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

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 6-K
Report of Foreign Issuer
Pursuant to Rule 13a-16 or 15d-16 of
the Securities Exchange Act of 1934
For the month of July, 2008
CANADIAN PACIFIC RAILWAY LIMITED
(Commission File No. 1-01342)
CANADIAN PACIFIC RAILWAY COMPANY
(Commission File No. 1-15272)
(translation of each Registrant s name into English)
Suite 500, Gulf Canada Square, 401 9th Avenue, S.W., Calgary, Alberta, Canada, T2P 4Z4
(address of principal executive offices)

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

Form 20-F o Form 40-F x

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

Yes o No x

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

The interim financial statements, Management s Discussion and Analysis, and updated earnings coverage calculations included in this Report furnished on Form 6-K shall be incorporated by reference into, or as an exhibit to, as applicable, each of the following Registration Statements under the Securities Act of 1933 of the registrant: Form S-8 No. 333-140955 (Canadian Pacific Railway Limited), Form S-8 No. 333-127943 (Canadian Pacific Railway Limited), Form S-8 No. 333-13962 (Canadian Pacific Railway Limited), and Form F-9 No. 333-142347 (Canadian Pacific Railway Company).

SIGNATURES

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

CANADIAN PACIFIC RAILWAY LIMITED
CANADIAN PACIFIC RAILWAY COMPANY
(Registrants)

Date: July 22, 2008

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

Canadian Pacific
Management s Discussion and Analysis
Second Quarter Report 2008

Release: Immediate, July 22nd, 2008

CANADIAN PACIFIC ANNOUNCES ITS SECOND-QUARTER RESULTS

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

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

Total revenues were essentially flat at $1.22 billion

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

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

Operating ratio was 79.4 per cent compared with 74.7 per cent

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

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

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

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

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

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

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

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

Income decreased to $267 million from $297 million.

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

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

2008 OUTLOOK

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Presentation of non-GAAP earnings

CP presents non-GAAP earnings in this news release to provide a basis for evaluating underlying earnings and liquidity trends in its business that can be compared with prior periods results of operations. These non-GAAP earnings exclude foreign currency translation impacts on long-term debt, which can be volatile and short term, and other specified items, which are not among CP s normal ongoing revenues and operating expenses. The impact of volatile short-term rate fluctuations on foreign-denominated debt is only realized when long-term debt matures or is settled. A reconciliation of income, excluding foreign exchange gains and losses on long-term debt and other specified items, to net income as presented in the financial statements is detailed in the attached Summary of Rail Data. Diluted EPS, excluding foreign exchange gains and losses on long-term debt and other specified items, is also referred to in this news release as adjusted diluted EPS .

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

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

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

Note on forward-looking information

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

By its nature, CP s forward-looking information involves numerous assumptions, inherent risks and uncertainties, including but not limited to the following factors: changes in business strategies; general North American and global economic and business conditions; risks in agricultural production such as weather conditions and insect populations; the availability and price of energy commodities; the effects of competition and pricing pressures; industry capacity; shifts in market demand; changes in laws and regulations, including regulation of rates; changes in taxes and tax rates; potential increases in maintenance and operating costs; uncertainties of litigation; labour disputes; risks and liabilities arising from derailments; timing of completion of capital and maintenance projects; currency and interest rate fluctuations; effects of changes in market conditions on the financial position of pension plans and investments; and various events that could disrupt operations, including severe weather conditions, security threats and governmental response to them, and technological changes.

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

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

Canadian Pacific, through the ingenuity of its employees located across Canada and in the United States, remains committed to being the safest, most fluid railway in North America. Our people are the key to delivering innovative transportation solutions to our customers and to ensuring the safe operation of our trains through the more than 900 communities where we operate. Our combined ingenuity makes CPR a better place to work, rail a better way to ship, and North America a better place to live. Come and visit us at www.cpr.ca to see how we can put our ingenuity to work for you. Canadian Pacific is proud to be the official rail freight services provider for the Vancouver 2010 Olympic and Paralympic Winter Games.

Contacts:

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

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

See notes to interim consolidated financial statements.

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

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

See notes to interim consolidated financial statements.

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

	For the three months ended June 30	
	2008	**2007**
	(unaudited)	
Comprehensive income		
Net income	$ 154.9	$ 256.7
Other comprehensive income		
Net change in foreign currency translation adjustments, net of hedging activities	(1.1)	(2.9)
Net change in gains on derivatives designated as cash flow hedges	16.7	(9.8)
Other comprehensive income (loss) before income taxes	15.6	(12.7)
Income tax expense	(5.3)	(2.0)
Other comprehensive income (loss) (*Note 13*)	10.3	(14.7)
Comprehensive income	$ 165.2	$ 242.0

	For the six months ended June 30	
	2008	**2007**
	(unaudited)	
Comprehensive income		
Net income	$ 245.7	$ 385.3
Other comprehensive income		
Net change in foreign currency translation adjustments, net of hedging activities	2.2	(3.2)
Net change in gains on derivatives designated as cash flow hedges	7.9	(13.0)
Other comprehensive income (loss) before income taxes	10.1	(16.2)
Income tax recovery (expense)	2.7	(1.3)

Other comprehensive income (loss) (*Note 13*)	12.8	(17.5)
Comprehensive income	$ 258.5	$ 367.8

See notes to interim consolidated financial statements.

CONSOLIDATED BALANCE SHEET
(in millions of Canadian dollars)

	June 30 2008	December 31 2007
	(unaudited)	
Assets		
Current assets		
Cash and cash equivalents	$ 80.9	$ 378.1
Accounts receivable and other current assets *(Note 9)*	681.3	542.8
Materials and supplies	199.5	179.5
Future income taxes	66.7	67.3
	1,028.4	1,167.7
Investments *(Note 10)*	1,717.6	1,668.6
Net properties	9,464.2	9,293.1
Other assets and deferred charges *(Note 15)*	1,468.0	1,235.6
Total assets	$ 13,678.2	$ 13,365.0
Liabilities and shareholders equity		
Current liabilities		
Short-term borrowing	$ 255.0	$ 229.7
Accounts payable and accrued liabilities	954.2	980.8
Income and other taxes payable	50.7	68.8
Dividends payable	38.1	34.5
Long-term debt maturing within one year	238.4	31.0
	1,536.4	1,344.8
Deferred liabilities	717.2	714.6
Long-term debt *(Note 11)*	4,016.8	4,146.2
Future income taxes	1,741.8	1,701.5
Shareholders equity		
Share capital *(Note 12)*	1,216.9	1,188.6
Contributed surplus	39.8	42.4
Accumulated other comprehensive income *(Note 13)*	52.4	39.6
Retained income	4,356.9	4,187.3

	5,666.0	5,457.9
Total liabilities and shareholders equity	$ 13,678.2	$ 13,365.0

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

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

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

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

See notes to interim consolidated financial statements.

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

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

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

See notes to interim consolidated financial statements.

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

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

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

See notes to interim consolidated financial statements.

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

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

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

See notes to interim consolidated financial statements.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2008
(unaudited)

1 Basis of presentation

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

CP s operations can be affected by seasonal fluctuations such as changes in customer demand and weather-related issues. This seasonality could impact quarter-over-quarter comparisons.

2 New accounting changes

Financial Instrument and Capital Disclosures

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

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

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

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

Inventories

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

3 Future accounting changes

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

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

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2008
(unaudited)

4 Other charges

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

5 Interest expense

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

6 Income taxes

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

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

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7 Earnings per share

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

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

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

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

	For the three months ended June 30		For the six months ended June 30	
(in millions)	**2008**	**2007**	**2008**	**2007**
Weighted average shares outstanding	153.7	154.3	153.6	154.9
Dilutive effect of stock options	1.4	1.8	1.4	1.5
Weighted average diluted shares outstanding	155.1	156.1	155.0	156.4
(in dollars)				
Basic earnings per share	$ 1.01	$ 1.66	$ 1.60	$ 2.49
Diluted earnings per share	$ 1.00	$ 1.64	$ 1.59	$ 2.46

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

8 Restructuring and environmental remediation

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

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

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8 Restructuring and environmental remediation (continued)

Three months ended June 30, 2008

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

Three months ended June 30, 2007

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

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

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8 Restructuring and environmental remediation (continued)

Six months ended June 30, 2008

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

Six months ended June 30, 2007

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

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

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

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9 Accounts Receivable

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

10 Investments

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

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

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

Canadian Third Party Asset-backed Commercial Paper (ABCP)

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

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

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

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

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10 Investments (continued)

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

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

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

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

Class A-1: $59.7 million

Class A-2: $46.5 million

Class B: $8.0 million

Class C: $3.5 million

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

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

The valuation technique used by the Company to estimate the fair value of its investment in ABCP at June 30, 2008, incorporates probability weighted discounted cash flows considering the best available public information regarding market conditions and other factors that a market participant would consider for such investments. The assumptions used in determining the estimated fair value reflect the details included in the Information Statement issued by the pan-Canadian restructuring committee and the risks associated with the long-term floating rate notes. The interest rates and maturities of the various long-term floating rate notes, discount rates and credit losses modelled are:

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

(1)

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

(2) Class B and Class C subordinated notes.

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

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

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

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10 Investments (continued)

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

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

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

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

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

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

11 Long-term debt

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

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12 Shareholders equity

An analysis of Common Share balances is as follows:

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

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

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

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
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13 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 June 30 2008		
(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	$ 8.0	$ (1.1)	$ 6.9
Unrealized foreign exchange loss on translation of the net investment in U.S. subsidiaries	(9.1)		(9.1)
Realized gain on cash flow hedges settled in the period	(6.0)	1.9	(4.1)
Decrease in unrealized holding losses on cash flow hedges	21.0	(6.6)	14.4
Realized loss on cash flow hedges settled in prior periods	1.7	0.5	2.2
Other comprehensive income (loss)	$ 15.6	$ (5.3)	$ 10.3

	For the three months ended June 30 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	$ 33.8	$ (5.2)	$ 28.6
Unrealized foreign exchange loss on translation of the net investment in U.S. subsidiaries	(36.7)		(36.7)
Realized gain on cash flow hedges settled in the period	(4.8)	1.5	(3.3)

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

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

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

	For the six months ended June 30 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	$ 37.7	$ (5.8)	$ 31.9
Unrealized foreign exchange loss on translation of the net investment in U.S. subsidiaries	(40.9)		(40.9)
Realized gain on cash flow hedges settled in the period	(8.1)	2.8	(5.3)
Decrease in unrealized holding gains on cash flow hedges	(6.5)	2.2	(4.3)

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

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

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

Three months ended June 30, 2008

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

Three months ended June 30, 2007

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

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

Six months ended June 30, 2008

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

Six months ended June 30, 2007

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

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

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

14 Financial instruments

The fair value of a financial instrument is the amount of consideration that would be agreed upon in an 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 approximate fair value because of the short maturity of these instruments.

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

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

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

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

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

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

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

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
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14 Financial instruments (continued)

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

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

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

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
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14 Financial instruments (continued)

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

Carrying value and fair value of financial instruments

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

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
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14 Financial instruments (continued)

Financial risk management

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

FRM objectives:

Maintaining sound financial condition as an ongoing entity;

Optimizing earnings per share and cash flow;

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

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

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

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

Measure the extent of operating risk within the business;

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

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

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

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

Risk factors

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

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

Foreign exchange risk

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

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

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

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
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14 Financial instruments (continued)

Foreign exchange management

In terms of net income, excluding FX on long-term debt, mitigation of U.S. dollar FX exposure is provided primarily through offsets created by revenues and expenses incurred in the same currency. Where appropriate the Company negotiates with U.S. customers and suppliers to reduce the net exposure. The Company may from time to time reduce residual exposure by hedging revenues through FX forward contracts. The Company had no revenue forward sales of U.S. dollars outstanding at June 30, 2008.

The FX gains and losses on long-term debt are mainly unrealized and can only be realized when U.S. dollar denominated long-term debt matures or is settled. The Company also has long term FX exposure on its investment in U.S. affiliates. A portion of the Company s U.S. dollar denominated long-term debt has been designated as a hedge of the net investment in self-sustaining foreign subsidiaries. This designation has the effect of mitigating volatility on net income by offsetting long-term FX gains and losses on long-term debt. In addition, for long-term debt denominated in U.S. dollars in Canada, the Company may enter into currency forwards to hedge debt that is denominated in U.S. dollars.

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

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

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

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

Foreign exchange forward contracts

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

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

Interest rate risk

This refers to the risk that the fair value or income and future cash flows of a financial instrument will vary as a result of changes in market interest rates.

In order to manage funding needs or capital structure goals, the Company enters into debt or capital lease agreements that are subject to either fixed market interest rates set at the time of issue or floating rates determined by on-going market conditions. Debt subject to variable interest rates exposes the Company to variability in interest expense, while debt subject to fixed interest rates exposes the Company to variability in the fair value of the debt.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
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14 Financial instruments (continued)

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

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

(1) Includes impact of interest rate swaps

Interest rate management

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

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

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

Note: All variables excluding interest rates are held constant.

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

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
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14 Financial instruments (continued)

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

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

Based on U.S. three-month LIBOR.

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

Stock-based compensation risk

This risk refers to the probability of increased compensation expense due to the increase in the Company s share price.

The Company s compensation expense is subject to volatility due to the movement of share price and its impact on the value of certain management and director stock-based compensation programs. These programs, as described in the management proxy circular, include deferred share units, restricted share units, performance share units and share appreciation rights. As the share price appreciates, these instruments are marked to market increasing compensation expense.

Stock-based compensation expense management

To minimize the volatility to compensation expense created by changes in share price, the Company entered into a Total Return Swap (TRS) to reduce the volatility and total cost to the Company over time of the four types of stock-based compensation programs noted above. These are derivatives that provide price appreciation and dividends, in return for a charge by the counterparty. The swaps minimize volatility to compensation expense by providing a gain to substantially offset increased compensation expense as the share price increases and a loss to offset reduced compensation expense when the share price falls. If stock-based compensation share units fall out of the money after entering the program, the loss associated with the swap would no longer be offset by any compensation expense reductions.

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

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

Note: All variables excluding share price are held constant.

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

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
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14 Financial instruments (continued)

Commodity risk

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

Fuel price management

The impact of variable fuel expense is mitigated substantially through fuel recovery programs which apportion incremental changes in fuel prices to shippers through price indices, tariffs, and, by contract, within agreed upon guidelines. While these programs provide effective and meaningful coverage, residual exposure remains as the fuel expense risk cannot be completely recovered from shippers due to timing and volatility in the market. The Company continually monitors residual exposure, and where appropriate, may enter into derivative instruments.

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

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

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

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

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

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

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

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
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14 Financial instruments (continued)

Credit risk

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

Credit risk management

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

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

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

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

Liquidity risk

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

Liquidity risk management

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

liquidity at levels that sustain an investment grade rating.

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

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14 Financial instruments (continued)

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

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

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

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

(in millions)	As at June 30, 2008			
		2009		
	2008	2011	2012+	Total
Financial liabilities				
Short-term borrowings	$ 255.0	$	$	$ 255.0
Accounts payable and accrued liabilities	782.9	42.6		825.5
Foreign exchange contracts on fuel	0.7	1.3		2.0
Currency forward		13.0		13.0
Long-term debt	32.5	1,193.9	3,642.4	4,868.8

15 Additions to investments and other assets

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

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16 Stock-based compensation

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

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

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

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

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

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

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

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

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
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17 Pensions and other benefits

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

18 Significant customers

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

19 Commitments and contingencies

In the normal course of its operations, the Company becomes involved in various legal actions, including claims relating to injuries and damages to property. The Company maintains provisions it considers to be adequate for such actions. While the final outcome with respect to actions outstanding or pending at June 30, 2008, cannot be predicted with certainty, it is the opinion of management that their resolution will not have a material adverse effect on the Company s financial position or results of operations.

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

Capital commitments

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

Operating lease commitments

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

Guarantees

At June 30, 2008, the Company had residual value guarantees on operating lease commitments of $246.9 million and certain guarantees related to the Company s investment in the DM&E, which include minimum lease payments of $58.5 million, residual value guarantees of $11.6 million, and a line of credit of US$25 million. The maximum amount that could be payable under these and all of the Company s other guarantees cannot be reasonably estimated due to the nature of certain of the guarantees. All or a portion of amounts paid under certain guarantees

could be recoverable from other parties or through insurance. The Company has accrued for all guarantees that it expects to pay. At June 30, 2008, these accruals amounted to $6.0 million.

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20 Capital disclosures

The Company s objectives when managing its capital are:

- to maintain a flexible capital structure which optimizes the cost of capital at acceptable risk while providing an appropriate return to its shareholders;
- to manage capital in a manner which balances the interests of equity and debt holders;
- to manage capital in a manner that will maintain compliance with its financial covenants;
- to manage its long term financing structure to maintain its investment grade rating; and
- to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business.

The Company defines its capital as follows:

- shareholders equity;
- long-term debt, including the current portion; and
- short-term borrowing.

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

The Company monitors capital using a number of key financial metrics, including:

- net-debt to net-debt-plus-equity; and
- interest coverage ratio: earnings before interest and taxes (EBIT) to interest expense.

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

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

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

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

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20 Capital disclosures (continued)

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

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

(1) These earnings measures have no standardized meanings prescribed by GAAP and,

therefore, are unlikely to be comparable to similar measures of other companies.

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

The Company s financial objectives and strategy as described above have remained substantially unchanged over the last two fiscal years. The objectives are reviewed on an annual basis and financial metrics and their guidelines are monitored on a quarterly basis. The Company believes that adherence to these guidelines increases its ability to access to capital at a reasonable cost and maintain credit ratings of an investment grade. The Company believes that these ratios are within reasonable limits, in light of the relative size of the Company and its capital management objectives. The Company is also subject to financial covenants in the bridge financing agreement obtained for the acquisition of DM&E and revolver loan agreements. Net-debt to net-debt-plus-equity and interest coverage ratio are two financial metrics that provide indicators as to whether the Company will be in compliance with its financial covenants. The Company is in compliance with all financial covenants.

Summary of Rail Data

Second Quarter 2008	Second Quarter 2007	Second Quarter Variance	Second Quarter %		Year-to-date 2008	Year-to-date 2007	Year-to-date Variance	Year-to-date %
				Financial (millions, except per share data and ratios)				
				Revenues				
$ 1,193.1	$ 1,174.1	$ 19.0	1.6	Freight revenue	$ 2,317.5	$ 2,265.0	$ 52.5	2.3
27.2	41.4	(14.2)	(34.3)	Other revenue	49.7	66.4	(16.7)	(25.2)
1,220.3	1,215.5	4.8	0.4		2,367.2	2,331.4	35.8	1.5
				Operating Expenses				
315.5	329.8	(14.3)	(4.3)	Compensation and benefits	643.8	662.3	(18.5)	(2.8)
260.3	193.7	66.6	34.4	Fuel	490.5	364.9	125.6	34.4
56.5	55.6	0.9	1.6	Materials	122.0	118.0	4.0	3.4
46.1	57.3	(11.2)	(19.5)	Equipment rents	92.0	112.8	(20.8)	(18.4)
124.7	119.1	5.6	4.7	Depreciation and amortization	244.6	237.7	6.9	2.9
166.1	152.3	13.8	9.1	Purchased services and other	325.0	298.7	26.3	8.8
969.2	907.8	61.4	6.8		1,917.9	1,794.4	123.5	6.9
251.1	307.7	(56.6)	(18.4)	Operating income	449.3	537.0	(87.7)	(16.3)
(13.4)		(13.4)		Equity income (net of tax) in Dakota, Minnesota & Eastern Railroad Corporation (DM&E)	(24.4)		(24.4)	
4.9	8.2	(3.3)	(40.2)	Other charges	11.6	13.0	(1.4)	(10.8)
62.9	49.2	13.7	27.8	Interest expense	122.8	96.0	26.8	27.9
46.3	75.5	(29.2)	(38.7)	Income tax expense before foreign exchange (gains) losses on long-term debt and other specified items [1]	72.5	130.6	(58.1)	(44.5)
150.4	174.8	(24.4)	(14.0)	Income before foreign exchange (gains) losses on long-term debt and other specified items [1]	266.8	297.4	(30.6)	(10.3)
				Foreign exchange (gains) losses on long-term debt (FX on LTD)				
(6.8)	(88.6)	81.8		FX on LTD	9.5	(97.2)	106.7	
2.3	23.8	(21.5)		Income tax on FX on LTD [2]	(3.4)	26.4	(29.8)	
(4.5)	(64.8)	60.3		FX on LTD (net of tax)	6.1	(70.8)	76.9	
				Other specified items				
				Change in estimated fair value of Canadian third party	21.3		21.3	

						asset-backed commercial paper (ABCP)					
						Income tax on special charges	(6.3)			(6.3)	
						Change in estimated fair value of ABCP (net of tax)	15.0			15.0	
		(17.1)		17.1		Income tax benefits due to rate reductions on opening future income tax balances			(17.1)	17.1	
$	154.9	$ 256.7	$	(101.8)	(39.7)	Net income	$ 245.7	$	385.3	$ (139.6)	(36.2)
						Earnings per share (EPS)					
$	1.01	$ 1.66	$	(0.65)	(39.2)	Basic earnings per share	$ 1.60	$	2.49	$ (0.89)	(35.7)
$	1.00	$ 1.64	$	(0.64)	(39.0)	Diluted earnings per share	$ 1.59	$	2.46	$ (0.87)	(35.4)
						EPS before FX on LTD and other specified items [1]					
$	0.98	$ 1.13	$	(0.15)	(13.3)	Basic earnings per share	$ 1.74	$	1.92	$ (0.18)	(9.4)
$	0.97	$ 1.12	$	(0.15)	(13.4)	Diluted earnings per share	$ 1.72	$	1.90	$ (0.18)	(9.5)
	153.7	154.3		(0.6)	(0.4)	Weighted average (avg)number of shares outstanding (millions)	153.6		154.9	(1.3)	(0.8)
	155.1	156.1		(1.0)	(0.6)	Weighted avg number of diluted shares outstanding (millions)	155.0		156.4	(1.4)	(0.9)
	79.4	74.7		4.7		Operating ratio[1] [3](%)	81.0		77.0	4.0	
	9.2	10.3		(1.1)		ROCE before FX on LTD and other specified items (after tax)[1] [3](%)	9.2		10.3	(1.1)	
	43.9	35.0		8.9		Net debt to net debt plus equity (%)	43.9		35.0	8.9	
$	259.6	$ 299.5	$	(39.9)	(13.3)	EBIT before FX on LTD and other specified items [1] [3] (millions)	$ 462.1	$	524.0	$ (61.9)	(11.8)
$	384.3	$ 418.6	$	(34.3)	(8.2)	EBITDA before FX on LTD and other specified items [1] [3] (millions)	$ 706.7	$	761.7	$ (55.0)	(7.2)

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

earnings measures attached to commentary.

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

(3) EBIT: Earnings before interest and taxes.

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

Summary of Rail Data (Page 2)

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

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

Summary of Rail Data (Page 3)

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

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

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

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

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

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

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

July 21, 2008

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

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

1.0 BUSINESS PROFILE

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

2.0 STRATEGY

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

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

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

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

3.0 ADDITIONAL INFORMATION

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

4.0 FINANCIAL HIGHLIGHTS

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

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

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

5.0 OPERATING RESULTS

5.1 Income

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

- higher fuel expense driven by higher West Texas Intermediate (WTI) prices, net of fuel recoveries;
- higher casualty expenses;
- unfavourable changes in volume mix;
- unfavourable impact of foreign exchange; and
- lower land sales.

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

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

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

- lower FX gains on US dollar-denominated long-term debt (LTD);
- lower operating income;
- future income tax benefit of $17.1 million recorded in second quarter of 2007 as a result of reduced Canadian income tax rates; and
- higher interest expense, primarily due to the funding required for our acquisition of Dakota, Minnesota and Eastern Railroad Corporation (DM&E , discussed further in Section 13.3).

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

The decrease in the first half of 2008 was primarily due to

- FX losses on US dollar-denominated LTD;
- lower operating income; and
- the after-tax change in estimated fair value of our investment in Canadian third party asset-backed commercial paper in the first quarter of 2008 (ABCP , discussed further in Section 10.3);

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

5.2 Diluted Earnings per Share

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

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

5.3 Operating Ratio

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

5.4 Return on Capital Employed

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

5.5 Impact of Foreign Exchange on Earnings

EFFECT ON EARNINGS DUE TO THE CHANGE IN FOREIGN EXCHANGE

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

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

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

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

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

6.0 NON-GAAP EARNINGS

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

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

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

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

6.1 Foreign Exchange Gains and Losses on Long-Term Debt

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

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

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

6.2 Other Specified Items

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

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

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

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

7.0 LINES OF BUSINESS

7.1 Volumes

	For the three months ended June 30		For the six months ended June 30	
VOLUMES	**2008**	**2007**	**2008**	**2007**
Carloads (in thousands)				
Grain	**87.7**	91.2	**180.0**	180.5
Coal	**77.2**	75.0	**142.0**	133.5
Sulphur and fertilizers	**53.4**	61.3	**105.7**	111.5
Forest products	**23.1**	29.9	**47.6**	60.0
Industrial and consumer products	**86.4**	79.2	**167.3**	154.9
Automotive	**40.1**	45.7	**76.4**	88.1
Intermodal	**315.1**	311.9	**611.8**	599.5
Total carloads	**683.0**	694.2	**1,330.8**	1,328.0
Revenue ton-miles (in millions)				
Grain	**6,775**	7,309	**14,273**	14,793
Coal	**6,118**	5,834	**11,204**	10,417
Sulphur and fertilizers	**5,552**	6,106	**10,982**	11,090

Forest products	**1,438**	2,019	**2,963**	4,019
Industrial and consumer products	**4,655**	4,177	**9,142**	8,310
Automotive	**645**	659	**1,193**	1,284
Intermodal	**7,296**	7,424	**14,264**	14,350
Total revenue ton-miles	**32,479**	33,528	**64,021**	64,263

Changes in freight volumes generally contribute to corresponding changes in freight revenues and certain variable expenses, such as fuel, equipment rents and crew costs.

Volumes in the second quarter of 2008, as measured by total carloads, decreased by 11,200, or 1.6%, and RTMs decreased by 1,049 million, or 3.1%, compared with the same period in 2007. Volumes in the first half of 2008 as measured by total carloads increased 2,834 or 0.2% and RTMs decreased by 242 million, or 0.4% compared with the same period in 2007.

These decreases in carloads and RTMs in second quarter 2008 were mainly due to:

- continued weakness in forest products due to a slowdown in the US housing market;
- higher than normal volumes in the second quarter of 2007 as a result of a recovery of potash and Canadian grain shipments that were delayed in the first quarter of 2007; and
- declining US auto sales.

The decrease in RTMs in the first six months of 2008 were mainly due to continued weakness in forest products due to a slowdown in the US housing market and decreasing grain shipments.

These decreases were partially offset by increased industrial product shipments driven by continued economic growth in Western Canada and continued strong global demand for metallurgical coal resulting in increased shipments through the western corridor.

The increase in carloads for the first half of 2008 was primarily driven by increased industrial product shipments driven by economic growth in Western Canada, and growth in our domestic intermodal business. This increase was partially offset by continued weakenss in forest products and declining US auto sales partially caused by the impact of the American Axle strike.

7.2 Revenues

Our revenues are primarily derived from transporting freight. Other revenues are generated mainly from leasing of certain assets, switching fees, land sales and income from business partnerships.

One customer comprised 12.3% and 11.7% of total revenues for the six months ended June 30, 2008 and June 30, 2007, respectively. The same customer comprised 5.4% and 5.2% of total accounts receivable at June 30, 2008 and June 30, 2007, respectively.

REVENUES	**For the three months ended June 30**		**For the six months ended June 30**	
(in millions)	**2008**	**2007**	**2008**	**2007**
Grain	**$ 203.0**	$ 224.0	**$ 435.4**	$ 443.6
Coal	**172.4**	162.4	**312.5**	293.7
Sulphur and fertilizers	**137.9**	144.5	**268.6**	266.9
Forest products	**58.4**	74.3	**116.4**	146.3
Industrial and consumer products	**185.3**	158.8	**352.7**	310.7
Automotive	**86.7**	88.5	**158.8**	170.6
Intermodal	**349.4**	321.6	**673.1**	633.2
Total freight revenues	**1,193.1**	1,174.1	**2,317.5**	2,265.0
Other revenues	**27.2**	41.4	**49.7**	66.4
Total revenues	**$ 1,220.3**	$ 1,215.5	**$ 2,367.2**	$ 2,331.4

7.2.1 Freight Revenues

Freight revenues are earned from transporting bulk, merchandise and intermodal goods, and include fuel recoveries billed to our customers. Freight revenues were $1,193.1 million in the second quarter of 2008, an increase of $19.0 million, or 1.6%. Freight revenues were $2,317.5 million in the first half of 2008, an increase of $52.5 million or 2.3% for the same period in 2007.

Freight revenues in the second quarter and first six months of 2008 increased mainly due to:

- continued growth in industrial products, intermodal shipments and coal shipments;
- our fuel price recovery programs; and
- increased freight rates.

These increases were partially offset by:

- the unfavourable impact of the change in FX of approximately $42 million in the second quarter of 2008 and approximately $113 million in the first half of 2008;
- continued weakness in forest products and automotives; and

a provision for the Canadian Transportation Agency (Agency) decision directing a downward adjustment of the railway maximum revenue entitlement for movement of regulated grain under the Canadian Transportation Act (CTA) (discussed further in Section 20.2.1).

7.2.1.1 Grain

Grain revenues for the second quarter of 2008 were $203.0 million, a decrease of $21.0 million, or 9.4%, from $224.0 million. Grain revenues for the first six months of 2008 was $435.4 million a decrease of $8.2 million, or 1.8%, from $443.6 million. These decreases were primarily due to a provision for the Agency decision directing a downward adjustment of the railway maximum revenue entitlement for movement of regulated grain under the CTA (CP has filed an appeal of this decision; see Section 20.2.1 for further information) and the unfavourable impact of the change in FX of approximately $9 million in second-quarter 2008 and $26 million in the first half of 2008. These decreases were partially offset by higher freight rates and an increase in US grain shipments driven by higher crop yields along with strong commodity prices.

7.2.1.2 Coal

Coal revenues for the second quarter of 2008 were $172.4 million, an increase of $10.0 million, or 6.2%, from $162.4 million. This increase was primarily due to a continued strong global demand for metallurgical coal and stronger shipments through the western corridor. These increases were partially offset by decreased shipments to the US, due to harsh weather conditions.

Coal revenues for the first six months of 2008 were $312.5 million, an increase of $18.8 million, or 6.4%, from $293.7 million for the same period in 2007. The increase was primarily due to strong global demand for metallurgical coal and stronger shipments through the western corridor. These increases were partially offset by decreased freight rates and decreased shipments in the US, due to harsh weather conditions.

7.2.1.3 Sulphur and Fertilizers

Sulphur and fertilizers revenues for the second quarter of 2008 were $137.9 million, a decrease of $6.6 million, or 4.6%, from $144.5 million for the same period in 2007. The decrease was primarily due to:

- strong shipments of potash in the second quarter of 2007;
- reduced sulphur shipments due to declining supply in the second quarter of 2008; and
- the unfavourable impact of foreign exchange of approximately $5 million.

For the first six months of 2008, these revenues were $268.6 million, an increase of $1.7 million or 0.6% from $266.9 million for the same period in 2007. The increase was primarily due to an increased demand for export potash through the western corridor. This increase was partially offset by the unfavourable impact of foreign exchange of approximately $13 million and reduced sulphur shipments due to declining supply.

7.2.1.4 Forest Products

Forest products revenues for the second quarter of 2008 were $58.4 million, a decrease of $15.9 million, or 21.4%, from $74.3 million. For the first six months of 2008, these revenues were $116.4 million, a decrease of $29.9 million or 20.4% from $146.3 million for the same period in 2007. These decreases were primarily due to:

- soft demand for lumber and panel products caused by a continued slowdown in the US housing market;
- continued customer mill closures and plant shutdowns;
- the impact of the strengthening of the Canadian dollar, which has led to decreased market competitiveness for Canadian producers; and
- the unfavourable impact of the change in FX of approximately $5 million for the second quarter of 2008 and $13 million for the first half of 2008.

7.2.1.5 Industrial and Consumer Products

Industrial and consumer products revenues for the second quarter of 2008 were $185.3 million, an increase of $26.5 million, or 16.7%, from $158.8 million. For the first six months of 2008, these revenues were $352.7 million, an increase of $42.0 million or 13.5% from $310.7 million for the same period in 2007. These increases were primarily due to continued economic growth in Western Canada as well as increases in freight rates. These increases were partially offset by the unfavourable impact of the change in FX of approximately $10 million in the second quarter of 2008, and $27 million in the first half of 2008.

7.2.1.6 Automotive

Automotive revenues for the second quarter of 2008 were $86.7 million, a decrease of $1.8 million, or 2.0%, from $88.5 million. For the first six months of 2008, these revenues were $158.8 million, a decrease of $11.8 million or 6.9% from $170.6 million for the same period in 2007. These decreases were primarily due to:

- lower volumes as a result of the impact of the American Axle strike;
- the unfavourable impact of the change in FX of approximately $4 million in the second quarter of 2008, and $11 million in the first half of 2008; and
- the weakening of US auto sales resulting in reduced production.

These decreases were partially offset by increased shipments by new domestics (Toyota and Honda).

7.2.1.7 Intermodal

Intermodal revenues for the second quarter of 2008 were $349.4 million, an increase of $27.8 million, or 8.6%, from $321.6 million. For the first six months of 2008, these revenues were $673.1 million, an increase of $39.9 million, or 6.3%, from $633.2 million for the same period in 2007. These increases were primarily due to increased freight rates and growth in our domestic intermodal business, partially offset by the unfavourable impact of the change in FX of approximately $6 million for the second quarter of 2008, and $17 million for the first six months of 2008.

7.2.2 Other Revenues

Other revenues for the second quarter of 2008 were $27.2 million, a decrease of $14.2 million or 34.3% from $41.4 million for the second quarter of 2007. For the first six months of 2008, these revenues were $49.7 million, a decrease of $16.7 million or 25.2% from $66.4 million for the same period in 2007. These decreases were primarily due to lower revenue from land sales and lower switching revenue in the second quarter of 2008, and were partially offset by increased leasing revenue.

7.2.3 Freight Revenue per Carload

FREIGHT REVENUE PER CARLOAD ($)	For the three months ended June 30		For the six months ended June 30	
	2008	**2007**	**2008**	**2007**
Freight revenue per carload	**1,747**	1,691	**1,741**	1,706
Grain	**2,315**	2,456	**2,419**	2,458
Coal	**2,233**	2,165	**2,201**	2,200
Sulphur and fertilizers	**2,582**	2,357	**2,541**	2,394
Forest products	**2,528**	2,485	**2,445**	2,438
Industrial and consumer products	**2,145**	2,005	**2,108**	2,006
Automotive	**2,162**	1,937	**2,079**	1,936
Intermodal	**1,109**	1,031	**1,100**	1,056

Total freight revenue per carload in the second quarter and first half of 2008 improved over comparable periods in 2007. The increases of 3.3% for the quarter and 2.1% for the first half of the year reflected improvements in freight rates, which were offset by the unfavourable impact of the change in FX.

8.0 PERFORMANCE INDICATORS

The indicators listed in this table are key measures of our operating performance. Definitions of these performance indicators are provided in Section 24.0.

PERFORMANCE INDICATORS(1)

	For the three months ended June 30		For the six months ended June 30	
	2008	**2007**	**2008**	**2007**
Safety indicators				
FRA personal injuries per 200,000 employee-hours	**1.11**	2.09	**1.25**	1.95
FRA train accidents per million train-miles	**1.11**	2.11	**1.65**	2.06
Efficiency and other indicators				
Gross ton-miles (GTM) of freight (millions)	**62,397**	64,481	**122,258**	122,041
Car miles per car day	**147.3**	147.5	**142.7**	141.0
U.S. gallons of locomotive fuel consumed per 1,000 GTMs freight and yard	**1.19**	1.19	**1.24**	1.22
Terminal dwell (hours)	**21.6**	21.7	**22.8**	22.8
Average train speed (miles per hour)	**24.1**	23.5	**23.7**	23.3
Number of active employees end of period	**16,407**	15,720	**16,407**	15,720
Freight revenue per RTM (cents)	**3.67**	3.50	**3.62**	3.52

(1) Certain comparative period figures have been updated to reflect new information.

8.1 Safety Indicators

Safety is a key priority for our management and Board of Directors. Our two main safety indicators personal injuries and train accidents follow strict US Federal Railroad Administration (FRA) reporting guidelines.

The FRA personal injury rate per 200,000 employee-hours was 1.11 for the second quarter of 2008, an improvement of 46.9%, compared with 2.09 for the second quarter in 2007. This rate was 1.25 for the six month period ended June 30, 2008, an improvement of 35.9%, compared with 1.95.

The FRA train accident rate for the second quarter of 2008 was 1.11 accidents per million train-miles, an improvement of 47.4%, compared with 2.11. This rate was 1.65 for the six month period ended June 30, 2008, an improvement 19.9%, compared with 2.06.

8.2 Efficiency and Other Indicators

GTMs decreased 3.2% in the second quarter of 2008, and are relatively unchanged for the first six months of 2008. The decrease in the second quarter of 2008 was mainly due to a reduction in grain, sulphur and fertilizers, and intermodal traffic, partially offset by growth in industrial and consumer products, and coal. Fluctuations in GTMs normally drive fluctuations in certain variable costs, such as fuel and train crew costs.

Car miles per car day remained relatively unchanged in the second quarter of 2008 and improved by 1.2% for the first six months of 2008. The improvement in the first six months was driven by productivity gains in the covered hopper fleet and export coal service.

US gallons of locomotive fuel consumed per 1,000 GTMs in both freight and yard activity was flat for the second quarter of 2008 and increased 1.6% for the first six months of 2008. The year to date increase was primarily due to difficult operating conditions,

mainly driven by harsh weather, in the first quarter of 2008. The increases were partially offset by on-going fuel-conservation programs.

Terminal dwell, the average time a freight car resides in a terminal, improved by 0.5% in the second quarter, and was flat for the first six months of 2008 compared to the same period in 2007.

Average train speed increased 2.6% in the second quarter and 1.7% in the first six months of 2008. This improvement was largely driven by adding locomotives to our coal trains, thereby allowing them to operate with greater velocity which increased capacity and fluidity through the western corridor. The improvement in the first six months of 2008 was offset by harsh weather conditions in the central and eastern part of our network.

The number of active employees at June 30, 2008 increased by 687, or 4.4%, compared with June 30, 2007. The June 30, 2007 active employee count was reduced by 480 employees by a strike by our Canadian unionized maintenance of way employees. Compared with the estimated strike-adjusted June 30, 2007 employment level, the June 30, 2008 employment level increased by 207 or 1.3%. This increase was primarily due to the number of employees added to work on capital projects. Approximately 14% of employees were assigned to capital projects at June 30, 2008, compared with 10% for June 30, 2007.

Freight revenue per RTM in the second quarter improved by 4.9%, and 2.8% for the first six months of 2008, compared with the same periods in 2007. These increases were the result of improvements in freight rates and mix per RTM, which were offset by the unfavourable impact of the change in FX.

9.0 OPERATING EXPENSES

OPERATING EXPENSES

	For the three months ended June 30				**For the six months ended June 30**			
	2008		**2007**		**2008**		**2007**	
(in millions)	**Expense**	**% of revenue**	Expense	% of revenue	**Expense**	**% of revenue**	Expense	% of revenue
Compensation and benefits	**$ 315.5**	**25.9**	$ 329.8	27.1	**$ 643.8**	**27.2**	$ 662.3	28.4
Fuel	**260.3**	**21.3**	193.7	16.0	**490.5**	**20.7**	364.9	15.7
Materials	**56.5**	**4.6**	55.6	4.6	**122.0**	**5.2**	118.0	5.1
Equipment rents	**46.1**	**3.8**	57.3	4.7	**92.0**	**3.9**	112.8	4.8
Depreciation and amortization	**124.7**	**10.2**	119.1	9.8	**244.6**	**10.3**	237.7	10.2
Purchased services and other	**166.1**	**13.6**	152.3	12.5	**325.0**	**13.7**	298.7	12.8
Total	**$ 969.2**	**79.4**	$ 907.8	74.7	**$ 1,917.9**	**81.0**	$ 1,794.4	77.0

Operating expenses were $969.2 million for the second quarter of 2008, up $61.4 million, or 6.8%, from $907.8 million and $1,917.9 million for the first six months of 2008, up $123.5 million or 6.9%, from $1,794.4 million.

Operating expenses for the second quarter and first half of 2008 increased primarily due to:

- higher fuel prices driven by higher WTI prices; and
- casualty related expenses.

These increases in operating expenses were partially offset by:

- the favourable impact of the change in FX of approximately $33 million in the second quarter of 2008, and approximately $87 million for the first six months of 2008;
- lower compensation and benefits expense; and

lower equipment rents.

9.1 Compensation and Benefits

Compensation and benefits expense was $315.5 million in the second quarter of 2008, a decrease of $14.3 million, or 4.3%, from $329.8 million. Compensation and benefits expense was $643.8 million for the first six months of 2008, down $18.5 million or 2.8%, from $662.3 million.

This decrease in the second quarter and first six months of 2008 was primarily due to:

- lower employee incentive program costs;
- the favourable impact of the change in FX of approximately $7 million for the second quarter and $19 million for the first six months of 2008; and
- lower pension expenses.

These decreases were partially offset by increased labour expenses due to inflation and a greater number of employees.

9.2 Fuel

Fuel expense was $260.3 million in the second quarter of 2008, an increase of $66.6 million, or 34.4%, from $193.7 million. Fuel expense was $490.5 million for the first six months of 2008, an increase of $125.6 million, or 34.4%, from $364.9 million. For the second quarter and first half of 2008, these increases were primarily due to higher WTI.

These increases were partially offset by decreased volumes in the second quarter of 2008. The increase in fuel prices was partially mitigated by the favourable impact of the change in FX of approximately $14 million for the second quarter of 2008 and approximately $35 million for the first half of the year. Fuel price increases are also mitigated by our fuel recovery program.

9.3 Materials

Materials expense was $56.5 million in the second quarter 2008, an increase of $0.9 million, or 1.6%, from $55.6 million. Materials expense was $122.0 million in the first six months of 2008, an increase of $4.0 million, or 3.4%, from $118.0 million. This increase was mainly due to higher input costs including highway vehicle fuel, partially offset by the favourable impact of the change in FX of approximately $2 million for the second quarter of 2008, and approximately $7 million for the first six months of 2008.

9.4 Equipment Rents

Equipment rents expense was $46.1 million in the second quarter of 2008, a decrease of $11.2 million, or 19.5%, from $57.3 million. Equipment rents expense was $92.0 million in the first half of 2008, a decrease of $20.8 million, or 18.4%, from $112.8 million. These decreases were due to higher recoveries for freight cars and locomotives. Decreases in volume and the favourable impact of the change in FX of approximately $5 million for the second quarter of 2008 and approximately $11 million for the first six months of 2008 also contributed to these decreases. These improvements were partially offset by higher costs due to network and supply chain disruptions in the first six months of 2008.

9.5 Depreciation and Amortization

Depreciation and amortization expense was $124.7 million in the second quarter of 2008, an increase of $5.6 million, or 4.7%, from $119.1 million. Depreciation and amortization expense was $244.6 million in the first half of 2008, an increase of $6.9 million, or 2.9%, from $237.7 million. These increases were primarily due to additions to capital assets for track and locomotives, which were partially offset by asset retirements and rate adjustments and the favourable impact of the change in FX of approximately $1 million for the second quarter of 2008 and $4 million for the first six months of 2008.

9.6 Purchased Services and Other

Purchased services and other expense was $166.1 million in second quarter 2008, an increase of $13.8 million, or 9.1%, from $152.3 million. Purchased services and other expense was $325.0 million in the first half of 2008, an increase of $26.3 million, or 8.8%, from $298.7 million. The increase in the second quarter of 2008 was mainly due to:

- casualty related expenses;
- inflation; and
- increased contract services and consulting fees.

The increase in the first six months of 2008 was mainly due to harsh weather conditions and casualty related expenses. These increases were partially offset by the favourable impact of the change in FX of approximately $4 million for the second quarter of 2008, and $11 million for the first six months of 2008, and one time CP strike-related expenses in the second quarter of 2007.

10.0 OTHER INCOME STATEMENT ITEMS

10.1 Other Charges

Other charges was an expense of $4.9 million in the second quarter of 2008, a decrease of $3.3 million or 40.2%, compared to $8.2 million in 2007. Other charges was an expense of $11.6 million in the first half of 2008, a decrease of $1.4 million or 10.8%, compared to $13.0 million 2007. These decreases were the result of lower restructuring and

other costs and lower exchange losses.

10.2 Equity Income in Dakota, Minnesota & Eastern Railroad Corporation

Equity income in DM&E was $13.4 million in the second quarter and $24.4 million for the first six months of 2008. The inclusion of the equity earnings of DM&E began in the fourth quarter of 2007.

10.3 Change in Estimated Fair Value of Canadian Third Party Asset-backed Commercial Paper

At June 30, 2008, the Company held ABCP issued by a number of trusts with an original cost of $143.6 million. At the dates the Company acquired these investments they were rated R1 (High) by DBRS Limited (DBRS), the highest credit rating issued for commercial paper, and backed by R1 (High) rated assets and liquidity agreements. These investments matured during the third

quarter of 2007 but, as a result of liquidity issues in the ABCP market, did not settle on maturity. As a result, the Company has classified its ABCP as long-term investments after initially classifying them as Cash and cash equivalents.

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

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

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

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

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

- $117.7 million is represented by a combination of leveraged collateralized debt, synthetic assets and traditional securitized assets and the Company will, on restructuring, receive replacement senior Class A-1 and Class A-2 and subordinated Class B and Class C long-term floating rate notes with maturities of approximately eight years and nine months. The Company expects to receive replacement notes with par values as follows:
  - Class A-1: $59.7 million
  - Class A-2: $46.5 million
  - Class B: $8.0 million
  - Class C: $3.5 million

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

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

The valuation technique used by the Company to estimate the fair value of its investment in ABCP at June 30, 2008, incorporates probability weighted discounted cash flows considering the best available public information regarding market conditions and other factors that a market participant would consider for such investments. The assumptions used in determining the estimated fair value reflect the details included in the Information Statement issued by the pan-Canadian restructuring committee and the risks associated with the long-term floating rate notes. The interest

rates and maturities of the various long-term floating rate notes, discount rates and credit losses modelled are:

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

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

(2) Class B and Class C subordinated notes.

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

Discount rates vary dependent upon the credit rating of the replacement long-term floating rate notes. Discount rates have been estimated using Government of Canada benchmark rates plus expected spreads for similarly rated instruments with similar maturities and structure. An increase in the estimated discount rates of 1 percent would reduce the estimated fair value of the Company s investment in ABCP by approximately $5 million.
Maturities vary by different replacement long-term floating rate notes as a result of the expected maturity of the underlying assets.
One of the cash flow scenarios modelled is a liquidation scenario whereby, if the restructuring is not successfully completed, recovery of the Company s investment is through the liquidation of the underlying assets of the ABCP trusts. In addition, while the likelihood is remote, there remains a possibility that a liquidation scenario may occur even with a successful approval of the restructuring plan.
In addition, assumptions have also been made as to the amount of restructuring costs that the Company will bear.
The probability weighted discounted cash flows resulted in an estimated fair value of the Company s ABCP of $100.8 million at June 30, 2008. This was unchanged from the estimated fair value at March 31, 2008. However, it represents a reduction from estimated fair value at December 31, 2007 of $122.1 million. A charge to income of $21.3 million before tax ($15.0 million after tax) was recorded in the first quarter of 2008. This represents 15 percent of the original value, bringing the total write-down to a aggregate of approximately 30% of the original value.
Sensitivity analysis is presented below for key assumptions:

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

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

10.4 Interest Expense

Interest expense was $62.9 million in the second quarter of 2008, an increase of $13.7 million from $49.2 million. Interest expense was $122.8 million in the first half of 2008, an increase of $26.8 million from $96.0 million. These increases were primarily due to:

- the use of bridge financing to fund the acquisition of DM&E (discussed further in Section 13.3);
- interest on new debt issued in May of 2008 (discussed further in Section 13.3) to replace the bridge financing and permanently fund the acquisition of the DM&E; and
- the issuance of US$450 million notes in May of 2007.

These increases were partially offset by the favourable impact from the change in FX on US dollar-denominated interest expense and capitalization of interest expense incurred for long-term capital projects.

10.5 Income Taxes

Income tax expense was $48.6 million in the second quarter of 2008, a decrease of $33.6 million from $82.2 million in 2007. Income tax expense was $62.8 million in the first half of 2008, a decrease of $77.1 million from $139.9 million in 2007. These decreases were mainly due to lower earnings and a future income tax benefit of $10.6 million recorded in the first quarter of 2008 and a further income tax benefit of $5.1 million recorded in the second quarter of 2008, resulting from tax rate changes implemented by provincial governments.

The effective income tax rate for second quarter 2008 was 23.9%, compared with 24.3% for second quarter 2007. For the first half of 2008 this rate was 20.4% compared with 26.6%. The normalized rates (income tax rate based on income adjusted for FX on LTD, DM&E equity income, and other specified items) for second quarter 2008 was 25.3%, compared with 30.2% for the

second quarter 2007. For the first half of 2008 this rate was 23.0% compared with 30.5% for the first half of 2007. In addition to provincial rate reductions, the change in the normalized tax rate was primarily due to lower Canadian federal and provincial corporate income tax rates and tax planning initiatives.

We expect a normalized 2008 income tax rate of between 26% and 27%. The outlook on our normalized income tax rate is based on certain assumptions about events and developments that may or may not materialize or that may be offset entirely or partially by other events and developments (see Sections 20.0 and 21.4 for a discussion of these assumptions and other factors affecting our expectations for 2008). We expect to have an increase in our cash tax payments in future years.

Beginning in the fourth quarter of 2005, certain capital losses were no longer available to offset capital gains arising from FX on LTD and other capital transactions. Following a review of impending transactions during third-quarter 2005, we concluded that our remaining unrecognized capital loss carryforwards for tax would more than likely be utilized. Consequently, we recorded a future tax asset for all previously unrecognized capital loss carryforwards. As a result, any future capital gains recorded, including FX on LTD, will be taxable, where historically they had resulted in no net tax expense. A reclassification moves previously recognized capital losses that historically were allocated to unrealized FX on LTD gains and includes them in the calculation of income tax for other realized capital transactions, which are included in income tax expense before income tax on FX on LTD. With the reclassification, the tax benefit of these losses is matched to the transactions that utilize them.

11.0 QUARTERLY FINANCIAL DATA

QUARTERLY FINANCIAL DATA

For the quarter ended	**2008**			2007			2006	
(in millions, except per share data)	**Jun. 30**	Mar. 31	Dec. 31	Sept. 30	Jun. 30	Mar. 31	Dec. 31	Sept. 30
Total revenue	**$ 1,220.3**	$ 1,146.9	$ 1,188.3	$ 1,187.9	$ 1,215.5	$ 1,115.9	$ 1,190.4	$ 1,151.3
Operating income[1]	**251.1**	198.2	305.5	321.7	307.7	229.3	320.1	299.1
Net income	**154.9**	90.8	342.3	218.6	256.7	128.6	145.6	163.8
Income, before FX on LTD and other specified items[1]	**150.4**	116.4	185.1	190.3	174.8	122.6	181.0	169.7
Basic earnings per share	**$ 1.01**	$ 0.59	$ 2.23	$ 1.43	$ 1.66	$ 0.83	$ 0.93	$ 1.05
Diluted earnings per share	**1.00**	0.59	2.21	1.41	1.64	0.82	0.92	1.04
Diluted earnings per share, before FX on LTD and other specified items[1]	**0.97**	0.75	1.20	1.23	1.12	0.78	1.15	1.07

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

These earnings measures and other specified items are described in Section 6.0. A reconciliation of operating income, income and diluted EPS, before FX on LTD and other specified items, to net income and diluted EPS, as presented in the financial statements is provided in Section 6.0.

11.1 Quarterly Trends

Volumes of and, therefore, revenues from certain goods are stronger during different periods of the year. First-quarter revenues can be lower mainly due to winter weather conditions, closure of the Great Lakes ports and reduced transportation of retail goods. Second- and third-quarter revenues generally improve over the first quarter as fertilizer volumes are typically highest during the second quarter and demand for construction-related goods is generally highest in the third quarter. Revenues are typically strongest in the fourth quarter, primarily as a result of the transportation of grain after the harvest, fall fertilizer programs and increased demand for retail goods moved by rail. Operating income (See Section 6.0 Non-GAAP Earnings) is also affected by seasonal fluctuations. Operating income is typically lowest in the first quarter due to higher operating costs associated with winter conditions. Net income is also influenced by seasonal fluctuations in customer demand and weather-related issues.

12.0 CHANGES IN ACCOUNTING POLICY

12.1 2008 Accounting Changes

12.1.1 Financial Instrument and Capital Disclosures

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

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

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

The adoption of these new accounting standards did not impact the amounts reported in the Company s financial statements; however, it resulted in expanded disclosure in Note 14 and Note 20 to the Company s June 30, 2008 unaudited Interim Consolidated Financial Statements.

12.1.2 Inventories

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

12.2 Future Accounting Changes

12.2.1 Goodwill and intangible assets

In February 2008, the CICA issued accounting standard Section 3064 Goodwill, and intangible assets , replacing accounting standard Section 3062 Goodwill and other intangible assets and accounting standard Section 3450 Research and development costs . The new Section will be applicable on a retrospective basis with restatement to financial statements relating to fiscal years beginning on or after October 1, 2008. Accordingly, the Company will adopt the new standards for its fiscal year beginning January 1, 2009. Section 3064 establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets by profit-oriented enterprises. Standards concerning goodwill are unchanged from the standards included in the previous Section 3062. The Company is currently evaluating the impact of the adoption of this new Section.

13.0 LIQUIDITY AND CAPITAL RESOURCES

We believe adequate amounts of cash and cash equivalents are available in the normal course of business to provide for ongoing operations, including the obligations identified in the tables in Section 18.0 and Section 19.4. We are not aware of any trends or expected fluctuations in our liquidity that would create any deficiencies. Liquidity risk is discussed in Section 20.1. The following discussion of operating, investing and financing activities describes our indicators of liquidity and capital resources.

13.1 Operating Activities

Cash provided by operating activities was $183.0 million in the second quarter of 2008, a decrease of $181.5 million from $364.5 million in the same period of 2007. Cash provided by operating activities was $343.0 million for the first half of 2008, a decrease of $249.2 million from $592.2 million in the same period of 2007. These decreases were primarily due to:

- the termination of our $120.0 million accounts receivable securitization program (discussed further in Section 16.1);
- lower operating income (See Section 6.0 Non-GAAP Earnings); and
- higher cash taxes.

There are no specific or unusual requirements relating to our working capital. In addition, there are no unusual restrictions on any subsidiary s ability to transfer funds to CPRL.

13.2 Investing Activities

Cash used in investing activities was $296.4 million in the second quarter of 2008, an increase of $126.2 million from $170.2 million in the same period of 2007. Cash used in investing activities was $567.3 million for the first half of 2008, an increase of $201.5 million from $365.8 million in the same period of 2007. The increase in the second quarter of 2008 was primarily due to an increase in capital expenditures and an acquisition of assets held for sale and leaseback, where the sale and leaseback is expected to be completed by the end of 2008. The increase in the first half of 2008 was mainly due to the acquisition of assets held for sale and leaseback.

Capital spending in 2008 is projected to be between $885 million and $895 million, which is similar to the 2007 capital program. While the expected total capital prog ram for 2008 remains relatively unchanged from 2007 spending levels, it will incorporate an increase for the maintenance and upgrade of rail, ballast, crossties and other basic right-of-way infrastructure components for which some spending was deferred in 2007 due to the 26-day strike by CP s maintenance of way employees in Canada during the second quarter of 2007 (CP strike). CP will also increase investments in information technology to improve the systems that manage railway operations and customer shipments, as well as investments planned to increase capacity of track and signalling systems in key corridors to improve end-to-end fluidity and increase train speed over the existing network. Compared to 2007, CP will also increase investments in modifications and upgrades to the freight car fleet to ensure customers continue to receive the quality of rail cars they require. This includes the ongoing program to upgrade government-owned grain cars to reduce grain spillage and protect wildlife along CP s right-of-way as well as upgrades to the automotive rail car fleet. These increases will be offset by reduced spending levels on strategic land purchases as these were largely completed in 2007. These capital investments do not include capital spending programs for the DM&E (discussed further in Section 17.0). Our capital spending outlook is

based on certain assumptions about events and developments that may not materialize or that may be offset entirely or partially by other events and developments (see Section 20.0 for a discussion of these assumptions and other factors affecting our expectations for 2008).

We intend to finance capital expenditures with cash from operations but may partially finance these expenditures with new debt. Our decision whether to acquire equipment through the use of capital and debt or through operating leases will be influenced by such factors as the need to keep our capital structure within debt covenants and to maintain financial ratios that would preserve our investment grade standing, as well as the amount of cash flow we believe can be generated from operations and the prevailing capital market conditions.

13.3 Financing Activities

Cash provided by financing activities was $123.0 million in the second quarter of 2008, a decrease of $49.2 million from cash provided by financing activities of $172.2 for the same period in 2007. Cash used in financing activities was $72.9 million for the first half of 2008, a decrease in cash of $114.3 million from $41.4 million of cash provided by financing in the same period of 2007.

The decreases in cash from financing activities in the second quarter and first half of 2008 were mainly due to the issuance of US$450 million notes in the second quarter of 2007. These decreases were partially offset by an increase in net short term borrowings and and the repurchase of CP shares in the second quarter of 2007.

CP filed a US$1.5 billion base shelf prospectus in May 2007 and a CAD$1.5 billion medium term note prospectus in June 2007 to provide the financial flexibility to offer debt securities for sale. This allowed CP to issue US$450 million of 5.95% 30-year notes in May 2007 under the US-dollar base shelf prospectus which was used to repay long-term debt, to repurchase CP shares through normal course issuer bids (discussed further in Section 14.4), and to partially finance the acquisition of DM&E on October 4, 2007.

In October 2007, CP entered into an eighteen-month US$1.8 billion credit agreement to provide bridge financing specifically to fund the acquisition of DM&E (discussed further in Section 17.0). The credit facility bears interest at a variable rate based on LIBOR. On October 4, 2007, CP drew down US$1.27 billion from this credit agreement to close the acquisition of DM&E.

In May 2008, CP entered into the following debt to permanently finance the acquisition of DM&E:

- US$400 million of 5.75% five-year notes;
- US$300 million of 6.50% 10-year notes; and
- CAD$375 million of 6.25% 10-year notes.

With the issuance of these notes, the majority of the draw-down from the bridge financing credit agreement was repaid. The capacity of this credit agreement was reduced to $203 million, which is the balance outstanding at June 30, 2008.

We also have available, as sources of financing, unused credit facilities of up to $351 million.

13.3.1 Net-debt to Net-debt-plus-equity Ratio

At June 30, 2008, our net-debt to net-debt-plus-equity ratio (discussed further in Section 6.0) increased to 43.9%, compared with 35.0% at June 30, 2007. This increase in 2008 was primarily due to:

- the bridge financing obtained for the acquisition of DM&E;
- the issuance of US$450 million notes in May 2007; and
- the reclassification of ABCP from Cash and cash equivalents to Investments (discussed further in Section 10.3).

These increases were partially offset by an increase in equity driven by earnings and the impact of the strengthening of the Canadian dollar on June 30, 2008, compared with June 30, 2007.

Net-debt to Net-debt-plus-equity ratio is calculated as follows. Net debt is the sum of long-term debt, long-term debt maturing within one year and short-term borrowing, less cash and short-term investments. This sum is divided by total net debt plus total shareholders equity as presented on our Consolidated Balance Sheet.

13.3.2 Interest Coverage Ratio

At June 30, 2008, our interest coverage ratio (discussed further in Section 6.0) decreased to 4.5, compared with 5.8 for the same period in 2007. This decrease was primarily due to a higher interest expense as a result of an increase in debt to fund the acquisition of DM&E (discussed further in Section 13.3).

Interest coverage ratio is measured, on a rolling twelve month basis, as earnings before interest and taxes (EBIT) divided by interest expense. EBIT is a non-GAAP measure that is calculated as operating income, before other specified items less the sum of the before-tax change in estimated fair value of our investment in ABCP, other charges and equity income in DM&E.

13.3.3 Security Ratings

Our unsecured long-term debt securities are currently rated Baa3 , BBB and BBB by Moody s Investors Service, Inc. (Moody s), Standard and Poor s Corporation (S&P) and DBRS, respectively. With the acquisition of the DM&E, CP s ratings were downgraded in the fourth quarter of 2007 by DBRS and Moody s from BBB(high) and Baa2 , respectively. Our rating with S&P remained unchanged but with a negative outlook.

13.4 Free Cash

CALCULATION OF FREE CASH (reconciliation of free cash to GAAP cash position) (in millions)	**For the three months ended June 30**		**For the six months ended June 30**	
	2008	2007	**2008**	2007
Cash provided by operating activities[1]	**$ 183.0**	$ 364.5	**$ 343.0**	$ 592.2
Cash used in investing activities	**(296.4)**	(170.2)	**(567.3)**	(365.8)
Dividends paid	**(38.0)**	(34.7)	**(72.5)**	(63.8)
Add back acquisition of DM&E[2]	**1.2**		**7.5**	
Termination of accounts receivable securitization program[3]	**120.0**		**120.0**	
Free cash[4]	**(30.2)**	159.6	**(169.3)**	162.6
Cash provided by financing activities, excluding dividend payment	**161.0**	206.9	**(0.4)**	105.2
Acquisition of DM&E[2]	**(1.2)**		**(7.5)**	
Accounts receivable securitization program[3]	**(120.0)**		**(120.0)**	
Increase (decrease) in cash, as shown on the Statement of Consolidated Cash Flows	**9.6**	366.5	**(297.2)**	267.8
Net cash at beginning of period	**71.3**	25.6	**378.1**	124.3
Net cash at end of period	**$ 80.9**	$ 392.1	**$ 80.9**	$ 392.1

(1) Cash provided by operating activities includes $120.0 relating to the termination of the accounts receivable securitization program. This amount is subsequently added back to arrive at free cash.

(2)

The acquisition of DM&E is discussed further in Section 17.0.

(3) The termination of accounts receivable securitization program is discussed further in Section 16.1.

(4) Free cash has no standardized meanings prescribed by Canadian GAAP and, therefore, is unlikely to be comparable to similar measures of other companies. Free cash is discussed further in this section and in Section 6.0.

Free cash is a non-GAAP measure that management considers to be an indicator of liquidity. Free cash is calculated as cash provided by operating activities, less cash used in investing activities and dividends paid, excluding changes in the accounts receivable securitization program (discussed further in Section 16.1) and adjusted for the acquisition of DM&E . Free cash is adjusted for the DM&E acquisition as it is not indicative of normal day-to-day investments in the Company s asset base. The securitization of accounts receivable is a financing-type transaction, which is excluded to clarify the nature of the use of free cash.

There was negative free cash of $30.2 million in the second quarter of 2008, compared with positive free cash of $159.6 million in the same period of 2007. For the first half of 2008, there was negative free cash of $169.3 million, compared with positive free cash of $162.6 million in the same period of 2007.

The decrease in free cash in the second quarter of 2008 was primarily due to:

- an increase in capital expenditures;
- the acquisition of assets held for sale and leaseback, where the sale and leaseback is expected to be completed by the end of 2008; and
- a decrease in cash generated by operating activities (as discussed in Section 13.1).

The decrease in free cash in the first half of 2008 was primarily due to the acquisition of assets held for sale and leaseback, where the sale and leaseback is expected to be completed by the end of 2008, and a decrease in cash

generated from operating activities.

We expect to generate a lower amount of free cash in 2008, compared with 2007, as a result of lower operating income and increased income tax payments, mainly due to the Company now being cash tax payable (discussed further in Section 10.5). Our free cash outlook is based on certain assumptions about events and developments that may not materialize or that may be offset entirely or partially by other events and developments (see Section 20.0 and Section 23.0 for a discussion of these assumptions and other factors affecting our expectations for 2008). Our free cash outlook relies on the assumptions established for earnings and capital expenditures, which are discussed in Section 7.2, Section 9.0, Section 10.0 and Section 13.0.

14.0 BALANCE SHEET

14.1 Assets

Assets totalled $13,678.2 million at June 30, 2008, compared with $13,365.0 million at December 31, 2007. This increase in assets in first half of 2008 was mainly due to an increase in assets held for sale and leaseback and the favourable impact of the change in FX on our US dollar-denominated assets. This was partially offset by a decrease in cash.

14.2 Total Liabilities

Our combined short-term and long-term liabilities were $8,012.2 million at June 30, 2008 compared with $7,907.1 million at December 31, 2007. This increase in total liabilities was mainly due to an increase in long-term debt related to the acquisition of DM&E.

14.3 Equity

At June 30, 2008, our Consolidated Balance Sheet reflected $5,666.0 million in equity, compared with an equity balance of $5,457.9 million at December 31, 2007. This increase in equity was primarily due to growth in retained income driven by net income and the issuance of Common Shares for stock options exercised, partially offset by dividends.

14.4 Share Capital

At July 17, 2008, 153,763,388 Common Shares and no Preferred Shares were issued and outstanding.

At June 30, 2008, 7.8 million options were outstanding under our Management Stock Option Incentive Plan (MSOIP) and Directors Stock Option Plan (DSOP), and 2.3 million Common Shares have been reserved for issuance of future options. Subject to the terms of the MSOIP and DSOP, each option granted can be exercised for one Common Share.

From time to time, the Company repurchases its own shares for cancellation. Purchases are typically made through the facilities of the Toronto Stock Exchange and the New York Stock Exchange. The prices that we pay for any shares will be the market price at the time of purchase.

The information on our 2006 and 2007 normal course issuer bids (NCIB) as well as the private share repurchase disclosed in our MD&A documents for the year ended December 31, 2007 remains unchanged.

Shareholders may obtain, without charge, a copy of our Notice of Intention to Make a Normal Course Issuer Bid by writing to The Office of the Corporate Secretary, Canadian Pacific Railway Limited, Suite 920, Gulf Canada Square, 401 9th Avenue S.W., Calgary, Alberta, T2P 4Z4, by telephone at (403) 319-7165 or 1-866-861-4289, by fax at (403) 319-6770, or by e-mail at Shareholder@cpr.ca.

14.5 Dividends

As announced in the first quarter of 2008 a dividend of $0.2475 per share (2007 $0.2250) was paid on April 28, 2008.

On May 9, 2008, our Board of Directors declared a quarterly dividend of $0.2475 per share (2007 $0.2250 per share) on the outstanding Common Shares. The dividend is payable on July 28, 2008 to holders of record at the close of business on June 27, 2008.

15.0 FINANCIAL INSTRUMENTS

Our policy with respect to using derivative financial instruments is to selectively reduce volatility associated with fluctuations in interest rates, FX rates and the price of fuel. We document the relationship between the hedging instruments and their associated hedged items, as well as the risk management objective and strategy for the use of the hedging instruments. This documentation includes linking the derivatives that are designated as fair value or cash flow hedges to specific assets or liabilities on our Balance Sheet, commitments or forecasted transactions. At the time a derivative contract is entered into, and at least quarterly, we assess whether the derivative item is effective in offsetting the changes in fair value or cash flows of the hedged items. The derivative qualifies for hedge accounting treatment if it is effective in substantially mitigating the risk it was designed to address.

It is not our intent to use financial derivatives or commodity instruments for trading or speculative purposes.

The nature and extent of CP s use of financial instruments, as well as the risks associated with the instruments have not changed from our MD&A documents for the year ended December 31, 2007.

15.1 Interest Rate Management

15.1.1 Interest Rate Swaps

At June 30, 2008, the Company had outstanding interest rate swap agreements, classified as a fair value hedge, for a notional amount of US$200 million or CAD$203.9 million. The swap agreements convert a portion of the Company s fixed-interest-rate liability into a variable-rate liability for the 6.250% Notes. During the three months ended June 30, 2008, the Company recorded a gain of $0.9 million (second quarter of 2007 losses of $0.3 million) to Interest expense . For the first six months of 2008 this gain was $1.1 million (first half of 2007 losses of $0.8 million). At June 30, 2008, the unrealized gain, derived from the fair value of the swap, was $6.1 million (December 31, 2007 $5.5 million) which was reflected in Other assets and deferred charges and Accounts receivable and other current

assets on our Consolidated Balance Sheet. The fair value was calculated utilizing swap, currency and basis-spread curves from Bloomberg. These swaps are fully effective.

15.1.2 Interest and Treasury Rate Locks

During 2007, the Company entered into derivative agreements, which were designated as cash flow hedges, that established the benchmark rate on $350.0 million of 30 year debt that was expected to be issued (new debt issued in 2008 is discussed further in Section 13.3). These hedges were de-designated on May 13, 2008 when it was no longer probable that the Company would issue 30 year debt. On May 23, 2008, the fair value of these instruments was a loss of $30.9 million at the time of the issuance of the debt and the settlement of the derivative instrument. A gain of $1.3 million from the date of de-designation to the date of settlement of the derivative instrument was recorded in net income. Losses of $0.2 million and $1.1 million due to some ineffectiveness were recognized and recorded in net income during the second quarter of 2008 and the first half of 2008, respectively. Effective hedge losses of $28.7 million will be deferred in accumulated other comprehensive income and will be amortized in earnings as an adjustment to interest expense.

At June 30, 2008, net unamortized losses for previously settled interest and treasury rate locks of $0.4 million was reflected in AOCI on the Consolidated Balance Sheet. These gains and losses are being amortized to income as interest is paid on the related debt. The amortization of these gains and losses resulted in an increase in interest expense and Other comprehensive income on the Statement of Consolidated Income of $1.7 million in second quarter of 2008 and $1.6 million for the first half of 2008. The amortization of these gains and losses resulted in an increase in interest expense by $1.7 million in the second quarter of 2007 and $1.6 million for the half of 2007.

15.2 Foreign Exchange Management

We enter into foreign exchange risk management transactions primarily to manage fluctuations in the exchange rate between Canadian and US currencies. From time to time, we use foreign exchange forward contracts as part of our foreign exchange risk management strategy. We have designated a portion of our US dollar-denominated long-term debt as a hedge of our net investment in self-sustaining foreign subsidiaries.

15.2.1 Foreign Exchange Forward Contracts on Revenue

From time to time, we hedge a portion of our US dollar-denominated freight revenues earned in Canada by selling forward US dollars. We had no forward sales of US dollars outstanding at June 30, 2008 nor at June 30, 2007. Freight revenues on our Statement of Consolidated Income did not include any gain or loss on forward contracts for the second quarters of 2008 or 2007or for the first half of 2008 and 2007, as no forward hedges settled.

15.2.2 Currency Forward on Long-term Debt

In June 2007, the Company entered into a currency forward to fix the exchange rate on US$400 million 6.250% notes due 2011. This derivative guarantees the amount of Canadian dollars that the Company will repay when its US$400 million 6.25% note matures in October 2011. During the second quarter of 2008, the Company recorded a loss of $9.7 million, and a gain of $4.2 million for the first half of 2008, to Foreign exchange (gain) loss on long-term debt . For the same periods in 2007, the Company recorded an unrealized loss of $2.0 million. At June 30, 2008, the unrealized loss on the forward of $11.5 million (December 31, 2007 $15.7 million) was included in Deferred liabilities .

15.3 Fuel Price Management

Swaps and fuel cost recovery programs, together with fuel conservation practices, are the key elements of our program to manage the risk arising from fuel price volatility.

15.3.1 Crude Oil Swaps

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

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

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

For every US$1.00 increase in the price of WTI, fuel expense before tax and hedging will increase by approximately $7 million to $8 million, assuming current FX rates and fuel consumption levels. We have a fuel risk mitigation program to moderate the impact of increases in fuel prices, which includes these swaps and fuel recoveries.

15.4 Stock-Based Compensation Expense Management

15.4.1 Total Return Swap (TRS)

During May 2006, CP entered into a TRS to reduce the volatility and total cost to the Company over time of four stock-based compensation programs: share appreciation rights (SARs), deferred share units (DSUs), restricted share units (RSUs) and performance share units (PSUs) (discussed further in Section 19.2). The value of the TRS derivative is linked to the market value of our stock. Unrealized gains and losses on the TRS partially offset the costs and benefits recognized in these stock-based compensation programs due to fluctuations in share price during the period the TRS is in place. Compensation and benefits expense on our Statement of Consolidated Income included an unrealized gain on these swaps of $3.3 million in the second quarter of 2008 (2007 unrealized gain of $16.5 million) and $6.0 million in the first half of 2008 (2007 unrealized gain of $22.8 million). At June 30, 2008, the unrealized gain of $2.3 million on the TRS was included in Accounts receivable and other current assets on our Consolidated Balance Sheet, compared to an unrealized loss of $3.8 million included in Deferred liabilities at December 31, 2007.

16.0 OFF-BALANCE SHEET ARRANGEMENTS

The information on off-balance sheet arrangements disclosed in our MD&A documents for the year ended December 31, 2007 remains substantially unchanged, except as updated as follows.

16.1 Sale of Accounts Receivable

During the second quarter of 2008, our accounts receivable securitization program was terminated. At June 30, 2008, the outstanding undivided co-ownership interest held by an unrelated trust under our accounts receivable securitization program was $nil compared to $120.0 million at June 30, 2007. Losses of $1.2 million on the securitization program in second quarter of 2008, and $2.7 million for the first half of 2008 compared to losses of $1.4 million and $2.7 million for the same periods in 2007, were included in Other charges on our Statement of Consolidated Income.

Proceeds from collections reinvested in the accounts receivable securitization program were $233.7 million for the second quarter of 2008, compared with $380.7 million for the same period in 2007. Proceeds from collections reinvested in the accounts receivable securitization program were $595.4 million for the first half of 2008, compared with $757.9 million for the first half of 2007. We have complied with all termination tests during the program.

16.2 Guarantees

At June 30, 2008 we have certain guarantees, including, but not limited to, residual value guarantees on certain leased equipment, of $246.9 million, compared with $387.9 million at June 30, 2007. In addition, we have residual value guarantees of $11.6 million related to our investment in DM&E at June 30, 2008 (2007 $nil). Management estimates that we will have no net payments under these residual guarantees. We have accrued for all guarantees where performance under these guarantees is expected (discussed further in Note 19 to the Company s June 30, 2008 unaudited Interim Consolidated Financial Statements). These accruals do not include any amounts for residual value guarantees.

17.0 ACQUISITION

17.1 Dakota, Minnesota & Eastern Railroad Corporation

In September 2007, the Company entered into an agreement to acquire all of the issued and outstanding shares of DM&E, a Class II railroad with approximately 2,500 miles of track in the US Midwest and primary customers in agri-products and merchandise. DM&E is connected to the CP network at Minneapolis, Chicago and Winona. DM&E has connections to and traffic interchanges with all seven Class I railroads and is proximate to the Powder River Basin (PRB), which contains the largest deposit of low-cost, low-sulphur coal in North America.

Effective October 4, 2007, the Company acquired all of the issued and outstanding shares of DM&E 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 PRB 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 (discussed further in Section 13.3).

The purchase is subject to review and approval by the US Surface Transportation Board (STB), during which time the shares of DM&E have been placed in a voting trust. The Company anticipates that the STB will complete its review and provide a final ruling during 2008. During the review period, the investment in the DM&E will be accounted for on an equity basis. Equity

income for the three months ended June 30, 2008 of $13.4 million, and equity income for the first half of 2008 of $24.4 million has been included in Equity income in Dakota, Minnesota & Eastern Railroad Corporation .

If the proposed transaction is approved by the STB, the acquisition will be accounted for 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.

Preliminary purchase price allocation is disclosed in Note 11 to the 2007 Annual Financial Statements and remains unchanged as at June 30, 2008.

18.0 CONTRACTUAL COMMITMENTS

The accompanying table indicates our known obligations and commitments to make future payments for contracts, such as debt and capital lease and commercial arrangements.

CONTRACTUAL COMMITMENTS AT JUNE 30, 2008

Payments due by period (in millions)	Total	< 1 year	1 - 3 years	3 - 5 years	After 5 years
Long-term debt	$4,030.4	$ 15.7	$ 599.2	$ 471.6	$2,943.9
Capital lease obligations	277.0	1.1	33.8	14.1	228.0
Operating lease obligations[1]	707.8	71.1	207.1	158.7	270.9
Supplier purchase obligations	776.5	101.9	189.6	182.4	302.6
Other long-term liabilities reflected on our Consolidated Balance Sheet [2]	2,737.1	63.2	208.2	191.2	2,274.5
Total contractual obligations	**$8,528.8**	**$253.0**	**$1,237.9**	**$1,018.0**	**$6,019.9**

(1) Residual value guarantees on certain leased equipment with a maximum exposure of $264.9 million (discussed in Section 16.2) are not included in the minimum payments shown above, as management estimates that we will not be required to make payments under these residual guarantees.

(2)

Includes expected cash payments for restructuring, environmental remediation, asset retirement obligations, post-retirement benefits, workers compensation benefits, long-term disability benefits, pension benefit payments for our non-registered supplemental pension plans, future income tax liabilities and certain other deferred liabilities. Projected payments for post-retirement benefits, workers compensation benefits and long-term disability benefits include the anticipated payments for years 2008 to 2016. Pension contributions for our registered pension plans are not included due to the volatility in calculating them. Pension payments are discussed

further in Section 19.5. Future income tax liabilities may vary according to changes in tax rates, tax regulations and the operating results of the Company. As the cash impact in any particular year cannot be reasonably determined, all long-term future tax liabilities have been reflected in the after 5 years category in this table. Future income taxes are further discussed in Section 21.4.

19.0 FUTURE TRENDS AND COMMITMENTS

The information on future trends and commitments disclosed in our MD&A for the year ended December 31, 2007 remains substantially unchanged, except as updated as follows.

19.1 Agreements and Recent Development

During the first half of 2007, we announced our intention to assemble a rail corridor to access the Alberta Industrial Heartland northeast of Edmonton that serves the Alberta oilsands development. The Company has filed its application with the Canadian Transportation Agency, to initiate the regulatory permitting process for construction of the rail corridor to proceed.

19.2 Stock Price

The market value of our Common Shares measured at June 30, 2008 increased $1.70 per share on the Toronto Stock Exchange in the second quarter of 2008 (from $66.00 to $67.70) and $3.48 per share in the first half of 2008 (from $64.22 to $67.70). The market value of our Common Shares increased $8.62 per share on the Toronto Stock Exchange in the second quarter of 2007 (from $64.95 to $73.57), and increased $12.17 in the first half of 2007 (from $61.40 to $73.57). These changes in share price caused corresponding increases in the value of our outstanding SARs, DSUs, RSUs and PSUs.

Effective the second quarter of 2006, we put in place a TRS to mitigate gains and losses associated with the effect of our share price on the SARs, DSUs, RSUs and PSUs. Excluding the impact of our TRS, the cost of our SARs, DSUs, RSUs and PSUs was $4.7 million in the second quarter of 2008 based on the change in share price, and $10.1 million for the first half of 2008, compared with $23.9 million and $33.7 million for the same periods in 2007. Including the impact of our TRS, the cost of our SARs, DSUs, RSUs and PSUs was $1.4 million in second quarter 2008 and $4.0 million for the first in the first half of 2008 compared with $7.4 million and $10.9 million for the same periods in 2007.

19.3 Environmental

We continue to be responsible for remediation work on portions of a property in the State of Minnesota and continue to retain liability accruals for remaining future expected costs. The costs are expected to be incurred over approximately 10 years. The

State of Minnesota s voluntary investigation and remediation program will oversee the work to ensure it is completed in accordance with applicable standards.

19.4 Certain Other Financial Commitments

In addition to the financial commitments mentioned previously in Section 16.0 and Section 18.0, we are party to certain other financial commitments set forth in the adjacent table and discussed below.

CERTAIN OTHER FINANCIAL COMMITMENTS AT JUNE 30, 2008

Amount of commitment per period (in millions)	**Total**	**2008**	**2009 & 2010**	**2011 & 2012**	**2013 & beyond**
Letters of credit	$ 339.0	$ 339.0	$	$	$
Capital commitments	566.5	160.9	184.4	34.3	186.9
Offset financial liability	201.2	201.2			
Total commitments	**$ 1,106.7**	**$ 701.1**	**$ 184.4**	**$ 34.3**	**$ 186.9**

19.4.1 Letters of Credit

Letters of credit are obtained mainly to provide security to third parties as part of various agreements, such as required by our workers compensation and pension fund requirements. We are liable for these contract amounts in the case of non-performance under these agreements. As a result, our available line of credit is adjusted for contractual amounts obtained through letters of credit currently included within our revolving credit facility.

19.4.2 Capital Commitments

We remain committed to maintaining our current high level of plant quality and renewing our franchise. As part of this commitment, we are obligated to make various capital purchases related to track programs, locomotive acquisitions and overhauls, freight cars, and land. At June 30, 2008, we had multi-year capital commitments of $566.5 million in the form of signed contracts, largely for locomotive overhaul agreements. Payments for these commitments are due in 2008 through 2022. These expenditures are expected to be financed by cash generated from operations or by issuing new debt.

19.4.3 Offset Financial Liability

We entered into a bank loan to finance the acquisition of certain equipment. This loan is offset by a financial asset with the same institution. At June 30, 2008, the loan had a balance of $201.2 million, offset by a financial asset of $196.2 million. The remainder is included in Long-term debt on our Consolidated Balance Sheet.

19.5 Pension Plan Deficit

We estimate that every 1.0 percentage point increase (or decrease) in the discount rate can cause our defined benefit pension plans deficit to decrease (or increase) by approximately $625 million, reflecting the changes to both the pension obligations and the value of the pension funds debt securities. Similarly, for every 1.0 percentage point the actual return on assets varies above (or below) the estimated return for the year, the deficit would decrease (or increase) by approximately $75 million. Adverse experience with respect to these factors could eventually increase funding and pension expense significantly, while favourable experience with respect to these factors could eventually decrease funding and pension expense significantly.

Between 46.5% and 52.5% of the plans assets are invested in public equity securities. As a result, stock market performance is the key driver in determining the pension funds asset performance. Most of the plans remaining assets are invested in debt securities, which, as mentioned above, provide a partial offset to the increase (or decrease) in our pension deficit caused by decreases (or increases) in the discount rate.

The deficit will fluctuate according to future market conditions and funding will be revised as necessary to reflect such fluctuations. We will continue to make contributions to the pension plans that, as a minimum, meet pension legislative requirements.

We made contributions of $26.2 million to the defined benefit pension plans in the second quarter of 2008 and $46.8 million in the first half of 2008, compared with $19.2 million and $39.5 million for the same periods in 2007. The minimum 2008 contribution requirement for our main pension plan is set out in an actuarial valuation as at January 1, 2008. At this time, we expect our pension contribution in 2008 to be approximately $95 million. Future pension contributions will be highly dependent on our actual experience with such variables as investment returns, interest rate fluctuations and demographic changes, as well as on any changes in the regulatory environment.

19.6 Restructuring

Restructuring initiatives were announced in 2003 and 2005 to improve efficiency in our administrative areas by eliminating 1,220 management and administrative positions. The total targeted reductions for these initiatives were successfully achieved by the end of the third quarter of 2006. We will continue to hire selectively in specific areas of the business, as required by growth or changes in traffic patterns.

Cash payments related to severance under all restructuring initiatives and to our environmental remediation program (described in Section 21.1) totalled $10.8 million in the second quarter of 2008, and $24.5 million for the first half of 2008, compared with $12.0 million and $25.2 million in the same periods in 2007. Payments relating to the labour liabilities were $8.3 million in the second quarter of 2008, and $20.6 million for the first half of 2008 compared with $9.6 million and $22.1 million for the same periods in 2007.

Cash payments for restructuring and environmental initiatives are estimated to be $35 million for the remainder of 2008, $40 million in 2009, $34 million in 2010, and a total of $120 million over the remaining years through 2025, which will be paid in decreasing amounts. All payments will be funded from general operations. Of these amounts, cash payments related only to the restructuring initiatives are expected to be $22 million for the remainder of 2008, $24 million in 2009, $20 million in 2010, and a total of $60 million over the remaining years through 2025. These amounts include residual payments to protected employees for previous restructuring plans that have been completed.

20.0 BUSINESS RISKS AND ENTERPRISE RISK MANAGEMENT

In the normal course of our operations, we are exposed to various business risks and uncertainties that can have an effect on our financial condition. While some financial exposures are reduced through insurance and hedging programs we have in place, there are certain cases where the financial risks are not fully insurable or are driven by external factors beyond our influence or control.

As part of the preservation and delivery of value to our shareholders, we have developed an integrated Enterprise Risk Management (ERM) framework to support consistent achievement of key business objectives through daily pro-active management of risk. The objective of the program is to identify events that result from risks, thereby requiring active management. Each event identified is assessed based on the potential severity and the ability of the risk to impact our financial position and reputation, taking into account existing management control and likelihood. Risk mitigation strategies are formulated to accept, treat, transfer, or eliminate the exposure to the identified events.

Key areas of business risks and uncertainties that we have identified through our ERM framework and our mitigating strategies are discussed in Section 22.0 of our MD&A for the year ended December 31, 2007. This information on business risks and enterprise risk management remains substantially unchanged, except as updated as follows. Readers are cautioned that the following is not an exhaustive list of all the risks we are exposed to, nor will our mitigation strategies eliminate all risks listed.

20.1 Liquidity

CP has long term debt ratings of Baa3, BBB, and BBB from Moody s, S&P, and DBRS respectively. The ratings of Moody s and DBRS have a stable outlook. The S&P rating has a negative outlook.

CP has a five year revolving credit facility of $945 million, with an accordion feature to $1,150 million, of which $351 million was available on June 30, 2008. This facility is arranged with a core group of highly rated international banks and incorporate pre-agreed pricing. The revolving credit facility and the temporary credit facility are available on next day terms.

It is CP s intention to manage its long term financing structure to maintain its investment grade rating. CP may decide to enter into certain derivative instruments to reduce interest rate exposure.

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

20.2 Regulatory Authorities

20.2.1 Regulatory Change

Our railway operations are subject to extensive federal laws, regulations and rules in both Canada and the US which directly affect how we manage many aspects of our railway operation and business activities. Our operations are primarily regulated by the Canadian Transportation Agency and Transport Canada in Canada and the FRA and STB in the US. Various other federal regulators directly and indirectly affect our operations in areas such as health, safety, security and environment and other matters, all of which may affect our business or operating results.

The *Canada Transportation Act* (CTA) contains shipper rate and service remedies, including final-offer arbitration, competitive line rates, and compulsory inter-switching.

In Canada, legislation amending the CTA was passed and is now in effect as law in Bill C-11 and Bill C-8. These amendments include, but are not limited to, amendments concerning the grain revenue cap, commuter and passenger

access, final offer arbitration, charges for ancillary services, and railway noise. The grain revenue cap is a cap imposed by Canadian federal law on the amount of revenue we may earn for the transportation of certain grain from western Canada to Vancouver for export or to

Thunder Bay. During the quarter ended March 31, 2008, the Canadian Transportation Agency (the Agency) announced a Decision directing a downward adjustment of the railway maximum revenue entitlement for movement of regulated grain under the Canada Transportation Act, for the period from August 1, 2007 to July 31, 2008. The Company has applied to the Federal Court of Appeal and received leave to appeal the Decision and the Court has stayed the Agency Decision pending outcome of the Appeal. A provision considered adequate by management has been maintained for a prospective adjustment effective February 20, 2008. The retroactive component of this potential adjustment from August 1, 2007 to February 19, 2008, for which no provision has been made and which is estimated to be $23 million, is, among other issues in the Decision, not considered to be legally supportable. Noise complaints have been filed with the Agency, with some noise complaints resolved through mediation and others remaining unresolved. No assurance can be given as to the effect on CP of the provisions of Bill C-11 or C-8 or as to the content, timing or effect on CP of any anticipated additional legislation.

The FRA has jurisdiction over safety-related aspects of our railway operations in the US. State and local regulatory agencies may also exercise limited jurisdiction over certain safety and operational matters of local significance.

The commercial aspects of CP s railway operations in the US are subject to regulation by the STB. The STB passed new rules for the imposition of fuel surcharges and has promulgated proposed new rules for the handling of disputes by small and medium shippers. It is too early to assess the possible impact on CP of such new rules, which are currently under judicial review, and any rules or regulation which might be forthcoming as a result of current STB reviews.

To mitigate statutory and regulatory impacts, we are actively and extensively engaged throughout the different levels of government and regulators, both directly and indirectly through industry associations, including the Association of American Railroads (AAR) and the Railway Association of Canada (RAC).

20.2.2 Security

We are subject to statutory and regulatory directives in the US that address security concerns. Because CP plays a critical role in the North American transportation system, our rail lines, facilities, and equipment, including rail cars carrying hazardous materials, could be direct targets or indirect casualties of terrorist attacks. Current proposed regulations by the Department of Transportation and the Department of Homeland Security include speed restrictions, chain of custody and security measures which could cause service degradation and higher costs for the transportation of hazard materials, especially toxic inhalation materials. In addition, insurance premiums for some or all of our current coverage could increase significantly, or certain coverage may not be available to us in the future. While CP will continue to work closely with Canadian and US government agencies, future decisions by these agencies on security matters or decisions by the industry in response to security threats to the North American rail network could have a materially adverse effect on our business or operating results.

As we strive to ensure our customers have unlimited access to North American markets, we have taken the following steps to provide enhanced security and reduce the risks associated with the cross-border transportation of goods:

- to strengthen the overall supply chain and border security, we are a certified carrier in voluntary customs programs, such as the Customs-Trade Partnership Against Terrorism and Partners in Protection;

- to streamline clearances at the border, we have implemented several regulatory security frameworks that focus on the provision of advanced electronic cargo information and improved security technology at border crossings, including the implementation of Vehicle and Cargo Inspection System at five of our border crossings;

- to strengthen railway security in North America, we signed a revised voluntary Memorandum of Understanding with Transport Canada and worked with the AAR to develop and put in place an extensive industry-wide security plan to address terrorism and security-driven efforts seeking to restrict the routings and operational handlings of certain hazardous materials; and

- to reduce toxic inhalation risk in high threat urban areas, we are working with the Transportation Security Administration; and

to comply with new U.S. regulations, we will be completing annual route assessments to select and use the route posing the least overall safety and security risk.

20.3 Labour Relations

Certain of our union agreements are currently under renegotiation. We cannot guarantee these negotiations will be resolved in a timely manner or on favourable terms. Work stoppage may occur if the negotiations are not resolved, which could materially impact business or operating results.

Agreements are in place with all seven bargaining units that represent our employees in Canada and 18 of 27 bargaining units that represent employees in our US operations. The following is a negotiations status summary.

20.3.1 Canada

On January 26, 2008, CP and the Canadian Auto Workers (CAW), representing employees who maintain and repair

locomotives and freight cars, reached a tentative three-year agreement extending through to the end of 2010. This agreement was ratified on February 15, 2008.

On December 5, 2007, CP and the Teamsters Canada Rail Conference (TCRC-RTE), which represents employees who operate trains, reached a tentative five-year agreement extending through the end of 2011. This agreement was ratified on February 13, 2008.

On July 18, 2007, a three-year agreement extending through December 31, 2009 with the Teamsters Canada Rail Conference (TCRC-MWED), which represents employees who maintain track infrastructure and perform capital programs, was ratified.

A five-year collective agreement with the International Brotherhood of Electrical Workers, representing signal maintainers, extends to the end of 2009.

A four-year collective agreement with the Canadian Pacific Police Association, representing CP Police sergeants and constables, extends to the end of 2009.

A three-year agreement with the Steelworkers Union, representing intermodal operation and clerical employees extends to the end of 2009.

A three-year collective agreement, with the Teamsters Canada Rail Conference, Rail Canada Traffic Controllers, representing employees who control train traffic, extends to the end of 2008.

20.3.2 US

We are party to collective agreements with 14 bargaining units of our Soo Line Railroad Company (Soo Line) subsidiary and 13 bargaining units of our Delaware and Hudson Railway (D&H) subsidiary.

With respect to Soo Line, negotiations are underway with one bargaining unit representing track maintainers. An Agreement with the car repair employees was ratified on June 25, 2008 and a tentative agreement was reached with the conductors on June 26, 2008 which is being submitted for ratification by the employees. We anticipate that this process will be completed by August 5, 2008. These agreements extend through 2009 as do existing agreements with the bargaining units representing locomotive engineers, train dispatchers, yard supervisors, clerks, machinists, boilermaker and blacksmiths, signal maintainers, electricians, sheet metal workers, mechanical laborers, and mechanical supervisors.

D&H has agreements in place with six unions representing mechanical supervisors, mechanical labourers, machinists, police and yard supervisors and the agreement which was ratified with the union representing locomotive engineers on May 14, 2008. A tentative agreement was reached with the conductors on June 19, 2008. Negotiations continue with electricians, track maintainers, clerks, signal repair employees, engineering supervisors, and car repairers.

20.4 Financial risks

20.4.1 Pension Funding Status Volatility

Our main Canadian defined benefit pension plan can produce significant volatility in pension funding requirements, given the pension fund s size, the differing drivers of the pension asset and liability values, and Canadian statutory pension funding requirements. CP has made several changes to the plan s investment policy over the last several years to reduce this volatility, without increasing the expected long-term costs of maintaining this plan. These investment policy changes include: reducing the plan s public equity markets exposure, with the funds redirected to less volatile Canadian commercial real estate and private market infrastructure; increasing the duration of the plan s fixed income assets so as to better match the sensitivity of the plan s liabilities to interest rate movements; and hedging approximately 50% of the plan s foreign currency exposure.

20.5 General and Other Risks

There are factors and developments that are beyond the influence or control of the railway industry generally and CP specifically which may have a material adverse effect on our business or operating results. Our freight volumes and

revenues are largely dependent upon the performance of the North American and global economies, which remains uncertain, and other factors affecting the volumes and patterns of international trade. We are also sensitive to factors including, but not limited to, natural disasters, security threats, weather, insect populations, commodity pricing, global supply and demand, and supply chain efficiency, as well as developments affecting North America s agricultural, mining, forest products, consumer products, import/export and automotive sectors.

21.0 CRITICAL ACCOUNTING ESTIMATES

The development, selection and disclosure of these estimates, and this MD&A, have been reviewed by the Board of Directors Audit, Finance and Risk Management Committee, which is comprised entirely of independent directors.

21.1 Environmental Liabilities

At June 30, 2008, the accrual for environmental remediation on our Consolidated Balance Sheet amounted to $103.7 million (June 30, 2007 $112.7 million), of which the long-term portion amounting to $85.0 million (2007 $92.0 million) was included in Deferred liabilities and the short-term portion amounting to $18.7 million (2007 $20.7 million) was included in Accounts

payable and accrued liabilities . Total payments were $2.5 million in the second quarter, and $3.7 million for the first half of 2008 and $2.4 million and $3.0 million for the same periods of 2007. The US dollar-denominated portion of the liability was affected by the change in FX, resulting in a decrease in environmental liabilities of $0.3 million in second quarter 2008, and an increase of $1.5 million for the first half 2008 compared with a decrease of $5.2 million and $5.8 million for the same periods in 2007.

21.2 Pensions and Other Benefits

Other assets and deferred charges on our June 30, 2008 Consolidated Balance Sheet included prepaid pension costs of $1,131.1 million. Our Consolidated Balance Sheet also included $0.3 million in Accounts payable and accrued liabilities and $0.8 million in Deferred liabilities for pension obligations.

We included post-retirement benefits accruals of $209.8 million in Deferred liabilities and post-retirement benefits accruals of $18.9 million in Accounts payable and accrued liabilities on our June 30, 2008 Consolidated Balance Sheet.

Pension and post-retirement benefits expenses were included in Compensation and benefits on our June 30, 2008 Statement of Consolidated Income. Combined pension and post-retirement benefits expenses (excluding self-insured workers compensation and long-term disability benefits) were $19.9 million in the second quarter of 2008, and $39.0 million for the first half of 2008, compared with $27.1 million and $54.5 million for the same periods of 2007. Pension expense consists of defined benefit pension expense plus defined contribution pension expense (equal to contributions). Pension expense was $11.5 million in the second quarter of 2008, and $21.8 million for the first half of 2008, compared with $16.0 million and $32.2 million for the same periods in 2007. Defined benefit pension expense was $10.7 million in the second quarter and $20.1 million in the first half of 2008, compared with $15.4 million and $30.5 million for the same periods in 2007. Defined contribution pension expense was $0.8 million in the second quarter and $1.7 million for the first half of 2008, compared with $0.6 million and $1.7 million for the same periods in 2007. Post-retirement benefits expense was $8.4 million in the second quarter and $17.2 million for the first half of 2008, compared with $11.0 million and $22.2 million for the same periods in 2007.

21.3 Property, Plant and Equipment

At June 30, 2008 accumulated depreciation was $5,427.3 million. Depreciation expense relating to properties amounted to $124.7 million in the second quarter of 2008, compared with $119.1 million for the same period of 2007. Depreciation expense related to properties amounted to $244.6 million in the first six months of 2008, compared with $237.7 million for the same period of 2007.

Revisions to the estimated useful lives and net salvage projections for properties constitute a change in accounting estimate and we address these prospectively by amending depreciation rates. It is anticipated that there will be changes in the estimates of weighted average useful lives and net salvage for each property group as assets are acquired, used and retired. Substantial changes in either the useful lives of properties or the salvage assumptions could result in significant changes to depreciation expense. For example, if the estimated average life of road locomotives, our largest asset group, increased (or decreased) by 5%, annual depreciation expense would decrease (or increase) by approximately $3 million.

We review the carrying amounts of our properties when circumstances indicate that such carrying amounts may not be recoverable based on future undiscounted cash flows. When such properties are determined to be impaired, recorded asset values are revised to the fair value and an impairment loss is recognized.

Depreciation expense increased $5.6 million in the second quarter of 2008, and $6.9 million in the first six months of 2008 primarily due to accelerated depreciation on software and capital additions (especially track).

21.4 Future Income Taxes

Future income tax expense totalling $32.4 million was included in income tax for the second quarter of 2008, and $27.9 million for the first half of 2008, compared with $57.7 million and $96.2 million of future tax expense for the same periods of 2007. The changes in future income tax for second quarter and first half of 2008 were primarily due to lower taxable income and tax rate changes implemented by provincial governments (discussed further in Section 10.5). At June 30, 2008, future income tax liabilities of $1,741.8 million were recorded as a long-term liability and comprised largely of temporary differences related to accounting for properties. Future income tax benefits of $66.7 million realizable within one year were recorded as a current asset.

21.5 Legal and Personal Injury Liabilities

Provisions for incidents, claims and litigation charged to income, which are included in Purchased services and other on our Statement of Consolidated Income, amounted to $18.7 million in the second quarter of 2008, and $37.7 million for the first half of the year compared with $5.2 million and $18.7 million for the same periods in 2007.

Accruals for incidents, claims and litigation, including Workers Compensation Board accruals, totalled $149.4 million, net of insurance recoveries, at June 30, 2008. The total accrual included $99.2 million in Deferred liabilities and $72.1 million in Accounts payable and accrued liabilities , offset by $11.5 million in Other assets and deferred charges and $10.4 million in Accounts receivable .

21.6 Canadian Third Party Asset-backed Commercial Paper

At June 30, 2008, ABCP has been valued at its estimated fair value (discussed further in Section 10.3). ABCP, at its estimated fair value of $100.8 million, was included in Investments . An estimated change in fair value of $21.5 million was recognized as a charge to income in Change in estimated fair value of Canadian third party asset-backed commercial paper in the third quarter of 2007. A further estimated change in fair value of $21.3 million was recognized as a charge to income to the same account in the first quarter of 2008.

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

22.0 SYSTEMS, PROCEDURES AND CONTROLS

The Company s Chief Executive Officer and Chief Financial Officer are responsible for establishing and maintaining disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the US Securities Exchange Act of 1934 (as amended)) to ensure that material information relating to the Company is made known to them. The Chief Executive Officer and Chief Financial Officer have a process to evaluate these disclosure controls and are satisfied that they are adequate for ensuring that such material information is made known to them.

23.0 FORWARD-LOOKING INFORMATION

This MD&A, especially but not limited to this section, contains certain forward-looking statements within the meaning of the *Private Securities Litigation Reform Act of 1995* (US) and other relevant securities legislation relating but not limited to our operations, anticipated financial performance, business prospects and strategies.

Forward-looking information typically contains statements with words such as anticipate , believe , expect , plan or similar words suggesting future outcomes.

Readers are cautioned to not place undue reliance on forward-looking information because it is possible that we will not achieve predictions, forecasts, projections and other forms of forward-looking information. In addition, except as required by law, we undertake no obligation to update publicly or otherwise revise any forward-looking information, whether as a result of new information, future events or otherwise.

By its nature, our forward-looking information involves numerous assumptions, inherent risks and uncertainties, including but not limited to the following factors: changes in business strategies; general North American and global economic and business conditions; the availability and price of energy commodities; the effects of competition and pricing pressures; industry capacity; shifts in market demands; changes in laws and regulations, including regulation of rates; changes in taxes and tax rates; potential increases in maintenance and operating costs; uncertainties of litigation; labour disputes; risks and liabilities arising from derailments; timing of completion of capital and maintenance projects; currency and interest rate fluctuations; effects of changes in market conditions on the financial position of pension plans and liquidity of investments; various events that could disrupt operations, including severe weather conditions; security threats and governmental response to them; and technological changes.

There are more specific factors that could cause actual results to differ from those described in the forward-looking statements contained in this MD&A. These more specific factors are identified and discussed in Section 20.0 and elsewhere in this MD&A and Section 22.0 in our MD&A for the year ended December 31, 2007 with the particular forward-looking statement in question.

23.1 2008 Financial Outlook

The following is the original 2008 guidance we provided in October 2007:

2008 Financial Outlook	Guidance	Date Approved	Key 2008 Assumptions
Total revenues	Increase of 4%-6%	Oct 29, 2007	average crude oil prices of US $80 per barrel;
Total operating expenses	Increase of 3%-5%	Oct 29, 2007	average FX rate of $1.00 per US dollar;

Adjusted Diluted EPS[1]	$4.70-$4.85	Oct 29, 2007	North American economic (GDP) growth of 2.5%; and
Capital expenditures	$885-$895 million	Oct 29, 2007	Tax rate of 29%-31%.
Free Cash[1]	In excess of $250 million	Oct 29, 2007	

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

23.1.1 2008 Q1 Guidance Updates

We subsequently revised certain of our 2008 guidance in April of 2008 as follows:

2008 Financial Outlook	Guidance	Date Approved	Key 2008 Assumptions
Total revenues	Increase of 4%-6%	Apr 21, 2008	average crude oil prices of US $98 per barrel[2];
Total operating expenses	Increase of 6%-8%	Apr 21, 2008	average all-in fuel cost of US $3.35 per US gallon[3];
Adjusted Diluted EPS[1]	$4.40-$4.60	Apr 21, 2008	average FX rate of $1.00 per US dollar;
Capital expenditures	$885-$895 million	Apr 21, 2008	US GDP growth of 1.2%[4];
Free Cash[1]	Approximately $200 million	Apr 21, 2008	Canadian GDP growth of 1.6%[4]; and
			Tax rate of 27%-29%[5].

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

(2) This assumption had been revised to US $87 per barrel in our January 29, 2008 press release, and revised to US $98 per barrel in our April 22, 2008 press release.

(3) This additional assumption was in our April 22, 2008 press release.

(4) The North American GDP growth assumption had been revised in April of 2008 to reflect current economic conditions.

(5) This assumption had been revised in our April 22, 2008 press release.

In our February 20, 2008 press release, our adjusted diluted EPS was revised downward to the range of $4.65 to $4.80. This was the result of the prospective application of the Canadian Transportation Agency s adjustment to the grain revenue entitlement under the CTA (discussed further in Section 20.2.1).

In our April 22, 2008 press release, our guidance was updated as follows:

adjusted diluted EPS was revised to the range of $4.40 to $4.60;

total operating expenses was expected to increase by six to eight percent; and

free cash was expected to be approximately $200 million.

Our 2008 guidance was revised in April of 2008 to reflect:

the harsh weather conditions in the first quarter of 2008;

continued increase in fuel price; and

the ongoing economic uncertainty.

23.1.2 2008 Q2 Guidance Updates

We further revised certain of our 2008 guidance in July of 2008 as follows. The following is the most updated 2008 guidance we provided:

08 Financial Outlook	Guidance	Date Approved	Key 2008 Assumptions
al revenues	Increase of 6%-8%	July 21, 2008	average crude oil prices of US $121 per barrel[2];
al operating expenses	Increase of 11%-13%	July 21, 2008	average all-in fuel cost of US $3.80 to $3.90 per US gallon[2];
justed Diluted EPS[1]	$4.00-$4.20	July 21, 2008	average FX rate of $1.00 per US dollar;
pital expenditures	$885-$895 million	July 21, 2008	US GDP growth of 1.6%[2];

e Cash[1]	Approximately $150 million	July 21, 2008	Canadian GDP growth of 1.2%[2]; and Tax rate of 26%-27%[2].

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

(2) This assumption had been revised subsequent to our April 22, 2008 press release.

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

The approximate net annual impact on EPS of changes in WTI and crack margin given our current portfolio of freight contracts is as follows:

a change in WTI of US$2 per barrel impacts EPS by $0.01; and

a change in crack margins of US$1 per barrel impacts EPS by $0.02.

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

Our 2008 guidance was revised in July of 2008 to reflect the continued increase in fuel price and the ongoing economic uncertainty.

The purpose of our guidance is to provide shareholders transparency with respect to management s expectations of our operations and financial performance. Undue reliance should not be placed on this guidance and other forward-looking information for other purposes.

24.0 GLOSSARY OF TERMS

ABCP	Canadian third party asset-backed commercial paper.
Average train speed	The average speed attained as a train travels between terminals, calculated by dividing the total train miles traveled by the total hours operated. This calculation does not include the travel time or the distance traveled by: i) trains used in or around CP s yards; ii) passenger trains; and iii) trains used for repairing track. The calculation also does not include the time trains spend waiting in terminals.
Car miles per car day	The total car-miles for a period divided by the total number of active cars. Total car-miles includes the distance travelled by every car on a revenue-producing train and a train used in or around our yards. A car-day is assumed to equal one active car. An active car is a revenue-producing car that is generating costs to CP on an hourly or mileage basis. Excluded from this count are i) cars that are not on the track or are being stored; ii) cars that are in need of repair; iii) cars that are used to carry materials for track repair; iv) cars owned by customers that are on the customer s tracks; and v) cars that are idle and waiting to be reclaimed by CP.
Carloads	Revenue-generating shipments of containers, trailers and freight cars.
CICA	Canadian Institute of Chartered Accountants.
CPRL	Canadian Pacific Railway Limited.
CP , the Company	CPRL, CPRL and its subsidiaries, CPRL and one or more of its subsidiaries, or one or more of CPRL s subsidiaries.
Diluted EPS	Calculated by dividing net income by the weighted average number of shares outstanding, adjusted for the dilutive effect of outstanding stock options, as calculated using the Treasury Stock Method. This method assumes options that have an exercise price below the market price of the shares are exercised and the proceeds are used to purchase common shares at the average market price during the period.
Diluted EPS, before FX on LTD and other specified items	A variation of the calculation of diluted EPS, which is calculated by dividing income, before FX on LTD and other specified items, by the weighted average number of shares outstanding, adjusted for outstanding stock options using the Treasury Stock Method, as described above under Diluted EPS .
D&H	Delaware and Hudson Railway Company, Inc., a wholly owned indirect US subsidiary of CPRL.
DM&E	Dakota, Minnesota & Eastern Railroad Corporation.
EPS	Earnings per share.

Fluidity	Obtaining more value from our existing assets and resources.
Foreign Exchange or FX	The value of the Canadian dollar relative to the US dollar (exclusive of any impact on market demand).
FRA	US Federal Railroad Administration, a regulatory agency whose purpose is to promulgate and enforce rail safety regulations; administer railroad assistance programs; conduct research and development in support of improved railroad safety and national rail transportation policy; provide for the rehabilitation of Northeast Corridor rail passenger service; and consolidate government support of rail transportation activities.

FRA personal injury rate per 200,000 employee-hours	The number of personal injuries, multiplied by 200,000 and divided by total employee-hours. Personal injuries are defined as injuries that require employees to lose time away from work, modify their normal duties or obtain medical treatment beyond minor first aid. Employee-hours are the total hours worked, excluding vacation and sick time, by all employees, excluding contractors.
FRA train accidents rate	The number of train accidents, multiplied by 1,000,000 and divided by total train-miles. Train accidents included in this metric meet or exceed the FRA reporting threshold of US$8,500 in damage.
Freight revenue per carload	The amount of freight revenue earned for every carload moved, calculated by dividing the freight revenue for a commodity by the number of carloads of the commodity transported in the period.
Freight revenue per RTM	The amount of freight revenue earned for every RTM moved, calculated by dividing the total freight revenue by the total RTMs in the period.
FX on LTD	Foreign exchange gains and losses on long-term debt.
GAAP	Canadian generally accepted accounting principles.
GTMs or gross ton-miles	The movement of total train weight over a distance of one mile. Total train weight is comprised of the weight of the freight cars, their contents and any inactive locomotives. An increase in GTMs indicates additional workload.
IOP	Integrated Operating Plan, the foundation for our scheduled railway operations.
LIBOR	London Interbank Offered Rate.
MD&A	Management s Discussion and Analysis.
Number of active employees	The number of actively employed workers during the last month of the period. This includes employees who are taking vacation and statutory holidays and other forms of short-term paid leave, and excludes individuals who have a continuing employment relationship with us but are not currently working.
Operating income	Calculated as revenues less operating expenses and is a common measure of profitability used by management.
Operating ratio	The ratio of total operating expenses to total revenues. A lower percentage normally indicates higher efficiency.
Return on capital employed or ROCE	Earnings before after-tax interest expense for the current quarter and the previous three quarters divided by average net debt plus equity.
RTMs or revenue ton-miles	The movement of one revenue-producing ton of freight over a distance of one mile.
Soo Line	Soo Line Railroad Company, a wholly owned indirect US subsidiary of CPRL.

STB	US Surface Transportation Board, a regulatory agency with jurisdiction over railway rate and service issues and rail restructuring, including mergers and sales.

Terminal dwell	The average time a freight car resides at a specified terminal location. The timing starts with a train arriving in the terminal, a customer releasing the car to us, or a car arriving that is to be transferred to another railway. The timing ends when the train leaves, a customer receives the car from us or the freight car is transferred to another railway. Freight cars are excluded if: i) a train is moving through the terminal without stopping; ii) they are being stored at the terminal; iii) they are in need of repair; or iv) they are used in track repairs.
US gallons of locomotive fuel consumed per 1,000 GTMs	The total fuel consumed in freight and yard operations for every 1,000 GTMs traveled. This is calculated by dividing the total amount of fuel issued to our locomotives, excluding commuter and non-freight activities, by the total freight-related GTMs. The result indicates how efficiently we are using fuel.
WCB	Workers Compensation Board, a mutual insurance corporation providing workplace liability and disability insurance in Canada.
WTI	West Texas Intermediate, a commonly used index for the price of a barrel of crude oil.

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CANADIAN PACIFIC RAILWAY LIMITED (CPRL)
Supplemental Financial Information (unaudited)
Exhibit to June 30, 2008 Consolidated Financial Statements
CONSOLIDATED EARNINGS COVERAGE RATIOS MEDIUM TERM NOTES AND DEBT SECURITIES

The following ratios, based on the consolidated financial statements, are provided in connection with the continuous offering of medium term notes and debt securities by Canadian Pacific Railway Company, a wholly-owned subsidiary of CPRL, and are for the **twelve month period** then ended.

	Twelve Months Ended June 30, 2008
Earnings Coverage on long-term debt	
Before foreign exchange on long-term debt [(1)] [(3)]	4.7
After foreign exchange on long-term debt [(2)] [(3)]	5.0

Notes:

(1) Earnings coverage is equal to income (before foreign exchange on long-term debt) before net interest expense and income tax expense divided by net interest expense on all debt.

(2) Earnings coverage is equal to income (after foreign exchange on long-term debt) before net interest expense and income tax expense divided by net interest expense on all debt.

(3) The earnings coverage ratios have been calculated

excluding carrying charges for the $238.4 million in long-term debt maturing within one year reflected as current liabilities in CPRL s consolidated balance sheet as at June 30, 2008. If such long-term debt maturing within one year had been classified in their entirety as long-term debt for purposes of calculating earnings coverage ratios, the entire amount of the annual carrying charges for such long-term debt maturing within one year would have been reflected in the calculation of CPRL s earnings coverage ratios. For the twelve-month period ended June 30, 2008, earnings coverage on long-term debt before foreign exchange on long term debt and after foreign exchange on long-term debt

would have been 4.5 and 4.8, respectively.

FORM 52-109F2
CERTIFICATION OF INTERIM FILINGS

I, F. J. Green, Chief Executive Officer of Canadian Pacific Railway Limited, certify that:

1. I have reviewed the interim filings (as this term is defined in Multilateral Instrument 52-109 *Certification of Disclosure in Issuers Annual and Interim Filings*) of Canadian Pacific Railway Limited (the issuer) for the interim period ending June 30, 2008;
2. Based on my knowledge, the interim filings do not contain any untrue statement of a material fact or omit to state a material fact required to be stated or that is necessary to make a statement not misleading in light of the circumstances under which it was made, with respect to the period covered by the interim filings;
3. Based on my knowledge, the interim financial statements together with the other financial information included in the interim filings fairly represent in all material respects the financial condition, results of operations and cash flows of the issuer, as of the date and for the periods presented in the interim filings;
4. The issuer s other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures and internal control over financial reporting for the issuer, and we have:
   (a) designed such disclosure controls and procedures, or caused them to be designed under our supervision, to provide reasonable assurance that material information relating to the issuer, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which the interim filings are being prepared; and

   (b) designed such internal control over financial reporting, or caused it 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 the issuer s GAAP; and
5. I have caused the issuer to disclose in the interim MD&A any change in the issuer s internal control over financial reporting that occurred during the issuer s most recent interim period that has materially affected, or is reasonably likely to materially affect, the issuer s internal control over financial reporting.

Date: July 22, 2008

Signed: F. J. Green

F. J. Green
Chief Executive Officer

FORM 52-109F2
CERTIFICATION OF INTERIM FILINGS

I, M. R. Lambert, Chief Financial Officer of Canadian Pacific Railway Limited, certify that:

1. I have reviewed the interim filings (as this term is defined in Multilateral Instrument 52-109 *Certification of Disclosure in Issuers Annual and Interim Filings*) of Canadian Pacific Railway Limited (the issuer) for the interim period ending June 30, 2008;
2. Based on my knowledge, the interim filings do not contain any untrue statement of a material fact or omit to state a material fact required to be stated or that is necessary to make a statement not misleading in light of the circumstances under which it was made, with respect to the period covered by the interim filings;
3. Based on my knowledge, the interim financial statements together with the other financial information included in the interim filings fairly represent in all material respects the financial condition, results of operations and cash flows of the issuer, as of the date and for the periods presented in the interim filings;
4. The issuer s other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures and internal control over financial reporting for the issuer, and we have:
   (a) designed such disclosure controls and procedures, or caused them to be designed under our supervision, to provide reasonable assurance that material information relating to the issuer, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which the interim filings are being prepared; and

   (b) designed such internal control over financial reporting, or caused it 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 the issuer s GAAP; and
5. I have caused the issuer to disclose in the interim MD&A any change in the issuer s internal control over financial reporting that occurred during the issuer s most recent interim period that has materially affected, or is reasonably likely to materially affect, the issuer s internal control over financial reporting.

Date: July 22, 2008

Signed: M. R. Lambert

M. R. Lambert
Chief Financial Officer