The Company has a five year revolving credit facility of \$945 million, with an accordion feature to \$1.15 billion, of which \$351 million was available on June 30, 2008.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**JUNE 30, 2008***(unaudited)***14 Financial instruments (continued)**

This facility is arranged with a core group of highly rated international financial institutions and they incorporate pre-agreed pricing. The revolving credit facility is available on next day terms.

The Company plans to access both Canadian and U.S. capital markets to secure long term financing for the temporary credit facility. Market conditions allowing, the Company will access debt capital markets in various maturities periodically prior to the expiry of the temporary credit facility in order to minimize risk and optimize pricing. It is the Company's intention to manage its long term financing structure to maintain its investment grade rating. The Company may decide to enter certain derivative instruments to reduce interest rate and foreign exchange exposure in advance of these issuances.

Surplus cash is invested into a range of short dated money market instruments meeting or exceeding the parameters of the Company's investment policy.

The table below reflects the contractual maturity of the Company's undiscounted cash flows for its financial liabilities and derivatives:

| (in millions) | As at June 30, 2008 | | | |
|--|---------------------|---------|---------|----------|
| | 2008 | 2009 | 2012+ | Total |
| Financial liabilities | | | | |
| Short-term borrowings | \$ 255.0 | \$ | \$ | \$ 255.0 |
| Accounts payable and accrued liabilities | 782.9 | 42.6 | | 825.5 |
| Foreign exchange contracts on fuel | 0.7 | 1.3 | | 2.0 |
| Currency forward | | 13.0 | | 13.0 |
| Long-term debt | 32.5 | 1,193.9 | 3,642.4 | 4,868.8 |

15 Additions to investments and other assets

Additions to investment and other assets includes the acquisition of locomotives and freight car assets of \$57.4 million and \$192.1 million for the three and six months ended June 30, 2008, respectively, (three and six months ended June 30, 2007 - \$12.0 million). These assets were purchased in anticipation of a sale and lease back arrangement with a financial institution.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**JUNE 30, 2008***(unaudited)***16 Stock-based compensation**

In 2008, under CP's stock option plans, the Company issued 1,360,400 options to purchase Common Shares at the weighted average price of \$71.59 per share, based on the closing price on the grant date. In tandem with these options, 425,650 stock appreciation rights were issued at the weighted average exercise price of \$71.54.

Pursuant to the employee plan, options may be exercised upon vesting, which is between 24 months and 36 months after the grant date, and will expire after 10 years. Some options vest after 48 months, unless certain performance targets are achieved, in which case vesting is accelerated. These options expire five years after the grant date. Other options only vest if certain performance targets are achieved and expire approximately five years after the grant date.

The following is a summary of the Company's fixed stock option plans as of June 30 (including options granted under the Directors' Stock Option Plan, which was suspended in 2003):

| | 2008 | | 2007 | |
|--------------------------------|----------------------------------|--|----------------------------------|--|
| | Number of options | Weighted average exercise price | Number of options | Weighted average exercise price |
| Outstanding, January 1 | 6,981,108 | 43.97 | 6,815,494 | \$ 38.50 |
| New options granted | 1,360,400 | 71.59 | 1,302,700 | 62.59 |
| Exercised | (493,460) | 34.40 | (811,856) | 31.78 |
| Forfeited/cancelled | (85,050) | 47.09 | (111,725) | 39.38 |
| Outstanding, June 30 | 7,762,998 | 49.39 | 7,194,613 | \$ 43.61 |
| Options exercisable at June 30 | 4,637,348 | 38.33 | 4,239,713 | \$ 34.01 |

Compensation expense is recognized over the vesting period for stock options issued since January 1, 2003, based on their estimated fair values on the date of grants, as determined by the Black-Scholes option pricing model.

Under the fair value method, the fair value of options at the grant date was \$14.1 million for options issued in the first six months of 2008 (first six months of 2007 \$11.3 million). The weighted average fair value assumptions were approximately:

| | For the six months ended June 30 | |
|------------------------------|---|-------------|
| | 2008 | 2007 |
| Expected option life (years) | 4.39 | 4.00 |

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| | | |
|--|----------|----------|
| Risk-free interest rate | 3.54% | 3.90% |
| Expected stock price volatility | 22% | 22% |
| Expected annual dividends per share | \$ 0.99 | \$ 0.90 |
| Weighted average fair value of options granted during the year | \$ 15.12 | \$ 12.96 |

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2008

(unaudited)

17 Pensions and other benefits

The total benefit cost for the Company's defined benefit pension plans and post-retirement benefits for the three months ended June 30, 2008, was \$19.9 million (three months ended June 30, 2007 \$27.1 million) and for the six months ended June 30, 2008, was \$39.0 million (six months ended June 30, 2007 \$54.5 million).

18 Significant customers

During the first six months of 2008, one customer comprised 12.3% of total revenue (first six months of 2007 11.7%). At June 30, 2008, that same customer represented 5.4% of total accounts receivable (June 30, 2007 5.2%).

19 Commitments and contingencies

In the normal course of its operations, the Company becomes involved in various legal actions, including claims relating to injuries and damages 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, 2008, 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.

During the quarter ended March 31, 2008, the Canadian Transportation Agency announced a Decision directing a downward adjustment of the railway maximum revenue entitlement for movement of regulated grain under the Canada Transportation Act, for the period from August 1, 2007 to July 31, 2008. The Company has applied to the Federal Court of Appeal for leave to appeal the decision. A provision considered adequate by management is maintained for the prospective adjustment. The retroactive component of the adjustment, which is estimated to be \$23 million, is not considered to be legally supportable and as such a provision has not been made.

Capital commitments

At June 30, 2008, the Company had multi-year capital commitments of \$566.5 million, mainly for locomotive overhaul agreements, in the form of signed contracts. Payments for these commitments are due in 2008 through 2022.

Operating lease commitments

At June 30, 2008, minimum payments under operating leases were estimated at \$707.7 million in aggregate, with annual payments in each of the next five years of: 2008 \$71.1 million; 2009 \$114.5 million; 2010 \$92.6 million; 2011 \$81.9 million; 2012 \$76.8 million.

Guarantees

At June 30, 2008, the Company had residual value guarantees on operating lease commitments of \$246.9 million and certain guarantees related to the Company's investment in the DM&E, which include minimum lease payments of \$58.5 million, residual value guarantees of \$11.6 million, and a line of credit of US\$25 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 has accrued for all guarantees that it expects to pay. At June 30, 2008, these accruals amounted to \$6.0 million.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2008

(unaudited)

20 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; and

short-term borrowing.

The Company manages its capital structure and makes adjustments to it in accordance with the aforementioned objectives, as well as in the 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 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:

net-debt to net-debt-plus-equity; and

interest coverage ratio: earnings before interest and taxes (EBIT) to interest expense.

Both of these metrics have no standardized meanings prescribed by GAAP and, therefore, are unlikely to be comparable to similar measures of other companies.

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

Net-debt to net-debt-plus-equity

Net debt, which is a non-GAAP measure, is the sum of long-term debt, long-term debt maturing within one year and short-term borrowing, less cash and short-term investments. This sum is divided by total net debt plus total shareholders' equity as presented on our Consolidated Balance Sheet.

Interest coverage ratio

EBIT, which is a non-GAAP measure that is calculated, on a twelve month rolling basis, as revenues less operating expenses, less change in estimated fair value of ABCP, other income and charges, and equity income in DM&E, divided by interest expense.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**JUNE 30, 2008***(unaudited)***20 Capital disclosures (continued)**

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

| (in millions) | Guidelines | June 30, 2008 | June 30, 2007 |
|---|-------------------------------|-------------------|------------------|
| Long-term debt | | \$ 4,016.8 | \$3,046.6 |
| Long-term debt maturing within one year | | 238.4 | 30.6 |
| Short-term borrowing | | 255.0 | |
| Less: | | | |
| Cash and cash equivalents | | (80.9) | (392.1) |
| Net Debt⁽¹⁾ | | \$ 4,429.3 | \$2,685.1 |
| Shareholders' equity | | \$ 5,666.0 | \$4,978.5 |
| Net debt | | 4,429.3 | 2,685.1 |
| Net Debt plus Equity⁽¹⁾ | | \$10,095.3 | \$7,663.6 |
| Revenues less operating expenses | | \$ 1,076.5 | \$1,156.2 |
| Less: | | | |
| ABCP | | (42.8) | |
| Other income and charges | | (28.2) | (26.3) |
| Equity income in DM&E | | 36.7 | |
| EBIT⁽¹⁾⁽²⁾ | | \$ 1,042.2 | \$1,129.9 |
| Net debt | | \$ 4,429.3 | \$2,685.1 |
| Net debt plus equity | | \$10,095.3 | \$7,663.6 |
| Net-debt to Net-debt-plus-equity⁽¹⁾ | No more than 50.0% | 43.9% | 35.0% |
| EBIT | | \$ 1,042.2 | \$1,129.9 |
| Interest expense | | \$ 231.1 | \$ 194.6 |
| Interest Coverage Ratio⁽¹⁾⁽²⁾ | No less than 4.0 | 4.5 | 5.8 |

(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 balance is calculated on a rolling twelve month 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 guidelines are monitored on a quarterly basis. The Company believes that adherence to these guidelines increases its ability to access to capital at a reasonable cost and maintain credit ratings of an investment grade. The Company believes that these ratios are within reasonable limits, in light of the relative size of the Company and its capital management objectives. The Company is also subject to financial covenants in the bridge financing agreement obtained for the acquisition of DM&E and revolver loan agreements. Net-debt to net-debt-plus-equity and interest coverage ratio are two financial metrics that provide indicators as to whether the Company will be in compliance with its financial covenants. The Company is in compliance with all financial covenants.

Summary of Rail Data

| Second Quarter | | | | Year-to-date | | | |
|---|-------------|-----------------|----------|---------------------|-------------|-----------------|----------|
| 2008 | 2007 | Variance | % | 2008 | 2007 | Variance | % |
| <u>Financial (millions, except per share data and ratios)</u> | | | | | | | |
| <u>Revenues</u> | | | | | | | |
| \$ 1,193.1 | \$ 1,174.1 | \$ 19.0 | 1.6 | \$ 2,317.5 | \$ 2,265.0 | \$ 52.5 | 2.3 |
| 27.2 | 41.4 | (14.2) | (34.3) | 49.7 | 66.4 | (16.7) | (25.2) |
| 1,220.3 | 1,215.5 | 4.8 | 0.4 | 2,367.2 | 2,331.4 | 35.8 | 1.5 |
| <u>Operating Expenses</u> | | | | | | | |
| 315.5 | 329.8 | (14.3) | (4.3) | 643.8 | 662.3 | (18.5) | (2.8) |
| 260.3 | 193.7 | 66.6 | 34.4 | 490.5 | 364.9 | 125.6 | 34.4 |
| 56.5 | 55.6 | 0.9 | 1.6 | 122.0 | 118.0 | 4.0 | 3.4 |
| 46.1 | 57.3 | (11.2) | (19.5) | 92.0 | 112.8 | (20.8) | (18.4) |
| 124.7 | 119.1 | 5.6 | 4.7 | 244.6 | 237.7 | 6.9 | 2.9 |
| 166.1 | 152.3 | 13.8 | 9.1 | 325.0 | 298.7 | 26.3 | 8.8 |
| 969.2 | 907.8 | 61.4 | 6.8 | 1,917.9 | 1,794.4 | 123.5 | 6.9 |
| 251.1 | 307.7 | (56.6) | (18.4) | 449.3 | 537.0 | (87.7) | (16.3) |
| | | | | | | | |
| | | | | | | | |
| (13.4) | | (13.4) | | (24.4) | | (24.4) | |
| 4.9 | 8.2 | (3.3) | (40.2) | 11.6 | 13.0 | (1.4) | (10.8) |
| 62.9 | 49.2 | 13.7 | 27.8 | 122.8 | 96.0 | 26.8 | 27.9 |
| | | | | | | | |
| | | | | | | | |
| 46.3 | 75.5 | (29.2) | (38.7) | 72.5 | 130.6 | (58.1) | (44.5) |
| | | | | | | | |
| | | | | | | | |
| 150.4 | 174.8 | (24.4) | (14.0) | 266.8 | 297.4 | (30.6) | (10.3) |
| <u>Foreign exchange (gains) losses on long-term debt (FX on LTD)</u> | | | | | | | |
| (6.8) | (88.6) | 81.8 | | 9.5 | (97.2) | 106.7 | |
| 2.3 | 23.8 | (21.5) | | (3.4) | 26.4 | (29.8) | |
| (4.5) | (64.8) | 60.3 | | 6.1 | (70.8) | 76.9 | |
| <u>Other specified items</u> | | | | | | | |
| | | | | 21.3 | | 21.3 | |

| | | | | | | | | | | | | | | | |
|----|--------|----|-------|--|---------|--------|---|-------|-------|-------|-------|-------|---------|--------|--------|
| | | | | asset-backed commercial paper (ABCP) | | | | | | | | | | | |
| | | | | Income tax on special charges | (6.3) | | | (6.3) | | | | | | | |
| | | | | Change in estimated fair value of ABCP (net of tax) | 15.0 | | | 15.0 | | | | | | | |
| | | | | Income tax benefits due to rate reductions on opening future income tax balances | | (17.1) | | 17.1 | | | | | | | |
| | (17.1) | | 17.1 | | | | | | | | | | | | |
| \$ | 154.9 | \$ | 256.7 | \$ | (101.8) | (39.7) | Net income | \$ | 245.7 | \$ | 385.3 | \$ | (139.6) | (36.2) | |
| | | | | <u>Earnings per share (EPS)</u> | | | | | | | | | | | |
| \$ | 1.01 | \$ | 1.66 | \$ | (0.65) | (39.2) | Basic earnings per share | \$ | 1.60 | \$ | 2.49 | \$ | (0.89) | (35.7) | |
| \$ | 1.00 | \$ | 1.64 | \$ | (0.64) | (39.0) | Diluted earnings per share | \$ | 1.59 | \$ | 2.46 | \$ | (0.87) | (35.4) | |
| | | | | <u>EPS before FX on LTD and other specified items ⁽¹⁾</u> | | | | | | | | | | | |
| \$ | 0.98 | \$ | 1.13 | \$ | (0.15) | (13.3) | Basic earnings per share | \$ | 1.74 | \$ | 1.92 | \$ | (0.18) | (9.4) | |
| \$ | 0.97 | \$ | 1.12 | \$ | (0.15) | (13.4) | Diluted earnings per share | \$ | 1.72 | \$ | 1.90 | \$ | (0.18) | (9.5) | |
| | | | | Weighted average (avg) number of shares outstanding (millions) | | | | 153.6 | | 154.9 | | (1.3) | | (0.8) | |
| | | | | Weighted avg number of diluted shares outstanding (millions) | | | | 155.0 | | 156.4 | | (1.4) | | (0.9) | |
| | 79.4 | | 74.7 | | 4.7 | (0.6) | Operating ratio ^{(1) (3)} (%) | | 81.0 | | 77.0 | | 4.0 | | |
| | | | | ROCE before FX on LTD and other specified items (after tax) ^{(1) (3)} (%) | | | | 9.2 | | 10.3 | | (1.1) | | | |
| | 9.2 | | 10.3 | | (1.1) | | Net debt to net debt plus equity (%) | | 43.9 | | 35.0 | | 8.9 | | |
| | 43.9 | | 35.0 | | 8.9 | | EBIT before FX on LTD and other specified items ^{(1) (3)} (millions) | | \$ | 462.1 | \$ | 524.0 | \$ | (61.9) | (11.8) |
| \$ | 259.6 | \$ | 299.5 | \$ | (39.9) | (13.3) | EBITDA before FX on LTD and other specified items ^{(1) (3)} (millions) | | \$ | 706.7 | \$ | 761.7 | \$ | (55.0) | (7.2) |
| \$ | 384.3 | \$ | 418.6 | \$ | (34.3) | (8.2) | | | | | | | | | |

(1) These earnings measures have no standardized meanings prescribed by GAAP and may not be comparable to similar measures of other companies. See note on non-GAAP

earnings
measures
attached to
commentary.

- (2) Income tax on
FX on LTD is
discussed in the
MD&A in the
Other Income
Statement Items
section Income
Taxes .

- (3) EBIT: Earnings
before interest
and taxes.

EBITDA: Earnings before interest, taxes, and depreciation and amortization.
ROCE (after tax): Return on capital employed (after tax) = earnings before after-tax interest expense (last 12 months) divided by average net debt plus equity.
Operating ratio: Operating expenses divided by revenues.

Summary of Rail Data (Page 2)

| 2008 | Second Quarter | | | | 2008 | Year-to-date | | |
|----------------------------|----------------|-----------|--------|------------------------------------|------------|--------------|----------|--------|
| | 2007 | Variance | % | | | 2007 | Variance | % |
| Commodity Data | | | | | | | | |
| Freight Revenues | | | | | | | | |
| (millions) | | | | | | | | |
| \$ 203.0 | \$ 224.0 | \$ (21.0) | (9.4) | - Grain | \$ 435.4 | \$ 443.6 | \$ (8.2) | (1.8) |
| 172.4 | 162.4 | 10.0 | 6.2 | - Coal | 312.5 | 293.7 | 18.8 | 6.4 |
| 137.9 | 144.5 | (6.6) | (4.6) | - Sulphur and fertilizers | 268.6 | 266.9 | 1.7 | 0.6 |
| 58.4 | 74.3 | (15.9) | (21.4) | - Forest products | 116.4 | 146.3 | (29.9) | (20.4) |
| 185.3 | 158.8 | 26.5 | 16.7 | - Industrial and consumer products | 352.7 | 310.7 | 42.0 | 13.5 |
| 86.7 | 88.5 | (1.8) | (2.0) | - Automotive | 158.8 | 170.6 | (11.8) | (6.9) |
| 349.4 | 321.6 | 27.8 | 8.6 | - Intermodal | 673.1 | 633.2 | 39.9 | 6.3 |
| \$ 1,193.1 | \$ 1,174.1 | \$ 19.0 | 1.6 | Total Freight Revenues | \$ 2,317.5 | \$ 2,265.0 | \$ 52.5 | 2.3 |
| Millions of Revenue | | | | | | | | |
| Ton-Miles (RTM) | | | | | | | | |
| 6,775 | 7,309 | (534) | (7.3) | - Grain | 14,273 | 14,793 | (520) | (3.5) |
| 6,118 | 5,834 | 284 | 4.9 | - Coal | 11,204 | 10,417 | 787 | 7.6 |
| 5,552 | 6,106 | (554) | (9.1) | - Sulphur and fertilizers | 10,982 | 11,090 | (108) | (1.0) |
| 1,438 | 2,019 | (581) | (28.8) | - Forest products | 2,963 | 4,019 | (1,056) | (26.3) |
| 4,655 | 4,177 | 478 | 11.4 | - Industrial and consumer products | 9,142 | 8,310 | 832 | 10.0 |
| 645 | 659 | (14) | (2.1) | - Automotive | 1,193 | 1,284 | (91) | (7.1) |
| 7,296 | 7,424 | (128) | (1.7) | - Intermodal | 14,264 | 14,350 | (86) | (0.6) |
| 32,479 | 33,528 | (1,049) | (3.1) | Total RTMs | 64,021 | 64,263 | (242) | (0.4) |
| Freight Revenue per | | | | | | | | |
| RTM (cents) | | | | | | | | |
| 3.00 | 3.06 | (0.06) | (2.0) | - Grain | 3.05 | 3.00 | 0.05 | 1.7 |
| 2.82 | 2.78 | 0.04 | 1.4 | - Coal | 2.79 | 2.82 | (0.03) | (1.1) |
| 2.48 | 2.37 | 0.11 | 4.6 | - Sulphur and fertilizers | 2.45 | 2.41 | 0.04 | 1.7 |
| 4.06 | 3.68 | 0.38 | 10.3 | - Forest products | 3.93 | 3.64 | 0.29 | 8.0 |
| 3.98 | 3.80 | 0.18 | 4.7 | - Industrial and consumer products | 3.86 | 3.74 | 0.12 | 3.2 |
| 13.44 | 13.43 | 0.01 | 0.1 | - Automotive | 13.31 | 13.29 | 0.02 | 0.2 |

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| | | | | | | | | |
|--|----------|----------|--------|---------------------------------------|----------|----------|---------|--------|
| 4.79 | 4.33 | 0.46 | 10.6 | - Intermodal | 4.72 | 4.41 | 0.31 | 7.0 |
| 3.67 | 3.50 | 0.17 | 4.9 | Freight Revenue per RTM | 3.62 | 3.52 | 0.10 | 2.8 |
| Carloads (thousands) | | | | | | | | |
| 87.7 | 91.2 | (3.5) | (3.8) | - Grain | 180.0 | 180.5 | (0.5) | (0.3) |
| 77.2 | 75.0 | 2.2 | 2.9 | - Coal | 142.0 | 133.5 | 8.5 | 6.4 |
| 53.4 | 61.3 | (7.9) | (12.9) | - Sulphur and fertilizers | 105.7 | 111.5 | (5.8) | (5.2) |
| 23.1 | 29.9 | (6.8) | (22.7) | - Forest products | 47.6 | 60.0 | (12.4) | (20.7) |
| 86.4 | 79.2 | 7.2 | 9.1 | - Industrial and consumer products | 167.3 | 154.9 | 12.4 | 8.0 |
| 40.1 | 45.7 | (5.6) | (12.3) | - Automotive | 76.4 | 88.1 | (11.7) | (13.3) |
| 315.1 | 311.9 | 3.2 | 1.0 | - Intermodal | 611.8 | 599.5 | 12.3 | 2.1 |
| 683.0 | 694.2 | (11.2) | (1.6) | Total Carloads | 1,330.8 | 1,328.0 | 2.8 | 0.2 |
| Freight Revenue per Carload | | | | | | | | |
| \$ 2,315 | \$ 2,456 | \$ (141) | (5.7) | - Grain | \$ 2,419 | \$ 2,458 | \$ (39) | (1.6) |
| 2,233 | 2,165 | 68 | 3.1 | - Coal | 2,201 | 2,200 | 1 | |
| 2,582 | 2,357 | 225 | 9.5 | - Sulphur and fertilizers | 2,541 | 2,394 | 147 | 6.1 |
| 2,528 | 2,485 | 43 | 1.7 | - Forest products | 2,445 | 2,438 | 7 | 0.3 |
| 2,145 | 2,005 | 140 | 7.0 | - Industrial and consumer products | 2,108 | 2,006 | 102 | 5.1 |
| 2,162 | 1,937 | 225 | 11.6 | - Automotive | 2,079 | 1,936 | 143 | 7.4 |
| 1,109 | 1,031 | 78 | 7.6 | - Intermodal | 1,100 | 1,056 | 44 | 4.2 |
| \$ 1,747 | \$ 1,691 | \$ 56 | 3.3 | Freight Revenue per Carload | \$ 1,741 | \$ 1,706 | \$ 35 | 2.1 |

Summary of Rail Data (Page 3)

| 2008 | Second Quarter | | | | 2008 | Year-to-date | | |
|---|----------------|----------|--------|---|---------|--------------|----------|--------|
| | 2007 | Variance | % | | | 2007 | Variance | % |
| <u>Operations and Productivity</u> | | | | | | | | |
| 62,397 | 64,481 | (2,084) | (3.2) | Freight gross ton-miles (GTM) (millions) | 122,258 | 122,041 | 217 | 0.2 |
| 32,479 | 33,528 | (1,049) | (3.1) | Revenue ton-miles (RTM) (millions) | 64,021 | 64,263 | (242) | (0.4) |
| 16,223 | 15,878 | 345 | 2.2 | Average number of active employees | 15,648 | 15,381 | 267 | 1.7 |
| 16,407 | 15,720 | 687 | 4.4 | Number of employees at end of period | 16,407 | 15,720 | 687 | 4.4 |
| 1.11 | 2.09 | (0.98) | (46.9) | FRA personal injuries per 200,000 employee-hours ⁽¹⁾ | 1.25 | 1.95 | (0.70) | (35.9) |
| 1.11 | 2.11 | (1.00) | (47.4) | FRA train accidents per million train-miles ⁽¹⁾ | 1.65 | 2.06 | (0.41) | (19.9) |
| 2.98 | 2.71 | 0.27 | 10.0 | Total operating expenses per RTM (cents) | 3.00 | 2.79 | 0.21 | 7.5 |
| 1.55 | 1.41 | 0.14 | 9.9 | Total operating expenses per GTM (cents) | 1.57 | 1.47 | 0.10 | 6.8 |
| 0.51 | 0.51 | | | Compensation and benefits expense per GTM (cents) | 0.53 | 0.54 | (0.01) | (1.9) |
| 3,846 | 4,061 | (215) | (5.3) | GTMs per average active employee (000) | 7,813 | 7,935 | (122) | (1.5) |
| 13,199 | 13,260 | (61) | (0.5) | Miles of road operated at end of period ⁽²⁾ | 13,199 | 13,260 | (61) | (0.5) |
| 24.1 | 23.5 | 0.6 | 2.6 | Average train speed AAR definition (mph) | 23.7 | 23.3 | 0.4 | 1.7 |
| 21.6 | 21.7 | (0.1) | (0.5) | Terminal dwell time AAR definition (hours) | 22.8 | 22.8 | | |
| 147.3 | 147.5 | (0.2) | (0.1) | Car miles per car day | 142.7 | 141.0 | 1.7 | 1.2 |
| 83.7 | 81.5 | 2.2 | 2.7 | Average daily total cars on-line AAR definition (000) | 83.2 | 81.4 | 1.8 | 2.2 |
| 55.7 | 59.0 | (3.3) | (5.6) | Average daily active cars on-line (000) | 56.4 | 59.0 | (2.6) | (4.4) |
| 1.19 | 1.19 | | | U.S. gallons of locomotive fuel per 1,000 | 1.24 | 1.22 | 0.02 | 1.6 |

| | | | | GTMs freight & yard U.S. gallons of locomotive fuel consumed total (millions) ⁽³⁾ | | | | |
|-------|-------|---------|-------|---|-------|-------|---------|--------|
| 73.6 | 76.8 | (3.2) | (4.2) | | 149.9 | 149.1 | 0.8 | 0.5 |
| 0.991 | 0.901 | 0.090 | 10.0 | Average foreign exchange rate (US\$/Canadian\$) | 0.999 | 0.877 | 0.122 | 13.9 |
| 1.009 | 1.111 | (0.102) | (9.2) | Average foreign exchange rate (Canadian\$/US\$) | 1.001 | 1.141 | (0.140) | (12.3) |

(1) Certain prior period figures have been revised to conform with current presentation or have been updated to reflect new information.

(2) Excludes track on which CP has haulage rights.

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

Canadian Pacific
Management Discussion and Analysis
for the three and six months ended June 30, 2008

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| <i>This Management's Discussion and Analysis (MD&A) supplements the Consolidated Financial Statements and related notes for the three and six months ended June 30, 2008. Except where otherwise indicated, all financial information reflected herein is expressed in Canadian dollars. All information has been prepared in accordance with Canadian generally accepted accounting principles (GAAP), except as described in Section 6.0 of this MD&A.</i> | |
| July 21, 2008 | |

In this MD&A, our , us , we , CP and the Company refer to Canadian Pacific Railway Limited (CPRL), CPRL and its subsidiaries, CPRL and one or more of its subsidiaries, or one or more of CPRL s subsidiaries, as the context may require. Other terms not defined in the body of this MD&A are defined in Section 24.0.

Unless otherwise indicated, all comparisons of results for the second quarter of 2008 are against the results for the second quarter of 2007.

1.0 BUSINESS PROFILE

Canadian Pacific Railway Limited, through its subsidiaries, operates a transcontinental railway in Canada and the United States and provides logistics and supply chain expertise. Through our subsidiaries, we provide rail and intermodal transportation services over a network of approximately 13,200 miles, serving the principal business centres of Canada from Montreal, Quebec, to Vancouver, British Columbia, and the US Northeast and Midwest regions. Our railway feeds directly into the US heartland from the East and West coasts. Agreements with other carriers extend our market reach east of Montreal in Canada, throughout the US and into Mexico. Through our subsidiaries, we transport bulk commodities, merchandise freight and intermodal traffic. Bulk commodities include grain, coal, sulphur and fertilizers. Merchandise freight consists of finished vehicles and automotive parts, as well as forest and industrial and consumer products. Intermodal traffic consists largely of high-value, time-sensitive retail goods in overseas containers that can be transported by train, ship and truck, and in domestic containers and trailers that can be moved by train and truck.

2.0 STRATEGY

Our vision is to become the safest and most fluid railway in North America. Through the ingenuity of our people, it is our objective to create long-term value for our customers, shareholders and employees by profitably growing within the reach of our rail franchise and through strategic additions. We seek to accomplish this objective through the following three-part strategy:

- generating quality revenue growth by realizing the benefits of demand growth in our bulk, intermodal and merchandise business lines with targeted infrastructure capacity investments linked to global trade opportunities;

- improving productivity by leveraging strategic marketing and operating partnerships, executing a scheduled railway through our Integrated Operating Plan (IOP) and driving more value from existing assets and resources by improving fluidity ; and

- continuing to develop a dedicated, professional and knowledgeable workforce that is committed to safety and sustainable financial performance through steady improvement in profitability, increased free cash flow and a competitive return on investment.

3.0 ADDITIONAL INFORMATION

Additional information, including our Consolidated Financial Statements, MD&A, Annual Information Form, press releases and other required filing documents, is available on SEDAR at www.sedar.com in Canada, on EDGAR at www.sec.gov in the US and on our website at www.cpr.ca. The aforementioned documents are issued and made available in accordance with legal requirements and are not incorporated by reference into this MD&A.

4.0 FINANCIAL HIGHLIGHTS

| FINANCIAL HIGHLIGHTS (in millions, except percentages and per-share data) | For the three months ended June 30 | | For the six months ended June 30 | |
|---|---|-------------|---|-------------|
| | 2008 | 2007 | 2008 | 2007 |
| Revenues | \$ 1,220.3 | \$ 1,215.5 | \$ 2,367.2 | \$ 2,331.4 |
| Operating income ⁽¹⁾ | 251.1 | 307.7 | 449.3 | 537.0 |
| Income, before FX on LTD and other specified items ⁽¹⁾ | 150.4 | 174.8 | 266.8 | 297.4 |
| Net income | 154.9 | 256.7 | 245.7 | 385.3 |
| Basic earnings per share | 1.01 | 1.66 | 1.60 | 2.49 |
| Diluted earnings per share | 1.00 | 1.64 | 1.59 | 2.46 |
| Diluted earnings per share, before FX on LTD and other specified items ⁽¹⁾ | 0.97 | 1.12 | 1.72 | 1.90 |
| Dividends declared per share | 0.2475 | 0.2250 | 0.4950 | 0.4500 |
| Free cash ⁽¹⁾ | (30.2) | 159.6 | (169.3) | 162.6 |
| Total assets at June 30 | 13,678.2 | 11,688.7 | 13,678.2 | 11,688.7 |
| Total long-term financial liabilities at June 30 | 6,475.8 | 5,621.2 | 6,475.8 | 5,621.2 |
| Operating ratio | 79.4% | 74.7% | 81.0% | 77.0% |
| Return on capital employed ⁽¹⁾ | 9.2% | 10.3% | 9.2% | 10.3% |

(1) These earnings measures have no standardized meanings prescribed by Canadian GAAP and, therefore, are unlikely to be comparable to similar measures of other companies. These earnings measures and other specified items are described in Section 6.0. A reconciliation of operating income, income and diluted EPS, before FX on

LTD and other specified items, to net income and diluted EPS, as presented in the financial statements is provided in Section 6.0. A reconciliation of free cash to the change in cash as presented in the financial statements is provided in Section 13.4.

5.0 OPERATING RESULTS

5.1 Income

Operating income (See Section 6.0 Non-GAAP Earnings) in the three months ended June 30, 2008 was \$251.1 million, down \$56.6 million, or 18.4%, from \$307.7 million for the same period in 2007. Operating income for the six months ended June 30, 2008 was \$449.3 million, down \$87.7 million or 16.3% from \$537.0 million for the same period in 2007. The decrease in second quarter and year to date 2008 operating income reflects:

- higher fuel expense driven by higher West Texas Intermediate (WTI) prices, net of fuel recoveries;

- higher casualty expenses;

- unfavourable changes in volume mix;

- unfavourable impact of foreign exchange; and

- lower land sales.

Operating income for the first half of 2008 was also affected by difficult operating conditions driven mainly by harsh weather

These decreases were partially offset by increases in revenues for intermodal, industrial and consumer products, and coal.

Net income for the three months ended June 30, 2008 was \$154.9 million, down \$101.8 million, or 39.7%, from \$256.7 million for the same period in 2007. Net income for the six months ended June 30, 2008 was \$245.7 million, down \$139.6 million, or 36.2%, from \$385.3 million for the same period in 2007. The decrease in the second quarter of 2008 was primarily due to:

- lower FX gains on US dollar-denominated long-term debt (LTD);

- lower operating income;

- future income tax benefit of \$17.1 million recorded in second quarter of 2007 as a result of reduced Canadian income tax rates; and

- higher interest expense, primarily due to the funding required for our acquisition of Dakota, Minnesota and Eastern Railroad Corporation (DM&E , discussed further in Section 13.3).

This decrease was partially offset by lower income tax expense driven by lower tax rates and equity earnings from our investment in DM&E (discussed further in Section 17.0).

The decrease in the first half of 2008 was primarily due to
FX losses on US dollar-denominated LTD;

lower operating income; and

the after-tax change in estimated fair value of our investment in Canadian third party asset-backed commercial
paper in the first quarter of 2008 (ABCP , discussed further in Section 10.3);

3

These decreases were partially offset by lower income tax expense driven by lower tax rates and equity earnings from our investment in DM&E (discussed further in Section 17.0).

5.2 Diluted Earnings per Share

Diluted EPS, which is defined in Section 24.0, was \$1.00 in the second quarter of 2008, a decrease of \$0.64, or 39.0% for the same period of 2007. Diluted EPS for the six months ended June 30, 2008 was \$1.59, a decrease of \$0.87 or 35.4%. This decrease reflected lower net income.

Diluted EPS excluding FX gains and losses on long-term debt (FX on LTD) and other specified items was \$0.97 in the second quarter of 2008, a decrease of \$0.15, or 13.4%. Diluted EPS excluding FX on LTD for the first six months of 2008 was \$1.72, a decrease of \$0.18, or 9.5%. These decreases were mainly due to lower income before FX on LTD and other specified items. Diluted EPS excluding FX on LTD and other specified items is discussed further in Section 6.0.

5.3 Operating Ratio

Our operating ratio increased to 79.4% in the second quarter of 2008, compared with 74.7% for the same period of 2007. This ratio was 81.0% for the six months ended June 30, 2008 compared with 77.0% for the same period in 2007. These increases were primarily due to higher fuel expenses (discussed further in Section 9.0). The operating ratio provides the percentage of revenues used to operate the railway, and is calculated as operating expenses divided by revenues. A lower percentage normally indicates higher efficiency in the operation of the railway.

5.4 Return on Capital Employed

Return on capital employed (ROCE) at June 30, 2008 was 9.2%, down 1.1%, compared with 10.3% in June 30, 2007. This decrease was primarily due to an increase in net debt resulting from the bridge financing obtained for the acquisition of DM&E (discussed further in Section 17.0). ROCE is discussed further in Section 6.0.

5.5 Impact of Foreign Exchange on Earnings

EFFECT ON EARNINGS DUE TO THE CHANGE IN FOREIGN EXCHANGE

| | For the three months ended June 30 | For the six months ended June 30 |
|---|---|---|
| | 2008 vs. 2007 | |
| | \$1.01 vs. \$1.11 | \$1.01 vs \$1.14 |
| (in millions, except foreign exchange rate) | | |
| Average foreign exchange rates | | |
| Freight revenues | | |
| Grain | \$ (9) | \$ (26) |
| Coal | (2) | (4) |
| Sulphur and fertilizers | (5) | (13) |
| Forest products | (5) | (13) |
| Industrial and consumer products | (10) | (27) |
| Automotive | (4) | (11) |
| Intermodal | (6) | (17) |
| Other revenues | (1) | (2) |
| (Unfavourable) favourable effect | (42) | (113) |
| Operating expenses | | |
| Compensation and benefits | 7 | 19 |
| Fuel | 14 | 35 |
| Materials | 2 | 7 |
| Equipment rents | 5 | 11 |
| Depreciation and amortization | 1 | 4 |
| Purchased services and other | 4 | 11 |

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| | | | | |
|---|-----------|------------|-----------|-------------|
| Favourable (unfavourable) effect | | 33 | | 87 |
| (Unfavourable) favourable effect on operating income ⁽¹⁾ | | (9) | | (26) |
| Other expenses | | | | |
| Other charges | | 1 | | 1 |
| Interest expense | | 3 | | 9 |
| Income tax expense, before FX on LTD and other specified items ⁽¹⁾ | | 3 | | 6 |
| Effect on income, before FX on LTD and other specified items ⁽¹⁾ | \$ | (2) | \$ | (10) |

(1) These earnings measures have no standardized meanings prescribed by Canadian GAAP and, therefore, are unlikely to be comparable to similar measures of other companies. These earnings measures and other specified items are described in Section 6.0.

The Canadian dollar strengthened against the US dollar on average by approximately 9% during the second quarter, and 12% for the six months ended 2008 compared with the same period in 2007. The average FX rate for converting US dollars to Canadian dollars decreased to \$1.01 in second quarter 2008 from \$1.11 in the second quarter 2007 and decreased to \$1.00 for the first six months of 2008 compared to \$1.14 for the same period of 2007. The adjoining table shows the approximate impact of the change in FX on our revenues and expenses, and income before FX on LTD and other specified items. This analysis does not include the impact of the change in FX on balance sheet accounts or FX hedging activity.

On average, a \$0.01 strengthening (or weakening) of the Canadian dollar reduces (or increases) annual operating income by approximately \$2 million to \$5 million. However, a large movement in FX can lead to a change in operating income that falls outside of the aforementioned range. FX fluctuations decreased operating income by approximately \$9 million in second quarter 2008 and approximately \$26 million for the first six months of 2008 compared with the same periods for 2007, as illustrated in the adjoining table. From time to time, we use FX forward contracts to partially hedge the impact on our business of FX transaction gains and losses and other economic factors.

6.0 NON-GAAP EARNINGS

We present non-GAAP earnings and cash flow information in this MD&A to provide a basis for evaluating underlying earnings and liquidity trends in our business that can be compared with the results of our operations in prior periods. These non-GAAP earnings exclude foreign currency translation effects on LTD, which can be volatile and short term, and other specified items (discussed further in Section 6.2) that are not among our normal ongoing revenues and operating expenses. The adjoining table details a reconciliation of operating income and income, before FX on LTD and other specified items, to net income, as presented in the financial statements. Free cash is calculated as cash provided by operating activities, less cash used in investing activities, dividends paid and excluding changes in the accounts receivable securitization program, and is adjusted for the acquisition of DM&E. Free cash is discussed further and is reconciled to the change in cash as presented in the financial statements in Section 13.4. Earnings measures that exclude FX on LTD and other specified items, operating income, ROCE, net-debt to net-debt-plus-equity ratio, interest coverage ratio and free cash as described in this MD&A have no standardized meanings and are not defined by Canadian GAAP and, therefore, are unlikely to be comparable to similar measures presented by other companies. Operating income is calculated as revenues less operating expenses and is a common measure of profitability used by management. ROCE reported quarterly represents the return over the current quarter and the previous three quarters. The measure is used by management to assess profitability of investments in the railway. ROCE is measured as income before FX on LTD and other specified items plus after-tax interest expense divided by average net debt plus equity. It does not have a comparable GAAP measure to which it can be reconciled. Net-debt to net-debt-plus-equity ratio and interest coverage ratio (discussed further in Sections 13.3.1 and 13.3.2) represent two of many metrics used in assessing the Company's capital structure and debt servicing capabilities, and they do not have a comparable GAAP measure to which they can be reconciled. Interest coverage ratio reported quarterly is measured on a twelve-month rolling basis.

| SUMMARIZED STATEMENT OF CONSOLIDATED INCOME (reconciliation of non-GAAP earnings to GAAP earnings) (in millions, except diluted EPS and operating ratio) | For the three months ended June 30 | | For the six months ended June 30 | |
|---|---|--------------|---|--------------|
| | 2008 | 2007 | 2008 | 2007 |
| Revenues | \$ 1,220.3 | \$ 1,215.5 | \$ 2,367.2 | \$ 2,331.4 |
| Operating expenses | 969.2 | 907.8 | 1,917.9 | 1,794.4 |
| Operating income⁽¹⁾ | 251.2 | 307.7 | 449.3 | 537.0 |
| Other charges | 4.9 | 8.2 | 11.6 | 13.0 |
| Equity income (net of tax) in DM&E | (13.4) | | (24.4) | |
| Interest expense | 62.9 | 49.2 | 122.8 | 96.0 |
| Income tax expense, before income tax on FX on LTD and other specified items ⁽¹⁾ | 46.3 | 75.5 | 72.5 | 130.6 |
| Income, before FX on LTD and other specified items⁽¹⁾ | 150.4 | 174.8 | 266.8 | 297.4 |
| <u>Foreign exchange (gains) losses on long-term debt</u> | | | | |
| FX on LTD (gains) losses | (6.8) | (88.6) | 9.5 | (97.2) |
| Income tax expense on FX on LTD | 2.3 | 23.8 | (3.4) | 26.4 |
| FX on LTD, net of tax (gain) loss | (4.5) | (64.8) | 6.1 | (70.8) |
| <u>Other specified items</u> | | | | |
| Change in estimated fair value of ABCP | | | 21.3 | |
| Income tax on change in estimated fair value of ABCP | | | (6.3) | |

| | | | | |
|--|-----------------|----------|-----------------|----------|
| Change in estimated fair value of ABCP, net of tax | | | 15.0 | |
| Income tax benefits due to rate reductions | | (17.1) | | (17.1) |
| Net income | \$ 154.9 | \$ 256.7 | \$ 245.7 | \$ 385.3 |
| Diluted EPS, before FX on LTD and other specified items ⁽¹⁾ | \$ 0.97 | \$ 1.12 | \$ 1.72 | \$ 1.90 |
| Diluted EPS, related to FX on LTD, net of tax ⁽¹⁾ | 0.03 | 0.41 | (0.04) | 0.45 |
| Diluted EPS, related to other specified items, net of tax ⁽¹⁾ | | 0.11 | (0.09) | 0.11 |
| Diluted EPS, as determined by GAAP | \$ 1.00 | \$ 1.64 | \$ 1.59 | \$ 2.46 |

(1) These earnings measures have no standardized meanings prescribed by Canadian GAAP and, therefore, are unlikely to be comparable to similar measures of other companies. These earnings measures and other specified items are described in this section of the MD&A.

6.1 Foreign Exchange Gains and Losses on Long-Term Debt

FX on LTD arises mainly as a result of translating US dollar-denominated debt into Canadian dollars. We calculate FX on LTD using the difference in FX rates at the beginning and at the end of each reporting period. The FX gains and losses are mainly unrealized and can only be realized when net US dollar-denominated LTD matures or is settled. Income, before FX on LTD and other specified items, is disclosed in the table above and excludes FX on LTD from our earnings in order to eliminate the impact of volatile short-term exchange rate fluctuations. At June 30, 2008, for every \$0.01 the Canadian dollar weakens (or strengthens) relative to the US dollar, the conversion of US dollar-denominated long-term debt to Canadian dollars creates a pre-tax FX loss (or gain) of approximately \$0.4 million, net of hedging.

On a pre-tax basis, we recorded FX gains on LTD of \$6.8 million in the second quarter of 2008, as the Canadian dollar exchange rate strengthened to \$1.0197 from \$1.0265 at March 31, 2008. We also recorded foreign exchange losses on LTD of \$9.5 million for the first half of 2008, as the Canadian dollar weakened from \$0.9913 at December 31, 2007, relative to the US dollar. We recorded FX gains on LTD of \$88.6 million before tax in second quarter 2007, and \$97.2 million in the first half of 2007. Compared with 2007 periods, the FX gains on US dollar-denominated LTD were lower as the Canadian dollar has remained reasonably consistent against the US dollar, over the second quarter and first half of the year.

Income tax expense (or benefit) related to FX on LTD is discussed further in Section 10.5.

6.2 Other Specified Items

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.

In the first quarter of 2008, there was one other specified item included in net income. We recorded a charge of \$15.0 million after tax (\$21.3 million before tax) to reflect the change in the estimated fair value of ABCP (discussed further in Section 10.3).

There were no other specified items in the second quarter or first half of 2008.

In the second quarter of 2007, the Government of Canada substantially enacted legislation to reduce corporate income tax rates in 2011. We recorded a future income tax benefit of \$17.1 million to reflect the positive impact of these tax rate reductions in transactions in prior years for which future taxes will be paid.

7.0 LINES OF BUSINESS

7.1 Volumes

| VOLUMES | For the three months ended June 30 | | For the six months ended June 30 | |
|----------------------------------|------------------------------------|------|----------------------------------|-------|
| | 2008 | 2007 | 2008 | 2007 |
| Carloads (in thousands) | | | | |
| Grain | 87.7 | 91.2 | 180.0 | 180.5 |
| Coal | 77.2 | 75.0 | 142.0 | 133.5 |
| Sulphur and fertilizers | 53.4 | 61.3 | 105.7 | 111.5 |
| Forest products | 23.1 | 29.9 | 47.6 | 60.0 |
| Industrial and consumer products | 86.4 | 79.2 | 167.3 | 154.9 |
| Automotive | 40.1 | 45.7 | 76.4 | |