Franchise Capital CORP
Form 10-Q
April 16, 2007

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

PURSUANT TO SECTION 13 OR 15 (d) OF THE

SECURITIES EXCHANGE ACT OF 1934

For the Quarter Ended	Commission File Number
December 31, 2005	000-26887

FRANCHISE CAPITAL CORPORATION

(Exact Name of Registrant as Specified in Its Charter)

Nevada	98-0353403
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification Number)
43180 Business Park Drive #202, Temecula, CA	92590
(Address of principal executive offices)	(Zip Code)

(951) 587-9100

Issuer's telephone number, including area code

N/A

(Registrant's Former Name and Address)

Check whether the Issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [ ] No[X]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer [ ]

Accelerated filer [ ]

Non-accelerated filer [X]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes [ ] No[X]

APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY

PROCEEDINGS DURING THE PRECEDING FIVE YEARS:

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13, or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes [ ] No[ ]

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's class of common stock, as of the last practicable date.

Class	Outstanding at April 5, 2007
Common Stock, $0.0001 par value	921,824,778 shares

PART I FINANCIAL INFORMATION

Item 1. Financial Statements

FRANCHISE CAPITAL CORPORATION

FINANCIAL STATEMENTS

December 31, 2005

Franchise Capital Corporation
Statement of Assets and Liabilities

	December 31, 2005 (Unaudited)		June 30, 2005 (Audited)	
ASSETS:				
Controlled Affiliated Issuers at fair value	$	432,377	$	1,014,430
Prepaid expenses and other assets		6,250		11,747

Total Assets		438,627		1,026,177
LIABILITIES:				
Accounts payable and accrued expenses	$	70,903	$	120,712
Bank overdraft		5,781		-
Note payable		-		200,000
Debentures payable		220,927		358,156
Total Liabilities		297,611		678,868
NET ASSETS	$	141,016	$	347,309
NET ASSETS consist of:				
Common Stock, 72,567,805 and 32,927,305 shares issued and outstanding, respectively	$	7,257	$	3,293
Preferred Stock		118		130
Paid-in capital		7,214,705		6,598,408
Accumulated deficit		(7,081,064)		(6,254,522)
TOTAL NET ASSETS	$	141,016	$	347,309
Shares Outstanding (5,000,000,000 of $0.0001 par value common stock authorized)		72,567,805		32,927,305
NET ASSET VALUE PER SHARE	$	0.002	$	0.011

The accompanying notes are an integral part of these financial statements.

Franchise Capital Corporation

Statements of Changes in Net Assets (Unaudited)

	For the Six Month Period Ended			
	December 31, 2005		December 31, 2004	
OPERATIONS:				
Net investment loss	$	(225,543)	$	(601,629)
Loss from discontinued operations		(463,526)		-
Financing costs		(137,473)		69,697
		(826,542)		(531,932)

Net decrease in net assets resulting from operations				
SHAREHOLDER ACTIVITY:				
Stock sales and conversion		620,249		1,041,442
NET INCREASE (DECREASE) IN ASSET VALUE		(206,293)		509,510
NET ASSETS:				
Beginning of Period		347,309		(162,201)
End of Period	$	141,016	$	347,309

The accompanying notes are an integral part of these financial statements.

FRANCHISE CAPITAL CORPORATION
PORTFOLIO OF INVESTMENTS DECEMBER 31, 2005 (UNAUDITED)

Principal Amount/Shares		Acquisition Date		Value	
PRIVATE COMPANIES (1) - 167%					
Common Stocks - 100%					
Restaurant companies - 100%					
INVESTMENTS IN CONTROLLED COMPANIES:					
Membership 72.5%	Comstock Jake's Franchise Co., LLC	12/2004	$	-	
Membership 50%	Cousin Vinnie's Franchise Co., LLC	12/2004		-	
Membership 100%	Kirby Foo's Franchise Co., LLC	12/2004		-	
Membership 90%	Kokopelli Mexican Grill Franchise Co., LLC	12/2004		432,377	(1)
ADVANCES TO CONTROLLED COMPANIES:					
	Comstock Jake's Franchise Co., LLC	12/2004		-	
	Cousin Vinnie's Franchise Co., LLC	12/2004		-	
	Kirby Foo's Franchise Co., LLC	12/2004		-	
	Kokopelli Mexican Grill Franchise Co., LLC	12/2004		-	
	TOTAL			432,377	
	TOTAL INVESTMENTS			432,377	
	OTHER ASSETS & LIABILITIES (NET)			(291,361)	
	NET ASSETS - 100%		$	141,016	

(1) At December 31, 2005, the Company owned 25% or more of the outstanding common stock thereby making each a controlled affiliate as defined by the Investment Company Act of 1940. Total market value of controlled affiliated securities owned at December 31, 2005 was $432,377.

The accompanying notes are an integral part of these financial statements.

Franchise Capital Corporation
Statements of Operations
(Unaudited)

	For the Six Months Ended		For the Three Months Ended	
	December 31, 2005	December 31, 2004	December 31, 2005	December 31, 2004
INCOME:				
Consulting income	$ 1,750	$ -	$ 1,750	$ -
Other income	-	-	-	-
Total Income	1,750	-	1,750	-
EXPENSES:				
Accounting fees	63,209	37,362	47,209	8,088
Consulting/contracted labor	77,936	293,665	48,468	211,000
Interest expense	39,022	119,025	2,402	9,810
Legal and professional fees	15,806	21,585	7,036	2,866
General and administrative expenses	31,320	129,992	24,722	52,672
Total Expenses	227,293	601,629	129,837	284,436
NET LOSS	(225,543)	(601,629)	(128,087)	(284,436)
Financing expense	(137,473)	69,697	-	-
Loss from discontinued operations	(463,526)	-	(461,731)	-
NET LOSS IN NET ASSETS RESULTING FROM OPERATIONS	$ (826,542)	$ (531,932)	$ (589,818)	$ (284,436)
WEIGHTED AVERAGE SHARES	47,854,009	4,845,863	47,231,044	4,845,863

NET LOSS PER SHARE	$	(0.017)	$	(0.110)	$	(0.012)	$	(0.059)

The accompanying notes are an integral part of these financial statements.

FRANCHISE CAPITAL CORPORATION
STATEMENTS OF CASH FLOWS
(Unaudited)

	For the Six Months Ended December 31, 2005		For the Six Months Ended December 31, 2004	
CASH FLOWS FROM OPERATING ACTIVITIES:				
Net Loss	$	(826,542)	$	(188,018)
Adjustments to reconcile net loss to net cash used				
by operating activities:				
Common stock issued as consideration for services		-		296,000
Unrealized loss on investment		582,053		-
Depreciation and amortization		-		3,909
Financing costs		137,473		-
Amortization of deferred compensation		-		16,000
Amortization of beneficial conversion feature		-		30,303
Amortization of deferred financing costs		-		1,334
Impairment of goodwill		-		44,836
Minority interest		-		(2,510)
Cumulative effect of accounting change		-		(549,727)
Changes in assets and liabilities:				
Prepaid expenses		5,497		(85,086)
Accounts receivable		-		(219,703)
Deferred revenue		-		325,000
Accounts payable and accrued liabilities		(49,734)		75,335

Net Cash (Used) by Operating Activities		(151,253)		(252,327)
CASH FLOWS FROM INVESTING ACTIVITIES				
Cash invested in portfolio companies		-		(29,166)
Purchase of computer equipment		-		(3,586)
Net Cash Provided by (Used) by Investing Activities		-		(32,752)
CASH FLOWS FROM FINANCING ACTIVITIES				
Common stock issued for cash		345,472		-
Bank overdraft		5,781		-
Advances from shareholders, officers and affiliates				(8,647)
Payments on notes payable		(200,000)		
Proceeds from issuance of convertible debentures		-		249,938
Net Cash Provided by Financing Activities		151,253		241,291
INCREASE (DECREASE) IN CASH AND EQUIVALENTS		-		(43,788)
CASH AND EQUIVALENTS, BEGINNING OF PERIOD		**-**		46,001
CASH AND EQUIVALENTS, END OF PERIOD	**$**	-	**$**	2,213

FRANCHISE CAPITAL CORPORATION
STATEMENTS OF CASH FLOWS (CONTINUED)
(Unaudited)

	For the Six Months Ended December 31, 2005		For the Six Months Ended December 31, 2004	
Cash Paid For:				
Interest	$	-	$	-
Income Taxes	$	-	$	-
Non-Cash Financing Activities:				
Common stock issued for debenture conversions	$	137,229	$	-

The accompanying notes are an integral part of these financial statements.

Franchise Capital Corporation
Financial Highlights
(Unaudited)

Per Unit Operating Performance:

	For the Period Ended			
	December 31, 2005		**December 31, 2004**	
NET ASSET VALUE, BEGINNING OF PERIOD	$	0.00479	$	(0.03337)
INCOME FROM INVESTMENT OPERATIONS:				
Net investment loss		(0.00311)		(0.123792)
Financing expense		(0.00189)		0.01

Income (loss) from discontinued operations	(0.00639)	-
Total from investment operations	(0.00660)	(0.14283)
Net increase in net assets resulting from stock sales	0.00855	0.214288
NET ASSET VALUE, END OF PERIOD	$ 0.001943	$ 0.071463
TOTAL NET ASSET VALUE RETURN	(59.40) %	114.12 %
RATIOS AND SUPPLEMENTAL DATA:		
Net assets, end of period	$ 141,016	$ 347,309
Ratios to average net assets:		
Net expenses	(1.61) %	4.28 %
Net investment loss	1.60 %	(4.28) %

The accompanying notes are an integral part of these financial statements.

FRANCHISE CAPITAL CORPORATION

NOTES TO FINANCIAL STATEMENTS

FOR THE PERIOD ENDED DECEMBER 31, 2005

NOTE 1 - ORGANIZATION AND BASIS OF PRESENTATION

Franchise Capital Corporation (the Company) a Nevada corporation, was incorporated on July 6, 2001. The Company was formerly named Cortex Systems, Inc. In December of 2004 the Company changed its name to Franchise Capital Corporation, to more accurately reflect its business of developing and franchising casual dining restaurants. The Company acquired the rights to four franchise concepts. Effective December 24, 2004, the Company became as an internally managed, closed end investment company electing to be treated as a business development company under the Investment Company Act of 1940, as amended.

In August 2006, the Company abandoned its business model and liquidated all of its investment holdings. On March 13, 2007, the Company held a shareholder meeting at which the Company s shareholders voted to withdraw the Company s election to be a business development company as defined by the 1940 Act. On March 14, 2007, the Company filed for N-54C to formally withdraw the Company s BDC status.

On January 12, 2007, the Company executed a definitive share exchange agreement with TTR HP, Inc. (dba Aero Exhaust, Inc.) pursuant to which the Company agreed to exchange shares of its common stock to acquire 100% of the total issued and outstanding stock of Aero. Once the share exchange is complete, the Company anticipates that the shareholders of Aero will become the majority shareholders of the Company. The share exchange is expected to be consummated at the end of the second quarter of 2007.

Following the share exchange, the Company s business will be that of Aero Exhaust. Aero designs and manufactures performance exhaust systems for both street and race applications. Aero Exhaust has been issued U.S. and Australian patents on its innovations and development in the exhaust industry, and its mufflers are available worldwide through major retailers, mass merchant centers, automotive aftermarket supply stores and wholesalers. Aero Exhaust mufflers are an exclusive National Association for Stock Car Auto Racing (NASCAR) Performance product and carry the NASCAR brand on product, packaging and related media.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. The Company has incurred material operating losses, has continued operating cash flow deficiencies and has working capital deficit at December 31, 2005. These factors raise substantial doubt about the Company s ability to continue as a going concern. The Company believes that the share exchange with Aero Exhaust will be successful and result in the Company s achieving profitability in the short term; however, the Company has consummated this transaction and there is no guarantee that Aero s operations will prove profitable. The accompanying financial statements do not include any adjustments that might result from this uncertainty.

NOTE 2

- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Franchise Capital Corporation changed to a Business Development Company, effective December 24, 2004. Therefore, the prior periods are no longer directly comparable. The balance sheets as of December 31, 2004, and 2005 are presented to reflect the nature of a BDC.

As required by ASR 118, the Board of Directors of the company is required to assign a fair value to all investments. To comply with Section 2(a)(41) of the Investment Company Act and Rule 2a-4 under the Investment Company Act, it is incumbent upon the board of directors to satisfy themselves that all appropriate factors relevant to the value of securities for which market quotations are not readily available have been considered and to determine the method of arriving at the fair value of each such security. To the extent considered necessary, the board may appoint persons to assist them in the determination of such value, and to make the actual calculations pursuant to the board's direction. The board must also, consistent with this responsibility, continuously review the appropriateness of the method used in valuing each issue of security in the company's portfolio. The directors must recognize their responsibilities in this matter and whenever technical assistance is requested from individuals who are not directors, the findings of such intervals must be carefully reviewed by the directors in order to satisfy themselves that the resulting valuations are fair.

Fair market value is determined on at least a quarterly basis. Where there are material changes in portfolio operations, fair market value is re-examined as such material changes occur. In the event the stock trading price is within 10% of Net Book Value, and the Company wishes to sell stock, fair market value is calculated on a monthly basis to ensure that stock is not sold below NBV.

The value of loans and lines of credit are adjusted down if there is a reasonable expectation that the Company will not be able to recoup the investment or if there is reasonable doubt about the investment s ability to continue as a going concern. Additionally, where available, the Board reviews other relevant factors affecting repayment including historical cash flows, material contracts, collateral, debt maturity, alternate financing resources, etc.

In light of the Company s decision to abandon it s business model and liquidate all investment holdings in August 2006, the accompanying financial statements reflect the value received upon liquidation. The Company recorded an unrealized loss on discontinued operations associated with this write off as of June 30, 2006. Notwithstanding the withdrawal of the BDC election in March 2007, the Company was still operating under the guidelines of the Investment Company Act of 1940 as of December 31, 2005. Accordingly, the accompanying financing statements have been prepared to represent those of an investment company.

NOTE 3 - INVESTMENT PORTFOLIO

In the year ended June 30, 2005, the Company entered into operating agreements for four restaurant concepts (Comstock Jake s, Kokopelli, CV, and Kirby) with the owners of the exclusive rights to the names, trademarks, menus, operating systems and recipes for the concepts.

As a business development company under the Investment Company Act of 1940, the Company's investments must be carried at either market value or fair value as determined by our Board of Directors for investments which do not have readily determinable market values. All of the Company s investment assets were acquired in privately negotiated transactions and have no readily determinable market values. These securities have therefore been carried at fair value as determined by the Board of Directors under our valuation policy.

At June 30, 2006, the Company s management determined that the business model in effect was not sustainable and voted to liquidate the Company s investment portfolio. From July 1, 2006 through December 31, 2006, the Company sold 100% of its portfolio assets and effectively ceased operations. The following transactions resulting from such liquidation were recorded:

Comstock Jake s Franchise Co., LLC

In August 2006, the Company sold its investment in Comstock Jake s, together with Kirby Foo s Franchise Corp., to a creditor in exchange for debt forgiveness of $100,000.

Cousin Vinnie s Franchise Co., LLC

In August 2006, the Company abandoned the Cousin Vinnie s concept due to lack of investment capital and sold the Cousin Vinnie s name for nominal cash. Cousin Vinnie s Franchise Co., LLC is presently an inactive shell wholly owned by the Company.

Kirby Foo s Franchise Co., LLC

In August 2006, the Company sold its investment in Kirby Foo s together with its interest in Comstock Jake s to a Company creditor in exchange for $100,000 in debt forgiveness.

Kokopelli Franchise Co., LLC

In August 2006, the Company sold its investment in Kokopelli to The Great American Food Chain (GAMN.PK) in exchange for 720,629 shares of GAMN common stock, valued at $0.60 per share on the date of issuance, plus the assumption of a note payable which the Company carried relative to Kokopelli. The 720,629 shares of GAMN common stock received were paid as a dividend to the Company s shareholders of record as of August 31, 2006.

Fathom Business Systems, Inc.

On September 30, 2005, the Company sold its interest in Fathom Business for $44,142.

The fair market values of the Company s portfolio assets at December 31, 2005 reflect the actual liquidation value subsequently received.

NOTE 4

- CONVERTIBLE DEBENTURES PAYABLE

As of December 31, 2005, the Company had the following convertible debentures on its books:

During the year ended June 30, 2004, the Company issued a 2-year 7.5% convertible debenture amounting to $250,000 with interest payable monthly and maturing June 25, 2006. The debenture also included non-detachable warrants for 2,500,000 shares of common stock. The debenture was convertible at the option of the holder into common shares of the Company. The conversion price was the lesser of $0.25 or 80% of the average of the five lowest volume weighted average price during the 20 trading days prior to the election to convert. Upon conversion, the holder must simultaneously purchase shares of the Company s common stock in a dollar amount equal to 10 times the dollar amount of the debenture converted. The purchase price for such shares was the same as the debenture conversion price. The value of the beneficial conversion feature of $21,212 was recorded as a discount to the principal balance of the debenture and amortized immediately as interest expense because the debenture is convertible at any time at the option of the holder.

The Company defaulted on the interest payment provisions in the debenture. Consequently, the principal amount due under the debenture became immediately due and payable in cash plus a default penalty of $42,500 plus any and all accrued interest. The default penalty of $42,500 was expensed as interest and financing costs in the accompanying statement of operations for the year ended June 30, 2004.

As of December 31, 2005, the balance owed on the debenture was $220,927, which included interest as penalties of $18,574. Subsequent to June 30, 2006, the Company was able to restructure this obligation (see Note 6 - Subsequent Events).

NOTE 5 - STOCKHOLDERS EQUITY

The Company declared a 1 for 10 reverse stock split in the year ended June 30, 2005. The number of shares presented in these financial statements has been retroactively restated for all periods to reflect this reverse stock split.

During the quarter ended December 31, 2005, the Company issued 4,000,000 shares of common stock for cash of $57,056. These shares were issued exempt from registration under Regulation E of the Securities Act of 1933.

NOTE 6 - SUBSEQUENT EVENTS

At June 30, 2006, the Company s management determined that the business model in effect was not sustainable and voted to liquidate the Company s investment portfolio. From July 1, 2006 through December 31, 2006, the Company sold 100% of its portfolio assets and effectively ceased operations. The following transactions resulting from such liquidation were recorded:

In August 2006, the Company sold its investment in Comstock Jake s, together with Kirby Foo s Franchise Corp., to a creditor in exchange for debt forgiveness of $100,000.

In August 2006, the Company abandoned the Cousin Vinnie s concept due to lack of investment capital and sold the Cousin Vinnie s name for nominal cash. Cousin Vinnie s Franchise Co., LLC is presently an inactive shell wholly owned by the Company.

In August 2006, the Company sold its investment in Kokopelli to The Great American Food Chain (GAMN.PK) in exchange for 720,629 shares of GAMN common stock plus the assumption of a note payable which the Company carried relative to Kokopelli. The 720,629 shares of GAMN common stock received were paid as a dividend to the Company s shareholders of record as of August 31, 2006.

On March 13, 2007, the Company s shareholders voted by majority consent to withdraw the Company s election as a BDC under the 1940 Act and, on March 13, 2007, the Company filed a Form N-54C which formally withdrew the BDC election.

In November 2006, the Company agreed to settle litigation with Golden Gate Investors on a past-due convertible debenture having a principle balance due of $220,927. Under the terms of the settlement, the Company placed 850,000,000 shares of its restricted common stock into an escrow account for satisfaction of the debenture. Golden Gate is allowed to withdraw the shares from escrow provided that their overall holdings in the Company do not exceed 4.9% of all issued and outstanding common stock. The debenture obligation is reduced by 80% of the average of the five lowest closing bid prices of the Company s common stock over a 45-day period prior to the share withdrawal multiplied by the number of shares being withdrawn. Under the terms of this settlement, 83,121,521 shares have subsequently been released from escrow and the debenture balance has been reduced to $203,291.

In connection with the debenture settlement with Golden Gate, Golden Gate entered into a stock purchase agreement which required Golden Gate to purchase $100,000 of the Company s restricted common stock for every $10,000 in debenture redeemed through the escrow. As of April 4, 2007, the Company had sold 682,329 shares of restricted common stock to Golden Gate for $682,329 under the agreement. In addition, the Company received $1,670,669 from Golden Gate as an advance on future stock purchases under the agreement.

On January 12, 2007, the Company executed a definitive share exchange agreement with TTR HP, Inc. (dba Aero Exhaust, Inc.) pursuant to which the Company agreed to exchange shares of its common stock to acquire 100% of the total issued and outstanding stock of Aero. Once the share exchange is complete, the Company anticipates that the shareholders of Aero will become the majority shareholders of the Company. The share exchange is expected to be consummated at the end of the second quarter of 2007. Following the share exchange, the Company s business will be that of Aero Exhaust. Aero designs and manufactures performance exhaust systems for both street and race applications. Aero Exhaust has been issued U.S. and Australian patents on its innovations and development in the exhaust industry, and its mufflers are available worldwide through major retailers, mass merchant centers, automotive aftermarket supply stores and wholesalers. Aero Exhaust mufflers are an exclusive National Association for Stock Car Auto Racing (NASCAR) Performance product and carry the NASCAR brand on product, packaging and related media.

As part of the definitive agreement between the Company and Aero Exhaust, the Company agreed to extend a line of credit to Aero in the amount of $1,500,000. Under the terms of the line of credit, any unpaid principle and interest on the line of credit will be converted into shares of Aero Exhaust common stock immediately prior to the share exchange. The net effect of this transaction will be an increase in the overall position that the Company s existing shareholders will have in the Company subsequent to the share exchange. The rate at which the line of credit will be converted into Aero Exhaust stock has yet to be determined; however, the price per share will be equal to the price per share Aero had sold stock in its most recent private placement. As of April 4, 2007, the Company had advanced a total of $1,200,000 to Aero under the line of credit.

Between February and March 2007, the Company converted 100% of the Series C Preferred Stock into shares of common stock. This conversion resulted in the issuance of 1,232,500 shares of restricted common stock. As of March 22, 2007, there were no shares of preferred stock issued or outstanding.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION

GENERAL

The statements contained in this Quarterly Report on Form 10-Q that are not historical facts may contain forward-looking statements that involve a number of known and unknown risks and uncertainties that could cause actual results to differ materially from those discussed or anticipated by management. Potential risks and uncertainties include, among other factors, general business conditions, government regulations, manufacturing practices, competitive market conditions, success of the Company's business strategy, delay of orders, changes in the mix of products sold, availability of suppliers, concentration of sales in markets and to certain customers, changes in manufacturing efficiencies, development and introduction of new products, fluctuations in margins, timing of significant orders, and other risks and uncertainties currently unknown to management.

CRITICAL ACCOUNTING POLICIES

The Company's financial statements and related public financial information are based on the application of accounting principles generally accepted in the United States of America ("GAAP"). GAAP requires the use of estimates; assumptions, judgments and subjective interpretations of accounting principles that have an impact on the assets, liabilities, revenue and expense amounts reported. These estimates can also affect supplemental information contained in the external disclosures of the Company including information regarding contingencies, risk and financial condition. We believe our use of estimates and underlying accounting assumptions adhere to GAAP and are consistently and conservatively applied. We review valuations based on estimates for reasonableness and conservatism on a consistent basis throughout the Company. Primary areas where financial information of the Company is subject to the use of estimates, assumptions and the application of judgment include acquisitions, valuation of long-lived and intangible assets, and the realizability of deferred tax assets. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. Actual results may differ materially from these estimates under different assumptions or conditions.

Valuation Of Long-Lived And Intangible Assets

The recoverability of long lived assets requires considerable judgment and is evaluated on an annual basis or more frequently if events or circumstances indicate that the assets may be impaired. As it relates to definite life intangible assets, we apply the impairment rules as required by SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and Assets to Be Disposed Of" as amended by SFAS No. 144, which also requires significant judgment and assumptions related to the expected future cash flows attributable to the intangible asset. The impact of modifying any of these assumptions can have a significant impact on the estimate of fair value and, thus, the recoverability of the asset.

Income Taxes

We recognize deferred tax assets and liabilities based on the differences between the financial statement carrying amounts and the tax bases of assets and liabilities. We regularly review our deferred tax assets for recoverability and establish a valuation allowance based upon historical losses, projected future taxable income and the expected timing of the reversals of existing temporary differences. As of December 31, 2005, we estimated the allowance on net deferred tax assets to be one hundred percent of the net deferred tax assets.

COMPANY OVERVIEW

Franchise Capital Corporation (The Company) was formed as a Nevada corporation on July 6, 2001 under the name Cortex Systems, Inc. They were originally a development stage company that intended to establish memory clinics in several different locations in North America. Unfortunately, the Company was unable to successfully execute its business plan. In July of 2003, the Company changed its name to BGR Corporation. Along with the name change came a new management and ownership team. The intention of management is to acquire new innovative fast-casual restaurant concepts, develop them into a profitable working design, and franchise them across the country. The Corporation's partner, American Restaurant Development Company, is a professional restaurant designer, franchiser, and restaurant management company where principles have extensive experience in the industry. In December of 2004 the Company changed its name to Franchise Capital Corporation. The names Franchise Capital Corporation , "we", "our" and "us" used in this report refer to Franchise Capital Corporation.

On December 23, 2004, the company elected to be regulated as a Business Development Company (BDC) as outlined in the Investment Company Act of 1940 by filing a Form N-54A. As a BDC, the Company focused on investing and developing restaurant franchise companies and made several investments (discussed below). During the fourth quarter of 2006, the Company abandoned its business model and liquidated all of its investment holdings. On March 13, 2007, the Company held a shareholder meeting at which the Company s shareholders voted to withdraw the Company s election to be a business development company as defined by the 1940 Act. On March 13, 2007, the Company filed for N-54C to formally withdraw the Company s BDC status.

On January 12, 2007, the Company executed a definitive share exchange agreement with TTR HP, Inc. (dba Aero Exhaust, Inc.) pursuant to which the Company agreed to exchange shares of its common stock to acquire 100% of the total issued and outstanding stock of Aero. Once the share exchange is complete, the Company anticipates that the shareholders of Aero will become the majority shareholders of the Company. The share exchange is expected to be consummated at the end of the second quarter of 2007.

Following the share exchange, the Company s business will be that of Aero Exhaust. Aero designs and manufactures performance exhaust systems for both street and race applications. Aero Exhaust has been issued U.S. and Australian patents on its innovations and development in the exhaust industry, and its mufflers are available worldwide through major retailers, mass merchant centers, automotive aftermarket supply stores and wholesalers. Aero Exhaust mufflers are an exclusive National Association for Stock Car Auto Racing (NASCAR) Performance product and carry the NASCAR brand on product, packaging and related media.

Investment Strategy

During the quarter ended December 31, 2005, the Company operated as a Business Development Company (BDC). As a BDC, the Company was required to have at lease 70% of its assets in eligible portfolio companies. It is stated in the Investment Committee Charter that the Company will endeavor to maintain this minimum asset ratio. Between September 1 and December 31, 2006, the Company liquidated all of its investments and ceased operating as a BDC. On March 13, 2007, the Company filed a Form N-54C withdrawing the Company s election as a BDC. As the result, the Company is no longer considered a BDC and is no longer subject to the requirements of the 1940 Act.

Portfolio Investments

Comstock Jake s Franchise Co., LLC

Comstock Jake s is a fast-casual/full-service family style dinner house concept. Jake s is designed for end-cap and/or in-line locations with the typical square footage being 2800-3200 sq./ft, and seating for 80-100 inside and 30 in a patio setting. The principle feature of the restaurant is their special blend of top sirloin hamburgers, sized to their specifications, delivered fresh, never frozen. They serve all sandwiches on fresh-baked buns, baked daily in each store. Jake s offers a unique variety of foods beyond their hamburgers, as the menu is designed to appeal to a diverse guest mix, including young, old, and the young-at-heart. Menu choices will include grilled ribs, grilled chicken breast sandwiches, roasted chicken, gourmet salads, homemade hearty soups, corn bread, beer and wine, and ice cream shakes and sundaes. In August 2006, the Company sold its investment in Comstock Jake s, together with Kirby Foo s Franchise Corp., to a creditor in exchange for debt forgiveness of $100,000.

Cousin Vinnie s Franchise Co., LLC

Cousin Vinnie s Italian Diner was intended to be a Roman-inspired Italian Diner offering appetizers, made-to-order pasta dishes, thin crust pizzas, special meats, seafood and chicken, paninis, soups, salads and desserts all made to order in the customer s full view. Cousin Vinnie s is postured closer to casual dining than the typical fast-casual format to realize a $20-per-person daylong check average, with a solid lunch business with an $8-$9 average check. Cousin Vinnie s was designed for end-cap and/or in-line locations, a third of the cost paying for a typical freestanding building. In August 2006, the Company abandoned the Cousin Vinnie s concept due to lack of investment capital and sold the Cousin Vinnie s name for nominal cash. Cousin Vinnie s Franchise Co., LLC is presently an inactive shell wholly owned by the Company.

Kirby Foo s Franchise Co., LLC

Kirby Foo s is a high-end, full-service/fast-casual Asian Grill concept and is positioned closer to casual dining than the typical fast-casual format. Kirby Foo s is designed for end-cap and/or in-line locations with the typical square footage being 2500-3000 sq./ft, and seating for 70-90 inside and 30 in a patio setting. Kirby Foo s food is simply prepared and of the highest quality and they offer a wide variety of food products, all of which are prepared in a casual dining environment. They serve special meats, seafood, and chicken all prepared to their specifications, delivered fresh, never frozen. Kirby Foo s is unique in the variety of foods they offer beyond the typical Asian fare, such as Blackened Ahi Katsu, Panko Fried Filet of Beef, Nori Crusted Seabass, Crispy Pork Won Tons, Shrimp Thai-Fu, and Peking Roasted Duck. All designed to contribute to a diverse guest mix and high guest frequency. In August 2006, the Company sold its investment in Kirby Foo s together with its interest in Comstock Jake s to a Company creditor in exchange for $100,000 in debt forgiveness.

Kokopelli Franchise Co., LLC

Kokopelli Sonoran Grill, founded in Phoenix, Arizona in 1997, specializes in Sonoran/Mexican cuisine featuring made-to-order big-burritos, tacos, fajitas, and other Mexican favorites. Kokopelli s uses only the freshest ingredients with no preservatives, additives, or conditioners and only the highest quality meats, chicken, and seafood products at a reasonable price. Kokopelli differentiates itself from other fast-casual chains such as Chipotle, QDOBA, and Baja Fresh by serving authentic hand-blended Sonoran spices, beans slow-cooked everyday (never refried) and tortillas steamed to order, not held in a warmer. Additionally, Kokopelli serves many items found in full service Mexican restaurants such as Grilled Salmon with Mango Salsa, Steak Verde with Tomatilla Salsa, Pollo Colorado with Smoked Cheese and Peppers, beer, wine and frozen-margaritas, and also offers a variety of healthful and low-carb meal options. In August 2006, the Company sold its investment in Kokopelli to The Great American Food Chain (GAMN.PK) in exchange for 720,629 shares of GAMN common stock plus the assumption of a note payable which the Company carried relative to Kokopelli. The 720,629 shares of GAMN common stock received were paid as a dividend to the Company s shareholders of record as of August 31, 2006.

Fathom Business Systems, Inc.

Fathom Business Systems is a licensed dealer of Point of Sale (POS) systems for restaurants of all types and sizes. Its president, James Medeiros, who has over 25 years of experience in the foodservice industry, heads the company. With a thorough working knowledge of restaurants, the company strives for cost-effective POS solutions for its clients. Fathom does not just sell register systems to restaurants, but also installs, services, and maintains them. The company is known for its fast, friendly, and personalized service. On September 30, 2005, the Company sold its interest in Fathom Business for $44,142.

RESULTS OF OPERATIONS

Three months ended December 31, 2005 compared to three months ended December 31, 2004

During the quarter ended December 31, 2005, the Company experienced a net loss of $128,087 compared to a net loss of $284,436 for the same period in 2004. The Company attributes the $156,349 decrease in net loss primarily to a $162,532 decrease in consulting and contracted labor expense.

Revenues for the three months ended December 31, 2005 were $1,750 compared with no revenues for the three months ended December 31, 2005. The revenues were generated from consulting income.

Six months ended December 31, 2005 compared to six months ended December 31, 2004

During the six months ended December 31, 2005, the Company experienced a net loss of $225,543 compared to $601,629 for the same period in 2004. The Company attributes the $376,086 decrease in net loss primarily to a $215,729 decrease in consulting and contracted labor expense, a $80,003 decrease in interest expense and a $98,672 decrease in general and administrative expenses.

Revenues for the six months ended December 31, 2005 were $1,750 compared with no revenues for the three months ended December 31, 2005. The revenues were generated from consulting income.

Liquidity and Capital Resources

The Company s financial statements present an impairment in terms of liquidity. As of December 31, 2005 the Company had $297,611 in liabilities and no current assets. The Company has accumulated $7,081,064 of net operating losses through December 31, 2005 which may be used to reduce taxes in future years through 2025. The use of these losses to reduce future income taxes will depend on the generation of sufficient taxable income prior to the expiration of the net operating loss carry forwards. The potential tax benefit of the net operating loss carry forwards have been offset by a valuation allowance of the same amount. The Company has not yet established revenues to cover its operating costs. .Management believes that the share exchange with Aero Exhaust will be successful and result in the Company s achieving profitability in the short term; however, the Company has consummated this transaction and there is no guarantee that Aero s operations will prove profitable. In the event the Company is unable to generate profits and if suitable financing is unavailable, there is substantial doubt about the Company s ability to continue as a going concern.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

An investment in the Company involves a high degree of risk. In addition to matters discussed elsewhere in this report, careful consideration should be given to the following risk factors. This report contains certain forward-looking statements that involve risks and uncertainties. Our actual results could be substantially different from the results we anticipate in these forward-looking statements because of one or more of the factors described below and/or elsewhere in this report. If any of these risks were to actually occur, our business, results of operations and financial condition would likely suffer materially. The risks outlined below are those which management believes are material to an understanding of our business and the risks inherent in it, but such list is not exclusive of every possible risk which may impact the Company and its shareholders in the future. Additional risks and uncertainties not presently known to us or that we currently deem immaterial may also appear or increase in significance, and could therefore impair our projected business results of operations and financial condition.

RISKS RELATED TO OUR BUSINESS

We Have Historically Lost Money and Losses May Continue in the Future

We have historically lost money. The loss for the 2005 fiscal year was $772,517 and future losses are likely to occur. Accordingly, we may experience significant liquidity and cash flow problems if we are not able to raise additional capital as needed and on acceptable terms. No assurances can be given we will be successful in reaching or maintaining profitable operations.

We Will Need to Raise Additional Capital to Finance Operations

Our operations have relied almost entirely on external financing to fund our operations. Such financing has historically come from a combination of borrowings and from the sale of common stock and assets to third parties. We will need to raise additional capital to fund our anticipated operating expenses and future expansion. Among other things, external financing will be required to cover our operating costs. We cannot assure you that financing whether from external sources or related parties will be available if needed or on favorable terms. The sale of our common stock to raise capital may cause dilution to our existing shareholders. Our inability to obtain adequate financing will result in the need to curtail business operations. Any of these events would be materially harmful to our business and may result in a lower stock price.

There is Substantial Doubt About Our Ability to Continue as a Going Concern Due to Recurring Losses and Working Capital Shortages, Which Means that We May Not Be Able to Continue Operations Unless We Obtain Additional Funding

The report of our independent accountants on our June 30, 2005 financial statements include an explanatory paragraph indicating that there is substantial doubt about our ability to continue as a going concern due to recurring losses and working capital shortages. Our ability to continue as a going concern will be determined by our ability to obtain additional funding. Our financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Our Common Stock May Be Affected By Limited Trading Volume and May Fluctuate Significantly

Prior to this offering, there has been a limited public market for our common stock and there can be no assurance that an active trading market for our common stock will develop. As a result, this could adversely affect our shareholders' ability to sell our common stock in short time periods, or possibly at all. Our common stock has experienced, and is likely to experience in the future, significant price and volume fluctuations that could adversely affect the market price of our common stock without regard to our operating performance. In addition, we believe that factors such as quarterly fluctuations in our financial results and changes in the overall economy or the condition of the financial markets could cause the price of our common stock to fluctuate substantially. Substantial fluctuations in our stock price could significantly reduce the price of our stock.

Our Common Stock is Traded on the "Pink Sheets," Which May Make it More Difficult For Investors to Resell Their Shares Due to Suitability Requirements

Our common stock is currently traded on the Pink Sheets where we expect it to remain for the foreseeable future. Broker-dealers often decline to trade in Pink Sheet stocks given that the market for such securities is often limited, the stocks are more volatile, and the risks to investors are greater. These factors may reduce the potential market for our common stock by reducing the number of potential investors. This may make it more difficult for investors in our common stock to sell shares to third parties or to otherwise dispose of them. This could cause our stock price to decline.

We Could Fail to Retain or Attract Key Personnel

Our future success depends in significant part on the continued services of Steven Peacock, our Chief Executive. We cannot assure you we would be able to find an appropriate replacement for key personnel. Any loss or interruption of our key personnel's services could adversely affect our ability to develop our business plan. We have no employment agreements or life insurance on Mr. Peacock.

Nevada Law and Our Charter May Inhibit a Takeover of Our Company That Stockholders May Consider Favorable

Provisions of Nevada law, such as its business combination statute, may have the effect of delaying, deferring or preventing a change in control of our company. As a result, these provisions could limit the price some investors might be willing to pay in the future for shares of our common stock.

Our Officers and Directors Have the Ability to Exercise Significant Influence Over Matters Submitted for Stockholder Approval and Their Interests May Differ From Other Stockholders

Our Chairman of the Board of Directors has the ability to vote a majority of the Company s issued and outstanding common shares by virtue of the stock power contained within the escrow agreement with Golden Gate Investors. Accordingly, he may have significant influence in determining the outcome of any corporate transaction or other matter submitted to our shareholders for approval, including issuing common and preferred stock, electing directors and appointing officers, and effecting recapitalizations of our equity, which could have a material impact on mergers, acquisitions, consolidations and the sale of all or substantially all of our assets, and also the power to prevent or cause a change in control. The interests of our Chairman may differ from the interests of the other stockholders.

ITEM 4. CONTROLS AND PROCEDURES.

Evaluation of Disclosure Controls and Procedures. As required by Rule 13a-15 under the Securities Exchange Act of 1934 (the Exchange Act"), we carried out an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures within the 90 days prior to the filing date of this report. This evaluation was carried out under the supervision and with the participation of the Company s Chief Executive Officer, Chief Financial Officer and Compliance Officer, Mr. Steven Peacock. Based upon that evaluation, Steven Peacock concluded that our disclosure controls and procedures are effective in timely alerting management to material information relating to us and required to be included in our periodic SEC filings. There have been no significant changes in our internal controls or in other factors that could significantly affect internal controls subsequent to the date we carried out our evaluation.

Disclosure controls and procedures are controls and other procedures that are designed to ensure that information required to be disclosed in our reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in our reports filed under the Exchange Act is accumulated and communicated to management, including our Chief Executive Officer, Chief Compliance Officer and Chief Financial Officer, to allow timely decisions regarding required disclosures.

PART II.

Other Information

Item 1. Legal Proceedings

None

Item 2. Changes in Securities

During the quarter ended December 31, 2005, the Company issued 4,000,000 shares of common stock for cash of $57,056. These shares were issued exempt from registration under Regulation E of the Securities Act of 1933.

Item 3. Defaults Upon Senior Securities

None

Item 4. Submission of Matters to Vote of Security Holders

None

Item 5. Other Information

None

Item 6. Exhibits

The following exhibits are filed as part of this statement:

The exhibits listed below are required by Item 601 of Regulation S-K.

Exhibit No.	**Description**	**Location**
3.1	Articles of Incorporation	*

3.2	Bylaws	*
14	Code of Ethics adopted December 23,2004	**
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	***
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	***
32.1	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	***
32.2	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	***
99(i)	Audit Committee Charter adopted December 23, 2004	**
99.2(ii)	Investment Committee Charter adopted December 23, 2004	**

* Incorporated by reference from Franchise Capital Corporation's Registration Statement on Form SB-2 filed on October 29, 2001.

** Incorporated by reference from Franchise Capital Corporation s Annual Report on Form 10-K for the Fiscal Year Ended June 30, 2005 filed on September 30, 2005.

*** Filed herewith.

SIGNATURE PAGE

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Dated: April 16, 2007

/s/ Steven Peacock
Steven Peacock
Chief Executive Officer

EXHIBIT 31.1

SECTION 302

CERTIFICATION OF CHIEF EXECUTIVE OFFICER

I, Steven Peacock, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Franchise Capital Corporation;

(2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

(3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

(4) The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

(5) The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: April 16, 2007

By*: /s/ Steven Peacock*

Steven Peacock, Chief Executive Officer

EXHIBIT 31.2

SECTION 302

CERTIFICATION OF CHIEF FINANCIAL OFFICER

I, Steven Peacock, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Franchise Capital Corporation;

(2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

(3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

(4) The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

(5) The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: April 16, 2007 *By: /s/ Steven Peacock*

Steven Peacock, Chief Financial Officer

EXHIBIT 32.1

CERTIFICATION PURSUANT TO

18 U.S.C. SECTION 1350,

AS ADOPTED PURSUANT TO

SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Franchise Capital Corporation (the "Company") on Form 10-Q for the period ending December 31, 2005, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Steven Peacock, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to the best of my knowledge and belief:

(1) the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of the operation of the Company.

/s/ Steven Peacock

Steven Peacock

Chief Executive Officer

April 16, 2007

EXHIBIT 32.2

CERTIFICATION PURSUANT TO

18 U.S.C. SECTION 1350,

AS ADOPTED PURSUANT TO

SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Franchise Capital Corporation (the "Company") on Form 10-Q for the period ending December 31, 2005, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Steven Peacock, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to the best of my knowledge and belief:

(1) the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of the operation of the Company.

/s/ Steven Peacock

Steven Peacock

Chief Financial Officer

April 16, 2007

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font-size: 8pt" valign="bottom">(in millions) **2007 (reduced) Payments of Discount Impact 2007**

Labour liability for terminations and severances	$187.4	(12.8)	(46.8)	6.1	(4.7)	$129.2
Other non-labour liabilities for exit plans	1.4	(0.2)	(0.2)		(0.2)	0.8
Total restructuring liability	**188.8**	**(13.0)**	**(47.0)**	**6.1**	**(4.9)**	**130.0**
Environmental remediation program	120.2	7.5	(14.0)		(9.7)	104.0
Total restructuring and environmental remediation liability	**$309.0**	**(5.5)**	**(61.0)**	**6.1**	**(14.6)**	**$234.0**

Year ended December 31, 2006

(in millions)	**Opening Balance Jan. 1 2006**	**Accrued (reduced)**	**Payments**	**Amortization of Discount**	**Foreign Exchange Impact**	**Closing Balance Dec. 31 2006**
Labour liability for terminations and severances	$ 263.6	(14.1)	(71.8)	9.8	(0.1)	187.4
Other non-labour liabilities for exit plans	5.8	0.7	(5.0)	0.1	(0.2)	1.4
Total restructuring liability	**269.4**	**(13.4)**	**(76.8)**	**9.9**	**(0.3)**	**188.8**
Environmental remediation program	129.4	10.5	(19.5)		(0.2)	120.2
Total restructuring and environmental remediation liability	**$ 398.8**	**(2.9)**	**(96.3)**	**9.9**	**(0.5)**	**$ 309.0**

Amortization of Discount is charged to income as Other (Income) 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
DECEMBER 31, 2007
(unaudited)
9 Investments

(in millions)	For the year ended December 31 2007	2006
Rail investments accounted for on an equity basis	$ 1,528.6	$ 37.9
Other investments	140.0	27.0
Total investments	$ 1,668.6	$ 64.9

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

Effective October 4, 2007, the Company acquired all of the issued and outstanding shares of DM&E, a Class II railroad operating in the U.S. Midwest, for a purchase price of approximately US$1.5 billion, including acquisition costs.

Future contingent payments of up to US$1.05 billion, may become payable up to December 31, 2025, upon the achievement of certain milestones towards the completion of a track expansion into the Powder River Basin and the achievement of certain traffic volume targets. Any contingent payments that may be made would be recorded as additional goodwill. The acquisition has been financed with cash on hand and debt. On October 4, 2007, the Company drew down US$1.27 billion from an eighteen-month US$1.8 billion credit agreement entered into in October 2007 specifically to fund the acquisition of DM&E. The credit facility bears interest at a variable rate based on London Interbank Offered Rate (LIBOR).

The purchase is subject to review and approval by the U.S. Surface Transportation Board (STB), during which time the shares of DM&E have been placed in a voting trust and are administered by an independent trustee. The Company anticipates that the STB will complete its review and provide a final ruling in 2008. During the review period, the investment in the DM&E is accounted for on an equity basis. Equity income for the three months ended and year ended December 31, 2007, of $12.3 million (2006 nil) has been included in Other (Income) Charges (See Note 4)

If the proposed transaction is approved by the STB, the acquisition will be accounted for prospectively using the purchase method of accounting. Under this method, the Company will prepare its consolidated financial statements reflecting a line-by-line consolidation of DM&E and the allocation of the purchase price to acquire DM&E to the fair values of their assets and liabilities.

Asset-backed Commercial Paper (ABCP)

At December 31, 2007, the Company held Canadian third party asset-backed commercial paper (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 Dominion Bond Rating Service (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 assets within 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 that they had agreed 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 market 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. The ABCP in which the Company has invested continues to be rated R1 (High, Under Review with Developing Implications) by DBRS.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2007
(unaudited)
9 Investments (continued)

Through to January 31, 2008, a Standstill Agreement is in place that commits investors not to take any action that would precipitate an event of default. It is expected that the restructuring of the ABCP will occur in March 2008 if approval by investors is obtained to do so. This approval will be requested on a trust by trust basis most likely during February 2008.

On December 23, 2007, the pan-Canadian restructuring committee provided certain details about the expected 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 long-term floating rate notes that are expected to receive a AAA credit rating;

$119.0 million is represented by a combination of leveraged collaterized debt, synthetic assets and traditional securitized assets and the Company will, on restructuring, receive replacement senior and subordinated long-term floating rate notes. The senior notes are expected to obtain a AAA rating while the subordinated notes are likely to be unrated; and

$12.1 million is represented by assets that have an exposure to US sub-prime mortgages. On restructuring, the Company is likely to receive long-term floating rate notes that may be rated, although at this time the pan-Canadian restructuring committee has provided no indication of the likely rating these notes may receive.

The valuation technique used by the Company to estimate the fair value of its investment in ABCP at December 31, 2007, 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 public statements made by the pan-Canadian restructuring committee that it expects the ABCP will be converted into various long-term floating rate notes, as discussed above, with maturities matching the maturities of the underlying assets and bearing market interest rates commensurate with the nature of the underlying assets and their associated cash flows and the credit rating and risk 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	4.6 per cent
Weighted average discount rate	5.3 per cent
Maturity of long-term floating rate notes	five to seven years
Credit losses	nil to 25 per cent on a going concern basis
	5 per cent to 50 per cent on a liquidation basis

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.

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

One of the probable 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.

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NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2007
(unaudited)

9 Investments (continued)

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

Based on additional information that became publicly available during the fourth quarter of 2007, the probability weighted cash flows resulted in an estimated fair value of the Company s investment in ABCP of $122.1 million at December 31, 2007. This was unchanged from the estimated fair value at September 30, 2007. The reduction in the fair value of $21.5 million compared to the original cost of the ABCP was recorded as a charge to income in the third quarter of 2007 with no further charges required in the fourth quarter of 2007.

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.

10 Long-term debt

During the year ended December 31, 2007, the Company issued US$450 million of 5.95% 30 - year notes. The notes are unsecured, but carry a negative pledge.

Also, during October 2007, the Company entered into an eighteen-month US$1.80 billion credit agreement. The credit facility bears interest at a variable rate based on London Interbank Offered Rate (LIBOR), and is unsecured. As at December 31, 2007, the Company had drawn down US$1.27 billion from the credit facility specifically to fund the acquisition of DM&E.

11 Shareholders equity

An analysis of Common Share balances is as follows:

(millions of shares)	For the three months ended December 31 2007	2006	For the year ended December 31 2007	2006
Share capital, beginning of period	153.2	155.9	155.5	158.2
Shares issued under stock option plans	0.1	0.5	1.0	2.3
Shares purchased		(0.9)	(3.2)	(5.0)
Share capital, end of period	153.3	155.5	153.3	155.5

In June 2006, the Company completed the acquisition of Common Shares under the previous normal course issuer bid and filed a new normal course issuer bid to purchase, for cancellation, up to 3.9 million of its outstanding Common Shares. Under this filing, share purchases could have been made during the 12-month period beginning June 6, 2006, and ending June 5, 2007. Of the 3.9 million shares authorized for purchase under this filing, 3.4 million were purchased in 2006 at an average price per share of $56.66 and 0.2 million shares were purchased during the three month period ended March 31, 2007, at an average price per share of $64.11.

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11 Shareholders equity (continued)

In March 2007, the Company completed the filing for a new normal course issuer bid (2007 NCIB) to cover the period of March 28, 2007 to March 27, 2008, to authorize the purchase, for cancellation, up to 5.0 million of its outstanding Common Shares. Effective April 30, 2007, the 2007 NCIB was amended to authorize the purchase, for cancellation, up to 15.3 million of its outstanding Common Shares. Of the 15.3 million shares authorized under the 2007 NCIB, 2.7 million shares were purchased at an average price per share of $73.64.

In addition, pursuant to a notice of intention to make an exempt issuer bid filed on March 23, 2007, the Company purchased, for cancellation, 0.3 million shares through a private agreement with an arm s length third party on March 29, 2007, at an average price of $63.12.

For the three months ended December 31, 2007, there were no shares purchased (2006 0.9 million shares were purchased at an average price per share of $63.85) and for the year ended December 31, 2007, 3.2 million shares were purchased at an average price per share of $71.99 (2006 5.0 million shares were purchased at an average price per share of $57.28).

The 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 first to contributed surplus and then 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
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12 Other comprehensive income and accumulated other comprehensive income

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

	For the three months ended December 31 2007		
(in millions)	Before tax amount	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	$ 3.5	$ 0.7	$ 4.2
Unrealized foreign exchange loss on translation of the net investment in U.S. subsidiaries	(7.0)		(7.0)
Realized gain on cash flow hedges settled in the period	(1.6)	0.9	(0.7)
Decrease in unrealized holding gains on cash flow hedges	(17.0)	5.9	(11.1)
Realized loss on cash flow hedges settled in prior periods	0.7	(0.3)	0.4
Other comprehensive loss	$ (21.4)	$ 7.2	$ (14.2)

	For the three months ended December 31 2006		
(in millions)	Before tax amount	Income tax 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	$ (23.6)	$ 3.7	$ (19.9)
Unrealized foreign exchange gain on translation of the net investment in U.S. subsidiaries	22.5		22.5
Other comprehensive income	$ (1.1)	$ 3.7	$ 2.6

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
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12 Other comprehensive income and accumulated other comprehensive income (continued)

	For the year ended December 31 2007		
(in millions)	Before tax amount	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	$ 71.0	$ (9.7)	$ 61.3
Unrealized foreign exchange loss on translation of the net investment in U.S. subsidiaries	(78.4)		(78.4)
Realized gain on cash flow hedges settled in the period	(12.8)	4.8	(8.0)
Decrease in unrealized holding gains on cash flow hedges	(26.2)	9.1	(17.1)
Realized loss on cash flow hedges settled in prior periods	2.2	(0.8)	1.4
Other comprehensive loss	$ (44.2)	$ 3.4	$ (40.8)

	For the year ended December 31 2006		
(in millions)	Before tax amount	Income tax 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	$ (3.7)	$ 0.5	$ (3.2)
Unrealized foreign exchange gain on translation of the net investment in U.S. subsidiaries	2.1		2.1
Other comprehensive loss	$ (1.6)	$ 0.5	$ (1.1)

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
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12 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 December 31, 2007

(in millions)	**Opening Balance, Oct. 1, 2007**	**Period change**	**Closing Balance, Dec. 31, 2007**
Foreign exchange on U.S. dollar debt designated as a hedge of the net investment in U.S. subsidiaries	$ 292.4	$ 4.2	$ 296.6
Foreign exchange on net investment in U.S. subsidiaries	(239.9)	(7.0)	(246.9)
Increase (decrease) in unrealized effective gains of cash flow hedges	5.6	(11.8)	(6.2)
Unrealized loss on settled hedge instruments	(4.3)	0.4	(3.9)
Accumulated other comprehensive income	$ 53.8	$ (14.2)	$ 39.6

Three months ended December 31, 2006

(in millions)	**Opening Balance, Oct. 1, 2006**	**Period change**	**Closing Balance, Dec. 31, 2006**
Foreign exchange on U.S. dollar debt designated as a hedge of the net investment in U.S. subsidiaries	$ 254.8	$ (19.9)	$ 234.9
Foreign exchange on net investment in U.S. subsidiaries	(191.0)	22.5	(168.5)
Accumulated other comprehensive income	$ 63.8	$ 2.6	$ 66.4

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
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12 Other comprehensive income and accumulated other comprehensive income (continued)

Year ended December 31, 2007

(in millions)	**Opening Balance, Jan. 1, 2007**	**Adjustment for change in accounting policy**	**Adjusted Opening Balance, Jan. 1, 2007**	**Period change**	**Closing Balance, Dec. 31, 2007**
Foreign exchange on U.S. dollar debt designated as a hedge of the net investment in U.S. subsidiaries	$ 234.9	$ 0.4	$ 235.3	$ 61.3	$ 296.6
Foreign exchange on net investment in U.S. subsidiaries	(168.5)		(168.5)	(78.4)	(246.9)
Increase (decrease) in unrealized effective gains of cash flow hedges		18.9	18.9	(25.1)	(6.2)
Unrealized loss on settled hedge instruments		(5.3)	(5.3)	1.4	(3.9)
Accumulated other comprehensive income	$ 66.4	$ 14.0	$ 80.4	$ (40.8)	$ 39.6

Year ended December 31, 2006

(in millions)	**Opening Balance, Jan. 1, 2006**	**Period change**	**Closing Balance, Dec. 31, 2006**
Foreign exchange on U.S. dollar debt designated as a hedge of the net investment in U.S. subsidiaries	$ 238.1	$ (3.2)	$ 234.9
Foreign exchange on net investment in U.S. subsidiaries	(170.6)	2.1	(168.5)
Accumulated other comprehensive income	$ 67.5	$ (1.1)	$ 66.4

During the next twelve months, the Company expects $10.9 million of unrealized holding gains on derivative instruments to be realized and recognized in the Statement of Consolidated Income. Derivative instruments designated as cash flow hedges will mature during the year ending December 31, 2009.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
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13 Fair value of financial instruments

The fair value of a financial instrument is the amount of consideration that would be agreed upon in an arm s 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 included in the Consolidated Balance Sheet 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 determined using discounted cash flow analysis using observable market based inputs.

Financial liabilities
Accounts payable and accrued liabilities and short-term borrowings The carrying amounts included in the Consolidated Balance Sheet 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 determined using the quoted market prices for the same or similar debt instruments.

Available for sale
Investments The Company s equity investments recorded on a cost basis have a carrying value that equals cost as fair value cannot be reliably established. The Company s equity investments recorded on an equity basis have a carrying value equal to cost plus the Company s share of the investees net income, less any dividends received, which approximates fair value. These investments are not traded on a liquid market.

Held for trading
Other assets and deferred charges and Deferred liabilities 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 the same or similar instruments and changes in the fair values of such derivative instruments are recognized in net income as they arise.

Cash and cash equivalents The carrying amounts included in the Consolidated Balance Sheet approximate fair value because of the short maturity of these instruments.

Investments 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 9).

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 $4,177.2 million and a fair value of approximately $4,308.3 million at December 31, 2007.

14 Reductions in investments and other assets

Reductions in investments and other assets includes the acquisition of freight car assets which were purchased in anticipation of a sale and lease back arrangement with a financial institution. For the three months ended December 31, 2007, $4.7 million in assets were acquired and $19.2 million were sold; and for the year ended December 31, 2007, $19.2 million in assets were acquired and $20.2 million sold. For the three months ended December 31, 2006, $4.6 million in assets were acquired and $26.7 million were sold; and for the year ended December 31, 2006, $137.1 million in assets were acquired and $136.1 million sold. No gains or losses were incurred in these sale and leaseback arrangements.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
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15 Stock-based compensation

In 2007, under CP s stock option plans, the Company issued 1,304,500 options to purchase Common Shares at the weighted average price of $62.60 per share, based on the closing price on the day prior to the grant date. In tandem with these options, 434,400 stock appreciation rights were issued at the weighted average exercise price of $62.60.

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 December 31 (including options granted under the Directors Stock Option Plan, which was suspended in 2003):

	2007			2006		
	Number of options		Weighted average exercise price	Number of options		Weighted average exercise price
Outstanding, January 1	6,807,644	$	38.50	7,971,917	$	32.07
New options granted	1,304,500		62.60	1,467,900		57.80
Exercised	(972,281)		31.99	(2,330,664)		28.59
Forfeited/cancelled	(158,755)		35.76	(301,509)		39.07
Outstanding, December 31	6,981,108	$	43.97	6,807,644	$	38.50
Options exercisable at December 31	4,035,008	$	34.12	2,918,294	$	29.64

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 $11.3 million for options issued during the year ended December 31, 2007 (year ended December 31, 2006 $12.4 million). The weighted average fair value assumptions were approximately:

	For the year ended December 31	
	2007	2006
Expected option life (years)	4.00	4.50
Risk-free interest rate	3.90%	4.07%

Expected stock price volatility	22%	22%
Expected annual dividends per share	$ 0.90	$ 0.75
Weighted average fair value of options granted during the year	$ 12.97	$ 12.99

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
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16 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 December 31, 2007, was $26.4 million (three months ended December 31, 2006 $30.3 million) and for the year ended December 31, 2007, was $95.0 million (year ended December 31, 2006 $119.0 million).

17 Significant customers

During the year ended 2007, one customer comprised 11.5% of total revenue (year ended 2006 11.5%). At December 31, 2007, that same customer represented 6.2% of total accounts receivable (December 31, 2006 5.6%).

18 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 December 31, 2007, 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.

Capital commitments

At December 31, 2007, the Company had multi-year capital commitments of $504.2 million, mainly for locomotive overhaul agreements, in the form of signed contracts. Payments for these commitments are due in 2008 through 2016.

Operating lease commitments

At December 31, 2007, minimum payments under operating leases were estimated at $614.9 million in aggregate, with annual payments in each of the next five years of: 2008 $120.3 million; 2009 $86.8 million; 2010 $68.9 million; 2011 $60.9 million; 2012 $58.0 million.

Guarantees

The Company had residual value guarantees on operating lease commitments of $321.7 million at December 31, 2007. 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 December 31, 2007, these accruals amounted to $7.0 million.

Summary of Rail Data

Fourth Quarter 2007	Fourth Quarter 2006	Variance	%		Year 2007	Year 2006	Variance	%
				Financial (millions, except per share data and ratios)				
				Revenues				
$1,142.6	$1,151.5	$ (8.9)	(0.8)	Freight revenue	$4,555.2	$4,427.3	$ 127.9	2.9
45.7	38.9	6.8	17.5	Other revenue	152.4	155.9	(3.5)	(2.2)
1,188.3	1,190.4	(2.1)	(0.2)		4,707.6	4,583.2	124.4	2.7
				Operating Expenses				
308.4	322.2	(13.8)	(4.3)	Compensation and benefits	1,284.2	1,327.6	(43.4)	(3.3)
196.3	171.2	25.1	14.7	Fuel	746.8	650.5	96.3	14.8
47.9	53.7	(5.8)	(10.8)	Materials	215.5	212.9	2.6	1.2
45.1	47.8	(2.7)	(5.6)	Equipment rents	207.5	181.2	26.3	14.5
116.3	115.9	0.4	0.3	Depreciation and amortization	472.0	464.1	7.9	1.7
168.8	159.5	9.3	5.8	Purchased services and other	617.4	618.3	(0.9)	(0.1)
882.8	870.3	12.5	1.4		3,543.4	3,454.6	88.8	2.6
305.5	320.1	(14.6)	(4.6)	Operating income	1,164.2	1,128.6	35.6	3.2
(3.8)	6.4	(10.2)		Other (income) charges, including DM&E equity income [(1)]	17.3	27.8	(10.5)	(37.8)
63.4	49.8	13.6	27.3	Interest expense	204.3	194.5	9.8	5.0
60.8	82.9	(22.1)	(26.7)	Income tax expense before foreign exchange (gains) losses on long-term debt and other specified items [(2)]	269.8	278.8	(9.0)	(3.2)
185.1	181.0	4.1	2.3	Income before foreign exchange (gains) losses on long-term debt and	672.8	627.5	45.3	7.2

				other specified items (2)				
				Foreign exchange (gains) losses on long-term debt (FX on LTD)				
(8.3)	44.9	(53.2)		FX on LTD	(169.8)	0.1	(169.9)	
(3.1)	(9.5)	6.4		Income tax on FX on LTD (3)	44.3	7.1	37.2	
(11.4)	35.4	(46.8)		FX on LTD (net of tax)	(125.5)	7.2	(132.7)	
				Other specified items				
				Change in estimated fair value of Canadian third party asset-backed commercial paper (ABCP)	21.5		21.5	
				Income tax on change in estimated fair value of ABCP	(6.5)		(6.5)	
				Change in estimated fair value of ABCP (net of tax)	15.0		15.0	
(145.8)		(145.8)		Income tax benefits due to rate reductions on opening future income tax balances	(162.9)	(176.0)	13.1	
$ 342.3	$ 145.6	$ 196.7	135.1	Net income	$ 946.2	$ 796.3	$ 149.9	18.8
				Earnings per share (EPS)				
$ 2.23	$ 0.93	$ 1.30	139.8	Basic earnings per share	$ 6.14	$ 5.06	$ 1.08	21.3
$ 2.21	$ 0.92	$ 1.29	140.2	Diluted earnings per share	$ 6.08	$ 5.02	$ 1.06	21.1
				EPS before FX on LTD and other				

				specified items (2)				
$ 1.21	$ 1.16	$ 0.05	4.3	Basic earnings per share	$ 4.37	$ 3.99	$ 0.38	9.5
$ 1.20	$ 1.15	$ 0.05	4.3	Diluted earnings per share	$ 4.32	$ 3.95	$ 0.37	9.4
153.2	155.8	(2.6)	(1.7)	Weighted average (avg)number of shares outstanding (millions)	154.0	157.3	(3.3)	(2.1)
154.6	157.4	(2.8)	(1.8)	Weighted avg number of diluted shares outstanding (millions)	155.6	158.8	(3.2)	(2.0)
74.3	73.1	1.2		Operating ratio (2) (4) (%)	75.3	75.4	(0.1)	
9.5	10.2	(0.7)		ROCE before FX on LTD and other specified items (after tax)(2) (4)(%)	9.5	10.2	(0.7)	
42.5	37.2	5.3		Net debt to net debt plus equity (%)	42.5	37.2	5.3	
$ 309.3	$ 313.7	$ (4.4)	(1.4)	EBIT before FX on LTD and other specified items (2) (4)	$1,146.9	$1,100.8	$ 46.1	4.2
$ 425.6	$ 429.6	$ (4.0)	(0.9)	EBITDA before FX on LTD and other specified items (2) (4)	$1,618.9	$1,564.9	$ 54.0	3.5

(1) Dakota, Minnesota & Eastern Railroad Corporation (DM&E) equity income is $12.3 million, net of tax.

(2) 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.

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

(4)	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.

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Summary of Rail Data (Page 2)

Fourth Quarter 2007	2006	Variance	%		Year 2007	2006	Variance	%
				Commodity Data				
				Freight Revenues (millions)				
$ 257.5	$ 261.6	$ (4.1)	(1.6)	- Grain	$ 938.9	$ 904.6	$ 34.3	3.8
131.2	149.3	(18.1)	(12.1)	- Coal	573.6	592.0	(18.4)	(3.1)
121.2	122.0	(0.8)	(0.7)	- Sulphur and fertilizers	502.0	439.3	62.7	14.3
61.5	71.2	(9.7)	(13.6)	- Forest products	275.8	316.4	(40.6)	(12.8)
157.9	148.5	9.4	6.3	- Industrial and consumer products	627.9	603.8	24.1	4.0
77.0	74.9	2.1	2.8	- Automotive	319.0	314.4	4.6	1.5
336.3	324.0	12.3	3.8	- Intermodal	1,318.0	1,256.8	61.2	4.9
$1,142.6	$1,151.5	$ (8.9)	(0.8)	Total Freight Revenues	$ 4,555.2	$ 4,427.3	$ 127.9	2.9
				Millions of Revenue Ton-Miles (RTM)				
8,283	8,463	(180)	(2.1)	- Grain	30,690	30,127	563	1.9
4,812	4,986	(174)	(3.5)	- Coal	20,629	19,650	979	5.0
5,202	5,065	137	2.7	- Sulphur and fertilizers	21,259	17,401	3,858	22.2
1,673	1,930	(257)	(13.3)	- Forest products	7,559	8,841	(1,282)	(14.5)
4,449	4,030	419	10.4	- Industrial and consumer products	16,987	16,844	143	0.8
621	572	49	8.6	- Automotive	2,471	2,450	21	0.9
7,500	7,009	491	7.0	- Intermodal	29,757	27,561	2,196	8.0
32,540	32,055	485	1.5	Total RTMs	129,352	122,874	6,478	5.3
				Freight Revenue per RTM (cents)				
3.11	3.09	0.02	0.6	- Grain	3.06	3.00	0.06	2.0
2.73	2.99	(0.26)	(8.7)	- Coal	2.78	3.01	(0.23)	(7.6)

2.33	2.41	(0.08)	(3.3)	- Sulphur and fertilizers	2.36	2.52	(0.16)	(6.3)
3.68	3.69	(0.01)	(0.3)	- Forest products	3.65	3.58	0.07	2.0
3.55	3.68	(0.13)	(3.5)	- Industrial and consumer products	3.70	3.58	0.12	3.4
12.40	13.09	(0.69)	(5.3)	- Automotive	12.91	12.83	0.08	0.6
4.48	4.62	(0.14)	(3.0)	- Intermodal	4.43	4.56	(0.13)	(2.9)
3.51	3.59	(0.08)	(2.2)	Freight Revenue per RTM	3.52	3.60	(0.08)	(2.2)
				Carloads (thousands)				
103.6	105.0	(1.4)	(1.3)	- Grain	385.0	382.8	2.2	0.6
64.9	68.6	(3.7)	(5.4)	- Coal	269.1	281.7	(12.6)	(4.5)
50.7	48.7	2.0	4.1	- Sulphur and fertilizers	209.8	178.3	31.5	17.7
26.0	30.7	(4.7)	(15.3)	- Forest products	114.1	135.0	(20.9)	(15.5)
80.4	77.1	3.3	4.3	- Industrial and consumer products	313.3	316.0	(2.7)	(0.9)
41.8	39.8	2.0	5.0	- Automotive	168.5	165.3	3.2	1.9
315.1	292.9	22.2	7.6	- Intermodal	1,238.1	1,159.0	79.1	6.8
682.5	662.8	19.7	3.0	Total Carloads	2,697.9	2,618.1	79.8	3.0
				Freight Revenue per Carload				
$ 2,486	$ 2,491	$ (5)	(0.2)	- Grain	$ 2,439	$ 2,363	$ 76	3.2
2,022	2,176	(154)	(7.1)	- Coal	2,132	2,102	30	1.4
2,391	2,505	(114)	(4.6)	- Sulphur and fertilizers	2,393	2,464	(71)	(2.9)
2,365	2,319	46	2.0	- Forest products	2,417	2,344	73	3.1
1,964	1,926	38	2.0	- Industrial and consumer products	2,004	1,911	93	4.9
1,842	1,882	(40)	(2.1)	- Automotive	1,893	1,902	(9)	(0.5)
1,067	1,106	(39)	(3.5)	- Intermodal	1,065	1,084	(19)	(1.8)
$ 1,674	$ 1,737	$ (63)	(3.6)	Freight Revenue per Carload	$ 1,688	$ 1,691	$ (3)	(0.2)

Summary of Rail Data (Page 3)

Fourth Quarter 2007	2006	Variance	%		Year 2007	2006	Variance	%
				Operations and Productivity				
62,104	62,190	(86)	(0.1)	Freight gross ton-miles (GTM) (millions)	246,322	236,405	9,917	4.2
32,540	32,055	485	1.5	Revenue ton-miles (RTM) (millions)	129,352	122,874	6,478	5.3
15,801	15,821	(20)	(0.1)	Average number of active employees	15,675	15,947	(272)	(1.7)
15,382	15,327	55	0.4	Number of employees at end of period	15,382	15,327	55	0.4
2.3	2.4	(0.1)	(4.2)	FRA personal injuries per 200,000 employee-hours (1)	2.1	2.0	0.1	5.0
1.6	1.9	(0.3)	(15.8)	FRA train accidents per million train-miles (1)	2.0	1.6	0.4	25.0
2.71	2.72	(0.01)	(0.4)	Total operating expenses per RTM (cents)	2.74	2.81	(0.07)	(2.5)
1.42	1.40	0.02	1.4	Total operating expenses per GTM (cents)	1.44	1.46	(0.02)	(1.4)
0.50	0.52	(0.02)	(3.8)	Compensation and benefits expense per GTM (cents)	0.52	0.56	(0.04)	(7.1)
3,930	3,931	(1)		GTMs per average active employee (000)	15,714	14,824	890	6.0
13,199	13,260	(61)	(0.5)	Miles of road operated at end of period (2)	13,199	13,260	(61)	(0.5)
22.6	24.1	(1.5)	(6.2)	Average train speed AAR definition (mph)	23.2	24.8	(1.6)	(6.5)
23.3	21.7	1.6	7.4	Terminal dwell time AAR definition (hours)	22.2	20.8	1.4	6.7

140.0	141.7	(1.7)	(1.2)	Car miles per car day	142.3	137.3	5.0	3.6
83.9	80.6	3.3	4.1	Average daily total cars on-line AAR definition (000)	82.0	80.9	1.1	1.4
1.23	1.20	0.03	2.5	U.S. gallons of locomotive fuel per 1,000 GTMs freight & yard	1.21	1.20	0.01	0.8
75.7	74.3	1.4	1.9	U.S. gallons of locomotive fuel consumed total (millions) (3)	296.7	283.4	13.3	4.7
1.020	0.887	0.133	15.0	Average foreign exchange rate (US$/Canadian$)	0.925	0.885	0.040	4.5
0.980	1.128	(0.148)	(13.1)	Average foreign exchange rate (Canadian$/US$)	1.081	1.130	(0.049)	(4.3)

(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.