

ITEM 1. FINANCIAL STATEMENTS

INTERIM CONSOLIDATED STATEMENTS OF INCOME (unaudited)

(in millions of Canadian dollars, except share and per share data)	For the three months ended June 30		For the six months ended June 30	
	2022	2021	2022	2021
Revenues (Note 3)				
Freight	\$ 2,154	\$ 2,008	\$ 3,950	\$ 3,926
Non-freight	48	46	90	87
Total revenues	2,202	2,054	4,040	4,013
Operating expenses				
Compensation and benefits	348	379	761	784
Fuel	370	218	643	424
Materials	63	54	125	113
Equipment rents	29	28	64	61
Depreciation and amortization	211	200	421	402
Purchased services and other (Note 10)	313	355	623	629
Total operating expenses	1,334	1,234	2,637	2,413
Operating income	868	820	1,403	1,600
Less:				
Equity earnings of Kansas City Southern (Note 10)	(208)	—	(406)	—
Other expense (Note 4, 10)	7	157	6	129
Merger termination fee (Note 10)	—	(845)	—	(845)
Other components of net periodic benefit recovery (Note 15)	(101)	(96)	(202)	(191)
Net interest expense	160	101	320	211
Income before income tax expense	1,010	1,503	1,685	2,296
Income tax expense (Note 5)	245	257	330	448
Net income	\$ 765	\$ 1,246	\$ 1,355	\$ 1,848
Earnings per share (Note 6)				
Basic earnings per share	\$ 0.82	\$ 1.87	\$ 1.46	\$ 2.77
Diluted earnings per share	\$ 0.82	\$ 1.86	\$ 1.45	\$ 2.76
Weighted-average number of shares (millions) (Note 6)				
Basic	929.9	666.7	929.8	666.6
Diluted	932.6	669.9	932.7	669.8
Dividends declared per share	\$ 0.190	\$ 0.190	\$ 0.380	\$ 0.380

See Notes to Interim Consolidated Financial Statements.

INTERIM CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(unaudited)

(in millions of Canadian dollars)	For the three months ended June 30		For the six months ended June 30	
	2022	2021	2022	2021
Net income	\$ 765	\$ 1,246	\$ 1,355	\$ 1,848
Net gain in foreign currency translation adjustments, net of hedging activities	719	10	383	20
Change in derivatives designated as cash flow hedges	2	(97)	3	(72)
Change in pension and post-retirement defined benefit plans	38	52	77	105
Equity accounted investments	73	—	135	—
Other comprehensive income (loss) before income taxes	832	(35)	598	53
Income tax recovery (expense) on above items	2	—	(34)	(30)
Other comprehensive income (loss) (Note 7)	834	(35)	564	23
Comprehensive income	\$ 1,599	\$ 1,211	\$ 1,919	\$ 1,871

See Notes to Interim Consolidated Financial Statements.

**INTERIM CONSOLIDATED BALANCE SHEETS AS AT
(unaudited)**

(in millions of Canadian dollars)	June 30 2022	December 31 2021
Assets		
Current assets		
Cash and cash equivalents	\$ 154	\$ 69
Restricted cash and cash equivalents	—	13
Accounts receivable, net (Note 8)	962	819
Materials and supplies	271	235
Other current assets	224	216
	1,611	1,352
Investment in Kansas City Southern (Note 11)	43,203	42,309
Investments	217	209
Properties	21,502	21,200
Goodwill and intangible assets	374	371
Pension asset	2,538	2,317
Other assets	429	419
Total assets	\$ 69,874	\$ 68,177
Liabilities and shareholders' equity		
Current liabilities		
Accounts payable and accrued liabilities	\$ 1,511	\$ 1,609
Long-term debt maturing within one year (Note 12, 13)	1,698	1,550
	3,209	3,159
Pension and other benefit liabilities	724	718
Other long-term liabilities	509	542
Long-term debt (Note 12, 13)	18,372	18,577
Deferred income taxes	11,646	11,352
Total liabilities	34,460	34,348
Shareholders' equity		
Share capital	25,488	25,475
Additional paid-in capital	73	66
Accumulated other comprehensive loss (Note 7)	(1,539)	(2,103)
Retained earnings	11,392	10,391
	35,414	33,829
Total liabilities and shareholders' equity	\$ 69,874	\$ 68,177

See Contingencies (Note 17).

See Notes to Interim Consolidated Financial Statements.

INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)

(in millions of Canadian dollars)	For the three months ended June 30		For the six months ended June 30	
	2022	2021	2022	2021
Operating activities				
Net income	\$ 765	\$ 1,246	\$ 1,355	\$ 1,848
Reconciliation of net income to cash provided by operating activities:				
Depreciation and amortization	211	200	421	402
Deferred income tax expense (Note 5)	114	9	113	60
Pension recovery and funding (Note 15)	(72)	(65)	(144)	(126)
Equity earnings of Kansas City Southern (Note 10)	(208)	—	(406)	—
Foreign exchange gain on debt and lease liabilities (Note 4)	—	(52)	—	(85)
Dividend from Kansas City Southern (Note 10)	—	—	334	—
Other operating activities, net	(16)	52	(99)	(36)
Change in non-cash working capital balances related to operations	(87)	564	(254)	473
Cash provided by operating activities	707	1,954	1,320	2,536
Investing activities				
Additions to properties	(370)	(416)	(596)	(739)
Proceeds from sale of properties and other assets	11	12	26	49
Other	(3)	(1)	2	(1)
Cash used in investing activities	(362)	(405)	(568)	(691)
Financing activities				
Dividends paid	(176)	(126)	(353)	(253)
Issuance of CP Common Shares	1	8	9	16
Repayment of long-term debt, excluding commercial paper (Note 12)	(10)	(10)	(552)	(31)
Repayment of term loan (Note 12)	(132)	—	(132)	—
Net issuance (repayment) of commercial paper (Note 11)	20	(872)	340	(779)
Acquisition-related financing fees (Note 10)	—	(12)	—	(45)
Other	—	(4)	—	(4)
Cash used in financing activities	(297)	(1,016)	(688)	(1,096)
Effect of foreign currency fluctuations on U.S. dollar-denominated cash and cash equivalents	8	(1)	8	(4)
Cash position				
Increase in cash, cash equivalents, and restricted cash	56	532	72	745
Cash, cash equivalents, and restricted cash at beginning of period	98	360	82	147
Cash and cash equivalents at end of period	\$ 154	\$ 892	\$ 154	\$ 892
Supplemental disclosures of cash flow information:				
Income taxes paid	\$ 93	\$ 139	\$ 252	\$ 272
Interest paid	\$ 169	\$ 57	\$ 319	\$ 212

See Notes to Interim Consolidated Financial Statements.

INTERIM CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
(unaudited)

(in millions of Canadian dollars except per share data)	For the three months ended June 30					
	Common Shares (in millions)	Share capital	Additional paid-in capital	Accumulated other comprehensive loss	Retained earnings	Total shareholders' equity
Balance as at April 1, 2022	929.9	\$25,486	\$ 68	\$ (2,373)	\$ 10,804	\$ 33,985
Net income	—	—	—	—	765	765
Other comprehensive income (Note 7)	—	—	—	834	—	834
Dividends declared (\$0.190 per share)	—	—	—	—	(177)	(177)
Effect of stock-based compensation expense	—	—	5	—	—	5
Shares issued under stock option plan	0.1	2	—	—	—	2
Balance as at June 30, 2022	930.0	\$25,488	\$ 73	\$ (1,539)	\$ 11,392	\$ 35,414
Balance as at April 1, 2021	666.6	\$ 1,993	\$ 58	\$ (2,756)	\$ 8,571	\$ 7,866
Net income	—	—	—	—	1,246	1,246
Other comprehensive loss (Note 7)	—	—	—	(35)	—	(35)
Dividends declared (\$0.190 per share)	—	—	—	—	(127)	(127)
Effect of stock-based compensation expense	—	—	7	—	—	7
Shares issued under stock option plan	0.2	10	(2)	—	—	8
Balance as at June 30, 2021	666.8	\$ 2,003	\$ 63	\$ (2,791)	\$ 9,690	\$ 8,965

(in millions of Canadian dollars except per share data)	For the six months ended June 30					
	Common Shares (in millions)	Share capital	Additional paid-in capital	Accumulated other comprehensive loss	Retained earnings	Total shareholders' equity
Balance as at January 1, 2022	929.7	\$25,475	\$ 66	\$ (2,103)	\$ 10,391	\$ 33,829
Net income	—	—	—	—	1,355	1,355
Other comprehensive income (Note 7)	—	—	—	564	—	564
Dividends declared (\$0.380 per share)	—	—	—	—	(354)	(354)
Effect of stock-based compensation expense	—	—	12	—	—	12
Shares issued for Kansas City Southern acquisition	—	—	(2)	—	—	(2)
Shares issued under stock option plan	0.3	13	(3)	—	—	10
Balance as at June 30, 2022	930.0	\$25,488	\$ 73	\$ (1,539)	\$ 11,392	\$ 35,414
Balance as at January 1, 2021	666.3	\$ 1,983	\$ 55	\$ (2,814)	\$ 8,095	\$ 7,319
Net income	—	—	—	—	1,848	1,848
Other comprehensive income (Note 7)	—	—	—	23	—	23
Dividends declared (\$0.380 per share)	—	—	—	—	(253)	(253)
Effect of stock-based compensation expense	—	—	12	—	—	12
Shares issued under stock option plan	0.5	20	(4)	—	—	16
Balance as at June 30, 2021	666.8	\$ 2,003	\$ 63	\$ (2,791)	\$ 9,690	\$ 8,965

See Notes to Interim Consolidated Financial Statements.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2022

(unaudited)

1 Basis of presentation

These unaudited Interim Consolidated Financial Statements ("Interim Consolidated Financial Statements") of Canadian Pacific Railway Limited ("CPRL") and its subsidiaries (collectively, "CP", or "the Company"), expressed in Canadian dollars, reflect management's estimates and assumptions that are necessary for their fair presentation in conformity with generally accepted accounting principles 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 2021 annual Consolidated Financial Statements and notes included in CP's 2021 Annual Report on Form 10-K. The accounting policies used are consistent with the accounting policies used in preparing the 2021 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 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 Accounting changes

Implemented in 2022

Government Assistance

On January 1, 2022, the Company adopted the new Accounting Standards Update ("ASU") 2021-10, issued by the Financial Accounting Standards Board ("FASB"), and all related amendments under FASB Accounting Standards Codification ("ASC") Topic 832, Government Assistance. The amendment is made to increase transparency by introducing specific disclosure requirements for entities who apply a grant or contribution model by analogy to account for transactions with a government. This update is applied to government assistance transactions within the scope of this amendment that are in the financial statements at the date of initial application and prospectively to new transactions entered into after initial application. See Note 9 for further discussion on government assistance.

All other accounting pronouncements that became effective during the period covered by the Interim Consolidated Financial Statements did not have a material impact on the Company's Consolidated Financial Statements and related disclosures.

Future changes

Contract Assets and Contract Liabilities Acquired in a Business Combination

In October 2021, the FASB issued ASU 2021-08, Business Combinations (Topic 805), Accounting for Contract Assets and Contract Liabilities from Contracts with Customers. This amendment introduces the requirement for an acquirer to recognize and measure contract assets and contract liabilities acquired in a business combination in accordance with the requirements of FASB ASC Topic 606, Revenue from Contracts with Customers, rather than at fair value. This amendment will be effective prospectively from January 1, 2023, with early adoption permitted. The Company is currently assessing the impact of this amendment.

All other accounting pronouncements recently issued, but not effective until after June 30, 2022, have been assessed and are not expected to have a material impact on the Company's Consolidated Financial Statements and related disclosures.

3 Revenues

The following table disaggregates the Company's revenues from contracts with customers by major source:

(in millions of Canadian dollars)	For the three months ended June 30		For the six months ended June 30	
	2022	2021	2022	2021
Freight				
Grain	\$ 370	\$ 444	\$ 730	\$ 892
Coal	163	170	302	333
Potash	171	134	275	235
Fertilizers and sulphur	85	78	163	155
Forest products	104	90	190	170
Energy, chemicals and plastics	340	369	650	757
Metals, minerals and consumer products	228	180	409	339
Automotive	120	98	211	206
Intermodal	573	445	1,020	839
Total freight revenues	2,154	2,008	3,950	3,926
Non-freight excluding leasing revenues	27	26	49	50
Revenues from contracts with customers	2,181	2,034	3,999	3,976
Leasing revenues	21	20	41	37
Total revenues	\$ 2,202	\$ 2,054	\$ 4,040	\$ 4,013

Contract liabilities

Contract liabilities represent payments received for performance obligations not yet satisfied and relate to deferred revenue and are presented as components of "Accounts payable and accrued liabilities" and "Other long-term liabilities" on the Company's Interim Consolidated Balance Sheets.

The following table summarizes the changes in contract liabilities:

(in millions of Canadian dollars)	For the three months ended June 30		For the six months ended June 30	
	2022	2021	2022	2021
Opening balance	\$ 67	\$ 114	\$ 67	\$ 61
Revenue recognized that was included in the contract liability balance at the beginning of the period	(7)	(19)	(11)	(23)
Increase due to consideration received, net of revenue recognized during the period	9	150	13	207
Closing balance	\$ 69	\$ 245	\$ 69	\$ 245

4 Other expense

(in millions of Canadian dollars)	For the three months ended June 30		For the six months ended June 30	
	2022	2021	2022	2021
Foreign exchange gain on debt and lease liabilities	\$ —	\$ (52)	\$ —	\$ (85)
Other foreign exchange gains	—	(3)	(2)	(2)
Acquisition-related costs (Note 10)	—	209	—	212
Other	7	3	8	4
Other expense	\$ 7	\$ 157	\$ 6	\$ 129

5 Income taxes

(in millions of Canadian dollars)	For the three months ended June 30		For the six months ended June 30	
	2022	2021	2022	2021
Current income tax expense	\$ 131	\$ 248	\$ 217	\$ 388
Deferred income tax expense	114	9	113	60
Income tax expense	\$ 245	\$ 257	\$ 330	\$ 448

The effective tax rates including discrete items for the three and six months ended June 30, 2022 were 24.21% and 19.59%, respectively, compared to 17.10% and 19.50%, respectively for the same periods of 2021.

For the three months ended June 30, 2022, the effective tax rate was 24.25%, excluding the discrete items of equity earnings of Kansas City Southern ("KCS"), acquisition-related costs incurred by CP of \$19 million, and outside basis deferred tax expense of \$49 million arising from the difference between the carrying amount of CP's investment in KCS for financial reporting and the underlying tax basis of this investment.

For the three months ended June 30, 2021, the effective tax rate was 24.60%, excluding the discrete items of the merger termination fee of \$845 million (U.S. \$700 million) received in connection with KCS's termination of the Original Merger Agreement, foreign exchange ("FX") gain of \$52 million on debt and lease liabilities, and acquisition-related costs of \$308 million.

For the six months ended June 30, 2022, the effective tax rate was 24.25%, excluding the discrete items of equity earnings of KCS, acquisition-related costs incurred by CP of \$39 million, and outside basis deferred tax expense of \$17 million arising from the difference between the carrying amount of CP's investment in KCS for financial reporting and the underlying tax basis of this investment.

For the six months ended June 30, 2021, the effective tax rate was 24.60%, excluding the discrete items of the merger termination fee of \$845 million (U.S. \$700 million), FX gain of \$85 million on debt and lease liabilities, and acquisition-related costs of \$344 million.

6 Earnings per share

Basic earnings per share has 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 the earnings per share calculations are reconciled as follows:

(in millions)	For the three months ended June 30		For the six months ended June 30	
	2022	2021	2022	2021
Weighted-average basic shares outstanding	929.9	666.7	929.8	666.6
Dilutive effect of stock options	2.7	3.2	2.9	3.2
Weighted-average diluted shares outstanding	932.6	669.9	932.7	669.8

For the three and six months ended June 30, 2022, there were 0.8 million and 0.4 million options, respectively, excluded from the computation of diluted earnings per share because their effects were not dilutive (three and six months ended June 30, 2021 - nil).

7 Changes in Accumulated other comprehensive loss ("AOCL") by component

(in millions of Canadian dollars)	For the three months ended June 30					Total ⁽¹⁾
	Foreign currency net of hedging activities ⁽¹⁾	Derivatives ⁽¹⁾⁽²⁾	Pension and post-retirement defined benefit plans ⁽¹⁾	Equity accounted investments ⁽¹⁾⁽²⁾		
Opening balance, April 1, 2022	\$ (531)	\$ (3)	\$ (1,884)	\$ 45	\$ (2,373)	
Other comprehensive income before reclassifications	748	—	—	57	805	
Amounts reclassified from accumulated other comprehensive loss	—	1	28	—	29	
Net other comprehensive income	748	1	28	57	834	
Closing balance, June 30, 2022	\$ 217	\$ (2)	\$ (1,856)	\$ 102	\$ (1,539)	
Opening balance, April 1, 2021	\$ 112	\$ (21)	\$ (2,839)	\$ (8)	\$ (2,756)	
Other comprehensive loss before reclassifications	(2)	(72)	—	(2)	(76)	
Amounts reclassified from accumulated other comprehensive loss	—	2	39	—	41	
Net other comprehensive (loss) income	(2)	(70)	39	(2)	(35)	
Closing balance, June 30, 2021	\$ 110	\$ (91)	\$ (2,800)	\$ (10)	\$ (2,791)	

⁽¹⁾ Amounts are presented net of tax.

⁽²⁾ Comparative figures have been reclassified to conform with current period presentation.

(in millions of Canadian dollars)	For the six months ended June 30					Total ⁽¹⁾
	Foreign currency net of hedging activities ⁽¹⁾	Derivatives ⁽¹⁾⁽²⁾	Pension and post-retirement defined benefit plans ⁽¹⁾	Equity accounted investments ⁽¹⁾⁽²⁾		
Opening balance, January 1, 2022	\$ (182)	\$ (4)	\$ (1,915)	\$ (2)	\$ (2,103)	
Other comprehensive income before reclassifications	399	—	—	103	502	
Amounts reclassified from accumulated other comprehensive loss	—	2	59	1	62	
Net other comprehensive income	399	2	59	104	564	
Closing balance, June 30, 2022	\$ 217	\$ (2)	\$ (1,856)	\$ 102	\$ (1,539)	
Opening balance, January 1, 2021	\$ 112	\$ (40)	\$ (2,878)	\$ (8)	\$ (2,814)	
Other comprehensive loss before reclassifications	(2)	(55)	—	(2)	(59)	
Amounts reclassified from accumulated other comprehensive loss	—	4	78	—	82	
Net other comprehensive (loss) income	(2)	(51)	78	(2)	23	
Closing balance, June 30, 2021	\$ 110	\$ (91)	\$ (2,800)	\$ (10)	\$ (2,791)	

⁽¹⁾ Amounts are presented net of tax.

⁽²⁾ Comparative figures have been reclassified to conform with current period presentation.

Amounts in Pension and post-retirement defined benefit plans reclassified from AOCL are as follows:

(in millions of Canadian dollars)	For the three months ended June 30		For the six months ended June 30	
	2022	2021	2022	2021
Recognition of net actuarial loss ⁽¹⁾	\$ 38	\$ 52	\$ 77	\$ 105
Income tax recovery	(10)	(13)	(18)	(27)
Total net of income tax	\$ 28	\$ 39	\$ 59	\$ 78

⁽¹⁾ Impacts "Other components of net periodic benefit recovery" on the Interim Consolidated Statements of Income.

8 Accounts receivable, net

(in millions of Canadian dollars)	As at June 30, 2022			As at December 31, 2021		
	Freight	Non-freight	Total	Freight	Non-freight	Total
Total accounts receivable	\$ 736	\$ 265	\$ 1,001	\$ 614	\$ 239	\$ 853
Allowance for credit losses	(24)	(15)	(39)	(20)	(14)	(34)
Total accounts receivable, net	\$ 712	\$ 250	\$ 962	\$ 594	\$ 225	\$ 819

(in millions of Canadian dollars)	For the three months ended June 30, 2022			For the three months ended June 30, 2021		
	Freight	Non-freight	Total	Freight	Non-freight	Total
Allowance for credit losses, opening balance	\$ (22)	\$ (14)	\$ (36)	\$ (24)	\$ (15)	\$ (39)
Current period credit loss provision, net	(2)	(1)	(3)	1	—	1
Allowance for credit losses, closing balance	\$ (24)	\$ (15)	\$ (39)	\$ (23)	\$ (15)	\$ (38)

(in millions of Canadian dollars)	For the six months ended June 30, 2022			For the six months ended June 30, 2021		
	Freight	Non-freight	Total	Freight	Non-freight	Total
Allowance for credit losses, opening balance	\$ (20)	\$ (14)	\$ (34)	\$ (25)	\$ (15)	\$ (40)
Current period credit loss provision, net	(4)	(1)	(5)	2	—	2
Allowance for credit losses, closing balance	\$ (24)	\$ (15)	\$ (39)	\$ (23)	\$ (15)	\$ (38)

9 Government assistance

By analogy to the grant model of accounting within International Accounting Standards ("IAS") 20, Accounting for Government Grants and Disclosure of Government Assistance, CP records government assistance from various levels of Canadian and U.S. governments and government agencies when the conditions of their receipt are complied with and there is reasonable assurance that the assistance will be received.

Government assistance related to properties have as a primary condition that CP should purchase, construct, or otherwise acquire property, plant and equipment. Under certain government assistance arrangements, there is a secondary condition which requires CP to repay a portion of the assistance if certain conditions related to the assets are not adhered to during a specified period. In these cases, it is CP's intention to comply with all conditions imposed by the terms of the government assistance. Government assistance received or receivable related to CP's property assets are deducted from the cost of the assets in the Interim Consolidated Balance Sheets within "Properties" and amortized over the same period as the related assets in "Depreciation and amortization" in the Interim Consolidated Statements of Income.

During the three and six months ended June 30, 2022, the Company received \$6 million and \$19 million, respectively, of government assistance towards the purchase and construction of properties.

As of June 30, 2022, the total Properties balance of \$21,502 million is net of \$274 million of unamortized government assistance (December 31, 2021 - \$259 million), primarily related to the enhancement of CP's track and roadway infrastructure. Amortization expense related to government assistance for the three and six months ended June 30, 2022 was \$2 million and \$5 million, respectively.

10 Business acquisition

Kansas City Southern

The Company accounts for its investment in KCS using the equity method of accounting while the U.S. Surface Transportation Board ("STB") considers the Company's application to control KCS. The STB review of CP's proposed control of KCS while KCS is in the voting trust is expected to be completed in the first quarter of 2023. The investment in KCS of \$43,203 million as at June 30, 2022 includes \$208 million and \$406 million of equity earnings of KCS for the three and six months ended June 30, 2022, respectively, offset by a dividend received of \$334 million on January 27, 2022. Included within the \$208 million and \$406 million of equity earnings of KCS recognized for the three and six months ended June 30, 2022 was amortization (net of tax), of the approximately \$30 billion basis difference, representing the difference in value between the consideration paid to acquire KCS and the underlying carrying value of the net assets of KCS as at December 14, 2021, immediately prior to the acquisition by CP. The amortization (net of tax), recognized for the three and six months ended June 30, 2022 was \$39 million and \$79 million, respectively. The basis difference is related to depreciable property, plant and equipment, intangible assets with definite lives, and long-term debt, and is amortized over the related assets' remaining useful lives, and the remaining terms to maturity of the debt instruments.

During the three and six months ended June 30, 2022, the Company incurred \$19 million and \$39 million, in acquisition-related costs, respectively, recorded within "Purchased services and other" in the Company's Interim Consolidated Statements of Income. Acquisition-related costs of \$14 million and \$27 million incurred by KCS during the three and six months ended June 30, 2022 are included within "Equity earnings of Kansas City Southern" in the Company's Interim Consolidated Statements of Income.

During the three and six months ended June 30, 2021, the Company incurred \$308 million and \$344 million in acquisition-related costs, respectively, of which \$99 million and \$132 million were recorded within "Purchased services and other" and \$209 million and \$212 million were recorded within "Other expense", respectively, including the amortization of financing fees associated with new credit facilities. Total financing fees paid for a bridge facility associated with the KCS acquisition during the three and six months ended June 30, 2021 were \$12 million and \$45 million, respectively, presented under Cash used in financing activities in the Company's Interim Consolidated Statements of Cash Flows.

On May 21, 2021, KCS terminated the Agreement and Plan of Merger entered into on March 21, 2021 (the "Original Merger Agreement") with CP to enter into a definitive agreement with Canadian National Railway. At the same time and in accordance with the terms of the Original Merger Agreement, KCS paid CP a termination fee of \$845 million (U.S. \$700 million). This amount is reported as "Merger termination fee" in the Company's Interim Consolidated Statements of Income for the three and six months ended June 30, 2021. No similar items were received in the same period of 2022.

11 Investment in KCS

The KCS investment carrying cost of \$43,203 million reported on the Company's Interim Consolidated Balance Sheets as at June 30, 2022 reflects the consideration paid to acquire KCS, the asset recorded upon recognition of a deferred tax liability computed on an outside basis (see Note 5), the subsequent recognition of equity earnings, the dividend received from KCS, and foreign currency translation based on the quarter-end exchange rate.

The following table presents summarized financial information for KCS, on its historical cost basis:

Statement of Income

(in millions of Canadian dollars) ⁽¹⁾	For the three months ended June 30, 2022	For the six months ended June 30, 2022
Total revenues	\$ 1,079	\$ 2,065
Total operating expenses	680	1,297
Operating income	399	768
Less: Other ⁽²⁾	59	98
Income before income taxes	340	670
Net income	\$ 248	\$ 485

⁽¹⁾ Amounts translated at the average FX rate for the three and six months ended June 30, 2022 of \$1.00 USD = \$1.28 CAD and \$1.00 USD = \$1.27 CAD, respectively.

⁽²⁾ Includes Equity in net earnings of KCS's affiliates, Interest expense, FX loss, and Other income, net.

12 Debt

During the six months ended June 30, 2022, the Company repaid at maturity \$125 million 5.100% 10-year Medium Term Notes, U.S. \$250 million (\$313 million) 4.500% 10-year Notes, and a U.S. \$76 million (\$97 million) 6.99% finance lease.

Credit facility

Effective March 14, 2022, the Company extended the maturity date of the U.S. \$500 million unsecured non-revolving term credit facility (the "term facility") to September 15, 2022. As at June 30, 2022, the Company had borrowings of U.S. \$400 million (\$515 million) under this term facility (December 31, 2021 - U.S. \$500 million) at an interest rate of 2.73% (December 31, 2021 - 1.38%).

Commercial paper program

The Company has a commercial paper program which enables it to issue commercial paper up to a maximum aggregate principal amount of U.S. \$1.0 billion in the form of unsecured promissory notes. This commercial paper program is backed by the U.S. \$1.3 billion revolving credit facility. As at June 30, 2022, the Company had total commercial paper borrowings of U.S. \$540 million (\$696 million), included in "Long-term debt maturing within one year" on the Company's Interim Consolidated Balance Sheets (December 31, 2021 - U.S. \$265 million). The weighted-average interest rate on these borrowings was 2.00% (December 31, 2021 - 0.32%). The Company presents issuances and repayments of commercial paper, all of which have a maturity of less than 90 days, in the Company's Interim Consolidated Statements of Cash Flows on a net basis.

13 Financial instruments

A. Fair values of financial instruments

The Company categorizes its financial assets and liabilities measured at fair value into a three-level hierarchy established by GAAP that prioritizes those inputs to valuation techniques used to measure fair value based on the degree to which they are observable. The three levels of the fair value hierarchy are as follows: Level 1 inputs are quoted prices in active markets for identical assets and liabilities; Level 2 inputs, other than quoted prices included within Level 1, are observable for the asset or liability either directly or indirectly; and Level 3 inputs are not observable in the market.

The Company's short-term financial instruments may include cash and cash equivalents, restricted cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, and short-term borrowings including commercial paper and term loans. The carrying values of short-term financial instruments approximate their fair values.

The carrying value of the Company's long-term debt and finance lease liabilities does not approximate their fair value. Their estimated fair value has been determined based on market information, where available, or by discounting future payments of principal and interest at estimated interest rates expected to be available to the Company at period end. All measurements are classified as Level 2. The Company's long-term debt and finance lease liabilities, including current maturities, with a carrying value of \$18,858 million as at June 30, 2022 (December 31, 2021 - \$19,151 million), had a fair value of \$17,570 million (December 31, 2021 - \$21,265 million).

B. Financial risk management

FX management

Net investment hedge

The effect of the Company's net investment hedge for the three and six months ended June 30, 2022 was an unrealized FX loss of \$216 million and \$118 million, respectively (three and six months ended June 30, 2021 - unrealized FX gain of \$86 million and \$162 million, respectively) recognized in "Other comprehensive income (loss)".

14 Shareholders' equity

On January 27, 2021, the Company announced a normal course issuer bid ("NCIB"), commencing January 29, 2021, to purchase up to 16.7 million Common Shares in the open market for cancellation on or before January 28, 2022. Upon expiry of this NCIB, the Company had not purchased any Common Shares under this NCIB.

15 Pension and other benefits

In the three and six months ended June 30, 2022, the Company made contributions to its defined benefit pension plans of \$4 million and \$7 million, respectively (three and six months ended June 30, 2021 - \$7 million and \$11 million, respectively).

Net periodic benefit costs for defined benefit pension plans and other benefits included the following components:

(in millions of Canadian dollars)	For the three months ended June 30			
	Pensions		Other benefits	
	2022	2021	2022	2021
Current service cost (benefits earned by employees)	\$ 37	\$ 43	\$ 3	\$ 3
Other components of net periodic benefit (recovery) cost:				
Interest cost on benefit obligation	96	88	4	4
Expected return on fund assets	(239)	(240)	—	—
Recognized net actuarial loss	38	51	—	1
Total other components of net periodic benefit (recovery) cost	(105)	(101)	4	5
Net periodic benefit (recovery) cost	\$ (68)	\$ (58)	\$ 7	\$ 8

(in millions of Canadian dollars)	For the six months ended June 30			
	Pensions		Other benefits	
	2022	2021	2022	2021
Current service cost (benefits earned by employees)	\$ 74	\$ 86	\$ 5	\$ 6
Other components of net periodic benefit (recovery) cost:				
Interest cost on benefit obligation	192	176	8	8
Expected return on fund assets	(479)	(480)	—	—
Recognized net actuarial loss	76	103	1	2
Total other components of net periodic benefit (recovery) cost	(211)	(201)	9	10
Net periodic benefit (recovery) cost	\$ (137)	\$ (115)	\$ 14	\$ 16

16 Stock-based compensation

As at June 30, 2022, the Company had several stock-based compensation plans including stock option plans, various cash-settled liability plans, and an employee share purchase plan. These plans resulted in an expense for the three and six months ended June 30, 2022 of \$2 million and \$46 million, respectively (three and six months ended June 30, 2021 - expense of \$25 million and \$49 million, respectively).

Stock option plans

In the six months ended June 30, 2022, under CP's stock option plans, the Company issued 831,052 options at the weighted-average price of \$90.91 per share, based on the closing price on the grant date. Pursuant to the employee plan, these options may be exercised upon vesting, which is between 12 months and 48 months after the grant date, and will expire after seven years.

Under the fair value method, the fair value of the stock options at grant date was approximately \$16 million. The weighted-average fair value assumptions were approximately:

	For the six months ended June 30, 2022
Expected option life (years) ⁽¹⁾	4.75
Risk-free interest rate ⁽²⁾	1.60%
Expected share price volatility ⁽³⁾	26.83%
Expected annual dividends per share ⁽⁴⁾	\$0.760
Expected forfeiture rate ⁽⁵⁾	3.00%
Weighted-average grant date fair value per option granted during the period	\$18.76

⁽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 term commensurate with the expected option life.

⁽³⁾ Based on the historical volatility of the Company's share price 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 estimates forfeitures based on past experience. This rate is monitored on a periodic basis.

Performance share unit plans

During the six months ended June 30, 2022, the Company issued 411,999 Performance Share Units ("PSUs") with a grant date fair value of approximately \$36 million and 13,506 Performance Deferred Share Units ("PDSUs") with a grant date fair value, including the value of expected future matching units, of approximately \$2 million. PSUs and PDSUs attract dividend equivalents in the form of additional units based on dividends paid on the Company's Common Shares, and vest approximately three years after the grant date, contingent upon CP's performance ("performance factor"). The fair value of these PSUs and PDSUs is measured periodically until settlement. Vested PSUs are settled in cash. Vested PDSUs are settled in cash pursuant to the Deferred Share Unit ("DSU") Plan and are eligible for a 25% match if the holder has not exceeded their share ownership requirements, and are paid out only when the holder ceases their employment with CP.

The performance period for PSUs and PDSUs issued in the six months ended June 30, 2022 is January 1, 2022 to December 31, 2024 and the performance factors are Free Cash Flow ("FCF"), Adjusted Net Debt to Adjusted earnings before interest, tax, depreciation, and amortization ("EBITDA") Modifier, Total Shareholder Return ("TSR") compared to the S&P/TSX 60 Index, and TSR compared to S&P 500 Industrials Index.

The performance period for PSUs issued in 2019 was January 1, 2019 to December 31, 2021. The performance factors for 668,405 PSUs were Return on Invested Capital ("ROIC"), TSR compared to the S&P/TSX 60 Index, and TSR compared to Class I Railways. The resulting payout was 200% of the outstanding units multiplied by the Company's average share price calculated using the last 30 trading days preceding December 31, 2021. In the first quarter of 2022, payouts occurred on 631,457 total outstanding awards, including dividends reinvested, totalling \$116 million.

Deferred share unit plan

During the six months ended June 30, 2022, the Company granted 46,930 Deferred Share Units ("DSUs") with a grant date fair value of approximately \$4 million. DSUs vest over various periods of up to 36 months and are only redeemable for a specified period after employment is terminated. The expense for DSUs is recognized over the vesting period for both the initial subscription price and the change in value between reporting periods.

17 Contingencies

In the normal course of its operations, the Company becomes involved in various legal actions, including claims relating to injuries and damage to property. The Company maintains provisions it considers to be adequate for such actions. While the final outcome with respect to actions outstanding or pending at June 30, 2022 cannot be predicted with certainty, it is the opinion of management that their resolution will not have a material adverse effect on the Company's business, financial position or results of operations. However, an unexpected adverse resolution of one or more of these legal actions could have a material adverse effect on the Company's business, financial position, results of operations, or liquidity in a particular quarter or fiscal year.

Legal proceedings related to Lac-Mégantic rail accident

On July 6, 2013, a train carrying petroleum crude oil operated by Montréal Maine and Atlantic Railway ("MMAR") or a subsidiary, Montréal Maine & Atlantic Canada Co. ("MMAC" and collectively the "MMA Group"), derailed in Lac-Mégantic, Québec. The derailment occurred on a section of railway owned and operated by the MMA Group and while the MMA Group exclusively controlled the train.

Following the derailment, MMAC sought court protection in Canada under the *Companies' Creditors Arrangement Act* and MMAR filed for bankruptcy in the U.S. Plans of arrangement were approved in both Canada and the U.S. (the "Plans"), providing for the distribution of approximately \$440 million amongst those claiming derailment damages.

A number of legal proceedings, set out below, were commenced in Canada and the U.S. against CP and others:

- (1) Québec's Minister of Sustainable Development, Environment, Wildlife and Parks ordered various parties, including CP, to remediate the derailment site (the "Cleanup Order") and served CP with a Notice of Claim for \$95 million for those costs. CP appealed the Cleanup Order and contested the Notice of Claim with the Administrative Tribunal of Québec. These proceedings are stayed pending determination of the Attorney General of Québec ("AGQ") action (paragraph 2 below).
- (2) The AGQ sued CP in the Québec Superior Court claiming \$409 million in damages, which was amended and reduced to \$315 million (the "AGQ Action"). The AGQ Action alleges that: (i) CP was responsible for the petroleum crude oil from its point of origin until its delivery to Irving Oil Ltd.; and (ii) CP is vicariously liable for the acts and omissions of the MMA Group.
- (3) A class action in the Québec Superior Court on behalf of persons and entities residing in, owning or leasing property in, operating a business in, or physically present in Lac-Mégantic at the time of the derailment was certified against CP on May 8, 2015 (the "Class Action"). Other defendants including MMAC and Mr. Thomas Harding ("Harding") were added to the Class Action on January 25, 2017. On November 28, 2019, the plaintiffs' motion to discontinue their action against Harding was granted. The Class Action seeks unquantified damages, including for wrongful death, personal injury, property damage, and economic loss.
- (4) Eight subrogated insurers sued CP in the Québec Superior Court claiming approximately \$16 million in damages, which was amended and reduced to approximately \$15 million (the "Promutuel Action"), and two additional subrogated insurers sued CP claiming approximately \$3 million in damages (the "Royal Action"). Both actions contain similar allegations as the AGQ Action. The actions do not identify the subrogated parties. As such, the extent of any overlap between the damages claimed in these actions and under the Plans is unclear. The Royal Action is stayed pending determination of the consolidated proceedings described below.

On December 11, 2017, the AGQ Action, the Class Action and the Promutuel Action were consolidated. The joint liability trial of these consolidated claims commenced on September 21, 2021 with oral arguments ending on June 15, 2022. A decision is expected by December 15, 2022. A damages trial will follow if necessary.

- (5) Forty-eight plaintiffs (all individual claims joined in one action) sued CP, MMAC, and Harding in the Québec Superior Court claiming approximately \$5 million in damages for economic loss and pain and suffering, and asserting similar allegations as in the Class Action and the AGQ Action. The majority of the plaintiffs opted-out of the Class Action and all but two are also plaintiffs in litigation against CP, described in paragraph 7 below. This action is stayed pending determination of the consolidated claims described above.
- (6) The MMAR U.S. bankruptcy estate representative commenced an action against CP in November 2014 in the Maine Bankruptcy Court claiming that CP failed to abide by certain regulations and seeking approximately U.S. \$30 million in damages for MMAR's loss in business value according to a recent expert report filed by the bankruptcy estate. This action asserts that CP knew or ought to have known that the shipper misclassified the petroleum crude oil and therefore should have refused to transport it.
- (7) The class and mass tort action commenced against CP in June 2015 in Texas (on behalf of Lac-Mégantic residents and wrongful death representatives) and the wrongful death and personal injury actions commenced against CP in June 2015 in Illinois and Maine, were all transferred and consolidated in Federal District Court in Maine (the "Maine Actions"). The Maine Actions allege that CP negligently misclassified and improperly packaged the petroleum crude oil. On CP's motion, the Maine Actions were dismissed. The plaintiffs appealed the dismissal decision to the United States First Circuit Court of Appeals, which dismissed the plaintiffs' appeal on June 2, 2021. The plaintiffs further petitioned the United States First Circuit Court of Appeals for a rehearing, which was denied on September 8, 2021. On January 24, 2022, the plaintiffs further appealed to the U.S. Supreme Court on two bankruptcy procedural grounds. On May 31, 2022, the U.S. Supreme Court denied the petition, thereby rejecting the plaintiffs' appeal.
- (8) The trustee for the wrongful death trust commenced Carmack Amendment claims against CP in North Dakota Federal Court, seeking to recover approximately U.S. \$6 million for damaged rail cars and lost crude and reimbursement for the settlement paid by the consignor and the consignee under the Plans (alleged to be U.S. \$110 million and U.S. \$60 million, respectively). The Court issued an Order on August 6, 2020 granting and denying in parts the parties' summary judgment motions which has been reviewed and confirmed following motions by the parties for clarification and reconsideration. This action is scheduled for trial on November 7 to 11, 2022.

At this stage of the proceedings, any potential responsibility and the quantum of potential losses cannot be determined. Nevertheless, CP denies liability and is vigorously defending these proceedings.

Environmental liabilities

Environmental remediation accruals, recorded on an undiscounted basis unless a reliable, determinable estimate as to an amount and timing of costs can be established, 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. 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, and as 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, 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" in the Company's Interim Consolidated Statements of Income for the three and six months ended June 30, 2022 was \$2 million and \$4 million (three and six months ended June 30, 2021 - \$2 million and \$4 million, respectively). Provisions for environmental remediation costs are recorded in the Company's Interim Consolidated Balance Sheets in "Other long-term liabilities", except for the current portion which is recorded in "Accounts payable and accrued liabilities". The total amount provided as at June 30, 2022 was \$81 million (December 31, 2021 - \$79 million). Payments are expected to be made over 10 years through 2031.