CANADIAN PACIFIC RAILWAY LTD/CN
Form 6-K
July 17, 2014
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 6-K

Report of Foreign Issuer

Pursuant to Rule 13a-16 or 15d-16

under the Securities Exchange Act of 1934

For the month of July, 2014

CANADIAN PACIFIC RAILWAY LIMITED

(Commission File No. 1-01342)

CANADIAN PACIFIC RAILWAY COMPANY

(Commission File No. 1-15272)

(translation of each Registrant s name into English)

Suite 500, Gulf Canada Square, 401 9th Avenue,

S.W., Calgary, Alberta, Canada, T2P 4Z4

(address of principal executive offices)

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

Form 20-F ¨ Form 40-F x

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

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

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, the Registration Statements of Canadian Pacific Railway Limited on Form S-8 (File Nos. 333-127943, 333-13962, 333-140955, 333-183891, 333-183892, 333-183893, 333-188826 and 333-188827) and Form F-10 (File No. 333-190229) and the Registration Statement of Canadian Pacific Railway Company on Form F-10 (File No. 333-189815).

Table of Contents

SIGNATURES

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

		CANADIAN PACIFIC RAILWAY LIMITED (Registrant)
Date: July 17, 2014	By:	Signed: /s/ Paul a. Guthrie Name: Paul A. Guthrie Title: Corporate Secretary
		CANADIAN PACIFIC RAILWAY COMPANY (Registrant)
Date: July 17, 2014	By:	Signed: /s/ Paul A. Guthrie Name: Paul A. Guthrie Title: Corporate Secretary

Table of Contents

Table of Contents

Immediate Release: July 17, 2014

CP reports Q2-2014 net income of C$371M or C$2.11 per diluted share

Delivers strongest financial results in company s history

Calgary, AB - Canadian Pacific Railway Limited (TSX: CP) (NYSE: CP) today announced record Q2 2014 financial results.

Reported net income in the second quarter was $371 million, or $2.11 per diluted share, versus $252 million, or $1.43 per share, in the second quarter of 2013. This represents a 48 per cent year-over-year improvement in earnings per share.

SECOND-QUARTER 2014 RESULTS COMPARED WITH SECOND-QUARTER 2013:

Total revenues were $1,681 million, an increase of 12 per cent

Operating expenses were $1,094 million, an increase of 2 per cent

Operating income was $587 million, an increase of 40 per cent

Operating ratio was 65.1 per cent, a 680 basis point improvement

CP delivered another record quarter, said E. Hunter Harrison, CP s Chief Executive Officer. The team has made great strides in my two years at CP and they continue to demonstrate resiliency by delivering these results despite continued operational challenges in the US Midwest after a devastating winter. The future is very promising for the railroad as we transition towards leveraging our lower cost structure and improved service.

- 30 -

Note on forward-looking information

This news release contains certain forward-looking information within the meaning of applicable securities laws relating, but not limited, to our operations, priorities and plans, anticipated financial performance, purchases of common shares for cancellation under CP s share repurchase program, future sources of capital, business prospects, planned capital expenditures, programs and strategies. This forward-looking information also includes, but is not limited to, statements concerning expectations, beliefs, plans, goals, objectives, assumptions and statements about possible future events, conditions, and results of operations or performance. Forward-looking information may contain statements with words or headings such as financial expectations , key assumptions , anticipate , believe , expect , will , outlook , should or similar words suggesting future outcomes.

Undue reliance should not be placed on forward-looking information as actual results may differ materially from the forward-looking information. Forward-looking information is not a guarantee of future performance. By its nature, CP s forward-looking information involves numerous assumptions, inherent risks and uncertainties that could cause actual results to differ materially from the forward-looking information, including but not limited to the following factors: changes in business strategies; general North American and global economic, credit and business conditions; risks in agricultural production such as weather conditions and insect populations; the availability and price of energy commodities; the effects of competition and pricing pressures; industry capacity; shifts in market demand; changes in commodity prices; uncertainty surrounding timing and volumes of commodities being shipped via CP; inflation; changes in laws and regulations, including regulation of rates; changes in taxes and tax rates; potential increases in maintenance and operating costs; uncertainties of investigations, proceedings or other types of claims and litigation; labour disputes; risks and liabilities arising

Table of Contents

from derailments; transportation of dangerous goods; timing of completion of capital and maintenance projects; currency and interest rate fluctuations; effects of changes in market conditions and discount rates on the financial position of pension plans and investments; and various events that could disrupt operations, including severe weather, droughts, floods, avalanches and earthquakes as well as security threats and governmental response to them, and technological changes. The foregoing list of factors is not exhaustive.

These and other factors are detailed from time to time in reports filed by CP with securities regulators in Canada and the United States. Reference should be made to Management s Discussion and Analysis in CP s annual and interim reports, Annual Information Form and Form 40-F. Readers are cautioned not to place undue reliance on forward-looking information. Forward-looking information is based on current expectations, estimates and projections and it is possible that predictions, forecasts, projections, and other forms of forward-looking information will not be achieved by CP. Except as required by law, CP undertakes no obligation to update publicly or otherwise revise any forward-looking information, whether as a result of new information, future events or otherwise.

About Canadian Pacific

Canadian Pacific (TSX:CP)(NYSE:CP) is a transcontinental railway in Canada and the United States with direct links to eight major ports, including Vancouver and Montreal, providing North American customers a competitive rail service with access to key markets in every corner of the globe. CP is growing with its customers, offering a suite of freight transportation services, logistics solutions and supply chain expertise. Visit www.cpr.ca to see the rail advantages of Canadian Pacific.

Contacts

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Table of Contents

CANADIAN PACIFIC RAILWAY LIMITED

INTERIM CONSOLIDATED STATEMENTS OF INCOME

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

(unaudited)

	For the three months ended June 30		For the six months ended June 30	
	2014	**2013**	**2014**	**2013**
Revenues				
Freight	$ 1,642	$ 1,458	$ 3,116	$ 2,917
Other	39	39	74	75
Total revenues	1,681	1,497	3,190	2,992
Operating expenses				
Compensation and benefits	342	334	687	726
Fuel	273	246	544	516
Materials	47	35	99	79
Equipment rents	40	44	81	90
Depreciation and amortization	137	141	278	282
Purchased services and other	255	277	491	517
Total operating expenses	1,094	1,077	2,180	2,210
Operating income	**587**	**420**	**1,010**	**782**
Less:				
Other income and charges	3	8	3	11
Net interest expense	69	68	139	138
Income before income tax expense	515	344	868	633
Income tax expense *(Note 4)*	144	92	243	164
Net income	**$ 371**	**$ 252**	**$ 625**	**$ 469**
Earnings per share *(Note 5)*				
Basic earnings per share	**$ 2.13**	**$ 1.44**	**$ 3.57**	**$ 2.68**
Diluted earnings per share	**$ 2.11**	**$ 1.43**	**$ 3.54**	**$ 2.66**
Weighted-average number of shares (in millions) *(Note 5)*				
Basic	174.4	174.9	174.9	174.6
Diluted	175.9	176.3	176.5	176.1

Dividends declared per share	**$ 0.3500**	**$ 0.3500**	**$ 0.7000**	**$ 0.7000**

Certain of the comparative figures have been reclassified in order to be consistent with the 2014 presentation. *(Note 12)*

See Notes to Interim Consolidated Financial Statements.

Table of Contents

CANADIAN PACIFIC RAILWAY LIMITED

INTERIM CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in millions of Canadian dollars)

(unaudited)

	For the three months ended June 30		For the six months ended June 30	
	2014	**2013**	**2014**	**2013**
Net income	$ 371	$ 252	$ 625	$ 469
Net gain (loss) in foreign currency translation adjustments, net of hedging activities	7	(1)	7	(3)
Change in derivatives designated as cash flow hedges	(1)	(1)	(2)	
Change in defined benefit pension and post-retirement plans	31	61	62	249
Other comprehensive income before income taxes	37	59	67	246
Income tax expense	(24)	(1)	(16)	(41)
Other comprehensive income *(Note 3)*	13	58	51	205
Comprehensive income	$ 384	$ 310	$ 676	$ 674

See Notes to Interim Consolidated Financial Statements.

4

Table of Contents

CANADIAN PACIFIC RAILWAY LIMITED

INTERIM CONSOLIDATED BALANCE SHEETS AS AT,

(in millions of Canadian dollars)

(unaudited)

	June 30 2014	December 31 2013
Assets		
Current assets		
Cash and cash equivalents	$ 369	$ 476
Restricted cash and cash equivalents	402	411
Accounts receivable, net	687	580
Materials and supplies	174	165
Deferred income taxes	220	344
Other current assets	61	53
	1,913	2,029
Investments	98	92
Properties	13,538	13,327
Assets held for sale *(Note 6)*		222
Goodwill and intangible assets	162	162
Pension asset	1,151	1,028
Other assets	150	200
Total assets	$ 17,012	$ 17,060
Liabilities and shareholders equity		
Current liabilities		
Accounts payable and accrued liabilities	$ 1,257	$ 1,189
Long-term debt maturing within one year *(Note 8)*	92	189
	1,349	1,378
Pension and other benefit liabilities	660	657
Other long-term liabilities	364	338
Long-term debt *(Note 8)*	4,633	4,687
Deferred income taxes	2,870	2,903
Total liabilities	9,876	9,963
Shareholders equity *(Note 7)*		
Share capital	2,248	2,240
Additional paid-in capital	34	34

Accumulated other comprehensive loss *(Note 3)*	(1,452)	(1,503)
Retained earnings	6,306	6,326
	7,136	7,097
Total liabilities and shareholders equity	$ 17,012	$ 17,060

Contingencies *(Note 11)*

See Notes to Interim Consolidated Financial Statements.

Table of Contents

CANADIAN PACIFIC RAILWAY LIMITED

INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS

(in millions of Canadian dollars)

(unaudited)

	For the three months ended June 30		For the six months ended June 30	
	2014	**2013**	**2014**	**2013**
Operating activities				
Net income	$ 371	$ 252	$ 625	$ 469
Reconciliation of net income to cash provided by operating activities:				
Depreciation and amortization	137	141	278	282
Deferred income taxes *(Note 4)*	(15)	87	74	150
Pension funding in excess of expense *(Note 10)*	(33)	(14)	(65)	(23)
Other operating activities, net	23	(21)	40	(19)
Change in non-cash working capital balances related to operations	162	75	(20)	(72)
Cash provided by operating activities	**645**	**520**	**932**	**787**
Investing activities				
Additions to properties	(298)	(301)	(522)	(504)
Proceeds from the sale of west end of Dakota, Minnesota and Eastern Railroad *(Note 6)*	236		236	
Proceeds from the sale of properties and other assets	11	11	16	27
Change in restricted cash and cash equivalents used to collateralize letters of credit	7	(99)	9	(99)
Other	(1)	(1)	(1)	(26)
Cash used in investing activities	**(45)**	**(390)**	**(262)**	**(602)**
Financing activities				
Dividends paid	(62)	(60)	(123)	(121)
Issuance of CP common shares	22	23	36	63
Purchase of CP common shares *(Note 7)*	(447)		(532)	
Repayment of long-term debt	(11)	(7)	(154)	(26)
Cash used in financing activities	**(498)**	**(44)**	**(773)**	**(84)**
Effect of foreign currency fluctuations on U.S. dollar-denominated cash and cash equivalents	**(12)**	**9**	**(4)**	**8**

Cash position				
Increase (decrease) in cash and cash equivalents	90	95	(107)	109
Cash and cash equivalents at beginning of period	279	347	476	333
Cash and cash equivalents at end of period	**$ 369**	**$ 442**	**$ 369**	**$ 442**
Supplemental disclosures of cash flow information:				
Income taxes paid	$ 30	$ 5	$ 39	$ 11
Interest paid	$ 88	$ 85	$ 160	$ 151

See Notes to Interim Consolidated Financial Statements.

6

Table of Contents

CANADIAN PACIFIC RAILWAY LIMITED

INTERIM CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY

(in millions of Canadian dollars, except common share amounts)

(unaudited)

	Common shares (in millions)	Share capital	Additional paid-in capital	Accumulated other comprehensive loss	Retained earnings	Total shareholders equity
Balance at January 1, 2014	175.4	$ 2,240	$ 34	$ (1,503)	$ 6,326	$ 7,097
Net income					625	625
Other comprehensive income *(Note 3)*				51		51
Dividends declared					(122)	(122)
Effect of stock-based compensation expense			11			11
CP common shares repurchased *(Note 7)*	(3.2)	(42)			(523)	(565)
Shares issued under stock option plans *(Note 9)*	0.6	50	(11)			39
Balance at June 30, 2014	172.8	$ 2,248	$ 34	$ (1,452)	$ 6,306	$ 7,136

	Common shares (in millions)	Share capital	Additional paid-in capital	Accumulated other comprehensive loss	Retained earnings	Total shareholders equity
Balance at January 1, 2013	173.9	$ 2,127	$ 41	$ (2,768)	$ 5,697	$ 5,097
Net income					469	469
Other comprehensive income *(Note 3)*				205		205
Dividends declared					(124)	(124)
Effect of stock-based compensation expense			10			10
Shares issued under stock option plans *(Note 9)*	1.1	86	(18)			68
Balance at June 30, 2013	175.0	$ 2,213	$ 33	$ (2,563)	$ 6,042	$ 5,725

See Notes to Interim Consolidated Financial Statements.

7

Table of Contents

CANADIAN PACIFIC RAILWAY LIMITED

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2014

(unaudited)

1 Basis of presentation

These unaudited interim consolidated financial statements of Canadian Pacific Railway Limited (CP , or the Company), expressed in Canadian dollars, reflect management s estimates and assumptions that are necessary for their fair presentation in conformity with accounting principles generally accepted in the United States of America (GAAP). They do not include all disclosures required under GAAP for annual financial statements and should be read in conjunction with the 2013 annual consolidated financial statements. The accounting policies used are consistent with the accounting policies used in preparing the 2013 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.

In management s opinion, the unaudited interim consolidated financial statements include all adjustments (consisting of normal and recurring adjustments) necessary to present fairly such information. Interim results are not necessarily indicative of the results expected for the fiscal year.

2 Future accounting changes

Reporting discontinued operations and disclosures of disposals of components

In April 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-08, Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity, an amendment to FASB Accounting Standards Codification (ASC) Topic 205 and Topic 360. The update amends the definition of a discontinued operation in Topic 205, expands disclosure requirements for transactions that meet the definition of a discontinued operation and requires entities to disclose information about individually significant components that are disposed of or held for sale and do not qualify as discontinued operations. In addition, an entity is required to separately present assets and liabilities of a discontinued operation for all comparative periods and separately present assets and liabilities of assets held for sale in the initial period in which the disposal group is classified as held for sale on the face of the consolidated balance sheets. For each period in which assets and liabilities are separately presented on the consolidated balance sheets, those amounts should not be offset and presented as a single amount. This ASU will be effective for public entities for fiscal years, and interim periods within those years, beginning after December 15, 2014, and will be applied prospectively. The adoption of this ASU is not expected to have a material impact to the Company s financial statements.

Revenue from contracts with customers

In May 2014, FASB issued ASU No. 2014-09, Revenue from Contracts with Customers, a new FASB ASC, Topic 606, which supersedes the revenue recognition requirements in Topic 605 and most industry-specific guidance throughout the Industry Topics of the Codification. This new standard requires an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In addition, the new standard requires enhanced disclosures about revenue to help users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. This ASU will be effective for public entities for fiscal years, and interim periods within those years, beginning after December 15, 2016. Entities have the option of using either a full retrospective or a modified retrospective approach to adopt the ASU. The Company has not, at this time, ascertained the full impact on the consolidated financial statements from the adoption of this new standard but does not expect the impact to be material.

Table of Contents

CANADIAN PACIFIC RAILWAY LIMITED

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2014

(unaudited)

3 Changes in accumulated other comprehensive loss (AOCL) by component

	For the three months ended June 30				**For the six months ended June 30**			
(in millions of Canadian dollars)	**Foreign currency net of hedging activities[1]**	**Derivatives and other[1]**	**Pension and post-retirement defined benefit plans[1][2]**	**Total[1]**	**Foreign currency net of hedging activities[1]**	**Derivatives and other[1]**	**Pension and post-retirement defined benefit plans[1][2]**	**Total[1]**
Opening balance, 2014	$ 122	$ (16)	$ (1,571)	$ (1,465)	$ 105	$ (15)	$ (1,593)	$ (1,503)
Other comprehensive income (loss) before reclassifications	(8)	(10)		(18)	9			9
Amounts reclassified from accumulated other comprehensive loss (income)		8	23	31		(3)	45	42
Net current-period other comprehensive (loss) income	(8)	(2)	23	13	9	(3)	45	51
Closing balance, 2014	$ 114	$ (18)	$ (1,548)	$ (1,452)	$ 114	$ (18)	$ (1,548)	$ (1,452)
Opening balance, 2013	$ 82	$ (15)	$ (2,688)	$ (2,621)	$ 74	$ (14)	$ (2,828)	$ (2,768)
Other comprehensive income before reclassifications	12	10	8	30	20	15	102	137
Amounts reclassified from accumulated other comprehensive (income)		(9)	37	28		(15)	83	68

loss								
Net current-period other comprehensive income	12	1	45	58	20		185	205
Closing balance, 2013	$ 94	$ (14)	$ (2,643)	$ (2,563)	$ 94	$ (14)	$ (2,643)	$ (2,563)

(1) Amounts are presented net of tax.

(2) Reclassified from Accumulated other comprehensive loss.

Amounts in Pension and post-retirement defined benefit plans reclassified from Accumulated other comprehensive loss

(in millions of Canadian dollars)	**For the three months ended June 30 2014**	**2013**	**For the six months ended June 30 2014**	**2013**
Amortization of prior service costs(1)	$ (17)	$ (17)	$ (34)	$ (23)
Recognition of net actuarial loss(1)	48	70	96	137
Total before income tax	31	53	62	114
Income tax recovery	(8)	(16)	(17)	(31)
Net of income tax	**$ 23**	**$ 37**	**$ 45**	**$ 83**

(1) Impacts Compensation and benefits on the Consolidated Statements of Income.

Table of Contents

CANADIAN PACIFIC RAILWAY LIMITED

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2014

(unaudited)

4 Income taxes

(in millions of Canadian dollars)	For the three months ended June 30 2014	2013	For the six months ended June 30 2014	2013
Current income tax expense	$ 159	$ 5	$ 169	$ 14
Deferred income tax expense (recovery)	(15)	87	74	150
Income tax expense	$ 144	$ 92	$ 243	$ 164

The effective income tax rate for the three and six months ended June 30, 2014 was 28% (three and six months ended June 30, 2013 27% and 26%, respectively). The lower rate in 2013 was primarily the result of a benefit recognized for a U.S. federal track maintenance credit of $6 million for 2012 enacted in the first quarter of 2013.

5 Earnings per share

At June 30, 2014, the number of shares outstanding was 172.8 million (June 30, 2013 175.0 million).

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

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

(in millions)	For the three months ended June 30 2014	2013	For the six months ended June 30 2014	2013
Weighted-average basic shares outstanding	174.4	174.9	174.9	174.6
Dilutive effect of stock options	1.5	1.4	1.6	1.5
Weighted-average diluted shares outstanding	175.9	176.3	176.5	176.1

For the three and six months ended June 30, 2014, there were 124,093 options and 120,930 options, respectively, excluded from the computation of diluted earnings per share because their effects were not dilutive (three and six months ended June 30, 2013 5,867 and 55,375, respectively).

6 Assets held for sale

On May 30, 2014, the Company completed the sale of the west end of Dakota, Minnesota and Eastern Railroad (DM&E West) to Genesee & Wyoming Inc. (G&W) for net proceeds of U.S. $218 million (CDN $236 million), subject to closing adjustments to be finalized between the Company and G&W in the third quarter of 2014.

Table of Contents

CANADIAN PACIFIC RAILWAY LIMITED

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2014

(unaudited)

7 Shareholders Equity

On February 20, 2014, the Board of Directors of the Company approved a share repurchase program, and in March 2014, the Company filed a new normal course issuer bid to purchase, for cancellation, up to 5.3 million of its outstanding Common Shares. Under the filing, share purchases may be made during the 12-month period that began March 17, 2014, and ends March 16, 2015. The purchases are made at the market price on the day of purchase, with consideration allocated to share capital up to the average carrying amount of the shares, and any excess allocated to retained earnings.

The following table provides the activities under the share repurchase program:

	For the three months ended June 30 2014		For the six months ended June 30 2014	
Number of common shares repurchased		2,702,232		3,269,982
Weighted-average price per share(1)	$	176.86	$	172.90
Amount of repurchase (in millions)(1)	$	478	$	565

(1) Includes brokerage fees.

8 Financial instruments

A. Fair values of financial instruments

The Company categorizes its financial assets and liabilities measured at fair value in line with the fair value hierarchy established by GAAP that prioritizes, with respect to reliability, the inputs to valuation techniques used to measure fair value. This hierarchy consists of three broad levels. Level 1 inputs consist of quoted prices (unadjusted) in active markets for identical assets and liabilities and give the highest priority to these inputs. Level 2 and 3 inputs are based on significant other observable inputs and significant unobservable inputs, respectively, and give lower priority to these inputs.

When possible, the estimated fair value is based on quoted market prices and, if not available, estimates from third party brokers. For non-exchange traded derivatives classified in Level 2, the Company uses standard valuation techniques to calculate fair value. Primary inputs to these techniques include observable market prices (interest, foreign exchange and commodity) and volatility, depending on the type of derivative and nature of the underlying risk. The Company uses inputs and data used by willing market participants when valuing derivatives and considers its own credit default swap spread as well as those of its counterparties in its determination of fair value.

The carrying values of financial instruments equal or approximate their fair values with the exception of long-term debt which has a fair value of approximately $5,715 million at June 30, 2014 (December 31, 2013 - $5,572 million) and a carrying value of $4,725 million at June 30, 2014 (December 31, 2013 $4,876 million). The estimated fair value of current and long-term borrowings has been determined based on market information where available, or by discounting future payments of interest and principal at estimated interest rates expected to be available to the Company at period end. All derivatives and long-term debt are classified as Level 2.

B. Financial risk management

Derivative financial instruments

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

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

Table of Contents

CANADIAN PACIFIC RAILWAY LIMITED

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2014

(unaudited)

8 Financial instruments (continued)

Foreign exchange management

The Company conducts business transactions and owns assets in both Canada and the United States. As a result, the Company is exposed to fluctuations in value of financial commitments, assets, liabilities, income or cash flows due to changes in FX rates. The Company may enter into foreign exchange risk management transactions primarily to manage fluctuations in the exchange rate between Canadian and U.S. currencies. FX exposure is primarily mitigated through natural offsets created by revenues, expenditures and balance sheet positions incurred in the same currency. Where appropriate, the Company may negotiate with customers and suppliers to reduce the net exposure.

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

Net investment hedge

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. The majority of the Company s U.S. dollar denominated long-term debt has been designated as a hedge of the net investment in foreign subsidiaries. This designation has the effect of mitigating volatility on net income by offsetting long-term FX gains and losses on U.S. dollar denominated long-term debt and gains and losses on its net investment. The effective portion recognized in Other comprehensive income for the three and six months ended June 30, 2014 was an unrealized foreign exchange gain of $119 million and a loss of $12 million, respectively (three and six months ended June 30, 2013 unrealized foreign exchange loss of $110 million and $177 million, respectively). There was no ineffectiveness during the three and six months ended June 30, 2014 and comparative periods.

Foreign exchange forward contracts

The Company may enter into FX forward contracts to lock in the amount of Canadian dollars it has to pay on its U.S. denominated debt maturities.

At June 30, 2014, the Company had no remaining FX forward contracts to fix the exchange rate on U.S. denominated debt maturities. At December 31, 2013, the Company had FX forward contracts to fix the exchange rate on US$100 million of principal outstanding on a capital lease due in January 2014, US$175 million of its 6.50% Notes due in May 2018, and US$100 million of its 7.25% Notes due in May 2019. These derivatives, which were accounted for as cash flow hedges, guaranteed the amount of Canadian dollars that the Company would repay when these obligations mature.

During the three months ended March 31, 2014, the Company settled the FX forward contract related to the repayment of a capital lease due in January 2014 for proceeds of $8 million.

During the three months ended June 30, 2014, the Company de-designated and settled prior to maturity the FX forward contracts related to the repayment of its 6.50% Notes due in May 2018 and its 7.25% Notes due in May 2019 for proceeds of $17 million to be settled in the third quarter of 2014.

During the three and six months ended June 30, 2014, the combined realized and unrealized foreign exchange loss was $8 million and the combined realized and unrealized foreign exchange gain was $3 million, respectively (three and six months ended June 30, 2013 unrealized gains of $10 million and $15 million, respectively), were recorded in Other income and charges in relation to these derivatives. Gains recorded in Other income and charges were largely offset by losses on the underlying debt which the derivatives were designated to hedge. Similarly, losses were largely offset by gains on the underlying debt.

At June 30, 2014, the realized gain derived from these FX forwards was $17 million which was recorded in Accounts receivables with the offset reflected as realized gains of $3 million in Accumulated other comprehensive loss and $14 million in Retained earnings . At December 31, 2013, the unrealized gains derived from these FX forwards was $25 million of which $6 million was included in Other current assets and $19 million in Other assets with the offsets reflected as unrealized gains of $5 million in Accumulated other comprehensive loss and $20 million in Retained earnings .

Amounts remaining in Accumulated other comprehensive loss at June 30, 2014 will be amortized to Other income and charges until the underlying debts which were hedged are repaid.

At June 30, 2014, the Company expected that, during the next twelve months, a pre-tax gain of $1 million would be reclassified to Other income and charges .

CANADIAN PACIFIC RAILWAY LIMITED

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2014

(unaudited)

9 Stock-based compensation

At June 30, 2014, the Company had several stock-based compensation plans, including stock option plans, various cash settled liability plans and an employee stock savings plan. These plans resulted in an expense of $39 million for the three months ended June 30, 2014 and an expense of $61 million for the six months ended June 30, 2014 (three and six months ended June 30, 2013, an expense of $10 million and $43 million, respectively).

Regular options

In the six months ended June 30, 2014, under CP s stock option plans, the Company issued 375,430 regular options at the weighted-average price of $169.00 per share, based on the closing price on the grant date.

Pursuant to the employee plans, these regular options may be exercised upon vesting, which is between 12 and 48 months after the grant date, and will expire after 10 years.

Under the fair value method, the fair value of the regular options at the grant date was $17 million. The weighted-average fair value assumptions were approximately:

		For the six months ended June 30, 2014
Grant price	$	169.00
Expected option life (years)(1)		5.83
Risk-free interest rate(2)		1.65%
Expected stock price volatility(3)		28.63%
Expected annual dividends per share(4)	$	1.40
Expected forfeiture rate(5)		1.40%
Weighted-average grant date fair value per regular options granted during the period	$	46.46

(1) Represents the period of time that awards are expected to be outstanding. Historical data on exercise behaviour, or when available, specific expectations regarding future exercise behaviour, were used to estimate the expected life of the option.

(2) Based on the implied yield available on zero-coupon government issues with an equivalent remaining term at the time of the grant.

(3)

Based on the historical stock price volatility of the Company s stock over a period commensurate with the expected term of the option.

(4) Determined by the current annual dividend at the time of grant. The Company does not employ different dividend yields throughout the contractual term of the option.

(5) The Company estimated forfeitures based on past experience. This rate is monitored on a periodic basis.

Performance share unit (PSU) plan

In the six months ended June 30, 2014, the Company issued 165,390 PSUs with a grant date fair value of approximately $25 million. These units attract dividend equivalents in the form of additional units based on the dividends paid on the Company s Common Shares. PSUs vest and are settled in cash, or in CP common shares approximately three years after the grant date, contingent upon CP s performance (performance factor). The fair value of PSUs is measured, both on the grant date and each subsequent quarter until settlement, using a Monte Carlo simulation model. The model utilizes multiple input variables that determine the probability of satisfying the performance factor and market conditions stipulated in the grant.

Deferred share unit (DSU) plan

In the six months ended June 30, 2014, the Company granted 49,846 DSUs with a grant date fair value of approximately $8 million. DSUs vest over various periods of up to 48 months and are only redeemable for a specified period after employment is terminated. An expense for DSUs is recognized over the vesting period for both the initial subscription price and the change in value between reporting periods.

Restricted share unit (RSU) plan

In the six months ended June 30, 2014, the Company granted 15,641 RSUs with a grant date fair value of approximately $3 million. RSUs are subject to time vesting over 36 months. An expense for RSUs is recognized over the vesting period for both the initial subscription price and the change in value between reporting periods.

Table of Contents

CANADIAN PACIFIC RAILWAY LIMITED

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2014

(unaudited)

10 Pensions and other benefits

In the three and six months ended June 30, 2014, the Company made contributions of $20 million and $39 million, respectively (three and six months ended 2013 - $22 million and $52 million, respectively) to its defined benefit pension plans. The net periodic benefit cost for defined benefit pension plans and other benefits recognized in the three and six months ended June 30, 2014 included the following components:

	For the three months ended June 30			
	Pensions		Other benefits	
(in millions of Canadian dollars)	2014	2013	2014	2013
Current service cost (benefits earned by employees in the period)	$ 26	$ 33	$ 4	$ 4
Interest cost on benefit obligation	119	111	6	6
Expected return on fund assets	(189)	(187)		
Recognized net actuarial loss	48	68		2
Amortization of prior service costs	(17)	(17)		
Net periodic benefit (recovery) cost	$ (13)	$ 8	$ 10	$ 12

	For the six months ended June 30			
	Pensions		Other benefits	
(in millions of Canadian dollars)	2014	2013	2014	2013
Current service cost (benefits earned by employees in the period)	$ 53	$ 68	$ 7	$ 8
Interest cost on benefit obligation	238	223	12	11
Expected return on fund assets	(378)	(373)		
Recognized net actuarial loss	95	134	1	3
Amortization of prior service costs	(34)	(23)		
Net periodic benefit (recovery) cost	$ (26)	$ 29	$ 20	$ 22

11 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, 2014 cannot be predicted with certainty, it is the opinion of management that their resolution will not have a material effect on the Company s financial position or results of operations individually and in aggregate.

Legal proceedings related to Lac-Megantic rail accident

On July 6, 2013, a train carrying crude oil operated by Montreal, Maine and Atlantic Railway (MM&A) derailed and exploded in Lac-Megantic, Quebec on a section of a railway line owned by MM&A. The day before CP had interchanged the train to MM&A, but after the interchange MM&A exercised exclusive control over the train.

Following this incident, the Minster of Sustainable Development, Environment, Wildlife and Parks of Quebec issued an order directing named parties to recover the contaminants and to clean up and decontaminate the derailment. CP was later added as a named party in the administrative action on August 14, 2013.

A class action has also been filed in the Superior Court of Quebec on behalf of a class of persons and entities residing in, owning or leasing property in, operating a business in or physically present in Lac-Megantic. The law-suit seeks damage

Table of Contents

CANADIAN PACIFIC RAILWAY LIMITED

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2014

(unaudited)

11 Contingencies (continued)

caused by the derailment including for wrongful deaths, personal injuries, and property damages. CP was added as a defendant on August 16, 2013. In the wake of the derailment and ensuing litigation, MM&A filed for bankruptcy in Canada and the United States.

At this early stage in the legal proceedings, any potential liability and the quantum of potential loss cannot be determined. Nevertheless, CP denies liability for MM&A s derailment and will vigorously defend itself in both proceedings or any proceeding that may be commenced in the future.

Environmental liabilities

Environmental remediation accruals cover site-specific remediation programs. The accruals for environmental remediation represent CP s best estimate of its probable future obligation and include both asserted and unasserted claims, without reduction for anticipated recoveries from third parties. Environmental remediation accruals are measured on an undiscounted basis unless a reliably determinable estimate as to amount and timing of costs can be established. The accruals are recorded when the costs to remediate are probable and reasonably estimable. Certain future costs to monitor sites are discounted at a risk free rate. Although the recorded accruals include CP s best estimate of all probable costs, CP s total environmental remediation costs cannot be predicted with certainty. Accruals for environmental remediation may change from time to time as new information about previously untested sites becomes known, environmental laws and regulations evolve and advances are made in environmental remediation technology. The accruals may also vary as the courts decide legal proceedings against outside parties responsible for contamination. These potential charges, which cannot be quantified at this time, are not expected to be material to CP s financial position, but may materially affect income in the particular period in which a charge is recognized. Costs related to existing, but as yet unknown, or future contamination will be accrued in the period in which they become probable and reasonably estimable.

The expense included in Purchased services and other for the three and six months ended June 30, 2014 was $nil and $1 million, respectively (three and six months ended June 30, 2013 $nil and expense of $1 million, respectively). Provisions for environmental remediation costs are recorded in Other long-term liabilities , except for the current portion which is recorded in Accounts payable and accrued liabilities . The total amount provided at June 30, 2014 was $89 million (December 31, 2013 $90 million). Payments are expected to be made over 10 years to 2024.

Table of Contents

CANADIAN PACIFIC RAILWAY LIMITED

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2014

(unaudited)

12 Reclassification of comparative figures

Billings to third parties for the recovery of costs incurred for freight car repairs and servicing have been reclassified from Purchased services and other to Compensation and benefits and Materials within Operating expenses , in order match the billings with the costs incurred on behalf of third parties. As a result, the changes to these components of Operating expenses for the three and six months ended June 30, 2013 are noted below. Operating expenses in total were unchanged as a result of this reclassification.

(in millions of Canadian dollars)	**Compensation and benefits**	**Material**	**Purchased services and other**
For the three months ended June 30, 2013			
As previously reported	$ 342	$ 58	$ 246
(Decrease) increase	(8)	(23)	31
As reclassified	$ 334	$ 35	$ 277
For the six months ended June 30, 2013			
As previously reported	$ 744	$ 130	$ 448
(Decrease) increase	(18)	(51)	69
As reclassified	$ 726	$ 79	$ 517

Table of Contents

Summary of Rail Data

Second Quarter 2014	Second Quarter 2013	Fav/(Unfav)	%	Financial (millions, except per share data)	Year-to-date 2014	Year-to-date 2013	Fav/(Unfav)	%
				Revenues				
$ 1,642	$ 1,458	$ 184	**13**	Freight revenue	$ 3,116	$ 2,917	$ 199	**7**
39	39			Other revenue	74	75	(1)	**(1)**
1,681	1,497	184	**12**	Total revenues	3,190	2,992	198	**7**
				Operating expenses				
342	334	(8)	**(2)**	Compensation and benefits(1)	687	726	39	**5**
273	246	(27)	**(11)**	Fuel	544	516	(28)	**(5)**
47	35	(12)	**(34)**	Materials(1)	99	79	(20)	**(25)**
40	44	4	**9**	Equipment rents	81	90	9	**10**
137	141	4	**3**	Depreciation and amortization	278	282	4	**1**
255	277	22	**8**	Purchased services and other (1)	491	517	26	**5**
1,094	1,077	(17)	**(2)**	Total operating expenses	2,180	2,210	30	**1**
587	420	167	**40**	Operating income	1,010	782	228	**29**
				Less:				
3	8	5	**63**	Other income and charges	3	11	8	**73**
69	68	(1)	**(1)**	Net interest expense	139	138	(1)	**(1)**
515	344	171	**50**	Income before income tax expense	868	633	235	**37**
144	92	(52)	**(57)**	Income tax expense	243	164	(79)	**(48)**
$ 371	$ 252	$ 119	**47**	Net income	$ 625	$ 469	$ 156	**33**
65.1	71.9	6.8	**680 bps**	Operating ratio (%)	68.3	73.9	5.6	**560 bps**
$ 2.13	**$ 1.44**	**$ 0.69**	**48**	Basic earnings per share	**$ 3.57**	**$ 2.68**	**$ 0.89**	**33**
$ 2.11	**$ 1.43**	**$ 0.68**	**48**	Diluted earnings per share	**$ 3.54**	**$ 2.66**	**$ 0.88**	**33**

				Shares Outstanding				
174.4	174.9	(0.5)		Weighted average number of shares outstanding (millions)	174.9	174.6	0.3	
175.9	176.3	(0.4)		Weighted average number of diluted shares outstanding (millions)	176.5	176.1	0.4	
				Foreign Exchange				
0.91	0.98	0.07	**7**	Average foreign exchange rate (US$/Canadian$)	0.91	0.99	0.08	**8**
1.10	1.02	0.08	**8**	Average foreign exchange rate (Canadian$/US$)	1.10	1.01	0.09	**9**

(1) Billings to third parties for the recovery of costs incurred for freight car repairs and servicing have been reclassified from Purchased services and other to Compensation and benefits and Materials within Operating expenses.

Table of Contents

Summary of Rail Data (Page 2)

Second Quarter 2014	2013	Fav/(Unfav)	%		Year-to-date 2014	2013	Fav/(Unfav)	%
				Commodity Data				
				Freight Revenues (millions)				
$ 252	$ 191	$ 61	**32**	- Canadian Grain	$ 473	$ 394	$ 79	**20**
115	91	24	**26**	- U.S. Grain	221	202	19	**9**
165	144	21	**15**	- Coal	313	293	20	**7**
101	95	6	**6**	- Potash	181	177	4	**2**
64	68	(4)	**(6)**	- Fertilizers and sulphur	118	138	(20)	**(14)**
52	53	(1)	**(2)**	- Forest products	100	106	(6)	**(6)**
155	138	17	**12**	- Chemicals and plastics	302	277	25	**9**
114	97	17	**18**	- Crude	218	189	29	**15**
170	144	26	**18**	- Metals, minerals, and consumer products	331	285	46	**16**
104	106	(2)	**(2)**	- Automotive	192	203	(11)	**(5)**
200	171	29	**17**	- Domestic intermodal	377	341	36	**11**
150	160	(10)	**(6)**	- International intermodal	290	312	(22)	**(7)**
$ 1,642	$ 1,458	$ 184	**13**	Total Freight Revenues	$ 3,116	$ 2,917	$ 199	**7**
				Millions of Revenue Ton-Miles (RTM)				
7,074	5,272	1,802	**34**	- Canadian Grain	12,920	10,647	2,273	**21**
2,679	2,411	268	**11**	- U.S. Grain	5,218	5,466	(248)	**(5)**
5,941	5,316	625	**12**	- Coal	11,382	10,956	426	**4**
4,114	4,254	(140)	**(3)**	- Potash	7,407	7,890	(483)	**(6)**
1,130	1,352	(222)	**(16)**	- Fertilizers and sulphur	2,204	2,668	(464)	**(17)**
1,003	1,267	(264)	**(21)**	- Forest products	1,923	2,490	(567)	**(23)**
3,326	3,435	(109)	**(3)**	- Chemicals and plastics	6,532	6,969	(437)	**(6)**
3,816	3,640	176	**5**	- Crude	7,174	7,131	43	**1**
2,698	2,339	359	**15**	- Metals, minerals, and consumer products	5,411	4,850	561	**12**
597	629	(32)	**(5)**	- Automotive	1,111	1,233	(122)	**(10)**
3,003	2,546	457	**18**	- Domestic intermodal	5,637	5,064	573	**11**
3,048	3,530	(482)	**(14)**	- International intermodal	5,885	6,790	(905)	**(13)**
38,429	35,991	2,438	**7**	Total RTMs	72,804	72,154	650	**1**
				Freight Revenue per RTM (cents)				
3.56	3.61	(0.05)	**(1)**	- Canadian Grain	3.66	3.69	(0.03)	**(1)**

4.31	3.77	0.54	**14**	- U.S. Grain	4.24	3.70	0.54	**15**
2.79	2.70	0.09	**3**	- Coal	2.75	2.67	0.08	**3**
2.46	2.24	0.22	**10**	- Potash	2.44	2.24	0.20	**9**
5.61	5.01	0.60	**12**	- Fertilizers and sulphur	5.35	5.16	0.19	**4**
5.20	4.20	1.00	**24**	- Forest products	5.19	4.26	0.93	**22**
4.67	3.98	0.69	**17**	- Chemicals and plastics	4.63	3.94	0.69	**18**
2.99	2.67	0.32	**12**	- Crude	3.04	2.65	0.39	**15**
6.27	6.22	0.05	**1**	- Metals, minerals, and consumer products	6.11	5.92	0.19	**3**
17.37	16.87	0.50	**3**	- Automotive	17.31	16.49	0.82	**5**
6.66	6.72	(0.06)	**(1)**	- Domestic intermodal	6.69	6.73	(0.04)	**(1)**
4.94	4.52	0.42	**9**	- International intermodal	4.93	4.60	0.33	**7**
4.27	4.05	0.22	**5**	Total Freight Revenue per RTM	4.28	4.04	0.24	**6**

18

Table of Contents

Summary of Rail Data (Page 3)

Second Quarter 2014	2013	Fav/(Unfav)	%		Year-to-date 2014	2013	Fav/(Unfav)	%
				Carloads (thousands)				
78	61	17	**28**	- Canadian Grain	140	120	20	**17**
44	42	2	**5**	- U.S. Grain	83	91	(8)	**(9)**
82	75	7	**9**	- Coal	160	156	4	**3**
33	35	(2)	**(6)**	- Potash	61	65	(4)	**(6)**
16	19	(3)	**(16)**	- Fertilizers and sulphur	31	38	(7)	**(18)**
15	18	(3)	**(17)**	- Forest products	29	36	(7)	**(19)**
49	48	1	**2**	- Chemicals and plastics	94	99	(5)	**(5)**
25	24	1	**4**	- Crude	49	46	3	**7**
60	58	2	**3**	- Metals, minerals, and consumer products	116	112	4	**4**
37	38	(1)	**(3)**	- Automotive	67	73	(6)	**(8)**
110	93	17	**18**	- Domestic intermodal	207	182	25	**14**
140	157	(17)	**(11)**	- International intermodal	270	309	(39)	**(13)**
689	668	21	**3**	Total Carloads	1,307	1,327	(20)	**(2)**
				Freight Revenue per Carload				
$ 3,219	$ 3,127	$ 92	**3**	- Canadian Grain	$ 3,374	$ 3,271	$ 103	**3**
2,645	2,159	486	**23**	- U.S. Grain	2,675	2,225	450	**20**
2,027	1,921	106	**6**	- Coal	1,963	1,878	85	**5**
3,046	2,706	340	**13**	- Potash	2,983	2,719	264	**10**
3,925	3,609	316	**9**	- Fertilizers and sulphur	3,770	3,593	177	**5**
3,502	2,998	504	**17**	- Forest products	3,452	2,944	508	**17**
3,185	2,809	376	**13**	- Chemicals and plastics	3,213	2,759	454	**16**
4,524	4,095	429	**10**	- Crude	4,452	4,122	330	**8**
2,810	2,537	273	**11**	- Metals, minerals, and consumer products	2,839	2,571	268	**10**
2,798	2,759	39	**1**	- Automotive	2,850	2,751	99	**4**
1,822	1,839	(17)	**(1)**	- Domestic intermodal	1,825	1,877	(52)	**(3)**
1,074	1,017	57	**6**	- International intermodal	1,074	1,011	63	**6**
$ 2,383	$ 2,183	$ 200	**9**	Total Freight Revenue per Carload	$ 2,384	$ 2,198	$ 186	**8**

Table of Contents

Summary of Rail Data (Page 4)

Second Quarter 2014	2013(1)	Fav/(Unfav)	%		Year-to-date 2014	2013(1)	Fav/(Unfav)	%
				Operations Performance				
71,333	67,232	4,101	**6**	Freight gross ton-miles (millions)	133,682	134,910	(1,228)	**(1)**
38,429	35,991	2,438	**7**	Revenue ton-miles (millions)	72,804	72,154	650	**1**
9,335	9,645	310	**3**	Train miles (thousands)	18,062	19,639	1,577	**8**
8,178	7,471	707	**9**	Average train weight - excluding local traffic (tons)	7,924	7,337	587	**8**
6,880	6,444	436	**7**	Average train length - excluding local traffic (feet)	6,634	6,369	265	**4**
8.6	6.8	(1.8)	**(26)**	Average terminal dwell - (hours)(2)	9.4	6.7	(2.7)	**(40)**
18.1	18.6	(0.5)	**(3)**	Average train speed - (mph)(3)	17.1	18.4	(1.3)	**(7)**
228.6	218.0	10.6	**5**	Locomotive productivity (daily average GTMs/active HP)	216.5	211.5	5.0	**2**
1.00	1.05	0.05	**5**	Fuel efficiency(4)	1.05	1.09	0.04	**4**
70.3	69.8	(0.5)	**(1)**	U.S. gallons of locomotive fuel consumed (millions)(5)	138.7	145.6	6.9	**5**
3.53	3.45	(0.08)	**(2)**	Average fuel price (U.S. dollars per U.S. gallon)	3.58	3.50	(0.07)	**(2)**
14,787	15,471	684	**4**	Total employees (average)(6)	14,516	15,196	680	**4**
14,736	15,355	619	**4**	Total employees (end of period)(6)	14,736	15,355	619	**4**
14,960	16,053	1,093	**7**	Workforce (end of period)(7)	14,960	16,053	1,093	**7**
				Safety				
1.84	1.51	(0.33)	**(22)**	FRA personal injuries per 200,000 employee-hours	1.73	1.62	(0.11)	**(7)**
1.03	1.94	0.91	**47**	FRA train accidents per million train-miles	1.08	1.95	0.87	**45**

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

(2) Incorporates a new reporting definition where average terminal dwell measures the average time a freight car resides within terminal boundaries.

(3) Incorporates a new reporting definition where average train speed measures the line-haul movement from origin to destination including terminal dwell hours.

(4) Fuel efficiency is defined as U.S. gallons of locomotive fuel consumed per 1,000 GTMs freight and yard.

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

(6) An employee is defined as an individual, including trainees, who has worked more than 40 hours in a standard biweekly pay period. This excludes part time employees, contractors, and consultants.

(7) Workforce is defined as total employees plus part time employees, contractors, and consultants.

Table of Contents

TABLE OF CONTENTS

This Management s Discussion and Analysis (MD&A) is provided in conjunction with the Interim Consolidated Financial Statements and related notes for the three and six months ended June 30, 2014 prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). All information has been prepared in accordance with GAAP, except as described in Section 14, Non-GAAP Measures of this MD&A. Except where otherwise indicated, all financial information reflected herein is expressed in Canadian dollars.

July 17, 2014

In this MD&A, our , us , we , CP , Canadian Pacific 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 23, Glossary of Terms.

Unless otherwise indicated, all comparisons of results for the second quarter and year to date of 2014 are against the results for the second quarter and year to date of 2013.

1. BUSINESS PROFILE

Canadian Pacific Railway Limited, through its subsidiaries, operates a transcontinental railway in Canada and the United States (U.S.) and provides logistics and supply chain expertise. CP provides rail and intermodal transportation services over a network of approximately 13,700 miles, serving the principal business centres of Canada from Montreal, Quebec, to Vancouver, British Columbia (B.C.), and the U.S. Northeast and Midwest regions. Our railway feeds directly into the U.S. heartland from the East and West coasts. Agreements with other carriers extend the Company s market reach east of Montreal in Canada, throughout the U.S. and into Mexico. The Company transports bulk commodities, merchandise freight and intermodal traffic. Bulk commodities include Canadian grain, U.S. grain, coal, potash, and fertilizers and sulphur. Merchandise freight consists of finished vehicles and automotive parts, chemicals and plastics, crude oil, forest products, and metals, minerals, 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. STRATEGY

Canadian Pacific is driving change as it moves through its transformational journey to become the best railroad in North America, while creating long-term value for shareholders. The Company is focused on providing customers with industry leading rail service; driving sustainable, profitable growth; optimizing our assets; and reducing costs, while remaining a leader in rail safety.

Looking forward, CP is executing its strategic plan to become the lowest cost rail carrier. This plan is centred on five key foundations, which are the Company s performance drivers.

Provide Service: Providing efficient and consistent transportation solutions for the Company s customers. Doing what we say we are going to do is what drives CP by providing a reliable product with a lower cost operating model.

Table of Contents

Centralized planning aligned with local execution is bringing the Company closer to the customer and accelerating decision-making.

Control Costs: Controlling and removing unnecessary costs from the organization, eliminating bureaucracy and continuing to identify productivity enhancements are the keys to success.

Optimize Assets: Through longer sidings, improved asset utilization, and increased train lengths, the Company is moving increased volumes with fewer locomotives and cars while unlocking capacity for future growth potential.

Operate Safely: Each year, CP safely moves millions of carloads of freight across North America while ensuring the safety of our people and the communities through which we operate. Safety is never to be compromised. Continuous research and development in state-of-the-art safety technology and highly focused employees ensure our trains are built for safe, efficient operations across our network.

Develop People: CP recognizes that none of the other foundations can be achieved without its people. Every CP employee is a railroader and the Company is shaping a new culture focused on a passion for service with integrity in everything it does. Coaching and mentoring managers into becoming leaders will help drive CP forward.

3. FORWARD-LOOKING INFORMATION

This MD&A contains certain forward-looking statements within the meaning of the *United States Private Securities Litigation Reform Act* of 1995 and other relevant securities legislation. These forward-looking statements include, but are not limited to, statements concerning the Company s defined benefit pension expectations for 2014 and 2015, financial expectations for 2014, as well as statements concerning the Company s operations, anticipated financial performance, business prospects and strategies, as well as statements concerning the anticipation that cash flow from operations and various sources of financing will be sufficient to meet debt repayments and obligations in the foreseeable future, statements regarding future payments including income taxes and pension contributions, and capital expenditures. Forward-looking information typically contains statements with words such as anticipate , believe , expect , plan or similar words suggesting future outcomes.

Readers are cautioned not to place undue reliance on forward-looking information because it is possible that CP will not achieve predictions, forecasts, projections and other forms of forward-looking information. Current economic conditions render assumptions, although reasonable when made, subject to greater uncertainty. In addition, 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.

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

There are more specific factors that could cause actual results to differ materially from those described in the forward-looking statements contained in this MD&A. These more specific factors are identified and discussed in Section 20, Business Risks and elsewhere in this MD&A. Other risks are detailed from time to time in reports filed by CP with securities regulators in Canada and the United States.

Financial Assumptions

Defined benefit pension expectations

Defined benefit pension contributions are currently estimated to be between $90 million and $110 million in each year from 2014 to 2016. This contribution level reflects the Company s intentions with respect to the rate at which the Company applies the voluntary prepayments made in previous years to reduce contribution requirements. Defined benefit pension income for 2014 and 2015 is expected to be approximately $50 million for each year. These pension contributions and pension income estimates are based on a number of economic and demographic assumptions and are sensitive to changes in the assumptions or to actual experience differing from the assumptions. Pensions are discussed further in Section 21, Critical Accounting Estimates.

Table of Contents

Financial expectations for 2014

The Company expects revenue growth to be 6-7%, operating ratio of 65% or lower and diluted earnings per share (EPS) growth to be 30% or greater from 2013 annual diluted EPS, excluding significant items, of $6.42, discussed further in Section 14, Non-GAAP Measures. CP plans to spend approximately $1.2 to $1.3 billion on capital programs in 2014, discussed further in Section 13, Liquidity and Capital Resources. Key assumptions for full year 2014 financial expectations include:

- an average fuel cost per gallon of US$3.50 per U.S. gallon;
- defined benefit pension income of approximately $50 million;
- Canadian to U.S. dollar exchange rate of 1.05; and
- an income tax rate of 28% discussed further in Section 10, Other Income Statement Items.

Undue reliance should not be placed on these assumptions and other forward-looking information.

4. ADDITIONAL INFORMATION

Additional information, including the Company s Consolidated Financial Statements, press releases and other required filing documents, are available on SEDAR at www.sedar.com in Canada, on EDGAR at www.sec.gov in the U.S. and on the Company website at www.cpr.ca. Copies of such documents, as well as the Company s Notice of Intention to Make a Normal course Issuer Bid, may be obtained by contacting the Corporate Secretary s Office. The aforementioned documents are issued and made available in accordance with legal requirements and are not incorporated by reference into this MD&A.

Table of Contents

5. FINANCIAL HIGHLIGHTS

(in millions, except percentages and per-share data)	For the three months ended June 30 2014	For the three months ended June 30 2013	For the six months ended June 30 2014	For the six months ended June 30 2013
Revenues	**$ 1,681**	$ 1,497	**$ 3,190**	$ 2,992
Operating income	**587**	420	**1,010**	782
Net income	**371**	252	**625**	469
Basic earnings per share	**2.13**	1.44	**3.57**	2.68
Diluted earnings per share	**2.11**	1.43	**3.54**	2.66
Dividends declared per share	**0.3500**	0.3500	**0.7000**	0.7000
Return on capital employed (ROCE[1])	**10.9%**	8.7%	**10.9%**	8.7%
Adjusted ROCE[2][3]	**13.7%**	10.9%	**13.7%**	10.9%
Operating ratio	**65.1%**	71.9%	**68.3%**	73.9%
Free cash[3][4]	**519**	178	**534**	171
Total assets at June 30	**17,012**	15,519	**17,012**	15,519
Total long-term financial liabilities at June 30[5]	**4,723**	4,800	**4,723**	4,800

(1) ROCE is defined as earnings before interest and taxes (EBIT) (on a rolling twelve month basis), divided by the average for the year of total assets, less current liabilities, excluding current portion of long-term debt, as measured under GAAP, and it is discussed further in Section 14, Non-GAAP Measures.

(2) Adjusted ROCE is defined as EBIT excluding significant items (on a rolling twelve month basis) divided by the average for the year of total assets, less current liabilities, excluding current portion of long-term debt, as measured under GAAP. Adjusted ROCE and EBIT excluding significant items are discussed further in Section 14, Non-GAAP Measures.

(3) These measures have no standardized meanings prescribed by GAAP and, therefore, are unlikely to be comparable to similar measures of other companies. These measures are discussed further in Section 14, Non-GAAP Measures.

(4) A reconciliation of free cash to GAAP cash position is provided in Section 14, Non-GAAP Measures.

(5) Excludes deferred income taxes: $2,870 million and $2,403 million; and other non-financial deferred liabilities of $934 million and $1,333 million at June 30, 2014 and 2013, respectively.

6. OPERATING RESULTS

Income

Operating income in the second quarter of 2014 was $587 million, an increase of $167 million, or 40%, from $420 million in the same period of 2013. Operating income increased primarily due to:

- higher overall shipments;

- efficiency savings generated from improved operating performance, asset utilization and insourcing of certain IT activities;
- higher freight rates;
- lower casualty expense;
- the favourable impact of the change in foreign exchange (FX); and
- lower pension expense.

This increase in Operating income was partially offset by higher incentive and stock-based compensation.

Operating income in the first six months of 2014 was $1,010 million, an increase of $228 million, or 29% from $782 million in the same period of 2013.

Operating income increased primarily due to:

- higher shipments of Canadian originating grain, Domestic intermodal , and Metals, minerals and consumer products;
- efficiency savings generated from improved operating performance, asset utilization and insourcing of certain IT activities;
- lower pension expense;
- the favourable impact of the change in foreign exchange (FX); and
- lower casualty expense.

This increase in Operating income was partially offset by the unfavourable impact of harsh winter operating conditions and higher incentive and stock-based compensation.

Table of Contents

Net income was $371 million in the second quarter of 2014, an increase of $119 million, or 47%, from $252 million in the same period of 2013. Net income was $625 million for the first six months of 2014, an increase of $156 million, or 33%, from $469 million in the same period of 2013. These increases were primarily due to higher Operating income, partially offset by an increase in income tax expense.

Diluted Earnings per Share

Diluted earnings per share (EPS) in the second quarter of 2014 was $2.11, an increase of $0.68, or 48%, from $1.43 in the same period of 2013. Diluted EPS for the first six months of 2014 was $3.54, an increase of $0.88, or 33%, from $2.66 in the same period of 2013. These increases were primarily due to higher net income.

Operating Ratio

The operating ratio provides the percentage of revenues used to operate the railway, and is calculated as total operating expenses divided by total revenues. A lower percentage normally indicates higher efficiency in the operation of the railway. The operating ratio was 65.1% in the second quarter of 2014, compared with 71.9% in the same period of 2013. This improvement was primarily due to higher volumes generating higher freight revenues and efficiency savings partially offset by higher incentive and stock-based compensation. The operating ratio was 68.3% for the six months ended June 30, 2014, compared with 73.9% in the same period of 2013. These decreases were primarily due to higher volumes and efficiency savings, partially offset by higher incentive and stock-based compensation and the impact of harsh winter operating conditions.

Impact of Foreign Exchange on Earnings

Fluctuations in foreign exchange affect the Company s results because U.S. dollar-denominated revenues and expenses are translated into Canadian dollars. U.S. dollar-denominated revenues and expenses increase (decrease) when the Canadian dollar weakens (strengthens) in relation to the U.S. dollar.

Canadian to U.S. dollar Average exchange rates	**2014**	2013
For the three months ended June 30	**$ 1.10**	$ 1.02
For the six months ended June 30	**$ 1.10**	$ 1.01

Canadian to U.S. dollar Exchange rates	**2014**	2013
Beginning of year January 1	**$ 1.06**	$ 0.99
Beginning of quarter April 1	**$ 1.11**	$ 1.02
End of quarter June 30	**$ 1.07**	$ 1.05

Average Fuel Price (U.S. dollars per U.S. gallon)	**2014**	2013
For the three months ended June 30	**$ 3.53**	$ 3.45

For the six months ended June 30	**$ 3.58**	$ 3.50

Table of Contents

7. PERFORMANCE INDICATORS

	For the three months ended June 30			For the six months ended June 30		
	2014	2013[1]	% Change	**2014**	2013[1]	% Change
Operations performance						
Freight gross ton-miles (GTMs) (millions)	**71,333**	67,232	6	**133,682**	134,910	(1)
Revenue ton-miles (RTMs) (millions)	**38,429**	35,991	7	**72,804**	72,154	1
Train miles (thousands)	**9,335**	9,645	(3)	**18,062**	19,639	(8)
Average train weight excluding local traffic (tons)	**8,178**	7,471	9	**7,924**	7,337	8
Average train length excluding local traffic (feet)	**6,880**	6,444	7	**6,634**	6,369	4
Average terminal dwell (hours)[2]	**8.6**	6.8	26	**9.4**	6.7	40
Average train speed (mph)[3]	**18.1**	18.6	(3)	**17.1**	18.4	(7)
Locomotive productivity (daily average GTMs / active horse power (HP))	**228.6**	218.0	5	**216.5**	211.5	2
Fuel efficiency (U.S. gallons of locomotive fuel consumed / 1000 GTMs)[4]	**1.00**	1.05	(5)	**1.05**	1.09	(4)
Total employees (average)[5]	**14,787**	15,471	(4)	**14,516**	15,196	(4)
Workforce (end of period)[6]	**14,960**	16,053	(7)	**14,960**	16,053	(7)
Safety indicators						
FRA personal injuries per 200,000 employee-hours	**1.84**	1.51	22	**1.73**	1.62	7
FRA train accidents per million train-miles	**1.03**	1.94	(47)	**1.08**	1.95	(45)

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

(2) Incorporates a new reporting definition where average terminal dwell measures the average time a freight car resides within terminal boundaries.

(3) Incorporates a new reporting definition where average train speed measures the line-haul movement from origin to destination including terminal dwell hours.

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

(5) An employee is defined as an individual, including trainees, who has worked more than 40 hours in a standard biweekly pay period. This excludes part time employees, contractors and consultants.

(6) Workforce is defined as total employees plus part time employees, contractors and consultants.

The indicators listed in this table are key measures of the Company s operating performance. Definitions of these performance indicators are provided in Section 23, Glossary of Terms.

Operations Performance

GTMs for the second quarter of 2014 were 71,333 million, which increased by 6% compared with 67,232 million in the same period of 2013. This increase was driven primarily by higher grain and coal traffic. GTMs for the first six months of 2014 decreased by 1% compared to the same period of 2013. This decrease was primarily due to lower overall traffic volumes in the Company s bulk franchise in the first quarter of 2014.

RTMs for the second quarter of 2014 were 38,429 million which increased by 7% compared with 35,991 million in the same period of 2013. RTMs for the first six months of 2014 were 72,804 million which increased by 1% compared with 72,154 million in the same period of 2013. RTMs are discussed further in Section 8, Lines of Business.

Train miles decreased by 3% in the second quarter of 2014, compared with the same period of 2013, and decreased by 8% for the first six months of 2014, compared to the same period of 2013. These reductions were primarily driven by improvements in operating efficiency.

Average train weight for the second quarter of 2014 was 8,178 tons, an increase of 707 tons or 9%, compared with 7,471 tons in the same period of 2013. Average train weights for the first six months of 2014 increased by 8% compared with the same period of 2013.

Table of Contents

Average train length for the second quarter of 2014 was 6,880 feet, an increase of 436 feet or 7%, compared with 6,444 feet in the same period of 2013 and was 6,634 feet in the first six months of 2014, an increase of 4% compared with the same period of 2013.

Average train weight and length benefited significantly from improvements in operating plan efficiency, as well as longer and heavier bulk train designs, both of which leverage the siding extensions completed in 2013. This improvement was achieved despite the impact of harsh winter operating conditions in the first quarter of 2014.

Average terminal dwell increased by 26% and 40% in the second quarter and first six months of 2014, respectively, compared with the same periods of 2013. These increases were due to harsh winter operating conditions and continued operational challenges in the U.S. Midwest.

Average train speed decreased by 3% in the second quarter of 2014, compared with the same period of 2013. This decrease is due to continued operational challenges in the U.S. Midwest following a challenging winter. Average train speed decreased by 7%, in the first six months of 2014, compared with the same period of 2013. This decrease is primarily due to the impact of harsh winter operating conditions.

Locomotive productivity increased by 5% and 2% for the second quarter and the first six months of 2014, respectively, compared to the same periods of 2013. These increases were primarily a result of reductions in locomotive dwell and continued improvements in train weights, partially offset by a reduction in train speed.

Fuel efficiency improved by 5% and 4% for the second quarter and the first six months of 2014, respectively, compared to the same periods of 2013. These improvements were due to the continued execution of the Company s fuel conservation strategy and increased locomotive productivity from higher average train weights.

The average number of total employees in the second quarter of 2014 decreased by 684, or 4%, compared with the same period in 2013 and in the first six months of 2014 decreased by 680, or 4%, compared with the same period in 2013. These decreases were primarily due to job reductions as a result of continuing strong operational performance and natural attrition, partially offset by additional Information Services (IS) employees as part of the Company s insourcing strategy. Workforce was further decreased due to fewer contractors.

8. LINES OF BUSINESS

Total Revenue, Volumes and Freight Rates

	For the three months ended June 30			For the six months ended June 30		
	2014	2013	% Change	**2014**	2013	% Change
Freight revenues (in millions)	**$ 1,642**	$ 1,458	13	**$ 3,116**	$ 2,917	7
Other revenue (in millions)	**39**	39		**74**	75	(1)
Total revenues (in millions)	**1,681**	1,497	12	**3,190**	2,992	7
Carloads (in thousands)	**689**	668	3	**1,307**	1,327	(2)
Revenue ton-miles (in millions)	**38,429**	35,991	7	**72,804**	72,154	1

Freight revenue per carload (dollars)	**$ 2,383**	$ 2,183	9	**$ 2,384**	$ 2,198	8
Freight revenue per revenue ton-mile (cents)	**4.27**	4.05	5	**4.28**	4.04	6

The Company s revenues are primarily derived from transporting freight. Other revenue is generated from leasing of certain assets, switching fees, contracts with passenger service operators, and logistical management services. Changes in freight volumes generally contribute to corresponding changes in freight revenues and certain variable expenses, such as fuel, equipment rents and crew costs.

Freight Revenues

Freight revenues are earned from transporting bulk commodities, merchandise and intermodal goods, and include fuel recoveries billed to the Company s customers. Freight revenues were $1,642 million in the second quarter of 2014, an increase of $184 million, or 13%, from $1,458 million in the same period of 2013. This increase was primarily due to:

higher volumes of Canadian originating grain shipments, Domestic intermodal and expressway containers, U.S. originating grain shipments, and Metals, minerals and consumer products;

the favourable impact of the change in FX; and

Table of Contents

- higher freight rates.

This increase was partially offset by lower shipments in International intermodal, Forest products, and Fertilizers and sulphur due to:

- the exit of certain customer contracts;
- lower shipments of fertilizers as a result of high inventories following a late harvest in 2013 and a narrow spring application window; and
- the delayed return to full production of customer facilities following a challenging winter.

Freight revenues were $3,116 million in the first six months of 2014, an increase of $199 million, or 7%, from $2,917 million in the same period of 2013. This increase was primarily due to:

- the favourable impact of the change in FX;
- higher volumes of Canadian originating grain shipments, Frac sand in Metals, minerals and consumer products, and Domestic intermodal and expressway container volumes; and
- higher freight rates.

This increase was partially offset by lower shipments in International intermodal, Forest products, and Fertilizers and sulphur due to the exit of certain customer contracts and lower shipments in certain lines of business due to harsh winter operating conditions.

Revenue ton miles (RTMs) were 38,429 million in the second quarter of 2014, an increase of 2,438 million, or 7%, compared to the same period of 2013. This increase was primarily due to higher shipments of:

- Canadian originating grain;
- Canadian originating metallurgical coal;
- Domestic intermodal and expressway containers; and
- Frac sand in Metals, minerals and consumer products.

This increase in RTMs was offset by lower shipments of:

- International intermodal;
- Forest product shipments; and
- Fertilizers and sulphur.

RTMs were 72,804 million for the first six months of 2014, an increase of approximately 650 million, or 1%, compared to the same period of 2013. This increase in RTMs was primarily due to higher volumes of:

- Canadian originating grain;
- Frac sand in Metals, minerals and consumer products;
- Domestic intermodal and expressway container volumes; and
- Canadian originating shipments of metallurgical coal.

This increase in RTMs was offset by lower shipments of:

- International intermodal due to the exit of certain customer contracts;
- Forest Products;
- Potash; and
- Fertilizers and sulphur.

Fuel Cost Recovery Programs

CP employs a fuel cost recovery program designed to automatically respond to fluctuations in fuel prices and help mitigate the financial impact of rising fuel prices. Fuel surcharge revenue is earned on individual shipments; as such, fuel surcharge revenue is a function of freight volumes. Short-term volatility in fuel prices may adversely or positively impact expenses and revenues.

Table of Contents

Canadian Grain	For the three months ended June 30			For the six months ended June 30		
	2014	2013	% Change	**2014**	2013	% Change
Freight revenues (in millions)	**$ 252**	$ 191	32	**$ 473**	$ 394	20
Carloads (in thousands)	**78**	61	28	**140**	120	17
Revenue ton-miles (in millions)	**7,074**	5,272	34	**12,920**	10,647	21
Freight revenue per carload (dollars)	**$ 3,219**	$ 3,127	3	**$ 3,374**	$ 3,271	3
Freight revenue per revenue ton-mile (cents)	**3.56**	3.61	(1)	**3.66**	3.69	(1)

Canadian grain revenue was $252 million in the second quarter of 2014, an increase of $61 million, or 32%, from $191 million in the same period of 2013 and was $473 million for the first six months of 2014, an increase of $79 million, or 20%, from $394 million in the same period of 2013. These increases were primarily due to higher shipments as a result of strong export demand and record Canadian crop production, and the favourable impact of the change in FX.

This increase was partially offset by reduced freight rates as measured by freight revenue per revenue ton-mile.

U.S. Grain	For the three months ended June 30			For the six months ended June 30		
	2014	2013	% Change	**2014**	2013	% Change
Freight revenues (in millions)	**$ 115**	$ 91	26	**$ 221**	$ 202	9
Carloads (in thousands)	**44**	42	5	**83**	91	(9)
Revenue ton-miles (in millions)	**2,679**	2,411	11	**5,218**	5,466	(5)
Freight revenue per carload (dollars)	**$ 2,645**	$ 2,159	23	**$ 2,675**	$ 2,225	20
Freight revenue per revenue ton-mile (cents)	**4.31**	3.77	14	**4.24**	3.70	15

U.S. grain revenue was $115 million in the second quarter of 2014, an increase of $24 million, or 26%, from $91 million in the same period of 2013. This increase was primarily due:

- higher shipments destined for the Pacific Northwest due to increased U.S. crop production in areas served by CP;
- the favourable impact of the change in FX; and
- increased freight rates.

This increase was partially offset by lower shipments to certain areas of the U.S. Midwest.

U.S. grain revenue was $221 million for the first six months of 2014, an increase of $19 million, or 9%, from $202 million in the same period of 2013. This increase was primarily due to the favourable impact of the change in FX, partially offset by lower shipments due to harsh winter operating conditions in the first quarter of 2014.

Table of Contents

Coal	For the three months ended June 30			For the six months ended June 30		
	2014	2013	% Change	**2014**	2013	% Change
Freight revenues (in millions)	**$ 165**	$ 144	15	**$ 313**	$ 293	7
Carloads (in thousands)	**82**	75	9	**160**	156	3
Revenue ton-miles (in millions)	**5,941**	5,316	12	**11,382**	10,956	4
Freight revenue per carload (dollars)	**$ 2,027**	$ 1,921	6	**$ 1,963**	$ 1,878	5
Freight revenue per revenue ton-mile (cents)	**2.79**	2.70	3	**2.75**	2.67	3

Coal revenue was $165 million in the second quarter of 2014, an increase of $21 million, or 15%, from $144 million in the same period of 2013. This increase was primarily due to:

- higher Canadian originating metallurgical coal shipments;
- the favourable impact of the change in FX; and
- higher freight rates.

This increase was partially offset by lower U.S. originating thermal coal shipments due to the continued operational challenges in the U.S. Midwest following a challenging winter.

Coal revenue was $313 million for the first six months of 2014, an increase of $20 million, or 7%, from $293 million in the same period of 2013. This increase was primarily due to:

- higher Canadian originating shipments of metallurgical coal;
- higher freight rates; and
- the favourable impact of the change in FX.

This increase was partially offset by lower U.S. originating thermal coal shipments due to harsh winter operating conditions.

Potash	For the three months ended June 30			For the six months ended June 30		
	2014	2013	% Change	**2014**	2013	% Change

Freight revenues (in millions)	**$ 101**	$ 95	6	**$ 181**	$ 177	2
Carloads (in thousands)	**33**	35	(6)	**61**	65	(6)
Revenue ton-miles (in millions)	**4,114**	4,254	(3)	**7,407**	7,890	(6)
Freight revenue per carload (dollars)	**$ 3,046**	$ 2,706	13	**$ 2,983**	$ 2,719	10
Freight revenue per revenue ton-mile (cents)	**2.46**	2.24	10	**2.44**	2.24	9

Potash revenue was $101 million in the second quarter of 2014, an increase of $6 million, or 6%, from $95 million in the same period of 2013. This increase was primarily due to:

- higher domestic potash shipments;
- the favourable impact of the change in FX; and
- higher freight rates.

This increase was partially offset by lower export potash shipments.

Potash revenue was $181 million for the first six months of 2014, an increase of $4 million, or 2%, from $177 million in the same period of 2013. This increase was primarily due to:

- the favourable impact of the change in FX;
- higher domestic potash shipments; and
- higher freight rates.

This increase was partially offset by the impact of the harsh winter operating conditions in the first quarter of 2014.

Table of Contents

Fertilizers and Sulphur

	For the three months ended June 30			For the six months ended June 30		
	2014	2013	% Change	**2014**	2013	% Change
Freight revenues (in millions)	**$ 64**	$ 68	(6)	**$ 118**	$ 138	(14)
Carloads (in thousands)	**16**	19	(16)	**31**	38	(18)
Revenue ton-miles (in millions)	**1,130**	1,352	(16)	**2,204**	2,668	(17)
Freight revenue per carload (dollars)	**$ 3,925**	$ 3,609	9	**$ 3,770**	$ 3,593	5
Freight revenue per revenue ton-mile (cents)	**5.61**	5.01	12	**5.35**	5.16	4

Fertilizers and sulphur revenue was $64 million in the second quarter of 2014, a decrease of $4 million, or 6%, from $68 million in the same period of 2013 and was $118 million for the first six months of 2014, a decrease of $20 million, or 14%, from $138 million in the same period of 2013. These decreases were primarily due to overall lower shipments of fertilizers as a result of high inventories following a late harvest in 2013 and a narrow spring application window as well as lower shipments of sulphur due to the delayed return to full production of customer facilities, as a result of harsh winter operating conditions in 2014, partially offset by the favourable impact of the change in FX and higher freight rates.

Forest Products

	For the three months ended June 30			For the six months ended June 30		
	2014	2013	% Change	**2014**	2013	% Change
Freight revenues (in millions)	**$ 52**	$ 53	(2)	**$ 100**	$ 106	(6)
Carloads (in thousands)	**15**	18	(17)	**29**	36	(19)
Revenue ton-miles (in millions)	**1,003**	1,267	(21)	**1,923**	2,490	(23)
Freight revenue per carload (dollars)	**$ 3,502**	$ 2,998	17	**$ 3,452**	$ 2,944	17
Freight revenue per revenue ton-mile (cents)	**5.20**	4.20	24	**5.19**	4.26	22

Forest products revenue was $52 million in the second quarter of 2014, a decrease of $1 million, or 2%, from $53 million in the same period of 2013 and was $100 million for the first six months of 2014, a decrease of $6 million, or 6%, from $106 million in the same period of 2013. These decreases were primarily due to lower lumber shipments as a result of the exit of certain customer contracts in Western Canada and lower pulp and paper shipments due to customer production issues, partially offset by the favourable impact of the change in FX and higher freight rates.

Chemicals and Plastics

	For the three months ended June 30			For the six months ended June 30		
	2014	2013	% Change	**2014**	2013	% Change
Freight revenues (in millions)	**$ 155**	$ 138	12	**$ 302**	$ 277	9

Carloads (in thousands)	**49**	48	2	**94**	99	(5)
Revenue ton-miles (in millions)	**3,326**	3,435	(3)	**6,532**	6,969	(6)
Freight revenue per carload (dollars)	**$ 3,185**	$ 2,809	13	**$ 3,213**	$ 2,759	16
Freight revenue per revenue ton-mile (cents)	**4.67**	3.98	17	**4.63**	3.94	18

Chemicals and plastics revenue was $155 million in the second quarter of 2014, an increase of $17 million, or 12%, from $138 million in the same period of 2013 and was $302 million for the first six months of 2014, an increase of $25 million, or 9%, from $277 million in the same period of 2013. These increases were primarily due to:

Table of Contents

higher volumes of Liquefied Petroleum Gas (LPG) and fuel oils as a result of strong market demand;

the favourable impact of the change in FX; and

higher freight rates.

These increases were partially offset by lower shipments of biofuels due to supply chain issues.

Crude	For the three months ended June 30			For the six months ended June 30		
	2014	2013	% Change	**2014**	2013	% Change
Freight revenues (in millions)	**$ 114**	$ 97	18	**$ 218**	$ 189	15
Carloads (in thousands)	**25**	24	4	**49**	46	7
Revenue ton-miles (in millions)	**3,816**	3,640	5	**7,174**	7,131	1
Freight revenue per carload (dollars)	**$ 4,524**	$ 4,095	10	**$ 4,452**	$ 4,122	8
Freight revenue per revenue ton-mile (cents)	**2.99**	2.67	12	**3.04**	2.65	15

Crude revenue was $114 million in the second quarter of 2014, an increase of $17 million, or 18%, from $97 million in the same period of 2013 and was $218 million for the first six months of 2014, an increase of $29 million, or 15%, from $189 million in the same period of 2013. These increases were primarily due to:

higher volumes as a result of increased demand for crude by rail shipments originating from the Bakken region and Western Canada;

the favourable impact of the change in FX; and

higher freight rates.

Metals, Minerals and Consumer Products	For the three months ended June 30			For the six months ended June 30		
	2014	2013	% Change	**2014**	2013	% Change
Freight revenues (in millions)	**$ 170**	$ 144	18	**$ 331**	$ 285	16
Carloads (in thousands)	**60**	58	3	**116**	112	4
Revenue ton-miles (in millions)	**2,698**	2,339	15	**5,411**	4,850	12

Freight revenue per carload (dollars)	**$ 2,810**	$ 2,537	11	**$ 2,839**	$ 2,571	10
Freight revenue per revenue ton-mile (cents)	**6.27**	6.22	1	**6.11**	5.92	3

Metals, minerals and consumer products revenue was $170 million in the second quarter of 2014, an increase of $26 million, or 18%, from $144 million in the same period of 2013 and was $331 million for the first six months of 2014, an increase of $46 million, or 16%, from $285 million in the same period of 2013. These increases were primarily due to:

- higher volumes as a result of strong Frac sand demand;
- the favourable impact of the change in FX; and
- higher freight rates.

Table of Contents

Automotive	For the three months ended June 30			For the six months ended June 30		
	2014	2013	% Change	**2014**	2013	% Change
Freight revenues (in millions)	**$ 104**	$ 106	(2)	**$ 192**	$ 203	(5)
Carloads (in thousands)	**37**	38	(3)	**67**	73	(8)
Revenue ton-miles (in millions)	**597**	629	(5)	**1,111**	1,233	(10)
Freight revenue per carload (dollars)	**$ 2,798**	$ 2,759	1	**$ 2,850**	$ 2,751	4
Freight revenue per revenue ton-mile (cents)	**17.37**	16.87	3	**17.31**	16.49	5

Automotive revenue was $104 million in the second quarter of 2014, a decrease of $2 million, or 2%, from $106 million in the same period of 2013. This decrease was primarily due to continued operational challenges in the U.S. Midwest following a challenging winter, partially offset by the favourable impact of FX.

Automotive revenue was $192 million for the first six months of 2014, a decrease of $11 million, or 5%, from $203 million in the same period of 2013. This decrease was primarily due to harsh winter operating conditions and was partially offset by the favourable impact of FX, as well as the movement of one time dimensional loads in 2014.

Domestic Intermodal	For the three months ended June 30			For the six months ended June 30		
	2014	2013	% Change	**2014**	2013	% Change
Freight revenues (in millions)	**$ 200**	$ 171	17	**$ 377**	$ 341	11
Carloads (in thousands)	**110**	93	18	**207**	182	14
Revenue ton-miles (in millions)	**3,003**	2,546	18	**5,637**	5,064	11
Freight revenue per carload (dollars)	**$ 1,822**	$ 1,839	(1)	**$ 1,825**	$ 1,877	(3)
Freight revenue per revenue ton-mile (cents)	**6.66**	6.72	(1)	**6.69**	6.73	(1)

Domestic intermodal revenue was $200 million in the second quarter of 2014, an increase of $29 million, or 17%, from $171 million in the same period of 2013 and was $377 million for the first six months of 2014, an increase of $36 million, or 11%, from $341 million in the same period of 2013. These increases were primarily due to higher Domestic intermodal and expressway container volumes as well as the favourable impact of the change in FX.

International Intermodal	For the three months ended June 30			For the six months ended June 30		
	2014	2013	% Change	**2014**	2013	% Change
Freight revenues (in millions)	**$ 150**	$ 160	(6)	**$ 290**	$ 312	(7)
Carload (in thousands)	**140**	157	(11)	**270**	309	(13)

Revenue ton-miles (in millions)	**3,048**	3,530	(14)	**5,885**	6,790	(13)
Freight revenue per carload (dollars)	**$ 1,074**	$ 1,017	6	**$ 1,074**	$ 1,011	6
Freight revenue per revenue ton-mile (cents)	**4.94**	4.52	9	**4.93**	4.60	7

International intermodal revenue was $150 million in the second quarter of 2014, a decrease of $10 million, or 6%, from $160 million in the same period of 2013 and was $290 million for the first six months of 2014, a decrease of $22 million, or 7%, from $312 million in the same period of 2013. These decreases were primarily due to the exit of certain customer contracts, partially offset by:

higher transcontinental container volumes from existing customers;

Table of Contents

the favourable impact of the change in FX; and

higher freight rates.

Other Revenues

Other revenues were $39 million in the second quarter of 2014 and $74 million for the first six months of 2014, essentially unchanged from the same periods in 2013.

9. OPERATING EXPENSES

	For the three months ended June 30			For the six months ended June 30		
(in millions)	**2014**	2013	% Change	**2014**	2013	% Change
Operating expenses						
Compensation and benefits[1]	**$ 342**	$ 334	2	**$ 687**	$ 726	(5)
Fuel	**273**	246	11	**544**	516	5
Materials[1]	**47**	35	34	**99**	79	25
Equipment rents	**40**	44	(9)	**81**	90	(10)
Depreciation and amortization	**137**	141	(3)	**278**	282	(1)
Purchased services and other[1]	**255**	277	(8)	**491**	517	(5)
Total operating expenses	**$ 1,094**	$ 1,077	2	**$ 2,180**	$ 2,210	(1)

(1) Billings to third parties for the recovery of costs incurred for freight car repairs and servicing have been reclassified from Purchased services and other to Compensation and benefits and Materials within Operating expenses.

Operating expenses were $1,094 million in the second quarter of 2014, an increase of $17 million, or 2%, from $1,077 million in the same period of 2013. This increase was primarily due to:

higher stock-based and incentive compensation;

the unfavourable impact in the change of FX;

higher volume variable expenses as a result of an increase in workload, as measured by GTMs;

wage and benefit inflation;

- higher fuel prices; and
- the receipt of an insurance recovery in the second quarter of 2013, related to flooding in 2011.

This increase was partially offset by:

- efficiencies generated from improved operating performance, asset utilization, and insourcing of certain IT activities;
- lower pension expense; and
- lower casualty expense.

Operating expense was $2,180 million for the first six months of 2014, a decrease of $30 million, or 1%, from $2,210 million in the same period of 2013. This decrease was primarily due to:

- efficiencies generated from improved operating performance, asset utilization, and insourcing of certain IT activities;
- lower pension expense;
- lower casualty expense; and
- lower volume variable expenses as a result of a decrease in workload, as measured by GTMs.

This decrease was partially offset by:

- the unfavourable impact in the change of FX;
- higher stock-based and incentive compensation;
- higher costs due to the impact of harsh winter operating conditions in the first quarter of 2014;
- wage and benefit inflation;
- higher fuel prices;

- a settlement of litigation in 2013 related to management transition; and
- lower land sales.

Compensation and Benefits

Compensation and benefits expense was $342 million in the second quarter of 2014, an increase of $8 million, or 2%, from $334 million in the same period of 2013. This increase was primarily due to:

- higher stock-based compensation primarily driven by the higher change in stock price and higher incentive compensation resulting from improved corporate performance;
- wage and benefit inflation;
- an increase in IS personnel as part of the Company s insourcing strategy, offset by efficiency savings recorded in Purchased services and other;
- the unfavourable impact of the change in FX; and
- higher volume variable expenses, as a result of an increase in workload as measured by GTMs.

This increase was partially offset by lower pension expense and lower costs achieved through a smaller workforce and road and yard crew efficiencies as a result of continuing strong operational performance.

Compensation and benefits expense was $687 million for the first six months of 2014, a decrease of $39 million, or 5%, from $726 million in the same period of 2013. This decrease was primarily due to a lower pension expense and lower costs achieved through a smaller workforce. This decrease was partially offset by:

- higher stock-based compensation primarily driven by the higher change in stock price and higher incentive compensation resulting from improved corporate performance;
- wage and benefit inflation;
- the unfavourable impact of the change in FX;
- an increase in IS personnel; and
- increased overtime wages and higher crew costs driven by harsh winter operating conditions.

Fuel

Fuel expense was $273 million in the second quarter of 2014, an increase of $27 million, or 11%, from $246 million in the same period of 2013. This increase was primarily due to:

- the unfavourable change in FX;

the change in workload, as measured by GTMs; and

increased fuel prices.

This increase was partially offset by improvements in fuel efficiency as a result of increased train weights and focus on the fuel conservation strategies of the Company s operating plan.

Fuel expense was $544 million for the first six months of 2014, an increase of $28 million, or 5%, from $516 million in the same period of 2013. The increase was primarily due to the unfavourable change in FX and increased fuel prices. This was partially offset by improvements in fuel efficiency as a result of increased train weights and focus on the fuel conservation strategies of the Company s operating plan, and by the change in workload, as measured by GTMs.

Materials

Materials expense was $47 million in the second quarter of 2014, an increase of $12 million, or 34%, from $35 million in the same period of 2013 and was $99 million for the first six months of 2014, an increase of $20 million, or 25%, from $79 million in the same period of 2013. These increases were primarily due to higher freight car repair material costs and track maintenance materials. In addition, the increase in the first six months of 2014 is also driven by harsh winter operating conditions in the first quarter of 2014.

Equipment Rents

Equipment rents expense was $40 million in the second quarter of 2014, a decrease of $4 million or 9%, from $44 million in the same period of 2013 and was $81 million for the first six months of 2014, a decrease of $9 million or 10%, from $90 million in the same period of 2013. These decreases reflect a reduction in equipment rents associated with freight cars and locomotives. As a result of operating efficiencies, the Company required fewer freight cars or locomotives, reducing the payments made to foreign railways for the use of their freight cars and permitting the return or sublease of certain leased freight cars and locomotives.

Depreciation and Amortization

Depreciation and amortization expense was $137 million in the second quarter of 2014, a decrease of $4 million, or 3%, from $141 million in the same period of 2013 and was $278 million for the first six months of 2014, a decrease of $4 million, or 1%, from $282 million in the same period of 2013. Depreciation expense was lower due to a decrease in accelerated depreciation on IT assets and lower depreciable assets resulting from the sale of the west end of Dakota, Minnesota and Eastern Railroad (DM&E West). The decrease was partially offset by higher depreciable assets as a result of the Company s capital program.

Table of Contents

Purchased Services and Other	For the three months ended June 30			For the six months ended June 30		
(in millions)	**2014**	2013[(1)]	% Change	**2014**	2013[(1)]	% Change
Purchased services and other						
Support and facilities	**$ 94**	$ 99	(5)	**$ 190**	$ 195	(3)
Track and operations	**48**	55	(13)	**93**	101	(8)
Intermodal	**43**	39	10	**80**	78	3
Equipment	**50**	50		**96**	95	1
Casualty	**6**	33	(82)	**15**	46	(67)
Other	**15**	4	275	**24**	15	60
Land sales	**(1)**	(3)	(67)	**(7)**	(13)	(46)
Total purchased services and other	**$ 255**	$ 277	(8)	**$ 491**	$ 517	(5)

(1) Billings to third parties for the recovery of costs incurred for freight car repairs and servicing have been reclassified from Purchased services and other to Compensation and benefits and Materials within Operating expenses.

Purchased services and other expense was $255 million in the second quarter of 2014, a decrease of $22 million, or 8% from $277 million in the same period of 2013. This decrease was primarily due to lower casualty expense and efficiencies generated from improved operating performance, asset utilization, and insourcing of certain IT activities.

This decrease was partially offset by:

- the unfavourable impact of the change in FX;
- the receipt of an insurance recovery in the second quarter of 2013, related to flooding in 2011, reported in Other;
- higher intermodal expenses related to pick up & delivery service, reported in Intermodal; and
- higher corporate sponsorships and donations, reported in Support and facilities.

Purchased services and other expense was $491 million for the first six months of 2014, a decrease of $26 million, or 5% from $517 million in the same period of 2013. This decrease was primarily due to:

- lower casualty expense;

- efficiencies generated from improved operating performance, asset utilization, and insourcing of certain IT activities; and
- lower interline expenses related to reduced workload, included in Track and operations.

This decrease was partially offset by:

- the unfavourable impact of the change in FX;
- a settlement of litigation in 2013 related to management transition, included in Other;
- lower land sales;
- the receipt of an insurance recovery in the second quarter of 2013, related to flooding in 2011, reported in Other; and
- higher corporate sponsorships and donations, reported in Support and facilities.

10. OTHER INCO ME STATEMENT ITEMS

Other Income and Charges

Other income and charges was an expense of $3 million in the second quarter of 2014, compared to an expense of $8 million in the same period of 2013. Other income and charges was an expense of $3 million for the first six months of 2014, compared to $11 million in the same period of 2013. These improvements were primarily due to higher FX gains.

Net Interest Expense

Net interest expense was $69 million and $139 million for the second quarter and the first six months of 2014 respectively, essentially unchanged from the same periods of 2013.

Income Taxes

Income tax expense was $144 million in the second quarter of 2014, an increase of $52 million, or 57%, from $92 million in the same period of 2013. This increase was primarily due to higher taxable earnings and a higher estimated annual effective income tax rate in 2014.

Income tax expense was $243 million for the first six months of 2014, an increase of $79 million, or 48%, from $164 million in the same period of 2013. This increase was due to higher taxable earnings and a higher estimated annual

16

effective income tax rate in 2014, and the recognition of a U.S. federal track maintenance tax credit for 2012 that was enacted and reported in the first quarter of 2013.

The estimated annual effective income tax rate for the second quarter and the first six months of 2014 was 28%, compared with an effective tax rate of 27% and 26% respectively, in the same periods in 2013. This increase was primarily due to the U.S. track maintenance tax credit for 2012 and higher estimated pre-tax net income in 2014.

The Company expects an annual effective income tax rate in 2014 of approximately 28%, which is based on certain estimates and assumptions for the year, discussed further in Section 20, Business Risks.

11. QUARTERLY FINANCIAL DATA

For the quarter ended (in millions, except per share data)	**2014**		2013				2012	
	Jun. 30	Mar. 31	Dec. 31	Sept. 30	Jun. 30	Mar. 31	Dec. 31	Sept. 30
Total revenues	**$ 1,681**	$ 1,509	$ 1,607	$ 1,534	$ 1,497	$ 1,495	$ 1,502	$ 1,451
Operating income	**587**	423	114	524	420	362	60	376
Net income	**371**	254	82	324	252	217	15	224
Basic earnings per share	**$ 2.13**	$ 1.45	$ 0.47	$ 1.85	$ 1.44	$ 1.25	$ 0.08	$ 1.31
Diluted earnings per share	**$ 2.11**	$ 1.44	$ 0.47	$ 1.84	$ 1.43	$ 1.24	$ 0.08	$ 1.30

Quarterly Trends

Volumes and revenues from certain goods are stronger during different periods of the year. Second and third quarter revenues generally improve over the first quarter as fertilizer volumes are typically highest during the second quarter. Operating income is also affected by seasonal fluctuations. Operating income is typically lowest in the first quarter due to lower freight revenue and higher operating costs associated with winter conditions. Net income is also influenced by seasonal fluctuations in customer demand and weather-related issues.

12. CHANGES IN ACCOUNTING POLICY

Future Accounting Changes

Reporting discontinued operations and disclosures of disposals of components

In April 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-08, Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity, an amendment to FASB Accounting Standards Codification (ASC) Topic 205 and Topic 360. The update amends the definition of a discontinued operation in Topic 205, expands disclosure requirements for transactions that meet the definition of a discontinued operation and requires entities to disclose information about individually significant components that are disposed of or held for sale and do not qualify as discontinued operations. In addition, an entity is required to separately present assets and liabilities of a discontinued operation for all comparative periods and separately present assets and liabilities of assets held for sale in the initial period in which the disposal group is classified as held for sale on the face of the consolidated balance sheets. For each period in which assets and liabilities are separately presented on the consolidated balance sheets, those amounts should not be offset and presented as a single amount. This ASU will be effective for public entities for fiscal years, and interim periods within those years, beginning after December 15, 2014, and will be applied prospectively. The adoption of this ASU is not expected to have a material impact to the Company s financial statements.

Revenue from contracts with customers

In May 2014, FASB issued ASU No. 2014-09, Revenue from Contracts with Customers, a new FASB ASC, Topic 606, which supersedes the revenue recognition requirements in Topic 605 and most industry-specific guidance throughout the Industry Topics of the Codification. This new standard requires an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In addition, the new standard requires enhanced disclosures about revenue to help users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. This ASU will be effective for public entities for fiscal years, and interim periods within those years, beginning after December 15, 2016. Entities have the option of using either a full retrospective or a modified retrospective approach to adopt the ASU. The Company has not, at this time, ascertained the full impact on the consolidated financial statements from the adoption of this new standard but does not expect the impact to be material.

Table of Contents

13. LIQUIDITY AND CAPITAL RESOURCES

CP believes 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, Contractual Commitments and Section 19, Future Trends and Commitments. The Company is not aware of any trends or expected fluctuations in the Company s liquidity that would create any deficiencies. Liquidity risk is discussed further in Section 20, Business Risks. The following discussion of operating, investing and financing activities describes the Company s indicators of liquidity and capital resources.

Operating Activities

Cash provided by operating activities was $645 million in the second quarter of 2014, an increase of $125 million from $520 million in the same period of 2013. Cash provided by operating activities was $932 million for the first six months of 2014, an increase of $145 million from $787 million in the same period of 2013. These increases were largely due to improved earnings partially offset by an increase in accounts receivable resulting from higher customer billings and slowdown in the Company s collections rate. In addition, the increase in the first six months compared to the same period in 2013 reflects the purchase of material in 2013 as part of the Company s insourcing strategy.

Investing Activities

Cash used in investing activities was $45 million in the second quarter of 2014, a decrease of $345 million from $390 million in the same period of 2013. Cash used in investing activities was $262 million for the first six months of 2014, a decrease of $340 million from $602 million in the same period of 2013. These decreases were largely due to the proceeds received from the sale of DM&E West and a decrease in Restricted cash and cash equivalents related to securitization of letters of credit, discussed further in Section 20, Business Risks.

Additions to properties (capital programs) in 2014 are expected to be approximately $1.2 to $1.3 billion. Planned capital programs include approximately $850 million to $875 million to preserve capacities through replacement or renewal of depleted assets, between $200 million and $250 million for network capacity expansions, business development projects and productivity initiatives, up to $120 million to opportunistically acquire core assets currently leased, and between $50 million and $75 million to address capital regulated by governments, principally Positive Train Control (PTC) and locomotive engine upgrades to meet emission standards.

The Company s 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. These assumptions and other factors affecting the Company s expectations for 2014 are discussed further in Section 20, Business Risks.

Financing Activities

Cash used in financing activities was $498 million in the second quarter of 2014, an increase of $454 million from $44 million used in the same period of 2013. Cash used in financing activities was $773 million for the first six months of 2014, an increase of $689 million from $84 million used in the same period of 2013. These increases were largely due to payments made to buy back shares under the share repurchase program, discussed further in Section 15, Shareholder Returns, and by lower proceeds from the issuance of common shares resulting from the exercising of options. In addition, there was a repayment of a capital lease in the first six months of 2014.

The Company has available, as sources of financing, up to $1.2 billion under its revolving credit facility and up to $195 million under its bilateral letter of credit facilities, discussed further in Section 20, Business Risks.

Debt to Total Capitalization

Debt to total capitalization is the sum of long-term debt, long-term debt maturing within one year and short-term borrowing, divided by debt plus total Shareholders equity as presented on the Company s Interim Consolidated Balance Sheets. At June 30, 2014, the Company s debt to total capitalization decreased to 39.8%, compared with 45.9% at June 30, 2013. This decrease was largely due to an increase in equity driven by the decrease in Pension and other benefit liabilities and by earnings during the last twelve months partially offset in part by a decrease in equity resulting from the share repurchase program discussed further in Section 15, Shareholder Returns.

Interest Coverage Ratio

Interest coverage ratio is used in assessing the Company s debt servicing capabilities. This ratio provides an indicator of the Company s debt servicing capabilities, and how these have changed, period over period and in comparison to the Company s peers. Interest coverage ratio is measured, on a rolling twelve month basis, as earnings before interest and taxes (EBIT) divided by Net interest expense, discussed further in Section 14, Non-GAAP Measures. At June 30, 2014, the Company s interest coverage ratio was 5.9, compared with 4.4 at June 30, 2013. This improvement was primarily due to an improvement in EBIT, based on the twelve month period ending June 30, 2014. EBIT was negatively impacted by labour restructuring, asset impairment charges, and management transition costs, discussed further in Section 14, Non-GAAP Measures.

Table of Contents

Excluding these significant items from EBIT, Adjusted interest coverage ratio, discussed further in Section 14, Non-GAAP Measures, was 7.4 at June 30, 2014, compared with 5.5 at June 30, 2013. This increase was primarily due to an increase in Adjusted EBIT based on the twelve month period ending June 30, 2014.

Credit Measures

Credit ratings provide information relating to the Company s financing costs, liquidity and operations and affect the Company s ability to obtain short-term and long-term financing and/or the cost of such financing.

A mid-investment grade credit rating is an important measure in assessing the Company s ability to maintain access to public financing and to minimize cost of capital. It also affects the ability of the Company to engage in certain collateralized business activities on a cost effective basis which is discussed further in Section 20, Business Risks.

Credit ratings and outlooks are based on the rating agencies methodologies and can change from time to time to reflect their views of CP. Their views are affected by numerous factors including, but not limited to, the Company s financial position and liquidity along with external factors beyond the Company s control.

On April 16, 2014, Standard & Poor s Ratings Services raised CP s long-term corporate credit rating to BBB from BBB- and assigned a positive outlook to the rating.

On April 24, 2014, Moody s Investors Service upgraded CP s senior unsecured ratings to Baa2 from Baa3 and assigned a positive outlook to the rating.

On June 5, 2014, DBRS upgraded CP s Issuer Rating, Unsecured Debentures and Medium-Term Notes ratings to BBB from BBB(low) and assigned a positive outlook to the ratings.

Adjusted net debt to Adjusted earnings before interest, tax, depreciation and amortization (EBITDA) is a non-GAAP measure that management uses to evaluate CP s financial discipline with respect to capital markets credit sensitivities. The Company s goal is to maintain a degree of continuity and predictability for investors by meeting a minimum threshold.

Adjusted net debt to Adjusted EBITDA for the years ended December 31, 2013, 2012, and 2011 was 2.2, 3.2, and 4.1 times, respectively. The improvement in this measure reflects the Company s improved net income and a net asset position for the Company s main Canadian defined benefit pension plan at December 31, 2013. Adjusted net debt to Adjusted EBITDA is discussed further in Section 14, Non-GAAP Measures.

Free Cash

Free cash and cash flow before dividends are non-GAAP measures that management considers to be indicators of liquidity. These measures are used by management to provide information with respect to the relationship between cash provided by operating activities and investment decisions and provide comparable measures for period to period changes. There was positive free cash of $519 million in the second quarter of 2014 and $534 million for the first six months of 2014, compared with positive free cash of $178 million and $171 million for the same periods of 2013.

The improvement in free cash in the second quarter and the first six months of 2014 compared to the same periods in 2013 was primarily due to improved earnings and proceeds received from the sale of DM&E West.

Free cash is affected by the seasonal fluctuations discussed further in Section 11, Quarterly Financial Data and by other factors including the size of the Company s capital programs. Capital additions were $298 million in the second quarter of 2014, $3 million lower than in the same period of 2013. Capital additions were $522 million for the first six months of 2014, $18 million higher than in the same period of 2013. Our 2014 capital programs are discussed further above in Investing Activities.

14. NON-GAAP MEASURES

The Company presents non-GAAP measures, cash flow information and credit metrics to provide a basis for evaluating underlying earnings and liquidity trends in its business that can be compared with the results of operations in prior periods. These non-GAAP measures may exclude other specified items that are not among the Company s normal ongoing revenues and operating expenses or may be adjusted for certain off-balance sheet obligations. These non-GAAP measures have no standardized meaning and are not defined by GAAP and, therefore, are unlikely to be comparable to similar measures presented by other companies.

Operating income, excluding significant items, provides a measure of the profitability of the railway on an ongoing basis. Operating ratio, excluding significant items, calculated as operating expenses, excluding significant items divided by revenues, provides the percentage of revenues used to operate the railway on an ongoing basis.

Income, excluding significant items, provides management with a measure of income that allows a multi-period assessment of long-term profitability and also allows management and other external users of the Company s consolidated financial statements to compare profitability on a long-term basis with that of the Company s peers.

Diluted earnings per share, excluding significant items provides the same information on a per share basis.

Operating ratio provides the percentage of revenue 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.

Significant Items

Significant 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 and other items that are not normal course business activities. The following significant items were discussed in further detail in Section 9, Operating Expenses, Section 10, Other Income Statement Items, Section 15, Non-GAAP Measures, and Section 20, Future Trends and Commitments of the annual 2012 and 2013 MD&A, which is herein incorporated by reference.

In the first quarter of 2014, CP recorded a recovery of $4 million ($3 million after tax) for the Company s 2012 labour restructuring initiative due to favourable experience gains, recorded in Compensation and benefits. In the first quarter of 2013, CP recorded a recovery of US$9 million (US$6 million after tax) related to the settlement of certain management transition amounts which had been subject to legal proceedings.

There were no significant items in the second quarter of 2013 or 2014.

The following tables reconcile the noted Non-GAAP measures to the respective nearest reported GAAP measures.

Reconciliation of Non-GAAP measures to GAAP measures

	For the three months ended June 30		For the six months ended June 30	
(in millions)	**2014**	2013	**2014**	2013
Operating income, excluding significant items	**$ 587**	$ 420	**$ 1,006**	$ 773
Add significant items:				
Labour restructuring			**4**	
Management transition costs				9
Operating income as reported	**$ 587**	$ 420	**$ 1,010**	$ 782
Income, excluding significant items	**$ 371**	$ 252	**$ 622**	$ 463

Add significant items, net of tax:				
Labour restructuring			**3**	
Management transition costs				6
Net income as reported	**$ 371**	$ 252	**$ 625**	$ 469

(in millions)	For the three months ended June 30 **2014**	2013	For the six months ended June 30 **2014**	2013	For the year ended Dec 31 2013
Diluted earnings per share, excluding significant items	**$ 2.11**	$ 1.43	**$ 3.52**	$ 2.63	$ 6.42
Add significant items:					
Labour restructuring			**0.02**		0.03
Management transition costs				0.03	0.01
Asset impairments					(1.46)
Income tax rate change					(0.04)
Diluted earnings per share as reported	**$ 2.11**	$ 1.43	**$ 3.54**	$ 2.66	$ 4.96

Table of Contents

	For the three months ended June 30		For the six months ended for June 30	
	2014	2013	**2014**	2013
Operating ratio, excluding significant items	**65.1%**	71.9%	**68.5%**	74.5%
Add significant items:				
Labour restructuring			**(0.2%)**	
Management transition costs				(0.6%)
Operating ratio as reported	**65.1%**	71.9%	**68.3%**	73.9%

(in millions)	**2014**	2013
Adjusted EBIT for the twelve months ended June 30[(1)]	**$ 2,068**	$ 1,511
Add significant items:		
Labour restructuring	**11**	(53)
Asset impairments	**(435)**	(265)
Management transition costs	**(5)**	9
EBIT for the twelve months ended June 30[(1)]	**$ 1,639**	$ 1,202
Add:		
Other income and charges	**9**	**16**
Operating income for the twelve months ended June 30[(1)]	**$ 1,648**	**$ 1,218**

(1) The amount is calculated on a rolling twelve months basis.

Free Cash

Free cash is calculated as cash provided by operating activities, less cash used in investing activities, excluding changes in restricted cash and cash equivalents and investment balances used to collateralize letters of credit, and dividends paid, adjusted for changes in cash and cash equivalents balances resulting from FX fluctuations. Free cash is discussed further in Section 13, Liquidity and Capital Resources. Cash provided by financing activities, excluding dividend payments, reflects financing activities cash flows not included in the computation of free cash. Cash flow before dividends is calculated as cash provided by operating activities less cash used in investing activities, excluding changes in restricted cash and cash equivalents and investment balances used to collateralize letters of credit.

21

Table of Contents

Reconciliation of Free Cash	For the three months		For the six months	
(Reconciliation of free cash to GAAP cash position)	ended June 30		ended June 30	
(in millions)	**2014**	2013	**2014**	2013
Cash provided by operating activities	**$ 645**	$ 520	**$ 932**	$ 787
Cash used in investing activities	**(45)**	(390)	**(262)**	(602)
Change in restricted cash and cash equivalents used to collateralize letters of credit[1]	**(7)**	99	**(9)**	99
Dividends paid	**(62)**	(60)	**(123)**	(121)
Foreign exchange effect on cash and cash equivalents	**(12)**	9	**(4)**	8
Free cash	**519**	178	**534**	171
Cash (used in) provided by financing activities, excluding dividend payment	**(436)**	16	**(650)**	37
Change in restricted cash and cash equivalents used to collateralize letters of credit[1]	**7**	(99)	**9**	(99)
Increase (decrease) in cash and cash equivalents, as shown on the Interim Consolidated Statements of Cash Flows	**90**	95	**(107)**	109
Cash and cash equivalents at beginning of period	**279**	347	**476**	333
Cash and cash equivalents at end of period	**$ 369**	$ 442	**$ 369**	$ 442

(1) Changes in Restricted cash and cash equivalents related to collateralized letters of credit are discussed further in Section 20, Business Risks.

Interest Coverage Ratio

Interest coverage ratio is used in assessing the Company s debt servicing capabilities. This ratio provides an indicator of the Company s debt servicing capabilities, and how these have changed, period over period and in comparison to the Company s peers. The ratio, measured as EBIT divided by Net interest expense is reported quarterly and is measured on a rolling twelve month basis.

The interest coverage ratio, excluding significant items, also referred to as Adjusted interest coverage ratio, is calculated as Adjusted EBIT