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Office of Proceedings
July 28, 2022
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July 28, 2022

BY ELECTRONIC FILING

The Honorable Cynthia T. Brown
Chief, Section of Administration, Office of Proceedings
Surface Transportation Board
395 E Street S.W.
Washington, D.C. 20423

Re: Finance Docket No. 36500, *Canadian Pacific Ry. – Control – Kansas City Southern*

Dear Ms. Brown:

Pursuant to 49 C.F.R. § 1180.6(b)(4) (2000), Applicants are submitting the attached Form 10-Q filed by Canadian Pacific Railway Limited with the SEC on July 28, 2022, and the attached Form 10-Q filed by Kansas City Southern with the SEC, also on July 28, 2022. This submission updates Exhibit 9 of the Application, set forth at Volume 1 (CP-25/KCS-13) (at 1-49 to -50) and in Volume 4 (CP-28/KCS-16).

Applicants will continue to supplement the Application with any additional annual and quarterly reports filed with the SEC over the duration of the proceeding.

Please contact me with any questions.

Respectfully submitted,



David L. Meyer

*Attorney for Canadian Pacific Railway
Limited*

Attachments

cc: William A. Mullins, Esq.
All Parties of Record

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark one)

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2022

OR

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from _____ to _____
Commission File Number 001-01342

Canadian Pacific Railway Limited

(Exact name of registrant as specified in its charter)

Canada

(State or Other Jurisdiction
of Incorporation or Organization)

98-0355078

(IRS Employer
Identification No.)

7550 Ogden Dale Road S.E.

Calgary AB

(Address of Principal Executive Offices)

T2C 4X9

(Zip Code)

Registrant's Telephone Number, Including Area Code: (403) 319-7000

Securities registered pursuant to Section 12(b) of the Act:

<u>Title of Each Class</u>	<u>Trading Symbol(s)</u>	<u>Name of Each Exchange on which Registered</u>
Common Shares, without par value, of Canadian Pacific Railway Limited	CP	New York Stock Exchange Toronto Stock Exchange
Perpetual 4% Consolidated Debenture Stock of Canadian Pacific Railway Company	CP/40 BC87	New York Stock Exchange London Stock Exchange

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports); and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically, every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer ☒ Accelerated Filer ☐ Non-accelerated Filer ☐ Smaller Reporting Company ☐ Emerging Growth Company ☐

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

As of the close of business on July 27, 2022, there were 929,917,325 of the registrant's Common Shares issued and outstanding.

CANADIAN PACIFIC RAILWAY LIMITED
FORM 10-Q
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PART I

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)**

	June 30 2022	December 31 2021
(in millions of Canadian dollars)		
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

	For the three months ended June 30					
(in millions of Canadian dollars)	Foreign currency net of hedging activities ⁽¹⁾	Derivatives ⁽¹⁾⁽²⁾	Pension and post- retirement defined benefit plans ⁽¹⁾	Equity accounted investments ⁽¹⁾⁽²⁾		Total ⁽¹⁾
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.

	For the six months ended June 30					
(in millions of Canadian dollars)	Foreign currency net of hedging activities ⁽¹⁾	Derivatives ⁽¹⁾⁽²⁾	Pension and post- retirement defined benefit plans ⁽¹⁾	Equity accounted investments ⁽¹⁾⁽²⁾		Total ⁽¹⁾
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.

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

The following Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") is intended to enhance a reader's understanding of the Company's results of operations and financial condition. The MD&A is provided as a supplement to, and should be read in conjunction with the Company's Interim Consolidated Financial Statements and the related notes for the three and six months ended June 30, 2022 in Item 1. Financial Statements, other information in this report, and Item 8. Financial Statements and Supplementary Data of the Company's 2021 Annual Report on Form 10-K. Except where otherwise indicated, all financial information reflected herein is expressed in Canadian dollars.

For purposes of this report, all references herein to "CP", "the Company", "we", "our" and "us" 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.

Available Information

CP makes available on or through its website www.cpr.ca free of charge, its annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and all amendments to those reports as soon as reasonably practicable after such reports are filed with or furnished to the Securities and Exchange Commission ("SEC"). Our website also contains charters for our Board of Directors and each of its committees, our corporate governance guidelines and our Code of Business Ethics. SEC filings made by CP are also accessible through the SEC's website at www.sec.gov. The information on our website is not part of this quarterly report on Form 10-Q.

The Company has included the Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO") certifications regarding the Company's public disclosure required by Section 302 of the Sarbanes-Oxley Act of 2002 as Exhibits to this report.

Executive Summary

Second Quarter of 2022 Results

- *Financial performance* - In the second quarter of 2022, CP reported Diluted earnings per share ("EPS") of \$0.82, a decrease of 56% compared to the same period of 2021. This decrease was primarily due to the merger termination fee received in the second quarter of 2021 as a result of Kansas City Southern's ("KCS") termination of the Agreement and Plan of Merger (the "Original Merger Agreement") and a higher average number of shares outstanding due to shares issued for the KCS acquisition, partially offset by lower KCS acquisition-related costs and equity earnings of KCS. Core adjusted diluted EPS was \$0.95 in the second quarter of 2022, a decrease of 8% compared to the same period of 2021. This decrease was primarily due to a higher average number of shares outstanding due to shares issued for the KCS acquisition and higher interest expense primarily due to debt issued related to the KCS acquisition, partially offset by equity earnings of KCS, excluding the impact of KCS purchase accounting and acquisition-related costs incurred by KCS.

CP reported Net income of \$765 million in the second quarter of 2022, a decrease of 39% compared to the same period of 2021. This decrease was primarily due to the merger termination fee received in the second quarter of 2021 as a result of KCS's termination of the Original Merger Agreement, partially offset by lower KCS acquisition-related costs and equity earnings of KCS. Core adjusted income was \$882 million in the second quarter of 2022, an increase of 28% compared to the same period of 2021. This increase was primarily due to equity earnings of KCS, excluding the impact of KCS purchase accounting and acquisition-related costs incurred by KCS, partially offset by higher interest expense primarily due to debt issued related to the KCS acquisition.

CP reported an Operating ratio of 60.6% in the second quarter of 2022, a 50 basis point increase compared to the same period of 2021. This increase was primarily due to the unfavourable impact of changes in fuel prices, net of recoveries, and lower crude liquidated damages, including customer volume commitments, due to the completion of customer contracts, partially offset by lower KCS acquisition-related costs. Adjusted operating ratio was 59.7%, a 440 basis point increase compared to the same period of 2021. This increase was primarily due to the same factors discussed above for the increase in Operating ratio, except that Adjusted operating ratio excludes the acquisition-related costs associated with the KCS transaction that were recognized in Purchased services and other in both periods.

Core adjusted diluted EPS, Core adjusted income, and Adjusted operating ratio are defined and reconciled in Non-GAAP Measures and discussed further in Results of Operations of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

- *Total revenues* - Total revenues increased by 7% in the second quarter of 2022 to \$2,202 million compared to the same period of 2021. This increase was primarily due to increased freight revenue per RTM, partially offset by lower volumes as measured by RTMs.
- *Operating performance* - CP's average train weight increased by 2% to 10,258 tons and average train length increased by 2% to 8,515 feet, compared to the same period in 2021. These increases were a result of improvements in operating plan

efficiency and continued improvements in bulk train efficiency due to moving heavier and longer Potash trains. These metrics are discussed further in Performance Indicators of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Recent Developments

- On July 20, 2022, KCS and its affiliate Kansas City Southern de México, S.A. de C.V. ("KCSM") announced an agreement extending the concession exclusivity rights granted to KCSM for an additional 10 years.

KCSM reached an agreement with the Mexican Ministry of Infrastructure, Communications and Transportation ("SICT") to fund a new investment in the Celaya-NBA Line Railway Bypass and other infrastructure. As part of the agreement, the SICT has authorized the amendment of KCSM's Concession Title effective July 14, 2022, to extend the exclusivity rights granted to KCSM for an additional period of 10 years. Under this amendment, KCSM's exclusivity will now expire in 2037.

The U.S. Surface Transportation Board's ("STB") review of CP's proposed control of KCS is expected to be completed in the first quarter of 2023. Prior to obtaining STB control approval, KCS's management and Board of Directors will continue to steward KCS while it is in trust, pursuing its independent business plan and growth strategies.

Specific risk factors related to the KCS acquisition and pending KCS business combination are provided in Part I, Item 1A. Risk Factors of the Company's 2021 Annual Report on Form 10-K.

Prior Developments

- On April 27, 2022, at the Company's Annual and Special Meeting of Shareholders, all nine director nominees were elected.
- On March 16, 2022, CP issued a 72-hour notice to the Teamsters Canada Rail Conference ("TCRC") - Train & Engine, of its plan to lock-out employees at 00:01 Eastern Time on March 20, 2022 if the TCRC leadership and the Company were unable to come to a negotiated settlement or agree to binding arbitration. The TCRC represents approximately 3,000 locomotive engineers, conductors, and train and yard workers across Canada. On March 19, 2022, while the Company was still engaged in ongoing negotiations facilitated by federal mediators, the TCRC withdrew its services in the final hours before the deadline for a legal strike or lockout to potentially occur. On March 22, 2022, CP reached an agreement with the TCRC Negotiating Committee to enter into binding arbitration. This agreement enabled CP employees to return to work effective noon March 22, 2022 local time to resume our essential services for our customers and the North American supply chain.

The work stoppage resulted in lower volumes during the first quarter. Once the TCRC members returned to work on March 22, 2022, the Company quickly re-established service.

Performance Indicators

The following table lists the key measures of the Company's operating performance:

	For the three months ended June 30			For the six months ended June 30		
	2022	2021	% Change	2022	2021	% Change
Operations Performance						
Gross ton-miles ("GTMs") (millions)	68,847	71,355	(4)	131,030	142,682	(8)
Train miles (thousands)	7,259	7,605	(5)	14,152	15,407	(8)
Average train weight - excluding local traffic (tons)	10,258	10,101	2	10,015	9,945	1
Average train length - excluding local traffic (feet)	8,515	8,335	2	8,289	8,150	2
Average terminal dwell (hours)	7.6	6.8	12	8.1	7.1	14
Average train speed (miles per hour, or "mph")	21.7	21.8	—	21.5	21.3	1
Locomotive productivity (GTMs / operating horsepower)	207	208	—	192	205	(6)
Fuel efficiency (U.S. gallons of locomotive fuel consumed / 1,000 GTMs)	0.930	0.918	1	0.960	0.938	2
Total Employees and Workforce						
Total employees (average)	12,509	12,688	(1)	12,138	12,375	(2)
Total employees (end of period)	12,711	12,709	—	12,711	12,709	—
Workforce (end of period)	12,758	12,749	—	12,758	12,749	—
Safety Indicators⁽¹⁾						
FRA personal injuries per 200,000 employee-hours	0.66	0.80	(18)	1.00	0.98	2
FRA train accidents per million train-miles	1.11	0.47	136	1.08	0.94	15

⁽¹⁾ Federal Railroad Administration ("FRA") personal injuries per 200,000 employee-hours for the three and six months ended June 30, 2021, previously reported as 0.77 and 0.96, were restated to 0.80 and 0.98, respectively in this report. FRA train accidents per million train-miles for the three and six months ended June 30, 2021, previously reported as 0.36 and 0.88, were restated to 0.47 and 0.94, respectively in this report. These restatements reflect new information available within specified periods stipulated by the FRA but that exceed the Company's financial reporting timeline.

Operations Performance

These key measures are used by management as comparisons to historical operating results and in the planning process to facilitate decisions that continue to drive further productivity improvements in the Company's operations. Results of these key measures reflect how effective CP's management is at controlling costs and executing the Company's operating plan and strategy. Continued monitoring of these key measures ensures that the Company can take appropriate actions to ensure the delivery of superior service and be able to grow its business at low incremental cost.

Three months ended June 30, 2022 compared to the three months ended June 30, 2021

- A **GTM** is defined as the movement of one ton of train weight over one mile. GTMs are calculated by multiplying total train weight by the distance the train moved. Total train weight comprises the weight of the freight cars, their contents, and any inactive locomotives. An increase in GTMs indicates additional workload. GTMs decreased by 4% in the second quarter of 2022 compared to the same period of 2021. This decrease was mainly attributable to lower volumes of Canadian grain and Coal. This decrease was partially offset by higher volumes of U.S. grain, Intermodal, Potash, and frac sand.
- **Train miles** are defined as the sum of the distance moved by all trains operated on the network. Train miles provide a measure of the productive utilization of our network. A smaller increase in train miles relative to increases in volumes, as measured by RTMs, and/or workload, as measured by GTMs, indicate improved train productivity. Train miles decreased by 5% in the second quarter of 2022 compared to the same period of 2021. This decrease reflects the impact of a 4% decrease in workload (GTM) and a 2% increase in train weights.
- **Average train weight** is defined as the average gross weight of CP trains, both loaded and empty. This excludes trains in short-haul service, work trains used to move CP's track equipment and materials, and the haulage of other railways' trains on CP's network. An increase in average train weight indicates improved asset utilization and may also be the result of moving heavier commodities. Average train weight increased by 2% in the second quarter of 2022 compared to the same period of 2021. This increase was a result of improvements in operating plan efficiency and moving longer and heavier Potash trains.

- **Average train length** is defined as the average total length of CP trains, both loaded and empty. This includes all cars and locomotives on the train and is calculated as the sum of each car or locomotive's length multiplied by the distance travelled, divided by train miles. This excludes trains in short-haul service, work trains used to move CP's track equipment and materials, and the haulage of other railways' trains on CP's network. An increase in average train length indicates improved asset utilization. Average train length increased by 2% in the second quarter of 2022 compared to the same period of 2021. This increase was a result of improvements in operating plan efficiency and higher volumes of Intermodal, which move in longer trains.
- **Average terminal dwell** is defined as the average time a freight car resides within terminal boundaries expressed in hours. The timing starts with a train arriving at the terminal, a customer releasing the car to the Company, or a car arriving at interchange from another railway. The timing ends when the train leaves, a customer receives the car from CP, or the freight car is transferred to another railway. Freight cars are excluded if they are being stored at the terminal or used in track repairs. A decrease in average terminal dwell indicates improved terminal performance resulting in faster cycle times and improved railcar utilization. Average terminal dwell increased by 12% in the second quarter of 2022 compared to the same period of 2021, primarily as a result of proportionally lower volumes of bulk commodities which require less processing time in yards.
- **Average train speed** is defined as a measure of the line-haul movement from origin to destination including terminal dwell hours. It is calculated by dividing the total train miles travelled by the total train hours operated. This calculation does not include delay time related to customers or foreign railroads and excludes the time and distance travelled by: i) trains used in or around CP's yards; ii) passenger trains; and iii) trains used for repairing track. An increase in average train speed indicates improved on-time performance resulting in improved asset utilization. Average train speed was flat in the second quarter of 2022 compared to the same period of 2021.
- **Locomotive productivity** is defined as the daily average GTMs divided by daily average operating horsepower. Operating horsepower excludes units offline, tied up or in storage, or in use on other railways, and includes foreign units online. An increase in locomotive productivity indicates more efficient locomotive utilization and may also be the result of moving heavier commodities. Locomotive productivity was flat in the second quarter of 2022 compared to the same period of 2021.
- **Fuel efficiency** is defined as U.S. gallons of locomotive fuel consumed per 1,000 GTMs. Fuel consumed includes gallons from freight, yard and commuter service but excludes fuel used in capital projects and other non-freight activities. An improvement in fuel efficiency indicates operational cost savings and CP's commitment to corporate sustainability through a reduction of greenhouse gas emissions intensity. Fuel efficiency decreased by 1% in the second quarter of 2022 compared to the same period of 2021. This decrease in efficiency was due to lower volumes of Canadian grain, which has higher horsepower utilization.

Six months ended June 30, 2022 compared to the six months ended June 30, 2021

- **GTM**s decreased by 8% for the first six months of 2022 compared to the same period of 2021. This decrease was mainly attributable to lower volumes of Canadian grain, Coal, and Energy, chemicals and plastics. This decrease was partially offset by higher volumes of U.S. grain, Intermodal, and Potash.
- **Train miles** decreased by 8% for the first six months of 2022 compared to the same period of 2021. This decrease reflected the impact of an 8% decrease in workload (GTM)s and a 1% increase in average train weights.
- **Average train weight** increased by 1% for the first six months of 2022 compared to the same period of 2021. This increase was a result of improvements in operating plan efficiency and moving longer and heavier Potash trains. This increase was partially offset by lower volumes of heavier commodities, such as Canadian grain and Coal.
- **Average train length** increased by 2% for the first six months of 2022 from the same period of 2021. This increase was primarily due to improvements in operating plan efficiency.
- **Average terminal dwell** increased by 14% in the first six months of 2022 compared to the same period of 2021. This increase was primarily the result of proportionally lower volumes of bulk commodities, which require less processing time in yards, and harsher winter operating conditions in the first quarter of 2022.
- **Average train speed** increased by 1% in the first six months of 2022 compared to the same period of 2021. This increase was primarily the result of lower volumes of Canadian grain and Coal trains through western Canada, which generally have lower train speeds.
- **Locomotive productivity** decreased by 6% in the first six months of 2022 compared to the same period of 2021, as a result of harsher winter operating conditions in the first quarter of 2022.

- **Fuel efficiency** decreased by 2% in the first six months of 2022 compared to the same period of 2021. This decrease in efficiency was due to lower locomotive productivity and harsher winter operating conditions in the first quarter of 2022, and lower volumes of Canadian grain, which has higher horsepower utilization.

Total Employees and Workforce

An **employee** is defined as an individual currently engaged in full-time, part-time, or seasonal employment with CP while **workforce** is defined as total employees plus contractors and consultants. The Company monitors employment and workforce levels in order to efficiently meet service and strategic requirements. The number of employees is a key driver to total compensation and benefits costs.

The average number of total employees decreased by 1% and 2% for the three and six months ended June 30, 2022, respectively, compared to the same periods of 2021. The decrease in average number of employees was due to reduced workload as measured in GTMs. The total number of employees and total workforce as at June 30, 2022 were flat compared to June 30, 2021.

Safety Indicators

Safety is a key priority and core strategy for CP's management, employees, and Board of Directors. Personal injuries and train accidents are indicators of the effectiveness of the Company's safety systems, and are used by management to evaluate and, as necessary, alter the Company's safety systems, procedures, and protocols. Each measure follows U.S. FRA reporting guidelines, which can result in restatement after initial publication to reflect new information available within specified periods stipulated by the FRA but that exceed the Company's financial reporting timeline.

The **FRA personal injuries per 200,000 employee-hours** frequency is the number of personal injuries, multiplied by 200,000 and divided by total employee hours. Personal injuries are defined as injuries that require employees to lose time away from work, modify their normal duties or obtain medical treatment beyond minor first aid. FRA employee-hours are the total hours worked, excluding vacation and sick time, by all employees, excluding contractors. The FRA personal injuries per 200,000 employee-hours frequency for CP was 0.66 in the second quarter of 2022, a decrease from 0.80 in the same period of 2021. For the first six months of 2022, the FRA personal injury rate per 200,000 employee-hours for CP was 1.00, an increase from 0.98 in the same period of 2021.

The **FRA train accidents per million train-miles** frequency is the number of train accidents, multiplied by 1,000,000 and divided by total train miles. Train accidents included in this metric meet or exceed the FRA reporting threshold of U.S. \$11,300 in 2022 and U.S. \$11,200 in damage for 2021. The FRA train accidents per million train-miles was 1.11 in the second quarter of 2022, an increase from 0.47 in the same period of 2021. For the first six months of 2022, the FRA train accidents per million train-miles was 1.08, an increase from 0.94 in the same period of 2021.

Financial Highlights

The following table presents selected financial data related to the Company's financial results as of, and for the three and six months ended, June 30, 2022 and the comparative figures in 2021. The financial highlights should be read in conjunction with Item 1. Financial Statements and this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

	For the three months ended June 30		For the six months ended June 30	
(in millions, except per share data, percentages and ratios)	2022	2021	2022	2021
Financial Performance and Liquidity				
Total revenues	\$ 2,202	\$ 2,054	\$ 4,040	\$ 4,013
Operating income	868	820	1,403	1,600
Adjusted operating income ⁽¹⁾	887	919	1,442	1,732
Net income	765	1,246	1,355	1,848
Core adjusted income ⁽¹⁾	882	689	1,510	1,289
Basic EPS	0.82	1.87	1.46	2.77
Diluted EPS	0.82	1.86	1.45	2.76
Core adjusted diluted EPS ⁽¹⁾	0.95	1.03	1.62	1.92
Dividends declared per share	0.190	0.190	0.380	0.380
Cash provided by operating activities	707	1,954	1,320	2,536
Cash used in investing activities	(362)	(405)	(568)	(691)
Cash used in financing activities	(297)	(1,016)	(688)	(1,096)
Free cash ⁽¹⁾	369	746	793	1,042
Financial Position				
	As at June 30, 2022		As at December 31, 2021	
Total assets	\$	69,874	\$	68,177
Total long-term debt, including current portion		20,070		20,127
Total shareholders' equity		35,414		33,829
	For the three months ended June 30		For the six months ended June 30	
Financial Ratios	2022	2021	2022	2021
Operating ratio ⁽²⁾	60.6%	60.1%	65.3%	60.1%
Adjusted operating ratio ⁽¹⁾	59.7%	55.3%	64.3%	56.8%
	For the twelve months ended June 30			
	2022	2021		
Return on average shareholders' equity ⁽³⁾		10.6%		39.5%
Adjusted return on invested capital ("Adjusted ROIC") ⁽¹⁾		8.5%		16.7%
Long-term debt to Net income ratio ⁽⁴⁾		8.5		2.7
Adjusted net debt to adjusted EBITDA ratio ⁽¹⁾		4.6		2.0
Pro-forma adjusted Net Debt to Pro-forma adjusted EBITDA Ratio ⁽¹⁾		4.2		N/A

⁽¹⁾ These measures have no standardized meanings prescribed by accounting principles generally accepted in the United States of America ("GAAP") and, therefore, may not be comparable to similar measures presented by other companies. These measures are defined and reconciled in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

⁽²⁾ Operating ratio is defined as operating expenses divided by revenues, further discussed in Results of Operations of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

⁽³⁾ Return on average shareholders' equity is defined as Net income divided by average shareholders' equity, averaged between the beginning and ending balance over a twelve month period, further discussed in Results of Operations of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

⁽⁴⁾ Long-term debt to Net income ratio is defined as long-term debt, including long-term debt maturing within one year, divided by Net income, further discussed in Liquidity and Capital Resources of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Results of Operations

Three months ended June 30, 2022 compared to the three months ended June 30, 2021

Income

Operating income was \$868 million in the second quarter of 2022, an increase of \$48 million, or 6%, from \$820 million in the same period of 2021. This increase was primarily due to:

- lower acquisition-related costs of \$80 million associated with the KCS acquisition that were recognized in Purchased services and other;
- higher freight rates;
- the favourable impact of changes in fuel prices of \$36 million; and
- lower stock-based compensation of \$23 million primarily driven by the impact of changes in share price.

This increase was partially offset by:

- lower crude liquidated damages, including customer volume commitments, due to the completion of customer contracts;
- cost inflation; and
- lower freight volumes as measured by RTMs.

Adjusted operating income was \$887 million in the second quarter of 2022, a decrease of \$32 million, or 3%, from \$919 million in the same period of 2021. This decrease was primarily due to:

- lower crude liquidated damages, including customer volume commitments, due to the completion of customer contracts;
- cost inflation; and
- lower freight volumes as measured by RTMs.

This decrease was partially offset by:

- higher freight rates;
- the favourable impact of changes in fuel prices of \$36 million; and
- lower stock-based compensation of \$23 million primarily driven by the impact of changes in share price.

Net income was \$765 million in the second quarter of 2022, a decrease of \$481 million, or 39%, from \$1,246 million in the same period of 2021. This decrease was primarily due to:

- the \$845 million merger termination fee received in the second quarter of 2021 in connection with KCS's termination of the Original Merger Agreement;
- higher interest expense primarily due to debt issued related to the KCS acquisition; and
- no FX translation gain on U.S. dollar-denominated debt and lease liabilities compared to \$52 million recognized in 2021.

This decrease was partially offset by:

- lower acquisition-related costs associated with the KCS transaction of \$209 million in Other expense;
- equity earnings of KCS of \$208 million; and
- higher operating income of \$48 million.

Core adjusted income was \$882 million in the second quarter of 2022, an increase of \$193 million, or 28%, from \$689 million in the same period of 2021. This increase was due to equity earnings of KCS, excluding the impact of KCS purchase accounting of \$39 million and acquisition-related costs of \$14 million, and lower income tax expense due to lower taxable earnings, partially offset by higher interest expense primarily due to debt issued related to the KCS acquisition and lower Adjusted operating income of \$32 million.

Diluted Earnings per Share

Diluted EPS was \$0.82 in the second quarter of 2022, a decrease of \$1.04, or 56%, from \$1.86 in the same period of 2021. This decrease was due to lower Net income and a higher average number of outstanding shares driven by shares issued for the KCS acquisition.

Core adjusted diluted EPS was \$0.95 in the second quarter of 2022, a decrease of \$0.08, or 8%, from \$1.03 in the same period of 2021. This decrease was due to a higher average number of outstanding shares driven by shares issued for the KCS acquisition, partially offset by higher Core adjusted income.

Operating Ratio

The Operating ratio provides the percentage of revenues used to operate the railway. A lower percentage normally indicates higher efficiency in the operation of the railway. The Company's Operating ratio was 60.6% in the second quarter of 2022, a 50 basis point increase from 60.1% in the same period of 2021. This increase was primarily due to:

- the unfavourable impact of changes in fuel prices, net of recoveries;
- lower crude liquidated damages, including customer volume commitments, due to the completion of customer contracts;

- cost inflation; and
- higher depreciation and amortization.

This increase was partially offset by:

- lower acquisition-related costs associated with the KCS transaction that were recognized in Purchased services and other;
- higher freight rates; and
- lower stock-based compensation primarily driven by the impact of changes in share price.

Adjusted operating ratio was 59.7% in the second quarter of 2022, a 440 basis point increase from the same period of 2021. This increase was primarily due to the same factors discussed above for the increase in Operating ratio, except that Adjusted operating ratio excludes the acquisition-related costs associated with the KCS transaction that were recognized in Purchased services and other in both periods.

Adjusted operating income, Core adjusted income, Core adjusted diluted EPS, and Adjusted Operating ratio are defined and reconciled in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Return on Average Shareholders' Equity and Adjusted Return on Invested Capital

Return on average shareholders' equity and Adjusted ROIC are measures used by management to determine how productively the Company uses its long-term capital investments, representing critical indicators of good operating and investment decisions. Adjusted ROIC is also an important performance criteria in determining certain elements of the Company's long-term incentive plan.

Return on average shareholders' equity was 10.6% for the twelve months ended June 30, 2022, a 2,890 basis point decrease compared to 39.5% for the twelve months ended June 30, 2021. This decrease was primarily due to higher average shareholders' equity driven by shares issued for the KCS acquisition and lower accumulated Net income.

Adjusted ROIC was 8.5% for the twelve months ended June 30, 2022, an 820 basis point decrease compared to 16.7% for the twelve months ended June 30, 2021. This decrease was primarily due to higher average long-term debt and shares issued for the KCS acquisition, partially offset by higher Adjusted income. Adjusted ROIC is a Non-GAAP measure, which is defined and reconciled from Return on average shareholders' equity, the most comparable measure calculated in accordance with GAAP, in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Six months ended June 30, 2022 compared to the six months ended June 30, 2021

Income

Operating income was \$1,403 million in the first six months of 2022, a decrease of \$197 million, or 12%, from \$1,600 million in the same period of 2021. This decrease was primarily due to:

- lower volumes as measured by RTMs;
- lower crude liquidated damages, including customer volume commitments, due to the completion of customer contracts;
- cost inflation; and
- a gain on exchange of property and construction easements in Chicago of \$50 million in 2021.

This decrease was partially offset by:

- higher freight rates;
- lower acquisition-related costs of \$93 million associated with the KCS acquisition that were recognized in Purchased services and other; and
- the favourable impact of changes in fuel prices of \$53 million.

Adjusted operating income was \$1,442 million in the first six months of 2022, a decrease of \$290 million, or 17%, from \$1,732 million in the same period of 2021. This decrease reflected the same factors discussed above for the decrease in Operating income, except that Adjusted operating income excludes the acquisition-related costs associated with the KCS acquisition that were recognized in Purchased services and other in both periods.

Net income was \$1,355 million in the first six months of 2022, a decrease of \$493 million, or 27%, from \$1,848 million in the same period of 2021. This decrease was primarily due to:

- the \$845 million merger termination payment received in the second quarter of 2021 in connection with KCS's termination of the Original Merger Agreement;
- lower Operating income of \$197 million;
- higher interest expense primarily due to debt issued related to the KCS acquisition; and
- no FX translation gain on U.S. dollar-denominated debt and lease liabilities compared to \$85 million recognized in 2021.

This decrease was partially offset by:

- equity earnings of KCS of \$406 million;
- lower acquisition-related costs associated with the KCS transaction of \$212 million in Other expense; and
- lower income tax expense due to lower taxable earnings.

Core adjusted income was \$1,510 million in the first six months of 2022, an increase of \$221 million, or 17%, from \$1,289 million in the same period of 2021. This increase was due to equity earnings of KCS, excluding the impact of KCS purchase accounting of \$79 million and acquisition-related costs of \$27 million, and lower income tax expense due to lower taxable earnings, partially offset by higher interest expense primarily due to debt issued related to the KCS acquisition and lower Adjusted operating income of \$290 million.

Diluted Earnings per Share

Diluted EPS was \$1.45 in the first six months of 2022, a decrease of \$1.31, or 47%, from \$2.76 in the same period of 2021. This decrease was due to lower Net income and a higher average number of outstanding shares driven by shares issued for the KCS acquisition.

Core adjusted diluted EPS was \$1.62 in the first six months of 2022, a decrease of \$0.30, or 16%, from \$1.92 in the same period of 2021. This decrease was due to a higher average number of outstanding shares driven by shares issued for the KCS acquisition, partially offset by higher Core adjusted income.

Operating Ratio

The Company's Operating ratio was 65.3% in the first six months of 2022, a 520 basis point increase from 60.1% in the same period of 2021. This increase was primarily due to:

- lower volumes as measured by RTMs;
- cost inflation;
- the unfavourable impact of changes in fuel prices, net of fuel recoveries;
- lower crude liquidated damages, including customer volume commitments, due to the completion of customer contracts; and
- a gain on the exchange of property and construction easements in Chicago in 2021.

This increase was partially offset by lower acquisition-related costs associated with the KCS acquisition that were recognized in Purchased services and other and higher freight rates.

Adjusted operating ratio was 64.3% in the first six months of 2022, a 750 basis point increase from 56.8% in the same period of 2021. This increase was due to the same factors as discussed above for the increase in operating ratio, except that Adjusted operating ratio excludes the acquisition-related costs associated with the KCS transaction that were recognized in Purchased services and other in both periods.

Adjusted operating income, Core adjusted income, Core adjusted diluted EPS, and Adjusted Operating ratio are defined and reconciled in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Impact of FX on Earnings

Fluctuations in FX 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.

On July 22, 2022, the noon buying rate certified for customs purposes by the U.S. Federal Reserve Bank of New York was U.S. \$1.00 = \$1.29 Canadian dollar.

The following tables set forth, for the periods indicated, the average exchange rate between the Canadian dollar and the U.S. dollar expressed in the Canadian dollar equivalent of one U.S. dollar, the high and low exchange rates and period end exchange rates for the periods indicated. Average for year-end periods are calculated by using the exchange rates on the last day of each full month during the relevant period. These rates are based on the noon buying rate certified for customs purposes by the U.S. Federal Reserve Bank of New York set forth in the H.10 statistical release of the Federal Reserve Board.

Average exchange rates (Canadian/U.S. dollar)	2022	2021
For the three months ended - June 30	\$ 1.28	\$ 1.23
For the six months ended - June 30	\$ 1.27	\$ 1.25

Ending exchange rates (Canadian/U.S. dollar)	2022		2021	
Beginning of year - January 1	\$	1.28	\$	1.28
Beginning of quarter - April 1	\$	1.25	\$	1.26
End of quarter - June 30	\$	1.29	\$	1.24

	For the three months ended June 30		For the six months ended June 30	
High/Low exchange rates (Canadian/U.S. dollar)	2022	2021	2022	2021
High	\$ 1.31	\$ 1.26	\$ 1.31	\$ 1.28
Low	\$ 1.25	\$ 1.20	\$ 1.25	\$ 1.20

In the second quarter of 2022, the impact of a stronger U.S. dollar resulted in an increase in total revenues of \$33 million, an increase in total operating expenses of \$17 million, and an increase in interest expense of \$4 million from the same period of 2021. In the first six months of 2022, the impact of a stronger U.S. dollar resulted in an increase in total revenues of \$34 million, an increase in total operating expenses of \$17 million, and an increase in interest expense of \$4 million from the same period of 2021.

There was no material change in the impact of FX on total revenues and operating expenses during the second quarter and first six months ended June 30, 2022 from the information provided in Part II, Item 7A. Quantitative and Qualitative Disclosure about Market Risk in CP's 2021 Annual Report on Form 10-K.

Impact of Fuel Price on Earnings

Fluctuations in fuel prices affect the Company's results because fuel expense constitutes a significant portion of CP's operating costs. As fuel prices fluctuate, there will be an impact on earnings due to the timing of recoveries from CP's fuel cost adjustment program. The following table indicates the average fuel price for the three and six months ended June 30, 2022 and the comparative periods of 2021.

Average Fuel Price (U.S. dollars per U.S. gallon)	2022		2021	
For the three months ended - June 30	\$	4.55	\$	2.71
For the six months ended - June 30	\$	4.03	\$	2.54

The impact of fuel prices on earnings includes the impacts of carbon taxes, levies, and obligations under cap-and-trade programs recovered and paid, on revenues and expenses, respectively.

In the second quarter of 2022, the favourable impact of fuel prices on Operating income was \$36 million. Higher fuel prices and increased carbon tax recoveries resulted in an increase in Total revenues of \$192 million. Higher fuel prices resulted in an increase in Total operating expenses of \$156 million from the same period of 2021.

In the first six months of 2022, the favourable impact of fuel prices on Operating income was \$53 million. Higher fuel prices and increased carbon tax recoveries resulted in an increase in Total revenues of \$305 million. Higher fuel prices resulted in Total operating expenses of \$252 million from the same period of 2021.

Impact of Share Price on Earnings

Fluctuations in the Common Share price affect the Company's operating expenses because share-based liabilities are measured at fair value. The Company's Common Shares are listed on the Toronto Stock Exchange ("TSX") and the New York Stock Exchange ("NYSE") with ticker symbol "CP". The following tables indicate the opening and closing Common Share price on the TSX and the NYSE for the three and six months ended June 30, 2022 and the comparative periods in 2021.

TSX (in Canadian dollars)	2022		2021	
Opening Common Share price, as at January 1	\$	90.98	\$	88.31
Ending Common Share price, as at March 31	\$	103.18	\$	96.00
Ending Common Share price, as at June 30	\$	89.91	\$	95.32
Change in Common Share price for the three months ended June 30	\$	(13.27)	\$	(0.68)
Change in Common Share price for the six months ended June 30	\$	(1.07)	\$	7.01

NYSE (in U.S. dollars)	2022	2021
Opening Common Share price, as at January 1	\$ 71.94	\$ 69.34
Ending Common Share price, as at March 31	\$ 82.54	\$ 75.86
Ending Common Share price, as at June 30	\$ 69.84	\$ 76.91
Change in Common Share price for the three months ended June 30	\$ (12.70)	\$ 1.05
Change in Common Share price for the six months ended June 30	\$ (2.10)	\$ 7.57

In the second quarter of 2022, the impact of the change in Common Share prices resulted in a decrease in stock-based compensation expense of \$24 million compared to a negligible change in the same period of 2021.

In the first six months of 2022, the impact of the change in Common Share prices resulted in a decrease in stock-based compensation expense of \$3 million compared to an increase of \$17 million in the same period of 2021.

The impact of share price on stock-based compensation is discussed further in Item 3. Quantitative and Qualitative Disclosures About Market Risk, Share Price Impact on Stock-Based Compensation.

Operating Revenues

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

For the three months ended June 30	2022	2021	Total Change	% Change	FX Adjusted % Change ⁽¹⁾
Freight revenues (in millions)	\$ 2,154	\$ 2,008	\$ 146	7	6
Non-freight revenues (in millions)	48	46	2	4	2
Total revenues (in millions)	\$ 2,202	\$ 2,054	\$ 148	7	6
Carloads (in thousands)	712.7	723.5	(10.8)	(1)	N/A
Revenue ton-miles (in millions)	38,093	39,061	(968)	(2)	N/A
Freight revenue per carload (in dollars)	\$ 3,022	\$ 2,775	\$ 247	9	7
Freight revenue per revenue ton-mile (in cents)	5.65	5.14	0.51	10	8

⁽¹⁾ FX Adjusted % Change does not have any standardized meaning prescribed by GAAP and, therefore, is unlikely to be comparable to similar measures presented by other companies. FX Adjusted % Change is defined and reconciled in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Freight revenues were \$2,154 million in the second quarter of 2022, an increase of \$146 million, or 7%, from \$2,008 million in the same period of 2021. This increase was primarily due to increased freight revenue per RTM, partially offset by lower volumes as measured by RTMs.

RTMs are defined as the movement of one revenue-producing ton of freight over a distance of one mile. RTMs measure the relative weight and distance of rail freight moved by the Company. RTMs for the second quarter of 2022 were 38,093 million, a decrease of 968 million, or 2%, from 39,061 million in the same period of 2021. This decrease was mainly attributable to lower volumes of Canadian grain and Coal. This decrease was partially offset by higher volumes of U.S. grain, Intermodal, Potash, and frac sand.

Freight revenue per RTM is defined as freight revenue per revenue-producing ton of freight over a distance of one mile. This is an indicator of yield. Freight revenue per RTM was 5.65 cents in the second quarter of 2022, an increase of 0.51 cents, or 10%, from 5.14 cents in the same period of 2021. This increase was primarily due to higher fuel surcharge revenue as a result of higher fuel prices of \$192 million, higher freight rates, and the favourable impact of the change in FX of \$32 million. This increase was partially offset by lower crude liquidated damages, including customer volume commitments, due to the completion of customer contracts.

Carloads are defined as revenue-generating shipments of containers and freight cars. Carloads were 712.7 thousand in the second quarter of 2022, a decrease of 10.8 thousand, or 1%, from 723.5 thousand in the same period of 2021. This decrease was primarily due to lower volumes of Canadian grain and Coal. This decrease was partially offset by higher volumes of Intermodal, frac sand, and U.S. grain.

Freight revenue per carload is defined as freight revenue per revenue-generating shipment of containers or freight cars. This is an indicator of yield. Freight revenue per carload was \$3,022 in the second quarter of 2022, an increase of \$247, or 9%, from \$2,775 in the same period of 2021. This increase was primarily due to higher fuel surcharge revenue as a result of higher fuel

prices of \$192 million, higher freight rates, and the favourable impact of the change in FX of \$32 million. This increase was partially offset by lower crude liquidated damages, including customer volume commitments, due to the completion of customer contracts.

Non-freight revenues were \$48 million in the second quarter of 2022, an increase of \$2 million, or 4%, from \$46 million in the same period of 2021. This increase was primarily due to higher revenue from passenger service operators.

For the six months ended June 30	2022	2021	Total Change	% Change	FX Adjusted % Change ⁽¹⁾
Freight revenues (in millions)	\$ 3,950	\$ 3,926	\$ 24	1	—
Non-freight revenues (in millions)	90	87	3	3	2
Total revenues (in millions)	\$ 4,040	\$ 4,013	\$ 27	1	—
Carloads (in thousands)	1,338.4	1,414.9	(76.5)	(5)	N/A
Revenue ton-miles (in millions)	71,786	78,334	(6,548)	(8)	N/A
Freight revenue per carload (in dollars)	\$ 2,951	\$ 2,775	\$ 176	6	5
Freight revenue per revenue ton-mile (in cents)	5.50	5.01	0.49	10	9

⁽¹⁾ FX Adjusted % Change does not have any standardized meaning prescribed by GAAP and, therefore, is unlikely to be comparable to similar measures presented by other companies. FX Adjusted % Change is defined and reconciled in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Freight revenues were \$3,950 million in the first six months of 2022, an increase of \$24 million, or 1%, from \$3,926 million in the same period of 2021. This increase was primarily due to increased freight revenue per RTM, partially offset by lower volumes as measured by RTMs.

RTMs for the first six months of 2022 were 71,786 million, a decrease of 6,548 million, or 8% from 78,334 million in the same period of 2021. This decrease was mainly attributable to lower volumes of Canadian grain, Coal, and Energy, chemicals and plastics. This decrease was partially offset by higher volumes of U.S. grain, Intermodal, and Potash.

Freight revenue per RTM was 5.50 cents in the first six months of 2022, an increase of 0.49 cents, or 10%, from 5.01 cents in the same period in 2021. This increase was primarily due to higher fuel surcharge revenue as a result of higher fuel prices of \$305 million, higher freight rates, and the favourable impact of the change in FX of \$33 million. This increase was partially offset by lower crude liquidated damages, including customer volume commitments, due to the completion of customer contracts.

Carloads were 1,338.4 thousand in the first six months of 2022, a decrease of 76.5 thousand, or 5%, from 1,414.9 thousand in the same period of 2021. This decrease was primarily due to lower volumes of Canadian grain, Energy, chemicals and plastics, Coal, and Automotive. This decrease was partially offset by higher volumes of Intermodal, frac sand, and U.S. grain.

Freight revenue per carload was \$2,951 in the first six months of 2022, an increase of \$176, or 6%, from \$2,775 in the same period of 2021. This increase was primarily due to higher fuel surcharge revenue as a result of higher fuel prices of \$305 million, higher freight rates, and the favourable impact of the change in FX of \$33 million. This increase was partially offset by lower crude liquidated damages, including customer volume commitments, due to the completion of customer contracts.

Non-freight revenues were \$90 million in the first six months of 2022, an increase of \$3 million, or 3%, from \$87 million in the same period of 2021. This increase was primarily due to higher revenue from passenger service operators and higher revenue recognized for construction easements in Chicago, partially offset by lower revenue from logistical services.

Fuel Cost Adjustment Program

Freight revenues include fuel surcharge revenues associated with CP's fuel cost adjustment program, which is designed to respond to fluctuations in fuel prices and help reduce exposure to changing fuel prices. The surcharge is applied to shippers through tariffs and by contract, within agreed-upon guidelines. This program includes recoveries of carbon taxes, levies, and obligations under cap-and-trade programs. Freight revenues included fuel surcharge revenues of \$359 million in the second quarter of 2022, an increase of \$226 million, or 170%, from \$133 million in the same period of 2021. This increase was primarily due to higher fuel prices and increased carbon tax recoveries.

In the first six months of 2022, fuel surcharge revenues were \$548 million, an increase of \$330 million, or 151%, from \$218 million in the same period of 2021. This increase was primarily due to higher fuel prices and increased carbon tax recoveries.

Lines of Business

Grain

For the three months ended June 30	2022	2021	Total Change	% Change	FX Adjusted % Change ⁽¹⁾
Freight revenues (in millions)	\$ 370	\$ 444	\$ (74)	(17)	(18)
Carloads (in thousands)	84.1	118.4	(34.3)	(29)	N/A
Revenue ton-miles (in millions)	7,784	10,076	(2,292)	(23)	N/A
Freight revenue per carload (in dollars)	\$ 4,400	\$ 3,750	\$ 650	17	16
Freight revenue per revenue ton-mile (in cents)	4.75	4.41	0.34	8	6

⁽¹⁾ FX Adjusted % Change does not have any standardized meaning prescribed by GAAP and, therefore, is unlikely to be comparable to similar measures presented by other companies. FX Adjusted % Change is defined and reconciled in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Grain revenue was \$370 million in the second quarter of 2022, a decrease of \$74 million, or 17%, from \$444 million in the same period of 2021. This decrease was primarily due to lower volumes of Canadian grain to Vancouver and eastern Canada due to drought conditions that impacted the Canadian crop size. This decrease was partially offset by higher volumes of U.S. corn from the U.S. Midwest to western Canada and the U.S. Pacific Northwest and increased freight revenue per RTM. Freight revenue per RTM increased due to higher fuel surcharge revenue as a result of higher fuel prices, the favourable impact of the change in FX, and higher freight rates. RTMs decreased less than carloads due to moving higher volumes of U.S. corn from the U.S. Midwest to western Canada and the U.S. Pacific Northwest, which have longer lengths of haul.

For the six months ended June 30	2022	2021	Total Change	% Change	FX Adjusted % Change ⁽¹⁾
Freight revenues (in millions)	\$ 730	\$ 892	\$ (162)	(18)	(19)
Carloads (in thousands)	167.8	234.8	(67.0)	(29)	N/A
Revenue ton-miles (in millions)	15,758	20,849	(5,091)	(24)	N/A
Freight revenue per carload (in dollars)	\$ 4,350	\$ 3,799	\$ 551	15	14
Freight revenue per revenue ton-mile (in cents)	4.63	4.28	0.35	8	7

⁽¹⁾ FX Adjusted % Change does not have any standardized meaning prescribed by GAAP and, therefore, is unlikely to be comparable to similar measures presented by other companies. FX Adjusted % Change is defined and reconciled in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Grain revenue was \$730 million in the first six months of 2022, a decrease of \$162 million, or 18%, from \$892 million in the same period of 2021. This decrease was primarily due to lower volumes of Canadian grain to Vancouver and eastern Canada due to drought conditions that impacted the Canadian crop size. This decrease was partially offset by higher volumes of U.S. corn from the U.S. Midwest to western Canada and increased freight revenue per RTM. Freight revenue per RTM increased due to higher fuel surcharge revenue as a result of higher fuel prices, higher freight rates, and the favourable impact of the change in FX. RTMs decreased less than carloads due to moving higher volumes of U.S. corn from the U.S. Midwest to western Canada, which have longer lengths of haul.

Coal

For the three months ended June 30	2022	2021	Total Change	% Change	FX Adjusted % Change ⁽¹⁾
Freight revenues (in millions)	\$ 163	\$ 170	\$ (7)	(4)	(4)
Carloads (in thousands)	71.7	78.8	(7.1)	(9)	N/A
Revenue ton-miles (in millions)	4,183	4,837	(654)	(14)	N/A
Freight revenue per carload (in dollars)	\$ 2,273	\$ 2,157	\$ 116	5	5
Freight revenue per revenue ton-mile (in cents)	3.90	3.51	0.39	11	11

⁽¹⁾ FX Adjusted % Change does not have any standardized meaning prescribed by GAAP and, therefore, is unlikely to be comparable to similar measures presented by other companies. FX Adjusted % Change is defined and reconciled in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Coal revenue was \$163 million in the second quarter of 2022, a decrease of \$7 million, or 4%, from \$170 million in the same period of 2021. This decrease was primarily due to lower volumes of Canadian coal to Vancouver and lower volumes of U.S. coal to the U.S. Midwest. This decrease was partially offset by higher volumes of Canadian coal to Kamloops, B.C. and increased freight revenue per RTM. Freight revenue per RTM increased due to higher fuel surcharge revenue as a result of higher fuel prices and higher freight rates. RTMs decreased more than carloads due to moving lower volumes of Canadian coal to

Vancouver, which has a longer length of haul, and moving higher volumes of Canadian coal to Kamloops, B.C., which has a shorter length of haul.

For the six months ended June 30	2022	2021	Total Change	% Change	FX Adjusted % Change ⁽¹⁾
Freight revenues (in millions)	\$ 302	\$ 333	\$ (31)	(9)	(9)
Carloads (in thousands)	141.6	150.8	(9.2)	(6)	N/A
Revenue ton-miles (in millions)	8,180	10,117	(1,937)	(19)	N/A
Freight revenue per carload (in dollars)	\$ 2,133	\$ 2,208	\$ (75)	(3)	(3)
Freight revenue per revenue ton-mile (in cents)	3.69	3.29	0.40	12	12

⁽¹⁾ FX Adjusted % Change does not have any standardized meaning prescribed by GAAP and, therefore, is unlikely to be comparable to similar measures presented by other companies. FX Adjusted % Change is defined and reconciled in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Coal revenue was \$302 million in the first six months of 2022, a decrease of \$31 million, or 9%, from \$333 million in the same period of 2021. This decrease was primarily due to lower volumes of Canadian coal to Vancouver, partially offset by higher volumes of Canadian coal to Kamloops, B.C. and increased freight revenue per RTM. Freight revenue per RTM increased due to higher fuel surcharge revenue as a result of higher fuel prices. RTMs decreased more than carloads due to moving lower volumes of Canadian coal to Vancouver, which has a longer length of haul, and moving higher volumes of Canadian coal to Kamloops, B.C., which has a shorter length of haul.

Potash

For the three months ended June 30	2022	2021	Total Change	% Change	FX Adjusted % Change ⁽¹⁾
Freight revenues (in millions)	\$ 171	\$ 134	\$ 37	28	26
Carloads (in thousands)	47.3	44.6	2.7	6	N/A
Revenue ton-miles (in millions)	5,481	4,978	503	10	N/A
Freight revenue per carload (in dollars)	\$ 3,615	\$ 3,004	\$ 611	20	19
Freight revenue per revenue ton-mile (in cents)	3.12	2.69	0.43	16	14

⁽¹⁾ FX Adjusted % Change does not have any standardized meaning prescribed by GAAP and, therefore, is unlikely to be comparable to similar measures presented by other companies. FX Adjusted % Change is defined and reconciled in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Potash revenue was \$171 million in the second quarter of 2022, an increase of \$37 million, or 28%, from \$134 million in the same period of 2021. This increase was primarily due to increased freight revenue per RTM and higher volumes of export potash to Thunder Bay, Vancouver, and the U.S. Pacific Northwest. This increase was partially offset by lower volumes of domestic potash. Freight revenue per RTM increased due to higher fuel surcharge revenue as a result of higher fuel prices, the favourable impact of the change in FX, and higher freight rates. RTMs increased more than carloads due to moving higher volumes of export potash, which has a longer length of haul.

For the six months ended June 30	2022	2021	Total Change	% Change	FX Adjusted % Change ⁽¹⁾
Freight revenues (in millions)	\$ 275	\$ 235	\$ 40	17	16
Carloads (in thousands)	79.4	79.0	0.4	1	N/A
Revenue ton-miles (in millions)	9,133	8,764	369	4	N/A
Freight revenue per carload (in dollars)	\$ 3,463	\$ 2,975	\$ 488	16	15
Freight revenue per revenue ton-mile (in cents)	3.01	2.68	0.33	12	11

⁽¹⁾ FX Adjusted % Change does not have any standardized meaning prescribed by GAAP and, therefore, is unlikely to be comparable to similar measures presented by other companies. FX Adjusted % Change is defined and reconciled in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Potash revenue was \$275 million in the first six months of 2022, an increase of \$40 million, or 17%, from \$235 million in the same period of 2021. This increase was primarily due to increased freight revenue per RTM and higher volumes of export potash to the U.S. Pacific Northwest and Thunder Bay. This increase was partially offset by lower volumes of domestic potash. Freight revenue per RTM increased due to higher fuel surcharge revenue as a result of higher fuel prices, higher freight rates, and the favourable impact of the change in FX. RTMs increased more than carloads due to moving higher volumes of export potash, which has a longer length of haul.

Fertilizers and Sulphur

For the three months ended June 30	2022	2021	Total Change	% Change	FX Adjusted % Change ⁽¹⁾
Freight revenues (in millions)	\$ 85	\$ 78	\$ 7	9	6
Carloads (in thousands)	16.0	17.0	(1.0)	(6)	N/A
Revenue ton-miles (in millions)	1,228	1,263	(35)	(3)	N/A
Freight revenue per carload (in dollars)	\$ 5,313	\$ 4,588	\$ 725	16	13
Freight revenue per revenue ton-mile (in cents)	6.92	6.18	0.74	12	9

⁽¹⁾ FX Adjusted % Change does not have any standardized meaning prescribed by GAAP and, therefore, is unlikely to be comparable to similar measures presented by other companies. FX Adjusted % Change is defined and reconciled in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Fertilizers and sulphur revenue was \$85 million in the second quarter of 2022, an increase of \$7 million, or 9%, from \$78 million in the same period of 2021. This increase was primarily due to increased freight revenue per RTM and higher volumes of dry fertilizers. This increase was partially offset by lower volumes of wet fertilizers and sulphur. Freight revenue per RTM increased due to higher fuel surcharge revenue as a result of higher fuel prices, the favourable impact of the change in FX, and higher freight rates. RTMs decreased less than carloads due to moving higher volumes of dry fertilizers from the U.S. Midwest to western Canada, which has a longer length of haul.

For the six months ended June 30	2022	2021	Total Change	% Change	FX Adjusted % Change ⁽¹⁾
Freight revenues (in millions)	\$ 163	\$ 155	\$ 8	5	3
Carloads (in thousands)	31.9	33.3	(1.4)	(4)	N/A
Revenue ton-miles (in millions)	2,447	2,532	(85)	(3)	N/A
Freight revenue per carload (in dollars)	\$ 5,110	\$ 4,655	\$ 455	10	8
Freight revenue per revenue ton-mile (in cents)	6.66	6.12	0.54	9	7

⁽¹⁾ FX Adjusted % Change does not have any standardized meaning prescribed by GAAP and, therefore, is unlikely to be comparable to similar measures presented by other companies. FX Adjusted % Change is defined and reconciled in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Fertilizers and sulphur revenue was \$163 million in the first six months of 2022, an increase of \$8 million, or 5%, from \$155 million in the same period of 2021. This increase was primarily due to increased freight revenue per RTM, partially offset by lower volumes of wet fertilizers. Freight revenue per RTM increased due to higher fuel surcharge revenue as a result of higher fuel prices, higher freight rates, and the favourable impact of the change in FX.

Forest Products

For the three months ended June 30	2022	2021	Total Change	% Change	FX Adjusted % Change ⁽¹⁾
Freight revenues (in millions)	\$ 104	\$ 90	\$ 14	16	12
Carloads (in thousands)	19.4	18.9	0.5	3	N/A
Revenue ton-miles (in millions)	1,517	1,508	9	1	N/A
Freight revenue per carload (in dollars)	\$ 5,361	\$ 4,762	\$ 599	13	9
Freight revenue per revenue ton-mile (in cents)	6.86	5.97	0.89	15	11

⁽¹⁾ FX Adjusted % Change does not have any standardized meaning prescribed by GAAP and, therefore, is unlikely to be comparable to similar measures presented by other companies. FX Adjusted % Change is defined and reconciled in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Forest products revenue was \$104 million in the second quarter of 2022, an increase of \$14 million, or 16%, from \$90 million in the same period of 2021. This increase was primarily due to increased freight revenue per RTM, higher volumes of newsprint from Saint John, N.B., and higher volumes of paper and panel products from B.C. This increase was partially offset by lower volumes of lumber. Freight revenue per RTM increased due to higher fuel surcharge revenue as a result of higher fuel prices, higher freight rates, and the favourable impact of the change in FX. Carloads increased more than RTMs due to moving higher volumes of newsprint from Saint John, N.B. to the U.S. Northeast, which has a shorter length of haul, and lower volumes of lumber between B.C. and the U.S. Midwest, which has a longer length of haul.

For the six months ended June 30	2022	2021	Total Change	% Change	FX Adjusted % Change ⁽¹⁾
Freight revenues (in millions)	\$ 190	\$ 170	\$ 20	12	10
Carloads (in thousands)	36.8	36.4	0.4	1	N/A
Revenue ton-miles (in millions)	2,878	2,871	7	—	N/A
Freight revenue per carload (in dollars)	\$ 5,163	\$ 4,670	\$ 493	11	9
Freight revenue per revenue ton-mile (in cents)	6.60	5.92	0.68	11	9

⁽¹⁾ FX Adjusted % Change does not have any standardized meaning prescribed by GAAP and, therefore, is unlikely to be comparable to similar measures presented by other companies. FX Adjusted % Change is defined and reconciled in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Forest products revenue was \$190 million in the first six months of 2022, an increase of \$20 million, or 12%, from \$170 million in the same period of 2021. This increase was primarily due to increased freight revenue per RTM, higher volumes of newsprint from Saint John, N.B., and higher volumes of paper and panel products from B.C. This increase was partially offset by lower volumes of lumber. Freight revenue per RTM increased due to higher fuel surcharge revenue as a result of higher fuel prices, higher freight rates, and the favourable impact of the change in FX.

Energy, Chemicals and Plastics

For the three months ended June 30	2022	2021	Total Change	% Change	FX Adjusted % Change ⁽¹⁾
Freight revenues (in millions)	\$ 340	\$ 369	\$ (29)	(8)	(10)
Carloads (in thousands)	73.5	76.1	(2.6)	(3)	N/A
Revenue ton-miles (in millions)	6,028	5,856	172	3	N/A
Freight revenue per carload (in dollars)	\$ 4,626	\$ 4,849	\$ (223)	(5)	(6)
Freight revenue per revenue ton-mile (in cents)	5.64	6.30	(0.66)	(10)	(12)

⁽¹⁾ FX Adjusted % Change does not have any standardized meaning prescribed by GAAP and, therefore, is unlikely to be comparable to similar measures presented by other companies. FX Adjusted % Change is defined and reconciled in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Energy, chemicals and plastics revenue was \$340 million in the second quarter of 2022, a decrease of \$29 million, or 8%, from \$369 million in the same period of 2021. This decrease was primarily due to decreased freight revenue per RTM and lower volumes of conventional crude. This decrease was partially offset by higher fuel surcharge revenue as a result of higher fuel prices, higher volumes of DRUbit™ crude to Kansas City, higher volumes of petroleum products, higher freight rates, and the favourable impact of the change in FX. Freight revenue per RTM decreased primarily due to lower crude liquidated damages, including customer volume commitments, as a result of the completion of customer contracts. RTMs increased while carloads decreased due to moving higher volumes of DRUbit™ crude to Kansas City, which has a longer length of haul, and lower volumes of conventional crude to Noyes, MN, which has a shorter length of haul.

For the six months ended June 30	2022	2021	Total Change	% Change	FX Adjusted % Change ⁽¹⁾
Freight revenues (in millions)	\$ 650	\$ 757	\$ (107)	(14)	(15)
Carloads (in thousands)	146.1	163.3	(17.2)	(11)	N/A
Revenue ton-miles (in millions)	11,935	12,998	(1,063)	(8)	N/A
Freight revenue per carload (in dollars)	\$ 4,449	\$ 4,636	\$ (187)	(4)	(5)
Freight revenue per revenue ton-mile (in cents)	5.45	5.82	(0.37)	(6)	(7)

⁽¹⁾ FX Adjusted % Change does not have any standardized meaning prescribed by GAAP and, therefore, is unlikely to be comparable to similar measures presented by other companies. FX Adjusted % Change is defined and reconciled in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Energy, chemicals and plastics revenue was \$650 million in the first six months of 2022, a decrease of \$107 million, or 14%, from \$757 million in the same period of 2021. This decrease was primarily due to lower volumes of conventional crude, plastics and chemicals, and decreased freight revenue per RTM. This decrease was partially offset by higher volumes of DRUbit™ crude to Kansas City, higher fuel surcharge revenue as a result of higher fuel prices, higher freight rates, and the favourable impact of the change in FX. Freight revenue per RTM decreased primarily due to lower crude liquidated damages, including customer volume commitments, as a result of the completion of customer contracts. Carloads decreased more than RTMs due to moving higher volumes of DRUbit™ crude to Kansas City, which has a longer length of haul, and lower volumes of conventional crude to Noyes, MN, which has a shorter length of haul.

Metals, Minerals and Consumer Products

For the three months ended June 30	2022	2021	Total Change	% Change	FX Adjusted % Change ⁽¹⁾
Freight revenues (in millions)	\$ 228	\$ 180	\$ 48	27	23
Carloads (in thousands)	66.6	61.1	5.5	9	N/A
Revenue ton-miles (in millions)	3,108	2,837	271	10	N/A
Freight revenue per carload (in dollars)	\$ 3,423	\$ 2,946	\$ 477	16	13
Freight revenue per revenue ton-mile (in cents)	7.34	6.34	1.00	16	13

⁽¹⁾ FX Adjusted % Change does not have any standardized meaning prescribed by GAAP and, therefore, is unlikely to be comparable to similar measures presented by other companies. FX Adjusted % Change is defined and reconciled in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Metals, minerals and consumer products revenue was \$228 million in the second quarter of 2022, an increase of \$48 million, or 27%, from \$180 million in the same period of 2021. This increase was primarily due to increased freight revenue per RTM, higher volumes of frac sand to the Marcellus Shale formation, and higher volumes of mines and metals, and aggregates. Freight revenue per RTM increased due to higher fuel surcharge revenue as a result of higher fuel prices, higher freight rates, and the favourable impact of the change in FX.

For the six months ended June 30	2022	2021	Total Change	% Change	FX Adjusted % Change ⁽¹⁾
Freight revenues (in millions)	\$ 409	\$ 339	\$ 70	21	19
Carloads (in thousands)	121.2	116.8	4.4	4	N/A
Revenue ton-miles (in millions)	5,627	5,336	291	5	N/A
Freight revenue per carload (in dollars)	\$ 3,375	\$ 2,902	\$ 473	16	15
Freight revenue per revenue ton-mile (in cents)	7.27	6.35	0.92	14	13

⁽¹⁾ FX Adjusted % Change does not have any standardized meaning prescribed by GAAP and, therefore, is unlikely to be comparable to similar measures presented by other companies. FX Adjusted % Change is defined and reconciled in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Metals, minerals and consumer products revenue was \$409 million in the first six months of 2022, an increase of \$70 million, or 21%, from \$339 million in the same period of 2021. This increase was primarily due to increased freight revenue per RTM and higher volumes of frac sand to the Marcellus Shale formation, partially offset by lower volumes of steel. Freight revenue per RTM increased due to higher fuel surcharge revenue as a result of higher fuel prices, higher freight rates, and the favourable impact of the change in FX.

Automotive

For the three months ended June 30	2022	2021	Total Change	% Change	FX Adjusted % Change ⁽¹⁾
Freight revenues (in millions)	\$ 120	\$ 98	\$ 22	22	19
Carloads (in thousands)	28.8	28.7	0.1	—	N/A
Revenue ton-miles (in millions)	487	467	20	4	N/A
Freight revenue per carload (in dollars)	\$ 4,167	\$ 3,415	\$ 752	22	18
Freight revenue per revenue ton-mile (in cents)	24.64	20.99	3.65	17	14

⁽¹⁾ FX Adjusted % Change does not have any standardized meaning prescribed by GAAP and, therefore, is unlikely to be comparable to similar measures presented by other companies. FX Adjusted % Change is defined and reconciled in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Automotive revenue was \$120 million in the second quarter of 2022, an increase of \$22 million, or 22%, from \$98 million in the same period of 2021. This increase was primarily due to increased freight revenue per RTM and higher volumes moving between Kansas City and Canada. Freight revenue per RTM increased due to higher fuel surcharge revenue as a result of higher fuel prices, the favourable impact of the change in FX, and higher freight rates. RTMs increased while carloads remained flat due to moving higher volumes between Kansas City and Canada, which has a longer length of haul, and moving lower volumes from Chicago to Minnesota, which has a shorter length of haul.

For the six months ended June 30	2022	2021	Total Change	% Change	FX Adjusted % Change ⁽¹⁾
Freight revenues (in millions)	\$ 211	\$ 206	\$ 5	2	1
Carloads (in thousands)	52.9	62.1	(9.2)	(15)	N/A
Revenue ton-miles (in millions)	890	975	(85)	(9)	N/A
Freight revenue per carload (in dollars)	\$ 3,989	\$ 3,317	\$ 672	20	19
Freight revenue per revenue ton-mile (in cents)	23.71	21.13	2.58	12	11

⁽¹⁾ FX Adjusted % Change does not have any standardized meaning prescribed by GAAP and, therefore, is unlikely to be comparable to similar measures presented by other companies. FX Adjusted % Change is defined and reconciled in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Automotive revenue was \$211 million in the first six months of 2022, an increase of \$5 million, or 2%, from \$206 million in the same period of 2021. This increase was primarily due to increased freight revenue per RTM due to higher fuel surcharge revenue as a result of higher fuel prices, higher freight rates, and the favourable impact of the change in FX. This increase was partially offset by lower volumes as a result of global supply chain challenges. Carloads decreased more than RTMs due to moving proportionately lower volumes between the U.S. Midwest and eastern Canada, which has a shorter length of haul.

Intermodal

For the three months ended June 30	2022	2021	Total Change	% Change	FX Adjusted % Change ⁽¹⁾
Freight revenues (in millions)	\$ 573	\$ 445	\$ 128	29	28
Carloads (in thousands)	305.3	279.9	25.4	9	N/A
Revenue ton-miles (in millions)	8,277	7,239	1,038	14	N/A
Freight revenue per carload (in dollars)	\$ 1,877	\$ 1,590	\$ 287	18	17
Freight revenue per revenue ton-mile (in cents)	6.92	6.15	0.77	13	12

⁽¹⁾ FX Adjusted % Change does not have any standardized meaning prescribed by GAAP and, therefore, is unlikely to be comparable to similar measures presented by other companies. FX Adjusted % Change is defined and reconciled in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Intermodal revenue was \$573 million in the second quarter of 2022, an increase of \$128 million, or 29%, from \$445 million in the same period of 2021. This increase was primarily due to increased freight revenue per RTM, higher international intermodal volumes driven by onboarding new customers, and higher domestic wholesale volumes. Freight revenue per RTM increased due to higher fuel surcharge revenue as a result of higher fuel prices, higher intermodal ancillary revenue, higher freight rates, and the favourable impact of the change in FX. RTMs increased more than carloads due to moving higher volumes of international intermodal from the Port of Saint John and the Port of Montreal to western Canada, which have longer lengths of haul.

For the six months ended June 30	2022	2021	Total Change	% Change	FX Adjusted % Change ⁽¹⁾
Freight revenues (in millions)	\$ 1,020	\$ 839	\$ 181	22	21
Carloads (in thousands)	560.7	538.4	22.3	4	N/A
Revenue ton-miles (in millions)	14,938	13,892	1,046	8	N/A
Freight revenue per carload (in dollars)	\$ 1,819	\$ 1,558	\$ 261	17	16
Freight revenue per revenue ton-mile (in cents)	6.83	6.04	0.79	13	13

⁽¹⁾ FX Adjusted % Change does not have any standardized meaning prescribed by GAAP and, therefore, is unlikely to be comparable to similar measures presented by other companies. FX Adjusted % Change is defined and reconciled in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Intermodal revenue was \$1,020 million in the first six months of 2022, an increase of \$181 million, or 22%, from \$839 million in the same period of 2021. This increase was primarily due to increased freight revenue per RTM, higher international intermodal volumes driven by onboarding new customers, and higher domestic wholesale volumes. Freight revenue per RTM increased due to higher fuel surcharge revenue as a result of higher fuel prices, higher intermodal ancillary revenue, higher freight rates, and the favourable impact of the change in FX. RTMs increased more than carloads due to moving higher volumes of international intermodal from the Port of Saint John and the Port of Montreal to western Canada, which have longer lengths of haul.

Operating Expenses

For the three months ended June 30
(in millions of Canadian dollars)

	2022	2021	Total Change	% Change	FX Adjusted % Change ⁽¹⁾
Compensation and benefits	\$ 348	\$ 379	\$ (31)	(8)	(9)
Fuel	370	218	152	70	65
Materials	63	54	9	17	15
Equipment rents	29	28	1	4	—
Depreciation and amortization	211	200	11	6	4
Purchased services and other	313	355	(42)	(12)	(13)
Total operating expenses	\$ 1,334	\$ 1,234	\$ 100	8	7

⁽¹⁾ FX Adjusted % Change does not have any standardized meaning prescribed by GAAP and, therefore, is unlikely to be comparable to similar measures presented by other companies. FX Adjusted % Change is defined and reconciled in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Operating expenses were \$1,334 million in the second quarter of 2022, an increase of \$100 million, or 8%, from \$1,234 million in the same period of 2021. This increase was primarily due to:

- the unfavourable impact of changes in fuel prices of \$156 million;
- cost inflation;
- the unfavourable impact of the change in FX of \$17 million; and
- higher casualty costs incurred in 2022.

This increase was partially offset by:

- lower acquisition-related costs of \$80 million associated with the KCS acquisition that were recognized in Purchased services and other;
- lower volume variable expenses; and
- lower stock-based compensation of \$23 million primarily driven by the impact of changes in share price.

For the six months ended June 30
(in millions of Canadian dollars)

	2022	2021	Total Change	% Change	FX Adjusted % Change ⁽¹⁾
Compensation and benefits	\$ 761	\$ 784	\$ (23)	(3)	(3)
Fuel	643	424	219	52	50
Materials	125	113	12	11	10
Equipment rents	64	61	3	5	3
Depreciation and amortization	421	402	19	5	4
Purchased services and other	623	629	(6)	(1)	(1)
Total operating expenses	\$ 2,637	\$ 2,413	\$ 224	9	9

⁽¹⁾ FX Adjusted % Change does not have any standardized meaning prescribed by GAAP and, therefore, is unlikely to be comparable to similar measures presented by other companies. FX Adjusted % Change is defined and reconciled in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Operating expenses were \$2,637 million in the first six months of 2022, an increase of \$224 million, or 9%, from \$2,413 million in the same period of 2021. This increase was primarily due to:

- the unfavourable impact of changes in fuel prices of \$252 million;
- cost inflation;
- a gain on the exchange of property and construction easements in Chicago of \$50 million in 2021; and
- a decrease in efficiencies primarily due to harsh winter weather conditions in the first quarter of 2022.

This increase was partially offset by lower volume variable expenses and lower acquisition-related costs of \$93 million associated with the KCS acquisition that were recognized in Purchased services and other.

Compensation and Benefits

Compensation and benefits expense includes employee wages, salaries, fringe benefits, and stock-based compensation. Compensation and benefits expense was \$348 million in the second quarter of 2022, a decrease of \$31 million, or 8%, from \$379 million in the same period of 2021.

This decrease was primarily due to:

- lower stock-based compensation of \$23 million primarily driven by the impact of changes in share price;

- decreased incentive compensation;
- lower defined benefit pension current service cost of \$6 million; and
- decreased volume variable expense as a result of a decrease in workload as measured by GTMs.

This decrease was partially offset by the impact of wage and benefit inflation.

Compensation and benefits expense was \$761 million in the first six months of 2022, a decrease of \$23 million, or 3%, from \$784 million in the same period of 2021. This decrease was primarily due to:

- lower volume variable expense as a result of a decrease in workload as measured by GTMs;
- decreased incentive compensation; and
- lower defined benefit pension current service cost of \$12 million.

This decrease was partially offset by the impact of wage and benefit inflation.

Fuel

Fuel expense consists mainly of fuel used by locomotives and includes provincial, state, and federal fuel taxes. Fuel expense was \$370 million in the second quarter of 2022, an increase of \$152 million, or 70%, from \$218 million in the same period of 2021. This increase was primarily due:

- the unfavourable impact of higher fuel prices of \$156 million;
- the unfavourable impact of the change in FX of \$6 million; and
- a decrease in fuel efficiency of 1% due to lower volumes of Canadian grain, which has higher horsepower utilization.

This increase was partially offset by a decrease in workload, as measured by GTMs.

Fuel expense was \$643 million in the first six months of 2022, an increase of \$219 million, or 52%, from \$424 million in the same period of 2021. This increase was primarily due to:

- the unfavourable impact of higher fuel prices of \$252 million;
- a decrease in fuel efficiency of 2% due to lower locomotive productivity and harsher winter operating conditions in the first quarter of 2022, and lower volumes of Canadian grain, which has higher horsepower utilization; and
- the unfavourable impact of the change in FX of \$6 million.

This increase was partially offset by a decrease in workload, as measured by GTMs.

Materials

Materials expense includes the cost of materials used for the maintenance of track, locomotives, freight cars, and buildings, as well as software sustainment. Materials expense was \$63 million in the second quarter of 2022, an increase of \$9 million, or 17%, from \$54 million in the same period of 2021. This increase was primarily due to the unfavourable impact of inflation including higher non-locomotive fuel prices.

Materials expense was \$125 million in the first six months of 2022, an increase of \$12 million, or 11%, from \$113 million in the same period of 2021. This increase was primarily due to the unfavourable impact of inflation including higher non-locomotive fuel prices, partially offset by reduced freight car maintenance.

Equipment Rents

Equipment rents expense includes the cost associated with using other railways' freight cars, intermodal equipment, and locomotives, net of rental income received from other railways for the use of CP's equipment. Equipment rents expense was \$29 million in the second quarter of 2022, an increase of \$1 million, or 4%, from \$28 million in the same period of 2021. This increase was primarily due to greater usage of pooled freight cars and lower price incentives received on Intermodal cars.

This increase was partially offset by higher receipts for CP rolling stock used by other railways.

Equipment rents expense was \$64 million in the first six months of 2022, an increase of \$3 million, or 5%, from \$61 million in the same period of 2021. This increase was primarily due to slower cycle times and greater usage of pooled freight cars.

This increase was partially offset by higher receipts for CP rolling stock used by other railways.

Depreciation and Amortization

Depreciation and amortization expense represents the charge associated with the use of track and roadway, buildings, rolling stock, information systems, and other depreciable assets. Depreciation and amortization was \$211 million and \$421 million for the three and six months ended June 30, 2022, an increase of \$11 million or 6%, and \$19 million or 5%, respectively, compared to the same periods of 2021. These increases were primarily due to a higher depreciable asset base.

Purchased Services and Other

For the three months ended June 30
(in millions of Canadian dollars)

	2022	2021	Total Change	% Change
Support and facilities	\$ 84	\$ 70	\$ 14	20
Track and operations	74	70	4	6
Intermodal	57	51	6	12
Equipment	28	26	2	8
Casualty	30	23	7	30
Property taxes	35	34	1	3
Other	5	86	(81)	(94)
Land sales	—	(5)	5	(100)
Total Purchased services and other	\$ 313	\$ 355	\$ (42)	(12)

Purchased services and other expense encompasses a wide range of third-party costs, including expenses for joint facilities, personal injuries and damage claims, environmental remediation, property taxes, contractor and consulting fees, insurance, and gains on land sales. Purchased services and other expense was \$313 million in the second quarter of 2022, a decrease of \$42 million, or 12%, from \$355 million in the same period of 2021. This decrease was primarily due to lower acquisition-related costs of \$80 million associated with the KCS acquisition and higher legal and other claim recoveries compared to the same period of 2021, reported in Other.

This decrease was partially offset by:

- cost inflation;
- higher expenses primarily due to the increased number and severity of casualty incidents, reported in Casualty; and
- higher expenses primarily due to higher legal, events and sponsorship costs, reported in Support and facilities.

For the six months ended June 30
(in millions of Canadian dollars)

	2022	2021	Total Change	% Change
Support and facilities	\$ 166	\$ 140	\$ 26	19
Track and operations	149	132	17	13
Intermodal	108	104	4	4
Equipment	56	55	1	2
Casualty	50	60	(10)	(17)
Property taxes	71	68	3	4
Other	33	129	(96)	(74)
Land sales	(10)	(59)	49	(83)
Total Purchased services and other	\$ 623	\$ 629	\$ (6)	(1)

Purchased services and other expense was \$623 million in the first six months of 2022, a decrease of \$6 million, or 1%, from \$629 million in the same period of 2021. This decrease was primarily due to:

- lower acquisition-related costs of \$93 million associated with the KCS acquisition, reported in Other;
- lower expenses from lower volumes, reported in Intermodal, and Track and operations;
- lower expenses primarily due to the reduced severity of casualty incidents, reported in Casualty; and
- higher legal and other claim recoveries compared to the same period of 2021, reported in Other.

This decrease was partially offset by:

- a gain on the exchange of property and construction easements in Chicago of \$50 million in 2021;
- cost inflation;
- higher expenses primarily due to higher legal, events and sponsorship costs, reported in Support and facilities.
- increased purchased services due to harsher weather conditions, reported in Track and operations; and
- a \$7 million arbitration settlement in 2021, reported in Track and operations.

Other Income Statement Items

Equity Earnings of Kansas City Southern

In the second quarter of 2022, the Company recognized \$208 million (U.S. \$163 million) equity income of KCS in the Company's Interim Consolidated Statements of Income. This amount is net of amortization of basis differences of \$39 million (U.S.

\$31 million) associated with KCS purchase accounting. No similar equity income existed in the same period of 2021 as CP acquired KCS into trust on December 14, 2021.

On a historical basis, without any effect of purchase accounting, KCS recorded net income attributable to controlling interests of \$248 million (U.S. \$194 million) in the second quarter of 2022, a favourable change of \$714 million (U.S. \$573 million), or 153%, from a \$466 million (U.S. \$379 million) net loss. This change was primarily due to lower acquisition-related costs, including the merger termination fee paid to CP in the same period of 2021, and higher revenues of \$123 million (U.S. \$96 million), partially offset by higher fuel cost of \$56 million (U.S. \$44 million). Acquisition-related costs (net of tax) incurred by KCS in the second quarter of 2022 were \$14 million (U.S. \$11 million), a decrease of \$686 million (U.S. \$558 million), or 98%, from \$700 million (U.S. \$569 million) in the same period of 2021. These values have been translated at the average FX rate of \$1.28 and \$1.23 CAD per USD for the three months ended June 30, 2022 and 2021, respectively.

In the first six months of 2022, the Company recognized \$406 million (U.S. \$319 million) equity income of KCS in the Company's Interim Consolidated Statements of Income. This amount is net of amortization of basis differences of \$79 million (U.S. \$62 million) associated with KCS purchase accounting.

On a historical basis, without any effect of purchase accounting, KCS recorded net income attributable to controlling interests of \$485 million (U.S. \$382 million) in the first six months of 2022, a favourable change of \$768 million (U.S. \$608 million), or 271%, from a \$283 million (U.S. \$226 million) net loss. This change was primarily due to lower acquisition-related costs, including the merger termination fee paid to CP in the same period of 2021, and higher revenues of \$214 million (U.S. \$168 million), partially offset by higher fuel cost of \$89 million (U.S. \$70 million). Acquisition-related costs (net of tax) incurred by KCS in the first six months of 2022 were \$27 million (U.S. \$21 million), a decrease of \$710 million (U.S. \$568 million), or 96%, from \$737 million (U.S. \$589 million) in the same period of 2021. These values have been translated at the average FX rate of \$1.27 and \$1.25 CAD per USD for the first six months of 2022 and 2021, respectively.

Other Expense

Other expense consists of gains and losses from the change in FX on debt and lease liabilities and working capital, costs related to financing, shareholder costs, equity income, and other non-operating expenditures. Other expense was \$7 million in the second quarter of 2022, a decrease of \$150 million, or 96%, compared to other expense of \$157 million in the same period of 2021. This decrease was primarily due to acquisition-related costs of \$209 million in 2021 which included losses on interest rate hedges of \$150 million, bridge facility fees of \$42 million, and a loss on FX hedges of \$17 million. This decrease was partially offset by an FX translation gain of \$52 million in the second quarter of 2021 compared to nil in the same period of 2022 as a result of the designation of all U.S. dollar-denominated debt and lease liabilities as a hedge following the KCS acquisition in the fourth quarter of 2021.

Other expense was \$6 million in the first six months of 2022, a decrease of \$123 million, or 95%, from \$129 million in the same period of 2021. This decrease is primarily due to acquisition-related costs of \$212 million in 2021 which include losses on interest rate hedges of \$150 million, bridge facility and backstop revolver fees of \$45 million, and net losses on FX hedges of \$17 million. This decrease was partially offset by an FX translation gain of \$85 million in the second quarter of 2021 compared to nil in the same period of 2022 as a result of the designation of all U.S. dollar-denominated debt and lease liabilities as discussed above.

FX translation gains and losses on debt and lease liabilities are discussed further in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Merger Termination Fee

On May 21, 2021, KCS terminated 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.

Other Components of Net Periodic Benefit Recovery

Other components of net periodic benefit recovery is related to the Company's pension and other post-retirement and post-employment benefit plans. It includes interest cost on benefit obligations, expected return on fund assets, recognized net actuarial losses, and amortization of prior service costs. Other components of net periodic benefit recovery was \$101 million and \$202 million for the three and six months ended June 30, 2022, an increase of \$5 million or 5%, and \$11 million or 6%, respectively, compared to the same periods of 2021. These increases were primarily due to a decrease in recognized net actuarial losses for the three and six months ended June 30, 2022 of \$14 million and \$28 million, respectively, partially offset by an increase in the interest cost on benefit obligations of \$8 million and \$16 million, respectively.

Net Interest Expense

Net interest expense includes interest on long-term debt and finance leases. Net interest expense was \$160 million in the second quarter of 2022, an increase of \$59 million, or 58%, from \$101 million in the same period of 2021. This increase was primarily due to interest of \$65 million incurred on long-term debt that was issued in the fourth quarter of 2021 related to the KCS acquisition, partially offset by the favourable impacts of \$8 million as a result of a lower effective interest rate and \$7 million related to repayment of maturing long-term debt.

Net interest expense was \$320 million in the first six months of 2022, an increase of \$109 million, or 52%, from \$211 million in the same period of 2021. This increase was primarily due to interest of \$128 million incurred on long-term debt that was issued in the fourth quarter of 2021 related to the KCS acquisition, partially offset by the favourable impacts of \$16 million related to repayment of maturing long-term debt and \$12 million as a result of a lower effective interest rate.

Income Tax Expense

Income tax expense was \$245 million in the second quarter of 2022, a decrease of \$12 million, or 5%, from \$257 million in the same period of 2021. Income tax expense was \$330 million in the first six months of 2022, a decrease of \$118 million, or 26%, from \$448 million in the same period of 2021. These decreases were primarily a result of higher taxable earnings in 2021 due to the \$845 million (U.S. \$700 million) merger termination payment received in connection with KCS's termination of the Original Merger Agreement and a lower effective tax rate excluding discrete items, partially offset by a decrease to tax recoveries on acquisition-related costs associated with the KCS acquisition, and outside basis deferred tax expense 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.

The effective tax rate in the second quarter of 2022, including equity earnings of KCS and discrete items, was 24.21% compared to 17.10% in the same period of 2021. The effective tax rate in the first six months of 2022, including equity earnings of KCS and discrete items, was 19.59% compared to 19.50% in the same period of 2021. The effective tax rate in the second quarter and first six months of 2022, excluding discrete items, was 24.25% compared to 24.60% for the same periods in 2021.

The Company's expects an annualized effective tax rate in 2022 between 24% and 24.50%, which excludes the impact of the change in equity investment in KCS and associated deferred tax on the outside basis difference during the year. The Company's 2022 outlook for its annualized effective income tax rate is based on certain assumptions about events and developments that may or may not materialize or that may be offset entirely or partially by new events and developments. This is discussed further in Item 1A. Risk Factors of CP's 2021 Annual Report on Form 10-K.

Liquidity and Capital Resources

The Company's primary sources of liquidity include its Cash and cash equivalents, commercial paper program, bilateral letter of credit facilities, and revolving credit facility. The Company believes that these sources as well as cash flow generated through operations and existing debt capacity are adequate to meet its short-term and long-term cash requirements. The Company is not aware of any material trends, events, or uncertainties that would create any deficiencies in the Company's liquidity.

As at June 30, 2022, the Company had \$154 million of Cash and cash equivalents compared to \$69 million at December 31, 2021.

As at June 30, 2022, the Company's existing revolving credit facility was undrawn, unchanged from December 31, 2021, from a total available amount of U.S. \$1.3 billion. Effective March 14, 2022, the Company amended its U.S. \$500 million unsecured non-revolving term credit facility, extending the maturity to September 15, 2022. As at June 30, 2022, the unsecured non-revolving term credit facility has an outstanding balance of U.S. \$400 million. The credit facility agreements require the Company to maintain a financial covenant. As at June 30, 2022, the Company was in compliance with all terms and conditions of the credit facility arrangements and satisfied the financial covenant.

The Company has a commercial paper program that 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 revolving credit facility. As at June 30, 2022, total commercial paper borrowings were U.S. \$540 million, compared to U.S. \$265 million as at December 31, 2021.

As at June 30, 2022, under its bilateral letter of credit facilities, the Company had letters of credit drawn of \$64 million, compared to \$58 million as at December 31, 2021, from a total available amount of \$300 million. Under the bilateral letter of credit facilities, the Company has the option to post collateral in the form of Cash or cash equivalents, equal at least to the face value of the letter of credit issued. As at June 30, 2022 and December 31, 2021, the Company did not have any collateral posted on its bilateral letter of credit facilities.

Contractual Commitments

The Company's material cash requirements from known contractual obligations and commitments to make future payments primarily consist of long-term debt and related interest, future capital commitments, supplier purchases, leases, and other long term liabilities. Debt and finance leases, interest obligations related to debt and finance leases, and letters of credit amount to \$1,698 million, \$636 million and \$65 million within the next 12 months, respectively, with the remaining amount committed thereafter of \$18,551 million, \$13,392 million and nil respectively. Future capital commitments amount to \$295 million within the next 12 months, with the remaining amount committed thereafter of \$156 million.

Supplier purchase agreements, operating leases, and other long-term liabilities amount to \$1,147 million, \$69 million, and \$52 million within the next 12 months, respectively, with the remaining amount committed thereafter of \$852 million, \$231 million and \$415 million, respectively. Other long-term liabilities includes expected cash payments for environmental remediation, post-retirement benefits, worker's compensation benefits, long-term disability benefits, pension benefit payments for the Company's non-registered supplemental pension plan, and certain other long-term liabilities. Pension payments are discussed further in Critical Accounting Estimates of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Guarantees

The Company accrues for all guarantees that it expects to pay. As at June 30, 2022, these accruals amounted to \$10 million (December 31, 2021 - \$14 million).

Operating Activities

Cash provided by operating activities was \$707 million in the second quarter of 2022, a decrease of \$1,247 million, or 64%, compared to \$1,954 million in the same period of 2021. Cash provided by operating activities was \$1,320 million in the first six months of 2022, a decrease of \$1,216 million, or 48%, compared to \$2,536 million in the same period of 2021. These decreases were primarily due to the \$845 million merger termination fee received from KCS in the second quarter of 2021 and an unfavourable change in working capital driven by acquisition-related payables and higher receipts from customers in advance of providing services in the second quarter of 2021.

Investing Activities

Cash used in investing activities was \$362 million in the second quarter of 2022, a decrease of \$43 million, or 11%, compared to \$405 million in the same period of 2021. Cash used in investing activities was \$568 million in the first six months of 2022, a decrease of \$123 million, or 18%, compared to \$691 million in the same period of 2021. These decreases were primarily due to lower capital additions during the second quarter and first six months of 2022 compared to the same periods of 2021, partially offset by lower proceeds from the sale of properties and other assets.

Free Cash

CP generated positive Free cash of \$369 million in the second quarter of 2022, a decrease of \$377 million, or 51%, from \$746 million in the same period of 2021. For the first six months of 2022, CP generated positive Free cash of \$793 million, a decrease of \$249 million, or 24%, from \$1,042 million in the same period of 2021. These decreases were primarily due to a decrease in Cash provided by operating activities, partially offset by lower capital additions during the second quarter and first six months of 2022 compared to the same period of 2021.

Free cash is affected by seasonal fluctuations and by other factors including the size of the Company's capital programs. Free cash is defined and reconciled in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Financing Activities

Cash used in financing activities was \$297 million in the second quarter of 2022, a decrease of \$719 million, or 71%, compared to cash used in financing activities of \$1,016 million in the same period of 2021. This decrease was primarily due to net issuance of commercial paper of \$20 million in the second quarter of 2022 compared to net repayments of \$872 million in the second quarter of 2021, partially offset by principal repayments of \$132 million (U.S. \$100 million) on a term loan during the second quarter of 2022 and higher dividends paid as a result of a higher number of shares outstanding associated with the shares issued to acquire KCS in the fourth quarter of 2021.

Cash used in financing activities was \$688 million in the first six months of 2022, a decrease of \$408 million, or 37%, compared to \$1,096 million in the same period of 2021. This decrease was primarily due to net issuance of commercial paper of \$340 million during the six months ended June 30, 2022 compared to net repayments of \$779 million during the six months of 2021 and acquisition-related financing fees amounting to \$45 million paid during the six months ended June 30, 2021. This decrease was partially offset by principal repayments of \$132 million (U.S. \$100 million) on a term loan, principal repayments of

\$125 million of the Company's 5.100% 10-year Medium Term Notes and \$313 million (U.S. \$250 million) of the Company's 4.500% 10-year Notes at maturity in January 2022, principal repayment of \$97 million (U.S. \$76 million) of the Company's 6.99% Finance lease at maturity in March 2022, and higher dividends paid as a result of a higher number of shares outstanding associated with the shares issued to acquire KCS in the fourth quarter of 2021.

Credit Measures

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

A strong investment grade credit rating is an important measure in assessing the Company's ability to maintain access to public financing and to minimize the cost of capital. It also affects the ability of the Company to engage in certain collateralized business activities on a cost-effective basis.

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.

As at June 30, 2022, CP's credit ratings from Standard & Poor's Rating Services ("Standard & Poor's") and Moody's Investor Service ("Moody's") remain unchanged from December 31, 2021.

Credit ratings as at June 30, 2022⁽¹⁾

Long-term debt			Outlook
Standard & Poor's			
Long-term corporate credit	BBB+		stable
Senior secured debt	A		stable
Senior unsecured debt	BBB+		stable
Moody's			
Senior unsecured debt	Baa2		stable
Commercial paper program			
Standard & Poor's	A-2		N/A
Moody's	P-2		N/A

⁽¹⁾ Credit ratings are not recommendations to purchase, hold or sell securities and do not address the market price or suitability of a specific security for a particular investor. Credit ratings are based on the rating agencies' methodologies and may be subject to revision or withdrawal at any time by the rating agencies.

Financial Ratios

The Long-term debt to Net income ratio for the twelve months ended June 30, 2022 and June 30, 2021 was 8.5 and 2.7, respectively. This increase was primarily due to a higher debt balance in connection with the KCS acquisition and lower net income for the twelve months ended June 30, 2022.

The Adjusted net debt to Adjusted earnings before interest, tax, depreciation and amortization ("EBITDA") ratio for the twelve months ended June 30, 2022 and June 30, 2021 was 4.6 and 2.0, respectively. This increase was primarily due to a higher debt balance in connection with the KCS acquisition, partially offset by higher Adjusted EBITDA. The Adjusted net debt to Adjusted EBITDA ratio is a Non-GAAP measure, which is defined and reconciled from the Long-term debt to Net income ratio, the most comparable measure calculated in accordance with GAAP, in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

The Pro-forma Adjusted Net Debt to Pro-forma Adjusted EBITDA ratio for the trailing twelve month ended June 30, 2022 was 4.2. This increase from the Adjusted net debt to Adjusted EBITDA ratio in the same period of 2021 was primarily due to a higher debt balance in connection with the KCS acquisition. Beginning in the first quarter of 2022, CP added disclosure of Pro-forma Adjusted Net Debt to Pro-forma Adjusted EBITDA Ratio to better align with CP's debt covenant calculation, which takes into account the trailing twelve month adjusted EBITDA of KCS as well as KCS's outstanding debt. Please see Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations for further discussion. Over the long term, CP targets an Adjusted net debt to Adjusted EBITDA ratio of 2.0 to 2.5.

Although CP has provided a target Non-GAAP measure (Adjusted Net Debt to Adjusted EBITDA ratio), management is unable to reconcile, without unreasonable efforts, the target Adjusted Net Debt to Adjusted EBITDA ratio to the most comparable GAAP measure (Long-term debt to Net income ratio), due to unknown variables and uncertainty related to future results. These unknown variables may include unpredictable transactions of significant value. In recent years, CP has recognized acquisition-

related costs, the merger termination payment received, changes in the outside basis tax difference between the carrying amount of CP's equity investment in KCS and its tax basis of the investment, changes in income tax rates, and a change to an uncertain tax item. Acquisition-related costs include legal, consulting, financing fees, integration planning costs consisting of third-party services and system migration, fair value gain or loss on FX forward contracts and interest rate hedges, FX gain on U.S. dollar-denominated cash on hand from the issuances of long-term debt to fund the KCS acquisition, and transaction and integration costs (net of tax) incurred by KCS which were recognized within the Equity loss of KCS). KCS has also recognized significant transaction costs and FX gains and losses. These or other similar, large unforeseen transactions affect Net income but may be excluded from CP's Adjusted EBITDA. Additionally, the U.S.-to-Canada dollar exchange rate is unpredictable and can have a significant impact on CP's reported results but may be excluded from CP's Adjusted EBITDA. In particular, CP excludes the FX impact of translating the Company's debt and lease liabilities, interest and taxes from Adjusted EBITDA. Please see Forward-Looking Statements in this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations for further discussion.

Supplemental Guarantor Financial Information

Canadian Pacific Railway Company ("CPRC"), a 100%-owned subsidiary of CPRL, is the issuer of certain securities which are fully and unconditionally guaranteed by CPRL on an unsecured basis. The other subsidiaries of CPRC do not guarantee the securities and are referred to below as the "Non-Guarantor Subsidiaries". The following is a description of the terms and conditions of the guarantees with respect to securities for which CPRC is the issuer and CPRL provides a full and unconditional guarantee.

As of the date of the filing of the Form 10-Q, CPRC had U.S. \$12,050 million principal amount of debt securities outstanding due through 2115, and U.S. \$30 million and GBP £3 million in perpetual 4% consolidated debenture stock, for all of which CPRL is the guarantor subject to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (the "Exchange Act"), as amended. As of the same date, CPRC also had \$3,300 million principal amount of debt securities issued under Canadian securities law due through 2050 for which CPRL is the guarantor and not subject to the Exchange Act.

CPRL fully and unconditionally guarantees the payment of the principal (and premium, if any) and interest on the debt securities and consolidated debenture stock issued by CPRC, any sinking fund or analogous payments payable with respect to such securities, and any additional amounts payable when they become due, whether at maturity or otherwise. The guarantee is CPRL's unsubordinated and unsecured obligation and ranks equally with all of CPRL's other unsecured, unsubordinated obligations.

CPRL will be released and relieved of its obligations under the guarantees after obligations to the holders are satisfied in accordance with the terms of the respective instruments.

Pursuant to Rule 13-01 of the SEC's Regulation S-X, the Company provides summarized financial and non-financial information of CPRC in lieu of providing separate financial statements of CPRC.

More information on the securities under this guarantee structure can be found in Exhibit 22.1 List of Issuers and Guarantor Subsidiaries of this quarterly report.

Summarized Financial Information

The following tables present summarized financial information for CPRC (Subsidiary Issuer) and CPRL (Parent Guarantor) on a combined basis after elimination of (i) intercompany transactions and balances among CPRC and CPRL; (ii) equity in earnings from and investments in the Non-Guarantor Subsidiaries; and (iii) intercompany dividend income.

Statements of Income

(in millions of Canadian dollars)	CPRC (Subsidiary Issuer) and CPRL (Parent Guarantor)	
	For the six months ended June 30, 2022	For the year ended December 31, 2021
Total revenues	\$ 2,888	\$ 5,924
Total operating expenses	1,948	3,712
Operating income ⁽¹⁾	940	2,212
Less: Other ⁽²⁾	119	(522)
Income before income tax expense	821	2,734
Net income	\$ 575	\$ 2,548

⁽¹⁾ Includes net lease costs incurred from non-guarantor subsidiaries for the six months ended June 30, 2022 and for the year ended December 31, 2021 of \$214 million and \$431 million, respectively.

⁽²⁾ Includes Other expense, Merger termination fee, Other components of net periodic benefit recovery, and Net interest expense.

Balance Sheets

(in millions of Canadian dollars)	CPRC (Subsidiary Issuer) and CPRL (Parent Guarantor)	
	As at June 30, 2022	As at December 31, 2021
Assets		
Current assets	\$ 1,175	\$ 963
Properties	11,471	11,342
Other non-current assets	2,777	2,536
Liabilities		
Current liabilities	\$ 2,838	\$ 2,789
Long-term debt	18,367	18,574
Other non-current liabilities	3,105	3,008

Excluded from the Income Statements and Balance Sheets above are the following significant intercompany transactions and balances that CPRC and CPRL have with the Non-Guarantor Subsidiaries:

Cash Transactions with Non-Guarantor Subsidiaries

(in millions of Canadian dollars)	CPRC (Subsidiary Issuer) and CPRL (Parent Guarantor)	
	For the six months ended June 30, 2022	For the year ended December 31, 2021
Dividend income from non-guarantor subsidiaries	\$ 116	\$ 297
Capital contributions to non-guarantor subsidiaries	—	(134)
Redemption of shares by non-guarantor subsidiaries	115	1,370

Balances with Non-Guarantor Subsidiaries

(in millions of Canadian dollars)	CPRC (Subsidiary Issuer) and CPRL (Parent Guarantor)	
	As at June 30, 2022	As at December 31, 2021
Assets		
Accounts receivable, intercompany	\$ 224	\$ 344
Short-term advances to affiliates	2,673	2,859
Long-term advances to affiliates	7,517	7,616
Liabilities		
Accounts payable, intercompany	\$ 179	\$ 212
Short-term advances from affiliates	2,614	2,777
Long-term advances from affiliates	83	82

Share Capital

At July 27, 2022, the latest practicable date, there were 929,917,325 Common Shares and no preferred shares issued and outstanding, which consists of 15,286 holders of record of the Common Shares. In addition, CP has a Management Stock Option Incentive Plan ("MSOIP"), under which key officers and employees are granted options to purchase the Common Shares. Options issued prior to the share split described in the Executive Summary now each provide rights over five shares. For consistency, all number of options presented herein are shown on the basis of the number of shares subject to the options. On April 27, 2022, at the Annual and Special Meeting, the Company's shareholders approved an amendment to the MSOIP to increase the maximum number of shares available for issuance under the MSOIP, effective at and after April 27, 2022, by 20,000,000 Common Shares. At July 27, 2022, 7,956,229 options were outstanding under the MSOIP and stand-alone option agreements entered into with Mr. Keith Creel. There are 22,496,832 options available to be issued by the Company's MSOIP in the future. CP has a Director's Stock Option Plan ("DSOP"), under which directors are granted options to purchase Common Shares. There are no outstanding options under the DSOP, which has 1,700,000 options available to be issued in the future.

Non-GAAP Measures

The Company presents Non-GAAP measures to provide a basis for evaluating underlying earnings and liquidity trends in the Company's business that can be compared with the results of operations in prior periods. In addition, these Non-GAAP measures facilitate a multi-period assessment of long-term profitability, allowing management and other external users of the Company's consolidated financial information to compare profitability on a long-term basis, including assessing future profitability, with that of the Company's peers.

These Non-GAAP measures have no standardized meaning and are not defined by GAAP and, therefore, may not be comparable to similar measures presented by other companies. The presentation of these Non-GAAP measures is not intended to be considered in isolation from, as a substitute for, or as superior to the financial information presented in accordance with GAAP.

Non-GAAP Performance Measures

The Company uses adjusted earnings results including Adjusted income, Adjusted diluted earnings per share, Adjusted operating income and Adjusted operating ratio to evaluate the Company's operating performance and for planning and forecasting future business operations and future profitability. Core adjusted income and Core adjusted diluted earnings per share are presented to provide financial statement users with additional transparency by isolating for the impact of KCS purchase accounting. KCS purchase accounting represents the amortization of basis differences, being the difference in value between the consideration paid to acquire KCS and the underlying carrying value of the net assets of KCS immediately prior to its acquisition by the Company. All assets subject to KCS purchase accounting contribute to income generation and will continue to amortize over their estimated useful lives. These Non-GAAP measures are presented in Financial Highlights and discussed further in other sections of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations. These Non-GAAP measures provide meaningful supplemental information regarding operating results because they exclude certain significant items that are not considered indicative of future financial trends either by nature or amount or provide improved comparability to past performance. As a result, these items are excluded for management assessment of operational performance, allocation of resources and preparation of annual budgets. These significant items may include, but are not limited to, restructuring and asset impairment charges, individually significant gains and losses from sales of assets, acquisition-related costs, the merger termination payment received, the foreign exchange ("FX") impact of translating the Company's debt and lease liabilities (including borrowings under the credit facility), discrete tax items, changes in the outside basis tax difference between the carrying amount of CP's equity investment in KCS and its tax basis of this investment, changes in income tax rates, changes to an uncertain tax item, and certain items outside the control of management. Acquisition-related costs include legal, consulting, financing fees, integration planning costs consisting of third-party services and system migration, fair value gain or loss on FX forward contracts and interest rate hedges, FX gain on U.S. dollar-denominated cash on hand from the issuances of long-term debt to fund the KCS acquisition, and transaction and integration costs incurred by KCS which were recognized within Equity earnings of Kansas City Southern in the Company's Interim Consolidated Statements of Income. These items may not be non-recurring. However, excluding these significant items from GAAP results allows for a consistent understanding of the Company's consolidated financial performance when performing a multi-period assessment including assessing the likelihood of future results. Accordingly, these Non-GAAP financial measures may provide insight to investors and other external users of the Company's consolidated financial information.

In the first six months of 2022, there were two significant items included in Net income as follows:

- a net deferred tax expense of \$17 million on changes in the outside basis difference of the equity investment in KCS that unfavourably impacted Diluted EPS by 2 cents as follows:
 - in the second quarter, a deferred tax expense of \$49 million on changes in the outside basis difference of the equity investment in KCS that unfavourably impacted Diluted EPS by 5 cents; and
 - in the first quarter, a deferred tax recovery of \$32 million on changes in the outside basis difference of the equity investment in KCS that favourably impacted Diluted EPS by 3 cents.

- acquisition-related costs of \$66 million in connection with the KCS acquisition (\$59 million after current tax recovery of \$7 million), including costs of \$39 million recognized in Purchased services and other, and \$27 million recognized in Equity earnings of KCS, that unfavourably impacted Diluted EPS by 6 cents as follows:
 - in the second quarter, acquisition-related costs of \$33 million in connection with the KCS acquisition (\$29 million after current tax recovery of \$4 million), including costs of \$19 million recognized in Purchased services and other and \$14 million recognized in Equity earnings of KCS, that unfavourably impacted Diluted EPS by 3 cents; and
 - in the first quarter, acquisition-related costs of \$33 million (\$30 million after current tax recovery of \$3 million), including costs of \$20 million recognized in Purchased services and other and \$13 million recognized in Equity earnings of KCS, that unfavourably impacted Diluted EPS by 3 cents.

In 2021, there were four significant items included in Net income as follows:

- in the fourth quarter, a deferred tax recovery of \$33 million on changes in the outside basis difference of the equity investment in KCS that favourably impacted Diluted EPS by 5 cents;
- in the second quarter, the merger termination payment received of \$845 million (\$748 million after current taxes) in connection with KCS's termination of the Original Merger Agreement effective May 21, 2021 that favourably impacted Diluted EPS by \$1.11;
- during the course of the year, acquisition-related costs of \$599 million in connection with the KCS acquisition (\$500 million after current tax recovery of \$107 million net of deferred tax expense of \$8 million), including costs of \$183 million recognized in Purchased services and other, \$169 million recognized in Equity loss of KCS, and \$247 million recognized in Other expense (income), that unfavourably impacted Diluted EPS by 75 cents as follows:
 - in the fourth quarter, acquisition-related costs of \$157 million (\$157 million after current tax recovery of \$13 million net of deferred tax expense of \$13 million), including costs of \$36 million recognized in Purchased services and other, \$169 million in Equity loss of KCS, and a \$48 million recovery recognized in Other (income) expense, that unfavourably impacted Diluted EPS by 22 cents;
 - in the third quarter, acquisition-related costs of \$98 million (\$80 million after current tax recovery of \$61 million net of deferred tax expense of \$43 million), including costs of \$15 million recognized in Purchased services and other and \$83 million recognized in Other expense (income), that unfavourably impacted Diluted EPS by 12 cents;
 - in the second quarter, acquisition-related costs of \$308 million (\$236 million after current taxes of \$25 million and deferred taxes of \$47 million), including costs of \$99 million recognized in Purchased services and other and \$209 million recognized in Other expense (income), that unfavourably impacted Diluted EPS by 35 cents; and
 - in the first quarter, acquisition-related costs of \$36 million (\$27 million after current taxes of \$8 million and deferred taxes of \$1 million), including costs of \$33 million recognized in Purchased services and other and \$3 million recognized in Other expense (income), that unfavourably impacted Diluted EPS by 4 cents; and
- during the course of the year, a net non-cash gain of \$7 million (\$6 million after deferred tax) due to FX translation of debt and lease liabilities that favourably impacted Diluted EPS by 1 cent as follows:
 - in the fourth quarter, a \$32 million loss (\$28 million after deferred tax) that unfavourably impacted Diluted EPS by 4 cents;
 - in the third quarter, a \$46 million loss (\$40 million after deferred tax) that unfavourably impacted Diluted EPS by 6 cents;
 - in the second quarter, a \$52 million gain (\$45 million after deferred tax) that favourably impacted Diluted EPS by 7 cents; and
 - in the first quarter, a \$33 million gain (\$29 million after deferred tax) that favourably impacted Diluted EPS by 4 cents.

In the six months ended December 31, 2020, there were two significant items included in Net income as follows:

- in the fourth quarter, a deferred tax recovery of \$29 million due to a change relating to a tax return filing election for the state of North Dakota that favourably impacted Diluted EPS by 5 cents; and
- a net non-cash gain of \$143 million (\$128 million after deferred tax) due to FX translation of debt and lease liabilities that favourably impacted Diluted EPS by 19 cents as follows:
 - in the fourth quarter, a \$103 million gain (\$90 million after deferred tax) that favourably impacted Diluted EPS by 13 cents; and
 - in the third quarter, a \$40 million gain (\$38 million after deferred tax) that favourably impacted Diluted EPS by 6 cents.

Reconciliation of GAAP Performance Measures to Non-GAAP Performance Measures

The following tables reconcile the most directly comparable measures presented in accordance with GAAP to the Non-GAAP measures presented in Financial Highlights and discussed further in other sections of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations:

Adjusted income is calculated as Net income reported on a GAAP basis adjusted for significant items. Core adjusted income is calculated as Adjusted income less KCS purchase accounting.

(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 as reported	\$ 765	\$ 1,246	\$ 1,355	\$ 1,848
Less significant items (pre-tax):				
Acquisition-related costs	(33)	(308)	(66)	(344)
Merger termination fee	—	845	—	845
Impact of FX translation gain on debt and lease liabilities	—	52	—	85
Add:				
Tax effect of adjustments ⁽¹⁾	(4)	32	(7)	27
Deferred tax expense on the outside basis difference of the investment in KCS	49	—	17	—
Adjusted income	\$ 843	\$ 689	\$ 1,431	\$ 1,289
Less: KCS purchase accounting	(39)	—	(79)	—
Core adjusted income	\$ 882	\$ 689	\$ 1,510	\$ 1,289

⁽¹⁾ The tax effect of adjustments was calculated as the pre-tax effect of the adjustments multiplied by the applicable tax rate for the above items of 10.32% and 9.50% for the three and six months ended June 30, 2022, respectively, and 5.48% and 4.67% for the three and six months ended June 30, 2021, respectively. The applicable tax rates reflect the taxable jurisdictions and nature, being on account of capital or income, of the significant items.

Adjusted diluted earnings per share is calculated using Adjusted income, as defined above, divided by the weighted-average diluted number of Common Shares outstanding during the period as determined in accordance with GAAP. Core adjusted diluted earnings per share is calculated as Adjusted diluted earnings per share less KCS purchase accounting.

	For the three months ended June 30		For the six months ended June 30	
	2022	2021	2022	2021
Diluted earnings per share as reported	\$ 0.82	\$ 1.86	\$ 1.45	\$ 2.76
Less significant items (pre-tax):				
Acquisition-related costs	(0.03)	(0.46)	(0.07)	(0.51)
Merger termination fee	—	1.26	—	1.26
Impact of FX translation gain on debt and lease liabilities	—	0.08	—	0.13
Add:				
Tax effect of adjustments ⁽¹⁾	—	0.05	(0.01)	0.04
Deferred tax expense on the outside basis difference of the investment in KCS	0.05	—	0.02	—
Adjusted diluted earnings per share	\$ 0.90	\$ 1.03	\$ 1.53	\$ 1.92
Less: KCS purchase accounting	(0.05)	—	(0.09)	—
Core adjusted diluted earnings per share	\$ 0.95	\$ 1.03	\$ 1.62	\$ 1.92

⁽¹⁾ The tax effect of adjustments was calculated as the pre-tax effect of the adjustments multiplied by the applicable tax rate for the above items of 10.32% and 9.50% for the three and six months ended June 30, 2022, respectively, and 5.48% and 4.67% for the three and six months ended June 30, 2021, respectively. The applicable tax rates reflect the taxable jurisdictions and nature, being on account of capital or income, of the significant items.

Adjusted operating income is calculated as Operating income reported on a GAAP basis less significant items.

(in millions of Canadian dollars)	For the three months ended June 30		For the six months ended June 30	
	2022	2021	2022	2021
Operating income as reported	\$ 868	\$ 820	\$ 1,403	\$ 1,600
Less significant item:				
Acquisition-related costs	(19)	(99)	(39)	(132)
Adjusted operating income	\$ 887	\$ 919	\$ 1,442	\$ 1,732

Adjusted operating ratio excludes those significant items that are reported within operating income.

	For the three months ended June 30		For the six months ended June 30	
	2022	2021	2022	2021
Operating ratio as reported	60.6 %	60.1 %	65.3 %	60.1 %
Less significant item:				
Acquisition-related costs	0.9 %	4.8 %	1.0 %	3.3 %
Adjusted operating ratio	59.7 %	55.3 %	64.3 %	56.8 %

Adjusted ROIC

Adjusted ROIC is calculated as Adjusted return divided by Adjusted average invested capital. Adjusted return is defined as Net income adjusted for interest expense, tax effected at the Company's adjusted annualized effective tax rate, and significant items in the Company's Consolidated Financial Statements, tax effected at the applicable tax rate. Adjusted average invested capital is defined as the sum of total Shareholders' equity, Long-term debt, and Long-term debt maturing within one year, as presented in the Company's Consolidated Financial Statements, each averaged between the beginning and ending balance over a trailing twelve month period, adjusted for the impact of significant items, tax effected at the applicable tax rate, on closing balances as part of this average. Adjusted ROIC excludes significant items reported in the Company's Consolidated Financial Statements, as these significant items are not considered indicative of future financial trends either by nature or amount, and excludes interest expense, net of tax, to incorporate returns on the Company's overall capitalization. Adjusted ROIC is a performance measure that measures how productively the Company uses its long-term capital investments, representing critical indicators of good operating and investment decisions made by management, and is an important performance criteria in determining certain elements of the Company's long-term incentive plan. Adjusted ROIC, which is reconciled below from Return on average shareholders' equity, the most comparable measure calculated in accordance with GAAP, is also presented in Financial Highlights and discussed further in Results of Operations of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Calculation of Return on average shareholders' equity

(in millions of Canadian dollars, except for percentages)	For the twelve months ended June 30	
	2022	2021
Net income as reported	\$ 2,359	\$ 3,248
Average shareholders' equity	\$ 22,190	\$ 8,215
Return on average shareholders' equity	10.6 %	39.5 %

Reconciliation of Net income to Adjusted return

(in millions of Canadian dollars)	For the twelve months ended June 30	
	2022	2021
Net income as reported	\$ 2,359	\$ 3,248
Add:		
Net interest expense	549	437
Tax on interest ⁽¹⁾	(130)	(107)
Significant items (pre-tax):		
Acquisition-related costs	321	344
Merger termination fee	—	(845)
Impact of FX translation loss (gain) on debt and lease liabilities	78	(228)
Tax on significant items ⁽²⁾	(35)	42
Income tax rate changes	—	(29)
Deferred tax recovery on the outside basis difference of the investment in KCS	(16)	—
Adjusted return	\$ 3,126	\$ 2,862

⁽¹⁾ Tax was calculated at the adjusted annualized effective tax rate of 23.74% and 24.45% for the twelve months ended June 30, 2022 and 2021, respectively.

⁽²⁾ Tax was calculated as the pre-tax effect of the adjustments multiplied by the applicable tax rate for the above items of 8.74% and 5.52% for the twelve months ended June 30, 2022 and 2021, respectively. The applicable tax rates reflect the taxable jurisdictions and nature, being on account of capital or income, of the significant items.

Reconciliation of Average shareholders' equity to Adjusted average invested capital

(in millions of Canadian dollars)	For the twelve months ended June 30	
	2022	2021
Average shareholders' equity	\$ 22,190	\$ 8,215
Average long-term debt, including long-term debt maturing within one year	14,396	9,135
	\$ 36,586	\$ 17,350
Less:		
Significant items (pre-tax):		
Acquisition-related costs	(161)	(172)
Merger termination fee	—	423
Tax on significant items ⁽¹⁾	12	(9)
Deferred tax recovery on the outside basis difference of the investment in KCS	8	—
Income tax rate changes	—	15
Adjusted average invested capital	\$ 36,727	\$ 17,093

⁽¹⁾ Tax was calculated at the pre-tax effect of the adjustment multiplied by the applicable tax rate of 7.65% and 3.21% for the twelve months ended June 30, 2022 and 2021, respectively. The applicable tax rate reflects the taxable jurisdiction and nature, being on account of capital or income, of the significant item.

Calculation of Adjusted ROIC

(in millions of Canadian dollars, except for percentages)	For the twelve months ended June 30	
	2022	2021
Adjusted return	\$ 3,126	\$ 2,862
Adjusted average invested capital	\$ 36,727	\$ 17,093
Adjusted ROIC	8.5 %	16.7 %

Free Cash

Free cash is calculated as Cash provided by operating activities, less Cash used in investing activities, adjusted for changes in cash and cash equivalents balances resulting from FX fluctuations, the operating cash flow impacts of acquisition-related costs associated with the KCS transaction, and the merger termination payment received related to KCS's termination of the Original Merger Agreement. Free cash is a measure that management considers to be a valuable indicator of liquidity. Free cash is useful to investors and other external users of the Company's Consolidated Financial Statements as it assists with the evaluation of the Company's ability to generate cash to satisfy debt obligations and discretionary activities such as dividends, share repurchase programs, and other strategic opportunities. The acquisition-related costs associated with the KCS acquisition are not indicative of operating trends and have been excluded from Free cash. Free cash should be considered in addition to, rather than as a substitute for, Cash provided by operating activities. Free cash is presented in Financial Highlights and discussed further in Liquidity and Capital Resources of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Reconciliation of Cash Provided by Operating Activities to Free Cash

(in millions of Canadian dollars)	For the three months ended June 30		For the six months ended June 30	
	2022	2021	2022	2021
Cash provided by operating activities	\$ 707	\$ 1,954	\$ 1,320	\$ 2,536
Cash used in investing activities	(362)	(405)	(568)	(691)
Effect of foreign currency fluctuations on U.S. dollar-denominated cash and cash equivalents	8	(1)	8	(4)
Less:				
Acquisition-related costs	(16)	(43)	(33)	(46)
Merger termination fee	—	845	—	845
Free cash	\$ 369	\$ 746	\$ 793	\$ 1,042

Foreign Exchange Adjusted % Change

FX adjusted % change allows certain financial results to be viewed without the impact of fluctuations in foreign currency exchange rates, thereby facilitating period-to-period comparisons in the analysis of trends in business performance. Financial result variances at constant currency are obtained by translating the comparable period of the prior year results denominated in U.S. dollars at the foreign exchange rates of the current period.

FX adjusted % changes in revenues are further used in calculating FX adjusted % change in freight revenue per carload and RTM. These items are presented in Operating Revenues of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations. FX adjusted % changes in revenues are as follows:

(in millions of Canadian dollars)	For the three months ended June 30				
	Reported 2022	Reported 2021	Variance due to FX	FX Adjusted 2021	FX Adjusted % Change
Freight revenues by line of business					
Grain	\$ 370	\$ 444	\$ 7	\$ 451	(18)
Coal	163	170	—	170	(4)
Potash	171	134	2	136	26
Fertilizers and sulphur	85	78	2	80	6
Forest products	104	90	3	93	12
Energy, chemicals and plastics	340	369	7	376	(10)
Metals, minerals and consumer products	228	180	5	185	23
Automotive	120	98	3	101	19
Intermodal	573	445	3	448	28
Freight revenues	2,154	2,008	32	2,040	6
Non-freight revenues	48	46	1	47	2
Total revenues	\$ 2,202	\$ 2,054	\$ 33	\$ 2,087	6

	For the six months ended June 30				
(in millions of Canadian dollars)	Reported 2022	Reported 2021	Variance due to FX	FX Adjusted 2021	FX Adjusted % Change
Freight revenues by line of business					
Grain	\$ 730	\$ 892	\$ 7	\$ 899	(19)
Coal	302	333	—	333	(9)
Potash	275	235	2	237	16
Fertilizers and sulphur	163	155	3	158	3
Forest products	190	170	3	173	10
Energy, chemicals and plastics	650	757	7	764	(15)
Metals, minerals and consumer products	409	339	5	344	19
Automotive	211	206	3	209	1
Intermodal	1,020	839	3	842	21
Freight revenues	3,950	3,926	33	3,959	—
Non-freight revenues	90	87	1	88	2
Total revenues	\$ 4,040	\$ 4,013	\$ 34	\$ 4,047	—

FX adjusted % changes in operating expenses are presented in Operating Expenses of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations. FX adjusted % changes in operating expenses are as follows:

	For the three months ended June 30				
(in millions of Canadian dollars)	Reported 2022	Reported 2021	Variance due to FX	FX Adjusted 2021	FX Adjusted % Change
Compensation and benefits	\$ 348	\$ 379	\$ 4	\$ 383	(9)
Fuel	370	218	6	224	65
Materials	63	54	1	55	15
Equipment rents	29	28	1	29	—
Depreciation and amortization	211	200	2	202	4
Purchased services and other	313	355	3	358	(13)
Total operating expenses	\$ 1,334	\$ 1,234	\$ 17	\$ 1,251	7

	For the six months ended June 30				
(in millions of Canadian dollars)	Reported 2022	Reported 2021	Variance due to FX	FX Adjusted 2021	FX Adjusted % Change
Compensation and benefits	\$ 761	\$ 784	\$ 4	\$ 788	(3)
Fuel	643	424	6	430	50
Materials	125	113	1	114	10
Equipment rents	64	61	1	62	3
Depreciation and amortization	421	402	2	404	4
Purchased services and other	623	629	3	632	(1)
Total operating expenses	\$ 2,637	\$ 2,413	\$ 17	\$ 2,430	9

Adjusted Net Debt to Adjusted EBITDA Ratio and Pro-forma adjusted Net Debt to Pro-forma adjusted EBITDA Ratio

Adjusted net debt to Adjusted earnings before interest, tax, depreciation and amortization ("EBITDA") ratio is calculated as Adjusted net debt divided by Adjusted EBITDA. The Adjusted net debt to Adjusted EBITDA ratio is a key credit measure used to assess the Company's financial capacity. The ratio provides information on the Company's ability to service its debt and other long-term obligations from operations, excluding significant items. The Adjusted net debt to Adjusted EBITDA ratio, which is reconciled below from the Long-term debt to Net income ratio, the most comparable measure calculated in accordance with GAAP, is also presented in Financial Highlights and discussed further in Results of Operations of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Beginning in the first quarter of 2022, CP added disclosure of Pro-forma adjusted net debt to Pro-forma adjusted EBITDA ratio to better align with CP's debt covenant calculation, which incorporates the trailing twelve month adjusted EBITDA of KCS as well as KCS's outstanding debt. CP is incorporating the trailing twelve month adjusted EBITDA of KCS on a pro-forma basis, as CP is not entitled to earnings prior to the acquisition date of December 14, 2021. CP does not control KCS while it is in the voting trust during review of our merger application by the STB, though CP is the beneficial owner of KCS's outstanding shares and receives cash dividends from KCS. The adjustment to include the trailing twelve month EBITDA and KCS's outstanding debt provides users of the financial statements with better insight into CP's progress in achieving deleveraging commitments. KCS's disclosed U.S. dollar financial values for the trailing twelve months ended June 30, 2022 were adjusted to Canadian dollars reflecting the FX rate for the appropriate period presented. We have not presented 2021 Pro-forma adjusted net debt to Pro-forma adjusted EBITDA as CP was not the beneficial owner of KCS's shares as at June 30, 2021.

Calculation of Long-term Debt to Net Income Ratio

(in millions of Canadian dollars, except for ratios)	2022	2021
Long-term debt including long-term debt maturing within one year as at June 30	\$ 20,070	\$ 8,722
Net income for the twelve months ended June 30	\$ 2,359	\$ 3,248
Long-term debt to Net income ratio	8.5	2.7

Reconciliation of Long-term Debt to Adjusted Net Debt and Pro-forma Adjusted Net Debt

Adjusted net debt is defined as Long-term debt, Long-term debt maturing within one year, and Short-term borrowing as reported on the Company's Consolidated Balance Sheets adjusted for pension plans deficit, operating lease liabilities recognized on the Company's Consolidated Balance Sheets, and Cash and cash equivalents. Adjusted net debt is used as a measure of debt and long-term obligations as part of the calculation of Adjusted Net Debt to Adjusted EBITDA.

(in millions of Canadian dollars) ⁽¹⁾	2022	2021
CP Long-term debt including long-term debt maturing within one year as at June 30	\$ 20,070	\$ 8,722
Add:		
Pension plans deficit ⁽²⁾	263	322
Operating lease liabilities	275	273
Less:		
Cash and cash equivalents	154	892
CP Adjusted net debt as at June 30	\$ 20,454	\$ 8,425
KCS's long-term debt including long-term debt maturing within one year as at June 30	\$ 4,872	N/A
Add:		
KCS operating lease liabilities	97	N/A
Less:		
KCS cash and cash equivalents	158	N/A
KCS Adjusted net debt as at June 30	4,811	N/A
CP Adjusted net debt as at June 30	20,454	N/A
Pro-forma Adjusted net debt as at June 30	\$ 25,265	N/A

⁽¹⁾ KCS's amounts were translated at the June 30, 2022 period end FX rate of \$1.29.

⁽²⁾ Pension plans deficit is the total funded status of the Pension plans in deficit only.

Reconciliation of Net Income to EBIT, Adjusted EBIT and Adjusted EBITDA and Pro-forma Adjusted EBITDA

Earnings before interest and tax ("EBIT") is calculated as Net income before Net interest expense and Income tax expense. Adjusted EBIT excludes significant items reported in both Operating income and Other expense. Adjusted EBITDA is calculated as Adjusted EBIT plus operating lease expense and Depreciation and amortization, less Other components of net periodic benefit recovery. Adjusted EBITDA is used as a measure of liquidity derived from operations, excluding significant items, as part of the calculation of Adjusted Net Debt to Adjusted EBITDA.

(in millions of Canadian dollars) ⁽¹⁾	For the twelve months ended June 30	
	2022	2021
CP Net income as reported	\$ 2,359	\$ 3,248
Add:		
Net interest expense	549	437
Income tax expense	650	832
EBIT	3,558	4,517
Less significant items (pre-tax):		
Acquisition-related costs	(321)	(344)
Merger termination fee	—	845
Impact of FX translation (loss) gain on debt and lease liabilities	(78)	228
Adjusted EBIT	3,957	3,788
Add:		
Operating lease expense	76	72
Depreciation and amortization	830	794
Less:		
Other components of net periodic benefit recovery	398	362
CP Adjusted EBITDA	\$ 4,465	\$ 4,292
Net income attributable to KCS and subsidiaries	\$ 1,431	N/A
Add:		
KCS interest expense	199	N/A
KCS income tax expense	480	N/A
KCS EBIT	2,110	N/A
Less significant item (pre-tax):		
KCS merger income	568	N/A
KCS Adjusted EBIT	1,542	N/A
Add:		
KCS total lease cost	39	N/A
KCS depreciation and amortization	477	N/A
KCS Adjusted EBITDA	2,058	N/A
CP Adjusted EBITDA	\$ 4,465	N/A
Less:		
Equity earnings of KCS ⁽²⁾	265	N/A
Acquisition-related costs of KCS ⁽³⁾	196	N/A
Pro-forma Adjusted EBITDA	\$ 6,062	N/A

⁽¹⁾ KCS's amounts were translated at the quarterly average FX rate of \$1.28, \$1.27, \$1.26, and \$1.26 for Q2 2022, Q1 2022, Q4 2021, and Q3 2021, respectively.

⁽²⁾ Equity earnings of KCS were part of CP's reported net income and therefore have been deducted in arriving to the Pro-forma Adjusted EBITDA.

⁽³⁾ Acquisition-related costs of KCS have been adjusted in CP's Adjusted EBITDA calculation above, therefore have been deducted in arriving to the Pro-forma Adjusted EBITDA.

Calculation of Adjusted Net Debt to Adjusted EBITDA Ratio and Pro-forma Adjusted Net Debt to Pro-forma Adjusted EBITDA Ratio

(in millions of Canadian dollars, except for ratios)	2022	2021
Adjusted net debt as at June 30	\$ 20,454	\$ 8,425
Adjusted EBITDA for the twelve months ended June 30	\$ 4,465	\$ 4,292
Adjusted net debt to Adjusted EBITDA ratio	4.6	2.0

(in millions of Canadian dollars, except for ratios)	2022	2021
Pro-forma adjusted net debt as at June 30	\$ 25,265	N/A
Pro-forma adjusted EBITDA for the twelve months ended June 30	\$ 6,062	N/A
Pro-forma adjusted net debt to Pro-forma adjusted EBITDA ratio	4.2	N/A

Critical Accounting Estimates

To prepare Consolidated Financial Statements that conform with GAAP, the Company is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the Consolidated Financial Statements, and the reported amounts of revenues and expenses during the reported periods. Using the most current information available, the Company reviews estimates on an ongoing basis, including those related to environmental liabilities, pensions and other benefits, property, plant and equipment, deferred income taxes, and personal injury and other claims liabilities. Additional information concerning critical accounting estimates is supplemented in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations of the Company's 2021 Annual Report on Form 10-K.

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

Forward-Looking Statements

This Management's Discussion and Analysis of Financial Condition and Results of Operations and Quarterly Report on Form 10-Q contains certain forward-looking statements within the meaning of the *United States Private Securities Litigation Reform Act of 1995* and forward-looking information within the meaning of other relevant securities legislation, including applicable securities laws in Canada (collectively referred to herein as "forward-looking statements"). Forward-looking statements typically include words such as "financial expectations", "key assumptions", "anticipate", "believe", "expect", "plan", "will", "outlook", "should" or similar words suggesting future outcomes. To the extent that CP has provided forecasts or targets using Non-GAAP financial measures, the Company may not be able to provide a reconciliation to a GAAP measure without unreasonable efforts, due to unknown variables and uncertainty related to future results.

This Management's Discussion and Analysis of Financial Condition and Results of Operations and Quarterly Report on Form 10-Q includes forward-looking statements relating, but not limited to, statements concerning the Company's expected impacts resulting from changes in the U.S.-to-Canadian dollar exchange rate, and the effective tax rate, as well as statements concerning the Company's operations, anticipated financial performance, business prospects and strategies, including 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 and concerning anticipated capital programs, and statements regarding future payments including income taxes.

The forward-looking statements contained in this Management's Discussion and Analysis of Financial Condition and Results of Operations and Quarterly Report on Form 10-Q are based on current expectations, estimates, projections and assumptions, having regard to the Company's experience and its perception of historical trends, and includes, but is not limited to, expectations, estimates, projections and assumptions relating to: changes in business strategies; North American and global economic growth; commodity demand growth; sustainable industrial and agricultural production; commodity prices and interest rates; foreign exchange rates (as specified herein); effective tax rates (as specified herein); performance of our assets and equipment; sufficiency of our budgeted capital expenditures in carrying out our business plan; geopolitical conditions; applicable laws, regulations and government policies; the availability and cost of labour, services and infrastructure; the satisfaction by third parties of their obligations to the Company; and the anticipated impacts of the COVID-19 pandemic on the Company's business, operating results, cash flows and/or financial condition. Although the Company believes the expectations, estimates, projections and assumptions reflected in the forward-looking statements presented herein are reasonable as of the date hereof, there can be no assurance that they will prove to be correct. Current conditions, economic and otherwise, render assumptions, although reasonable when made, subject to greater uncertainty.

With respect to the pending KCS business combination, we can provide no assurance when or if the combination will be completed. Completion of the combination is subject to the receipt of final approval from the STB of the CP-KCS control application by December 31, 2023. There can be no assurance of receipt of this final approval by December 31, 2023 or, if received, the successful integration of KCS.

Undue reliance should not be placed on forward-looking statements as actual results may differ materially from those expressed or implied by forward-looking statements. By their nature, forward-looking statements involve numerous inherent risks and uncertainties that could cause actual results to differ materially from the forward-looking statements, including but not limited to the following factors: changes in business strategies; general North American and global economic, credit and business conditions; risks associated with 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; geopolitical instability; changes in laws, regulations and government policies, including regulation of rates; changes in taxes and tax rates; potential increases in maintenance and operating costs; changes in fuel prices; 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 and discount rates on the financial position of pension plans and investments; trade restrictions or other changes to international trade arrangements; climate change; various events that could disrupt operations, including severe weather, such as droughts, floods, avalanches and earthquakes, and cybersecurity attacks, as well as security threats and governmental response to them, and technological changes; and the pandemic created by the outbreak of COVID-19 and its variants and resulting effects on economic conditions, the demand environment for logistics requirements and energy prices, restrictions imposed by public health authorities or governments, fiscal and monetary policy responses by governments and financial institutions, and disruptions to global supply chains. The foregoing list of factors is not exhaustive.

There are more specific factors that could cause actual results to differ materially from those described in the forward-looking statements contained in this Management's Discussion and Analysis of Financial Condition and Results of Operations and Quarterly Report on Form 10-Q. These more specific factors are identified and discussed in Item 1A. Risk Factors of CP's 2021 Annual Report on Form 10-K. Other risks are detailed from time to time in reports filed by CP with securities regulators in Canada and the United States.

The forward-looking statements contained in this Management's Discussion and Analysis of Financial Condition and Results of Operations and Quarterly Report on Form 10-Q are made as of the date hereof. Except as required by law, CP undertakes no obligation to update publicly or otherwise revise any forward-looking statements, or the foregoing assumptions and risks affecting such forward-looking statements, whether as a result of new information, future events or otherwise.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There was no material change in market risk during the second quarter and first six months ended June 30, 2022 from the information provided in Part II, Item 7A. Quantitative and Qualitative Disclosure about Market Risk in CP's 2021 Annual Report on Form 10-K except as provided below.

Share Price Impact on Stock-Based Compensation

Based on information available at June 30, 2022, for every \$1.00 change in share price, stock-based compensation expense has a corresponding change of approximately \$1.7 million to \$1.9 million (December 31, 2021 - approximately \$1.5 million to \$2.0 million). This excludes the impact of changes in share price relative to the S&P/TSX 60 Index, S&P 500 Industrials Index, and to Class I railways, which may trigger different performance share unit payouts. Stock-based compensation may also be impacted by non-market performance conditions.

Additional information concerning stock-based compensation is included in Item 1. Financial Statements, Note 16 Stock-based compensation.

Interest Rate Risk

Debt financing forms part of the Company's capital structure. The debt agreements entered into expose CP to increased interest costs on future fixed debt instruments and existing variable rate debt instruments, should market rates increase. As at June 30, 2022, a hypothetical one percentage point change in interest rates on the Company's floating rate debt obligations outstanding is not material. In addition, the present value of the Company's assets and liabilities will also vary with interest rate changes. To manage interest rate exposure, CP may enter into forward rate agreements such as treasury rate locks or bond locks that lock in rates for a future date, thereby protecting against interest rate increases. CP may also enter into swap agreements whereby one party agrees to pay a fixed rate of interest while the other party pays a floating rate. Contingent on the direction of interest rates, the Company may incur higher costs depending on the contracted rate.

The fair value of the Company's fixed rate debt may fluctuate with changes in market interest rates. A hypothetical one percentage point decrease in interest rates as of June 30, 2022 would result in an increase of approximately \$1.6 billion to the fair value of the Company's debt as at June 30, 2022 (December 31, 2021 - approximately \$2.3 billion). Fair values of CP's fixed rate debt are estimated by considering the impact of the hypothetical interest rates on quoted market prices and current borrowing rates, but do not consider other factors that could impact actual results.

Information concerning market risks is supplemented in Item 1. Financial Statements, Note 13 Financial instruments.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

As of June 30, 2022, an evaluation was carried out under the supervision of and with the participation of CP's management, including its CEO and CFO, of the effectiveness of the design and operation of the Company's disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act. Based on that evaluation, the CEO and CFO concluded that these disclosure controls and procedures were effective as of June 30, 2022, to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is (i) recorded, processed, summarized and reported within the time periods specified by the SEC rules and forms and (ii) accumulated and communicated to the Company's management, including the CEO and CFO, as appropriate, to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

During the second quarter of 2022, the Company has not identified any changes in internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II

ITEM 1. LEGAL PROCEEDINGS

For further details refer to Item 1. Financial Statements, Note 17 Contingencies.

SEC regulations require the disclosure of any proceeding under environmental laws to which a government authority is a party unless the registrant reasonably believes it will not result in sanctions over a certain threshold. The Company uses a threshold of U.S. \$1 million for the purposes of determining proceedings requiring disclosure.

ITEM 1A. RISK FACTORS

There have been no material changes to the risk factors from the information provided in Item 1A. Risk Factors of CP's 2021 Annual Report on Form 10-K.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Issuer Purchase of Equity Securities

CP established a share repurchase program which is further described in Item 1. Financial Statements, Note 14 Shareholders' equity. This program expired on January 28, 2022 and upon expiry of this normal course issuer bid ("NCIB"), the Company had not purchased any Common Shares under this NCIB.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

Exhibit	Description
<u>3.1</u>	<u>Restated Certificate and Articles of Incorporation of Canadian Pacific Railway Limited (incorporated by reference to Exhibit 99.2 to Canadian Pacific Railway Limited's Form 6-K filed with the Securities and Exchange Commission on October 22, 2015, File No. 001-01342).</u>
<u>3.2</u>	<u>Articles of Amendment to Restated Certificate and Articles of Incorporation of Canadian Pacific Railway Limited (incorporated by reference to Exhibit 3.1 to Canadian Pacific Railway Limited's Form 8-K filed with the Securities and Exchange Commission on May 5, 2021, File No. 001-01342).</u>
<u>3.3</u>	<u>By-law No. 1, as amended, of Canadian Pacific Railway Limited (incorporated by reference to Exhibit 1 to Canadian Pacific Railway Limited's Form 6-K filed with the Securities and Exchange Commission on May 22, 2009, File No. 001-01342).</u>
<u>3.4</u>	<u>By-law No. 2 of Canadian Pacific Railway Limited (incorporated by reference to Exhibit 99.1 to Canadian Pacific Railway Limited's Form 6-K filed with the Securities and Exchange Commission on March 13, 2015, File No. 001-01342).</u>
<u>3.5</u>	<u>General By-law, as amended, of Canadian Pacific Railway Company, a wholly owned subsidiary of Canadian Pacific Railway Limited (incorporated by reference to Exhibit 2 to Canadian Pacific Railway Limited's Form 6-K filed with the Securities and Exchange Commission on May 22, 2009, File No. 001-01342).</u>
<u>10.1**</u>	<u>Canadian Pacific Railway Limited Amended and Restated Management Stock Option Incentive Plan, as amended and restated effective April 27, 2022 (incorporated by reference to Appendix B to Exhibit 99.1 to Canadian Pacific Railway Limited's Current Report on Form 8-K filed with the Securities and Exchange Commission on March 28, 2022, File No. 001-01342).</u>
<u>22.1*</u>	<u>List of Issuers and Guarantor Subsidiaries</u>
<u>31.1*</u>	<u>CEO Rule 13a-14(a) Certifications</u>
<u>31.2*</u>	<u>CFO Rule 13a-14(a) Certifications</u>
<u>32.1*</u>	<u>CEO Section 1350 Certifications</u>
<u>32.2*</u>	<u>CFO Section 1350 Certifications</u>
101.INS*	Inline XBRL Instance Document - the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document.
101.SCH*	Inline XBRL Taxonomy Extension Schema Document
101.CAL*	Inline XBRL Taxonomy Extension Calculation Linkbase Document
101.LAB*	Inline XBRL Taxonomy Extension Label Linkbase Document
101.DEF*	Inline XBRL Taxonomy Extension Definition Linkbase Document
101.PRE*	Inline XBRL Taxonomy Extension Presentation Linkbase Document
	The following financial information from Canadian Pacific Railway Limited's Quarterly Report on Form 10-Q for the second quarter ended June 30, 2022, formatted in Extensible Business Reporting Language (XBRL) includes: (i) the Interim Consolidated Statements of Income for the second quarters and first six months ended June 30, 2022 and 2021; (ii) the Interim Consolidated Statements of Comprehensive Income for the second quarters and first six months ended June 30, 2022 and 2021; (iii) the Interim Consolidated Balance Sheets at June 30, 2022, and December 31, 2021; (iv) the Interim Consolidated Statements of Cash Flows for the second quarters and first six months ended June 30, 2022 and 2021; (v) the Interim Consolidated Statements of Changes in Shareholders' Equity for the second quarters and first six months ended June 30, 2022 and 2021; and (vi) the Notes to Interim Consolidated Financial Statements.
104*	Cover Page Interactive Data File (embedded within the Inline XBRL document)

* Filed with this Quarterly Report on Form 10-Q

** Management contract or compensatory arrangement

List of Issuers and Guarantor Subsidiaries

As of the date of the filing of the Form 10-Q of which this exhibit is a part, Canadian Pacific Railway Limited, a corporation incorporated under the laws of Canada (the "Registrant") has guaranteed each of the following securities issued by Canadian Pacific Railway Company, a corporation incorporated under the laws of Canada and a direct, wholly owned subsidiary of the Registrant (the "Issuer") subject to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (the "Exchange Act"), as amended:

- The Issuer's 4.450% notes due March 2023;
- The Issuer's 1.350% notes due December 2024;
- The Issuer's 2.900% notes due February 2025;
- The Issuer's 3.700% notes due February 2026;
- The Issuer's 1.750% notes due December 2026;
- The Issuer's 4.000% notes due June 2028;
- The Issuer's 2.050% notes due March 2030;
- The Issuer's 7.125% notes due October 2031;
- The Issuer's 2.450% notes due December 2031;
- The Issuer's 5.750% notes due March 2033;
- The Issuer's 4.800% notes due September 2035;
- The Issuer's 5.950% notes due May 2037;
- The Issuer's 3.000% notes due December 2041;
- The Issuer's 5.750% notes due January 2042;
- The Issuer's 4.800% notes due August 2045;
- The Issuer's 3.100% notes due December 2051;
- The Issuer's 6.125% notes due September 2115;
- The Issuer's Perpetual 4% Consolidated Debenture Stock denominated in U.S. dollars; and
- The Issuer's Perpetual 4% Consolidated Debenture Stock denominated in British Pounds Sterling.

The above list does not include the following guaranteed securities issued under Canadian securities laws, as the following guaranteed securities are not subject to Section 13(a) or 15(d) of the Exchange Act:

- The Issuer's 1.589% notes due November 2023;
- The Issuer's 2.540% notes due February 2028.
- The Issuer's 3.150% notes due March 2029;
- The Issuer's 6.450% notes due November 2039; and
- The Issuer's 3.050% notes due March 2050.

**Certification by the Chief Executive Officer of the Registrants filed pursuant to Rule 13a-14(a) of the Exchange Act.
Canadian Pacific Railway Limited**

I, Keith Creel, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Canadian Pacific Railway Limited;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: **July 28, 2022**

/s/ KEITH CREEL

Keith Creel

President and Chief Executive Officer

**Certification by the Chief Financial Officer of the Registrants filed pursuant to Rule 13a-14(a) of the Exchange Act.
Canadian Pacific Railway Limited**

I, Nadeem Velani, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Canadian Pacific Railway Limited;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: **July 28, 2022**

/s/ NADEEM VELANI

Nadeem Velani

Executive Vice-President and Chief Financial Officer

**Certifications Furnished Pursuant to 18 U.S.C. Section 1350,
As Adopted Pursuant to
Section 906 of the Sarbanes-Oxley Act of 2002**

Canadian Pacific Railway Limited

In connection with the Quarterly Report of Canadian Pacific Railway Limited (the "Company") on Form 10-Q for the period ended June 30, 2022 (the "Report") to which this certificate is an exhibit, I, Keith Creel, hereby certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: **July 28, 2022**

/s/ KEITH CREEL

Keith Creel

President and Chief Executive Officer

**Certifications Furnished Pursuant to 18 U.S.C. Section 1350,
As Adopted Pursuant to
Section 906 of the Sarbanes-Oxley Act of 2002**

Canadian Pacific Railway Limited

In connection with the Quarterly Report of Canadian Pacific Railway Limited (the "Company") on Form 10-Q for the period ended June 30, 2022 (the "Report") to which this certificate is an exhibit, I, Nadeem Velani, hereby certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: **July 28, 2022**

/s/ NADEEM VELANI

Nadeem Velani

Executive Vice-President and Chief Financial Officer

SIGNATURE

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

CANADIAN PACIFIC RAILWAY LIMITED

(Registrant)

By: /s/ NADEEM VELANI

Nadeem Velani

Executive Vice-President and
Chief Financial Officer
(Principal Financial Officer)

Date: July 28, 2022

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

Form 10-Q

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2022

or

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from _____ to _____

Commission File Number 1-4717

KANSAS CITY SOUTHERN

(Exact name of registrant as specified in its charter)

Delaware

*(State or other jurisdiction of
incorporation or organization)*

427 West 12th Street

Kansas City, Missouri

(Address of principal executive offices)



87-3883291

*(I.R.S. Employer
Identification No.)*

64105

(Zip Code)

816.983.1303

(Registrant's telephone number, including area code)

No Change

(Former name, former address and former fiscal year, if changed since last report.)

Securities registered pursuant to Section 12(b) of the Act: None

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☐ No ☒ (The registrant is a voluntary filer and is not subject to the filing requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934. However, the registrant has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months.)

Indicate by check mark whether the registrant has submitted electronically, every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes ☒ No ☐

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

Large accelerated filer ☐ Accelerated filer ☐ Non-accelerated filer ☒ Smaller reporting company ☐ Emerging growth company ☐

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

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

Class
Common Stock, \$0.01 per share par value

July 25, 2022
100 Shares

Kansas City Southern and Subsidiaries**Form 10-Q
June 30, 2022****Index**

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PART I — FINANCIAL INFORMATION

Item 1. *Financial Statements (unaudited)*

Kansas City Southern and Subsidiaries Consolidated Statements of Operations (In millions) (Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2022	2021	2022	2021
Revenues	\$ 845.5	\$ 749.5	\$ 1,623.7	\$ 1,455.5
Operating expenses:				
Compensation and benefits	136.4	128.4	269.4	257.9
Purchased services	54.5	55.8	105.8	109.6
Fuel	123.0	79.0	220.1	149.9
Equipment costs	23.1	24.1	41.7	45.2
Depreciation and amortization	97.7	91.2	193.9	183.2
Materials and other	85.5	81.9	163.6	148.3
Merger costs	12.5	720.8	25.3	740.1
Total operating expenses	532.7	1,181.2	1,019.8	1,634.2
Operating income (loss)	312.8	(431.7)	603.9	(178.7)
Equity in net earnings (losses) of affiliates	(0.8)	3.4	8.0	9.4
Interest expense	(40.2)	(39.1)	(79.1)	(78.1)
Foreign exchange gain (loss)	(4.3)	6.8	(5.7)	(0.5)
Other income (expense), net	(0.8)	1.0	0.1	0.2
Income (loss) before income taxes	266.7	(459.6)	527.2	(247.7)
Income tax expense (benefit)	72.6	(81.6)	145.1	(23.1)
Net income (loss)	194.1	(378.0)	382.1	(224.6)
Less: Net income attributable to noncontrolling interest	—	0.5	0.6	0.9
Net income (loss) attributable to Kansas City Southern and subsidiaries	194.1	(378.5)	381.5	(225.5)
Preferred stock dividends	—	0.1	—	0.1
Net income (loss) available to common stockholder(s)	\$ 194.1	\$ (378.6)	\$ 381.5	\$ (225.6)

See accompanying notes to the unaudited consolidated financial statements.

Kansas City Southern and Subsidiaries
Consolidated Statements of Comprehensive Income (Loss)
(In millions)
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2022	2021	2022	2021
Net income (loss)	\$ 194.1	\$ (378.0)	\$ 382.1	\$ (224.6)
Other comprehensive income (loss):				
Unrealized gain (loss) on interest rate derivative instruments, net of tax of \$14.2 million, \$(9.0) million, \$26.8 million and \$12.0 million, respectively	53.3	(33.9)	100.6	45.2
Reclassification adjustment from cash flow hedges included in net income, net of tax of \$0.1 million, \$0.1 million, \$0.2 million and \$0.2 million, respectively	0.5	0.5	1.0	1.0
Foreign currency translation adjustments	—	0.3	0.3	0.1
Other comprehensive income (loss)	53.8	(33.1)	101.9	46.3
Comprehensive income (loss)	247.9	(411.1)	484.0	(178.3)
Less: Comprehensive income attributable to noncontrolling interest	—	0.5	0.6	0.9
Comprehensive income (loss) attributable to Kansas City Southern and subsidiaries	\$ 247.9	\$ (411.6)	\$ 483.4	\$ (179.2)

See accompanying notes to the unaudited consolidated financial statements.

Kansas City Southern and Subsidiaries
Consolidated Balance Sheets

	June 30, 2022	December 31, 2021
	(In millions, except share and per share amounts) (Unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 122.5	\$ 339.3
Accounts receivable, net	601.6	271.0
Materials and supplies	162.4	131.0
Other current assets	328.2	142.1
Total current assets	1,214.7	883.4
Operating lease right-of-use assets	75.6	69.6
Investments	59.2	48.3
Property and equipment (including concession assets), net	9,266.8	9,209.3
Other assets	134.1	217.5
Total assets	\$ 10,750.4	\$ 10,428.1
LIABILITIES AND EQUITY		
Current liabilities:		
Long-term debt due within one year	\$ 454.4	\$ 8.8
Accounts payable and accrued liabilities	548.3	479.7
Total current liabilities	1,002.7	488.5
Long-term operating lease liabilities	52.6	46.4
Long-term debt	3,326.4	3,768.8
Deferred income taxes	1,267.9	1,213.7
Other noncurrent liabilities and deferred credits	148.0	178.1
Total liabilities	5,797.6	5,695.5
Stockholder equity:		
\$.01 par, common stock, 100 shares authorized; 100 shares issued; 100 shares outstanding at June 30, 2022 and December 31, 2021	—	—
Additional paid-in capital	860.6	860.6
Retained earnings	3,640.9	3,524.4
Accumulated other comprehensive income	121.3	19.4
Total stockholder equity	4,622.8	4,404.4
Noncontrolling interest	330.0	328.2
Total equity	4,952.8	4,732.6
Total liabilities and equity	\$ 10,750.4	\$ 10,428.1

See accompanying notes to the unaudited consolidated financial statements.

Kansas City Southern and Subsidiaries
Consolidated Statements of Cash Flows
(In millions)
(Unaudited)

	Six Months Ended June 30,	
	2022	2021
Operating activities:		
Net income (loss)	\$ 382.1	\$ (224.6)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	193.9	183.2
Deferred income taxes	27.2	(135.5)
Equity in net earnings of affiliates	(8.0)	(9.4)
Share-based compensation	—	14.4
Loss on foreign currency derivative instruments	10.8	4.1
Foreign exchange gain	(5.1)	(3.6)
Merger costs	25.3	740.1
Distributions from affiliates	2.0	2.5
Settlement of foreign currency derivative instruments	(2.2)	(1.9)
Cash payments for merger costs	(30.4)	(719.5)
Reimbursement of merger termination fee	—	700.0
Refundable Mexican value added tax payments	—	(34.5)
Changes in working capital items:		
Accounts receivable	(330.7)	(52.1)
Materials and supplies	(30.9)	(6.6)
Other current assets	38.4	10.5
Accounts payable and accrued liabilities	12.0	33.8
Other, net	(1.4)	6.4
Net cash provided by operating activities	283.0	507.3
Investing activities:		
Capital expenditures	(197.3)	(250.5)
Property investments in MSLLC	(21.8)	(19.4)
Investments in and advances to affiliates	(8.1)	(7.2)
Proceeds from disposal of property	1.8	2.8
Other, net	(2.4)	(4.7)
Net cash used for investing activities	(227.8)	(279.0)
Financing activities:		
Repayment of long-term debt	(5.0)	(3.5)
Dividends paid	(265.0)	(89.3)
Proceeds from employee stock plans	—	2.5
Net cash used for financing activities	(270.0)	(90.3)
Effect of exchange rate changes on cash	(2.0)	(0.4)
Cash and cash equivalents:		
Net increase (decrease) during each period	(216.8)	137.6
At beginning of year	339.3	188.2
At end of period	\$ 122.5	\$ 325.8

See

accompanying notes to the unaudited consolidated financial statements.

Kansas City Southern and Subsidiaries
Consolidated Statements of Changes in Equity
(in millions, except per share amounts)
(Unaudited)

	\$25 Par Preferred Stock	\$.01 Par Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Non- controlling Interest	Total
Balance at December 31, 2020	\$ 5.4	\$ 0.9	\$ 830.9	\$ 3,219.6	\$ 0.4	\$ 326.4	\$ 4,383.6
Net income				153.0		0.4	153.4
Other comprehensive income					79.4		79.4
Dividends on common stock (\$0.54/share)			—	(49.1)			(49.1)
Dividends on \$25 par preferred stock (\$0.25/share)				—			—
Share repurchases	—	—	(2.1)	(72.9)			(75.0)
Settlement of forward contract for accelerated share repurchases			75.0				75.0
Options exercised and stock subscribed, net of shares withheld for employee taxes		—	(3.0)				(3.0)
Share-based compensation			8.2				8.2
Balance at March 31, 2021	5.4	0.9	909.0	3,250.6	79.8	326.8	4,572.5
Net income (loss)				(378.5)		0.5	(378.0)
Other comprehensive loss					(33.1)		(33.1)
Dividends on common stock (\$0.54/share)			—	(49.1)			(49.1)
Dividends on \$25 par preferred stock (\$0.25/share)				(0.1)			(0.1)
Options exercised and stock subscribed, net of shares withheld for employee taxes		—	(2.0)				(2.0)
Share-based compensation			6.2				6.2
Balance at June 30, 2021	5.4	0.9	913.2	2,822.9	46.7	327.3	4,116.4
Net income				156.2		0.3	156.5
Other comprehensive loss					(1.4)		(1.4)
Dividends on common stock (\$0.54/share)			—	(49.1)			(49.1)
Dividends on \$25 par preferred stock (\$0.25/share)				(0.1)			(0.1)
Options exercised and stock subscribed, net of shares withheld for employee taxes		—	4.4				4.4
Share-based compensation			6.1				6.1
Balance at September 30, 2021	5.4	0.9	923.7	2,929.9	45.3	327.6	4,232.8
Net income				594.5		0.6	595.1
Other comprehensive loss					(25.9)		(25.9)
Options exercised and stock subscribed, net of shares withheld for employee taxes		—	0.4				0.4
Share-based compensation			59.9				59.9
Replacement of equity share awards with liability awards			(54.5)				(54.5)
Cash settlement of stock options			(75.2)				(75.2)
Recapitalization of stock	(5.4)	(0.9)	6.3				—
Balance at December 31, 2021	—	—	860.6	3,524.4	19.4	328.2	4,732.6
Net income				187.4		0.6	188.0
Other comprehensive income					48.1		48.1
Dividend to Canadian Pacific				(265.0)			(265.0)
Balance at March 31, 2022	—	—	860.6	3,446.8	67.5	328.8	4,703.7
Net income				194.1		—	194.1
Other comprehensive income					53.8		53.8
Contribution from noncontrolling interest						1.2	1.2
Balance at June 30, 2022	—	—	\$ 860.6	\$ 3,640.9	\$ 121.3	\$ 330.0	\$ 4,952.8

See accompanying notes to the unaudited consolidated financial statements.

Kansas City Southern and Subsidiaries
Notes to the Unaudited Consolidated Financial Statements

For purposes of this Quarterly Report on Form 10-Q, “KCS” or the “Company” may refer to Kansas City Southern or, as the context requires, to one or more subsidiaries of Kansas City Southern.

1. Basis of Presentation

In the opinion of the management of KCS, the accompanying unaudited consolidated financial statements contain all adjustments (consisting of normal and recurring adjustments) necessary to reflect a fair statement of the results for interim periods in accordance with U.S. generally accepted accounting principles (“U.S. GAAP”). Pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”), certain information and note disclosures normally included in financial statements prepared in accordance with U.S. GAAP have been condensed or omitted. These consolidated financial statements should be read in conjunction with the consolidated financial statements and accompanying notes included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2021. The results of operations for the three and six months ended June 30, 2022, are not necessarily indicative of the results to be expected for the full year ending December 31, 2022.

On September 15, 2021, KCS and Canadian Pacific Railway Limited (“CP”), a Canadian corporation, entered into a merger agreement (the “Merger Agreement”) and on December 14, 2021, CP acquired the outstanding common and preferred stock of KCS. Therefore, earnings per share data is not presented as the Company does not have any outstanding or issued publicly traded stock. The merger is further discussed in Note 2, Merger Agreement.

In November 2021, the Financial Accounting Standards Board (“FASB”) issued Accounting Standard Update (“ASU”) 2021-10, Government Assistance (Topic 832), Disclosures by Business Entities about Government Assistance. The standard is intended to increase transparency of government assistance by requiring disclosures of the following: (1) the types of assistance, (2) an entity’s accounting for the assistance, and (3) the effect of the assistance on the entity’s financial statements. This ASU was effective for the Company on January 1, 2022 and the Company adopted the ASU prospectively. See Note 4, Property and Equipment for the newly required disclosure.

2. Merger Agreement

On December 14, 2021, CP acquired the outstanding common and preferred stock of KCS. Each share of common stock, par value \$0.01 per share, of KCS that was outstanding immediately prior to the merger was converted into the right to receive (1) 2.884 common shares of CP and (2) \$90 in cash (together, the “Merger Consideration”), and each share of preferred stock, par value \$25 per share, that was outstanding immediately prior to the merger was converted into the right to receive \$37.50 in cash. The Merger Consideration value received by KCS stockholders was \$301.20 per KCS common share.

The merger transaction was completed through a series of mergers as outlined in the Merger Agreement. These mergers ultimately resulted in KCS being merged with and into Cygnus Merger Sub 1 Corporation (“Surviving Merger Sub”), a wholly owned subsidiary of CP, with Surviving Merger Sub continuing as the surviving entity. Pursuant to the Merger Agreement, Surviving Merger Sub was renamed “Kansas City Southern” and as successor company of KCS, continued to own the assets of KCS. Immediately following the consummation of the mergers, CP caused the contribution, directly and indirectly, of all of the outstanding shares of capital stock of Surviving Merger Sub, as successor to KCS, to be deposited into an independent, irrevocable voting trust (the “Voting Trust”) under a voting trust agreement (the “Voting Trust Agreement”) approved by the U.S. Surface Transportation Board (“STB”), pending receipt of the final and non-appealable approval or exemption by the STB pursuant to 49 U.S.C. § 11323 et seq., of the transactions contemplated by the Merger Agreement (“STB Final Approval”). The Voting Trust prevents CP, or any affiliate of CP, from controlling or having the power to control KCS prior to STB Final Approval. Following receipt of STB Final Approval and approval from other applicable regulatory authorities, the Voting Trust will be terminated and CP will acquire control over KCS’s railroad operations.

On December 14, 2021, the merger of KCS and Surviving Merger Sub was accounted for as a recapitalization of KCS’s equity. Upon STB Final Approval, the transaction will be accounted for as a business combination using the acquisition method of accounting.

In the first quarter of 2022, pursuant to the Merger Agreement, KCS paid a cash dividend of \$265.0 million to a wholly-owned subsidiary of CP. Periodic cash distributions may be made to a wholly-owned subsidiary of CP based upon cash generated, the timing of capital expenditures and working capital needs of the Company.

For the three and six months ended June 30, 2022, KCS reported \$12.5 million and \$25.3 million, respectively, of merger-related costs, which primarily related to incentive compensation costs. During the three and six months ended June 30, 2021, the Company recognized merger-related costs of \$720.8 million and \$740.1 million, respectively, which primarily related to the

Kansas City Southern and Subsidiaries
Notes to the Unaudited Consolidated Financial Statements—(Continued)

termination fee associated with the termination of the CP merger agreement by KCS of \$700.0 million in May 2021. For the year ended December 31, 2021, KCS incurred \$1,400.0 million of merger termination fees, completely offset by the recovery of \$1,400.0 million of merger termination fees recognized in merger costs within the consolidated statements of operations.

3. Revenue

Disaggregation of Revenue

The following table presents revenues disaggregated by the major commodity groups as well as the product types included within the major commodity groups (*in millions*). The Company believes disaggregation by product type best depicts how cash flows are affected by economic factors. See Note 10 for revenues by geographical area.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2022	2021	2022	2021
<i>Chemical & Petroleum</i>				
Chemicals	\$ 74.7	\$ 64.8	\$ 144.6	\$ 125.4
Petroleum	81.4	132.9	160.4	268.1
Plastics	44.2	34.8	82.7	70.3
Total	200.3	232.5	387.7	463.8
<i>Industrial & Consumer Products</i>				
Forest Products	73.2	62.6	142.3	120.3
Metals & Scrap	64.8	51.0	121.3	97.3
Other	36.5	31.0	71.6	61.0
Total	174.5	144.6	335.2	278.6
<i>Agriculture & Minerals</i>				
Grain	111.1	88.9	216.8	163.6
Food Products	43.1	36.6	83.3	73.6
Ores & Minerals	7.4	6.1	15.7	11.3
Stone, Clay & Glass	10.9	8.3	20.1	15.8
Total	172.5	139.9	335.9	264.3
<i>Energy</i>				
Utility Coal	37.9	31.2	78.1	62.9
Coal & Petroleum Coke	12.6	12.0	25.0	22.4
Frac Sand	4.9	4.2	9.8	7.6
Crude Oil	16.5	7.1	30.6	19.1
Total	71.9	54.5	143.5	112.0
<i>Intermodal</i>	117.5	91.1	213.4	172.4
<i>Automotive</i>	66.4	49.4	120.7	93.5
Total Freight Revenues	803.1	712.0	1,536.4	1,384.6
<i>Other Revenue</i>	42.4	37.5	87.3	70.9
Total Revenues	\$ 845.5	\$ 749.5	\$ 1,623.7	\$ 1,455.5

Contract Balances

The amount of revenue recognized in the second quarter of 2022 from performance obligations partially satisfied in previous periods was \$23.2 million. The performance obligations that were unsatisfied or partially satisfied as of June 30, 2022 were \$28.9 million, which represents in-transit shipments that are fully satisfied the following month.

A receivable is any unconditional right to consideration, and is recognized as shipments have been completed and the relating performance obligation has been fully satisfied. At June 30, 2022 and December 31, 2021, the accounts receivable, net balance was \$601.6 million and \$271.0 million, respectively. Contract assets represent a conditional right to consideration in exchange for goods or services. The Company did not have any contract assets at June 30, 2022 and December 31, 2021.

Kansas City Southern and Subsidiaries
Notes to the Unaudited Consolidated Financial Statements—(Continued)

Contract liabilities represent consideration received in advance from customers, and are recognized as revenue over time as the relating performance obligation is satisfied. The amount of revenue recognized in the second quarter of 2022 that was included in the opening contract liability balance was \$14.2 million. The Company has recognized contract liabilities within the accounts payable and accrued liabilities and other long-term liabilities financial statement captions on the consolidated balance sheets.

The following tables summarize the changes in contract liabilities *(in millions)*:

Contract liabilities

	Three Months Ended June 30,		Six Months Ended June 30,	
	2022	2021	2022	2021
Beginning balance	\$ 61.1	\$ 18.8	\$ 68.4	\$ 29.9
Revenue recognized that was included in the contract liability balance at the beginning of the period	(14.2)	(8.3)	(22.2)	(20.1)
Increases due to consideration received, excluding amounts recognized as revenue during the period	2.5	9.2	3.2	9.9
Ending balance	<u>\$ 49.4</u>	<u>\$ 19.7</u>	<u>\$ 49.4</u>	<u>\$ 19.7</u>

4. Property and Equipment (including Concession Assets)

Property and equipment, including concession assets, and related accumulated depreciation and amortization are summarized below *(in millions)*:

	June 30, 2022	December 31, 2021
Land	\$ 244.7	\$ 243.0
Concession land rights	141.1	141.1
Road property	8,583.8	8,430.6
Equipment	2,871.3	2,842.4
Technology and other	429.3	372.6
Construction in progress	329.3	335.8
Total property	<u>12,599.5</u>	<u>12,365.5</u>
Accumulated depreciation and amortization	<u>3,332.7</u>	<u>3,156.2</u>
Property and equipment (including concession assets), net	<u>\$ 9,266.8</u>	<u>\$ 9,209.3</u>

Concession assets, net of accumulated amortization of \$770.6 million and \$744.8 million, totaled \$2,333.4 million and \$2,459.3 million at June 30, 2022 and December 31, 2021, respectively.

The Company has historically received assistance from governmental entities, typically in the form of cash, for purposes of making improvements to its rail network as part of public safety and/or economic revitalization initiatives. The governmental entity generally specifies how the monetary assistance is to be spent, and may include limited conditions requiring the Company to return the assistance. The Company accounts for this assistance received as reductions to property and equipment in the period in which the improvement is made, with the assistance being amortized as an offset to depreciation expense over the life of the improvement. As of June 30, 2022 and December 31, 2021, the total governmental assistance received, net of accumulated amortization, was \$36.1 million and \$37.3 million, respectively. For the three and six months ended June 30, 2022, governmental assistance amortization was \$0.6 million and \$1.2 million, respectively.

5. Fair Value Measurements

The Company's derivative financial instruments are measured at fair value on a recurring basis and consist of foreign currency forward contracts and treasury lock agreements, which are classified as Level 2 valuations. The Company determines the fair value of its derivative financial instrument positions based upon pricing models using inputs observed from actively quoted markets and also takes into consideration the contract terms as well as other inputs, including market currency exchange rates and in the case of option contracts, volatility, the risk-free interest rate and the time to expiration.

The Company's short-term financial instruments include cash and cash equivalents, accounts receivable, accounts payable and short-term borrowings. The carrying value of the short-term financial instruments approximates their fair value.

Kansas City Southern and Subsidiaries
Notes to the Unaudited Consolidated Financial Statements—(Continued)

The fair value of the Company's debt is estimated using quoted market prices when available. When quoted market prices are not available, fair value is estimated based on current market interest rates for debt with similar maturities and credit quality. The carrying value of the Company's debt was \$3,780.8 million and \$3,777.6 million at June 30, 2022 and December 31, 2021, respectively. If the Company's debt were measured at fair value, the fair value measurements of the individual debt instruments would have been classified as Level 2 in the fair value hierarchy.

The fair value of the Company's financial instruments is presented in the following table (*in millions*):

	June 30, 2022	December 31, 2021
	Level 2	Level 2
Assets		
Treasury lock agreements	\$ 184.8	\$ 57.4
Liabilities		
Debt instruments	3,464.9	4,311.1
Foreign currency derivative instruments	10.4	1.8

6. Derivative Instruments

The Company enters into derivative transactions in certain situations based on management's assessment of current market conditions and perceived risks. Management intends to respond to evolving business and market conditions and in doing so, may enter into such transactions as deemed appropriate.

Credit Risk. As a result of the use of derivative instruments, the Company is exposed to counterparty credit risk. The Company manages this risk by limiting its counterparties to large financial institutions which meet the Company's credit rating standards and have an established banking relationship with the Company. As of June 30, 2022, the Company did not expect any losses as a result of default of its counterparties.

Interest Rate Derivative Instruments. In 2020, the Company executed six 30-year treasury lock agreements with an aggregate notional value of \$650.0 million and a weighted average interest rate of 1.58%. The purpose of the treasury locks is to hedge the U.S. Treasury benchmark interest rate associated with future interest payments related to the anticipated refinancing of the \$444.7 million principal amount of 3.00% senior notes due May 15, 2023 (the "3.00% Senior Notes") and the \$200.0 million principal amount of 3.85% senior notes due November 15, 2023 (the "3.85% Senior Notes"). The Company has designated the treasury locks as cash flow hedges and recorded unrealized gains and losses in accumulated other comprehensive income (loss). For the six months ended June 30, 2022, the total unrealized gain of \$184.8 million recognized in accumulated other comprehensive income increased by \$127.4 million compared to December 31, 2021, reflecting a change in the value of the treasury locks as U.S. treasury rates rose. Upon settlement, the unrealized gain or loss in accumulated other comprehensive income (loss) will be amortized to interest expense over the life of the future underlying debt issuance.

Foreign Currency Derivative Instruments. The Company's Mexican subsidiaries have net U.S. dollar-denominated monetary liabilities which, for Mexican income tax purposes, are subject to periodic revaluation based on changes in the value of the Mexican peso against the U.S. dollar. This revaluation creates fluctuations in the Company's Mexican income tax expense in the consolidated statements of operations and the amount of income taxes paid in Mexico. The Company also has net monetary assets denominated in Mexican pesos that are subject to periodic re-measurement and settlement that create fluctuations in foreign currency gains and losses in the consolidated statements of operations. The Company hedges its net exposure to foreign currency fluctuations in earnings by entering into foreign currency forward contracts. The foreign currency forward contracts involve the Company's agreement to buy or sell pesos at an agreed-upon exchange rate on a future date.

Kansas City Southern and Subsidiaries
Notes to the Unaudited Consolidated Financial Statements—(Continued)

Below is a summary of the Company's 2022 and 2021 foreign currency derivative contracts (*amounts in millions, except Ps./USD*):

Foreign currency forward contracts

	Contracts to sell Ps./receive USD			Offsetting contracts to purchase Ps./pay USD			Cash received/(paid) on settlement
	Notional amount	Notional amount	Weighted-average exchange rate (in Ps./USD)	Notional amount	Notional amount	Weighted-average exchange rate (in Ps./USD)	
Contracts executed in 2022 and outstanding	\$ 400.0	Ps. 8,554.0	Ps. 21.4	—	—	—	—
Contracts executed in 2022 and settled in 2022	\$ 50.0	Ps. 1,105.3	Ps. 22.1	\$ 50.5	Ps. 1,105.3	Ps. 21.9	\$ (0.5)
Contracts executed in 2021 and settled in 2022	\$ 270.0	Ps. 5,583.3	Ps. 20.7	\$ 271.7	Ps. 5,583.3	Ps. 20.6	\$ (1.7)
	Contracts to purchase Ps./pay USD			Offsetting contracts to sell Ps./receive USD			Cash received/(paid) on settlement
	Notional amount	Notional amount	Weighted-average exchange rate (in Ps./USD)	Notional amount	Notional amount	Weighted-average exchange rate (in Ps./USD)	
Contracts executed in 2021 and settled in 2021 (i)	\$ 100.0	Ps. 1,993.5	Ps. 19.9	\$ 98.1	Ps. 1,993.5	Ps. 20.3	\$ (1.9)

(i) During the first half of 2021, the Company settled \$100.0 million of these forward contracts, resulting in cash paid of \$1.9 million.

The Company has not designated any of the foreign currency derivative contracts as hedging instruments for accounting purposes. The Company measures the foreign currency derivative contracts at fair value each period and recognizes any change in fair value in foreign exchange gain (loss) within the consolidated statements of operations. The cash flows associated with these instruments is classified as an operating activity within the consolidated statements of cash flows.

Offsetting. The Company's treasury lock agreements and foreign currency forward contracts are executed with counterparties in the U.S. and are governed by International Swaps and Derivatives Association agreements that include standard netting arrangements. Asset and liability positions from contracts with the same counterparty are net settled upon maturity/expiration and presented on a net basis in the consolidated balance sheets prior to settlement.

The following tables present the fair value of derivative instruments included in the Consolidated Balance Sheets (*in millions*):

Derivative Assets			
	Balance Sheet Location	June 30, 2022	December 31, 2021
Derivatives designated as hedging instruments:			
Treasury lock agreements	Other current assets	\$ 184.8	\$ —
	Other assets	—	57.4
Total derivatives designated as hedging instruments		184.8	57.4
Total derivative assets		\$ 184.8	\$ 57.4
Derivative Liabilities			
	Balance Sheet Location	June 30, 2022	December 31, 2021
Derivatives not designated as hedging instruments:			
Foreign currency forward contracts	Accounts payable and accrued liabilities	\$ 10.4	\$ 1.8
Total derivatives not designated as hedging instruments		10.4	1.8
Total derivative liabilities		\$ 10.4	\$ 1.8

Kansas City Southern and Subsidiaries
Notes to the Unaudited Consolidated Financial Statements—(Continued)

The following table summarizes the gross and net fair value of derivative liabilities (*in millions*):

As of June 30, 2022	Gross Liabilities	Gross Assets	Net Amounts Presented in the Consolidated Balance Sheets
Derivatives subject to a master netting arrangement or similar agreement	\$ 10.6	\$ (0.2)	\$ 10.4
As of December 31, 2021			
Derivatives subject to a master netting arrangement or similar agreement	\$ 2.8	\$ (1.0)	\$ 1.8

The following table presents the effects of derivative instruments on the Consolidated Statements of Operations and Consolidated Statements of Comprehensive Income (Loss) for the three months ended June 30 (*in millions*):

Derivatives in Cash Flow Hedging Relationships	Amount of Gain/(Loss) Recognized in OCI on Derivative		Location of Gain/(Loss) Reclassified from AOCI into Income	Amount of Gain/(Loss) Reclassified from AOCI into Income	
	2022	2021		2022	2021
Treasury lock agreements	\$ 67.5	\$ (42.9)	Interest expense	\$ (0.6)	\$ (0.6)
Total	\$ 67.5	\$ (42.9)		\$ (0.6)	\$ (0.6)
Derivatives Not Designated as Hedging Instruments			Location of Gain/(Loss) Recognized in Income on Derivative	Amount of Gain/(Loss) Recognized in Income on Derivative	
				2022	2021
Foreign currency forward contracts			Foreign exchange loss	\$ (2.7)	\$ (1.7)
Total				\$ (2.7)	\$ (1.7)

The following table presents the effects of derivative instruments on the Consolidated Statements of Operations and Consolidated Statements of Comprehensive Income (Loss) for the six months ended June 30 (*in millions*):

Derivatives in Cash Flow Hedging Relationships	Amount of Gain/(Loss) Recognized in OCI on Derivative		Location of Gain/(Loss) Reclassified from AOCI into Income	Amount of Gain/(Loss) Reclassified from AOCI into Income	
	2022	2021		2022	2021
Treasury lock agreements	\$ 127.4	\$ 57.2	Interest expense	\$ (1.2)	\$ (1.2)
Total	\$ 127.4	\$ 57.2		\$ (1.2)	\$ (1.2)
Derivatives Not Designated as Hedging Instruments			Location of Gain/(Loss) Recognized in Income on Derivative	Amount of Gain/(Loss) Recognized in Income on Derivative	
				2022	2021
Foreign currency forward contracts			Foreign exchange loss	\$ (10.8)	\$ (4.1)
Total				\$ (10.8)	\$ (4.1)

See Note 5, Fair Value Measurements, for the determination of the fair values of derivatives.

7. Short-Term Borrowings

Commercial Paper. The Company's commercial paper program generally serves as the primary means of short-term funding. As of June 30, 2022 and December 31, 2021, KCS had no commercial paper outstanding. For the six months ended June 30, 2022 and 2021, any commercial paper borrowings were outstanding for less than 90 days and the related activity is presented on a net basis in the consolidated statements of cash flows.

8. Refundable Mexican Value Added Tax

Kansas City Southern de México, S.A. de C.V. ("KCSM") is not required to charge its customers value added tax ("VAT") on international import or export transportation services, which prior to 2022 resulted in KCSM paying more VAT on its expenses than it

Kansas City Southern and Subsidiaries
Notes to the Unaudited Consolidated Financial Statements—(Continued)

collected from customers. These excess VAT payments are refundable by the Mexican government. Prior to 2019, Mexican companies could offset their monthly refundable VAT balance with other tax obligations. In January 2019, Mexico tax reform eliminated the ability to offset other tax obligations with refundable VAT. Over 2019 through 2021, KCSM generated a refundable VAT balance and filed refund claims with the Servicio de Administración Tributaria (the “SAT”), which have not been refunded.

In November 2021, changes to the VAT law were announced and became effective beginning January 1, 2022. These changes reduced the recoverability of VAT paid by KCSM on its expenditures that support international import transportation service revenues that are not subject to a VAT charge. VAT that is unrecoverable from the Mexican government results in incremental VAT expense for KCSM. Beginning in 2022, KCSM changed certain service offerings to either require VAT to be charged to customers on revenue, or impose a rate increase to offset the incremental VAT expense. These measures implemented by KCSM increased the VAT to be collected from customers and payable to the Mexican government.

As of June 30, 2022 and December 31, 2021, the KCSM refundable VAT balance was \$119.6 million and \$152.2 million, respectively. KCSM has prior favorable Mexican court decisions and a legal opinion supporting its right under Mexican law to recover the refundable VAT balance from the Mexican government and believes the VAT to be fully recoverable. KCSM will recover the refundable VAT balance as VAT billed to customers exceeds creditable VAT charged by vendors. As of June 30, 2022 and December 31, 2021, \$79.0 million and \$78.0 million, respectively, of the refundable VAT balance was classified as a short-term asset.

9. Commitments and Contingencies

Concession Duty. Under KCSM’s 50-year railroad concession from the Mexican government (the “Concession”), which could expire in 2047 unless extended, KCSM pays annual concession duty expense of 1.25% of gross revenues. For the three and six months ended June 30, 2022, the concession duty expense, which is recorded within materials and other in operating expenses, was \$5.6 million and \$10.5 million, respectively, compared to \$4.9 million and \$9.4 million, for the same periods in 2021.

Litigation. Occasionally, the Company is a party to various legal proceedings, regulatory examinations, investigations, administrative actions, and other legal matters, arising for the most part in the ordinary course of business, incidental to its operations. Included in these proceedings are various tort claims brought by current and former employees for job-related injuries and by third parties for injuries related to railroad operations. KCS aggressively defends these matters and has established liability provisions that management believes are adequate to cover expected costs. The outcome of litigation and other legal matters is always uncertain. KCS believes it has valid defenses to the legal matters currently pending against it, is defending itself vigorously, and has recorded accruals determined in accordance with U.S. GAAP, where appropriate. In making a determination regarding accruals, using available information, KCS evaluates the likelihood of an unfavorable outcome in legal or regulatory proceedings to which it is a party to and records a loss contingency when it is probable a liability has been incurred and the amount of the loss can be reasonably estimated. These subjective determinations are based on the status of such legal or regulatory proceedings, the merits of KCS’s defenses and consultation with legal counsel. Actual outcomes of these legal and regulatory proceedings may materially differ from the current estimates. It is possible that resolution of one or more of the legal matters currently pending or threatened could result in losses material to KCS’s consolidated results of operations, liquidity or financial condition.

Environmental Liabilities. The Company’s U.S. operations are subject to extensive federal, state and local environmental laws and regulations. The major U.S. environmental laws to which the Company is subject include, among others, the federal Comprehensive Environmental Response, Compensation and Liability Act (“CERCLA,” also known as the Superfund law), the Toxic Substances Control Act, the Clean Water Act, and the Hazardous Materials Transportation Act. CERCLA can impose joint and several liabilities for cleanup and investigation costs, without regard to fault or legality of the original conduct, on current and predecessor owners and operators of a site, as well as those who generate, or arrange for the disposal of hazardous substances. The Company does not believe that compliance with the requirements imposed by the environmental legislation will impair its competitive capability or result in any material additional capital expenditures, operating or maintenance costs. The Company is, however, subject to environmental remediation costs as described in the following paragraphs.

The Company’s Mexico operations are subject to Mexican federal and state laws and regulations relating to the protection of the environment through the establishment of standards for water discharge, water supply, emissions, noise pollution, hazardous substances and transportation and handling of hazardous and solid waste. The Mexican government may bring administrative and criminal proceedings, impose economic sanctions against companies that violate environmental laws, and temporarily or even permanently close non-complying facilities.

The risk of incurring environmental liability is inherent in the railroad industry. As part of serving the petroleum and chemicals industry, the Company transports hazardous materials and has a professional team available to respond to and handle environmental issues that might occur in the transport of such materials.

Kansas City Southern and Subsidiaries
Notes to the Unaudited Consolidated Financial Statements—(Continued)

The Company performs ongoing reviews and evaluations of the various environmental programs and issues within the Company's operations, and, as necessary, takes actions intended to limit the Company's exposure to potential liability. Although these costs cannot be predicted with certainty, management believes that the ultimate outcome of identified matters will not have a material adverse effect on the Company's consolidated financial statements.

Personal Injury. The Company's personal injury liability is based on semi-annual actuarial studies performed on an undiscounted basis by an independent third party actuarial firm and reviewed by management. This liability is based on personal injury claims filed and an estimate of claims incurred but not yet reported. Actual results may vary from estimates due to the number, type and severity of the injury, costs of medical treatments and uncertainties in litigation. Adjustments to the liability are reflected within operating expenses in the period in which changes to estimates are known. Personal injury claims in excess of self-insurance levels are insured up to certain coverage amounts, depending on the type of claim and year of occurrence. The personal injury liability as of June 30, 2022, is based on an updated actuarial study of personal injury claims through April 30, 2022, and review of the last two months' experience. Although these estimates cannot be predicted with certainty, management believes that the ultimate outcome will not have a material adverse effect on the Company's consolidated financial statements.

Tax Contingencies. Tax returns filed in the U.S. for periods after 2015 and in Mexico for periods after 2012 remain open to examination by the taxing authority. The Internal Revenue Service ("IRS") has completed its examination of the 2017 deemed mandatory repatriation tax included in the 2017 U.S. federal tax return and the 2016 U.S. federal tax return with no material impact to the consolidated financial statements. The Servicio de Administración Tributaria (the "SAT"), the Mexican equivalent of the IRS, has initiated examinations of the KCSM 2013 through 2020 Mexico tax returns and the Financiera Inspira, S.A. de C.V. SOFOM, E.N.R. 2016 and 2017 Mexico tax returns. The Company does not expect that these examinations will have a material impact on the consolidated financial statements. During 2017, the Company received audit assessments from the SAT for the KCSM 2009 and 2010 Mexico tax returns. The Company commenced administrative actions with the SAT and the audit assessments were subsequently nullified. In the third quarter of 2018, the SAT issued new assessments and the Company filed administrative appeals with the SAT. During the first quarter of 2022, the Company received an audit assessment from the SAT for the KCSM 2013 Mexico tax return and filed an administrative appeal of the assessment in the second quarter of 2022.

On April 13, 2022, the SAT used an electronic tax mailbox to deliver an audit assessment on the 2014 KCSM tax returns for Ps.5.5 billion (approximately \$280 million USD) of tax, interest, penalties and inflation (the "2014 Audit Assessment"). In 2014, KCSM filed an amparo lawsuit with the district court, objecting to the SAT's electronic accounting requirements, including the SAT's use of the electronic tax mailbox, and KCSM was granted a permanent injunction in 2015 preventing the SAT from delivering any notification of assessments using the electronic tax mailbox. The permanent injunction remains in effect through the date of this filing. The Company became aware of the 2014 Audit Assessment on June 30, 2022 and based on the permanent injunction on the electronic accounting requirements, the Company believes it has thirty business days from that date, to file an appeal. On July 7, 2022, the Company filed an administrative appeal of the 2014 Audit Assessment with the SAT. The Company believes that it has strong legal arguments in its favor and it is more likely than not that the administrative appeal of the 2014 Audit Assessment was timely filed.

The 2014 Audit Assessment includes tax positions where KCSM has prior favorable court decisions or strong legal arguments in its favor. Management believes it is more likely than not it will prevail in any challenge of the 2014 Audit Assessment. Historically, the Company has not been required to pay to settle previous SAT audit assessments or has settled SAT audit assessments for an immaterial amount.

On July 1, 2022, the SAT froze KCSM's Mexico bank account without any request for payment of the 2014 Audit Assessment or notification of the freeze. The Company filed an amparo lawsuit challenging the legality of the bank account freeze. The district court issued a permanent injunction requiring the SAT to remove the freeze subject to KCSM posting a performance bond or other collateral upon the SAT demonstrating a tax obligation exists. The freeze has not had and is not expected to have a significant impact on KCSM's cash flows or operations. The provision of the performance bond or other collateral, if necessary, would not be an agreement or concession with regard to the 2014 Audit Assessment and in no way would impact KCSM's ability to further defend its tax position.

The Company believes that it has strong legal arguments in its favor and it is more likely than not that it will prevail in any challenge of the assessments.

Contractual Agreements. In the normal course of business, the Company enters into various contractual agreements related to commercial arrangements and the use of other railroads' or governmental entities' infrastructure needed for the operations of the business. The Company is involved or may become involved in certain disputes involving transportation rates, product loss or damage,

Kansas City Southern and Subsidiaries
Notes to the Unaudited Consolidated Financial Statements—(Continued)

charges, and interpretations related to these agreements. While the outcome of these matters cannot be predicted with certainty, the Company believes that, when resolved, these disputes will not have a material effect on its consolidated financial statements.

Credit Risk. The Company continually monitors risks related to economic changes and certain customer receivables concentrations. Significant changes in customer concentration or payment terms, deterioration of customer creditworthiness, bankruptcy, insolvency or liquidation of a customer, or weakening in economic trends could have a significant impact on the collectability of the Company's receivables and its operating results. If the financial condition of the Company's customers were to deteriorate and result in an impairment of their ability to make payments, additional allowances may be required. The Company has recorded provisions for credit losses based on its best estimate at June 30, 2022.

Panama Canal Railway Company ("PCRC") Guarantees and Indemnities. At June 30, 2022, the Company had issued and outstanding \$5.7 million under a standby letter of credit to fulfill its obligation to fund fifty percent of the debt service reserve and liquidity reserve established by PCRC in connection with the issuance of the 7.0% Senior Secured Notes due November 1, 2026 (the "PCRC Notes"). Additionally, KCS has pledged its shares of PCRC as security for the PCRC Notes.

10. Geographic Information

The Company strategically manages its rail operations as one reportable business segment over a single coordinated rail network that extends from the midwest and southeast portions of the United States south into Mexico and connects with other Class I railroads. Financial information reported at this level, such as revenues, operating income and cash flows from operations, is used by corporate management, including the Company's chief operating decision-maker, in evaluating overall financial and operational performance, market strategies, as well as the decisions to allocate capital resources. The Company's chief operating decision-maker is the chief executive officer.

The following tables provide information by geographic area (*in millions*):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2022	2021	2022	2021
Revenues				
U.S.	\$ 449.9	\$ 384.1	\$ 875.6	\$ 751.0
Mexico	395.6	365.4	748.1	704.5
Total revenues	\$ 845.5	\$ 749.5	\$ 1,623.7	\$ 1,455.5
			June 30, 2022	December 31, 2021
Property and equipment (including concession assets), net				
U.S.			\$ 5,804.1	\$ 5,744.4
Mexico			3,462.7	3,464.9
Total property and equipment (including concession assets), net			\$ 9,266.8	\$ 9,209.3

11. Subsequent Event

On July 14, 2022, KCSM reached an agreement with the Mexican Ministry of Infrastructure, Communications and Transportation (SICT) to fund a new investment in the Celaya-NBA Line Railway Bypass and related infrastructure in an amount not to exceed Ps.4.0 billion. In exchange for the investment, the SICT agreed to amend KCSM's Concession Title effective July 14, 2022, to extend the exclusivity rights granted to KCSM for an additional period of 10 years. Under this amendment, KCSM's exclusivity will now expire in 2037.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The discussion below, as well as other portions of this Form 10-Q, contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, Section 21E of the Securities Exchange Act of 1934, as amended and the Private Securities Litigation Reform Act of 1995. In addition, management may make forward-looking statements orally or in other writing, including, but not limited to, in press releases, quarterly earnings calls, executive presentations, in the annual report to stockholders and in other filings with the Securities and Exchange Commission (the "SEC"). Readers can usually identify these forward-looking statements by the use of such words as "may," "will," "should," "likely," "plans," "projects," "expects," "anticipates," "believes" or similar words. These statements involve a number of risks and uncertainties. Actual results could materially differ from those anticipated by such forward-looking statements. Such differences could be caused by a number of factors or combination of factors including, but not limited to, the factors identified below and those discussed under the captions "Part II - Item 1A - Risk Factors" herein and Item 1A, "Risk Factors", of the Company's Annual Report on Form 10-K for the year ended December 31, 2021 (the "Annual Report"). Readers are strongly encouraged to consider these factors and the following factors when evaluating any forward-looking statements concerning the Company: public health threats or outbreaks of communicable diseases, such as the ongoing COVID-19 pandemic (including its variants) and its impact on KCS's business, suppliers, consumers, customers, employees and supply chains; rail accidents or other incidents or accidents on KCS's rail network or at KCS's facilities or customer facilities involving the release of hazardous materials, including toxic inhalation hazards; legislative and regulatory developments and disputes, including tax disputes and environmental regulations; loss of the rail concession of Kansas City Southern's subsidiary, Kansas City Southern de México, S.A. de C.V.; North American and global economic, political and social conditions; disruptions to the Company's technology infrastructure, including its computer systems; increased demand and traffic congestion; the level of trade between the United States and Asia or Mexico; fluctuations in the peso-dollar exchange rate; natural events such as severe weather, hurricanes and floods; the outcome of claims and litigation involving the Company or its subsidiaries; changes in business strategy and strategic opportunities; competition and consolidation within the transportation industry; the business environment in industries that produce and use items shipped by rail; the termination of, or failure to renew, agreements with customers, other railroads and third parties; the satisfaction of by third parties of their obligations; fluctuation in prices or availability of key materials, fluctuations in commodity demand; in particular diesel fuel; insurance coverage limitations; access to capital; sufficiency of budgeted capital expenditures in carrying out business plans; services infrastructure; climate change and the market and regulatory responses to climate change; dependency on certain key suppliers of core rail equipment; changes in securities and capital markets; unavailability of qualified personnel; difficulty attracting, motivating, and retaining executives and other key employees due to the uncertainty of the merger transaction with Canadian Pacific Railway Limited ("CP"); significant demands placed on the Company as a result of the merger of the Company with CP; labor difficulties, including strikes and work stoppages; acts of terrorism or risk of terrorist activities, war or other acts of violence; and other factors affecting the operation of the business. For more discussion about each risk factor, see "Part II - Item 1A - Risk Factors" herein and Part I, Item 1A - "Risk Factors" in the Company's Annual Report and "Management's Discussion and Analysis of Financial Condition and Results of Operations" herein and in the Company's Annual Report, in each case as updated by the Company's periodic filings with the SEC.

Forward-looking statements reflect the information only as of the date on which they are made. The Company does not undertake any obligation to update any forward-looking statements to reflect future events, developments, or other information. If KCS does update one or more forward-looking statements, no inference should be drawn that additional updates will be made regarding that statement or any other forward-looking statements.

This discussion is intended to clarify and focus on KCS's results of operations, certain changes in its financial position, liquidity, capital structure and business developments for the periods covered by the consolidated financial statements included under Item 1 of this Quarterly Report on Form 10-Q for the quarter ended June 30, 2022. This discussion should be read in conjunction with those consolidated financial statements and the related notes and is qualified by reference to them.

Critical Accounting Policies and Estimates

The Company's discussion and analysis of its financial position and results of operations is based upon its consolidated financial statements. The preparation of these consolidated financial statements requires estimation and judgment that affect the reported amounts of revenue, expenses, assets and liabilities. The Company bases its estimates on historical experience and on various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the accounting for assets and liabilities that are not readily apparent from other sources. If the estimates differ materially from actual results, the impact on the consolidated financial statements may be material. The Company's critical accounting policies are disclosed in its 2021 Annual Report.

Overview

The Company is engaged primarily in the freight rail transportation business, operating a single coordinated rail network under one reportable business segment. The primary operating subsidiaries of the Company consist of the following: The Kansas City Southern Railway Company (“KCSR”), Kansas City Southern de México, S.A. de C.V. (“KCSM”), Meridian Speedway, LLC (“MSLLC”), and The Texas Mexican Railway Company (“TexMex”). The Company generates revenues and cash flows by providing customers with freight delivery services both within its regions and throughout North America through connections with other Class I rail carriers. KCS’s customers conduct business in a number of different industries, including chemical and petroleum, industrial and consumer products, agriculture and minerals, energy, automotive, and intermodal transportation. Appropriate eliminations and reclassifications have been recorded in preparing the consolidated financial statements.

Merger Agreement

On September 15, 2021, KCS and CP entered into a merger agreement (the “Merger Agreement”) and on December 14, 2021, CP acquired the outstanding common and preferred stock of KCS. Each share of common stock, par value \$0.01 per share, of KCS that was outstanding immediately prior to the merger was converted into the right to receive (1) 2.884 common shares of CP and (2) \$90 in cash (together, the “Merger Consideration”), and each share of preferred stock, par value \$25 per share, that was outstanding immediately prior to the merger was converted into the right to receive \$37.50 in cash. The Merger Consideration value received by KCS stockholders was \$301.20 per KCS common share.

The merger transaction was completed through a series of mergers as outlined in the Merger Agreement. These mergers ultimately resulted in KCS being merged with and into Cygnus Merger Sub 1 Corporation (“Surviving Merger Sub”), a wholly owned subsidiary of CP, with Surviving Merger Sub continuing as the surviving entity. Pursuant to the Merger Agreement, Surviving Merger Sub was renamed “Kansas City Southern” and as successor company of KCS, continued to own the assets of KCS. Immediately following the consummation of the mergers, CP caused the contribution, directly and indirectly, of all of the outstanding shares of capital stock of Surviving Merger Sub, as successor to KCS, to be deposited into an independent, irrevocable voting trust (the “Voting Trust”) under a voting trust agreement (the “Voting Trust Agreement”) approved by the U.S. Surface Transportation Board (“STB”), pending receipt of the final and non-appealable approval or exemption by the STB pursuant to 49 U.S.C. § 11323 et seq., of the transactions contemplated by the Merger Agreement (“STB Final Approval”). The Voting Trust prevents CP, or any affiliate of CP, from controlling or having the power to control KCS prior to STB Final Approval. Following receipt of STB Final Approval and approval from other applicable regulatory authorities, the Voting Trust will be terminated and CP will acquire control over KCS’s railroad operations. STB Final Approval is expected to be granted in the first quarter of 2023, subject to the regulatory review process.

On December 14, 2021, the merger of KCS and Surviving Merger Sub was accounted for as a recapitalization of KCS’s equity. Upon STB Final Approval, the transaction will be accounted for as a business combination using the acquisition method of accounting.

In the first quarter of 2022, pursuant to the Merger Agreement, KCS paid a cash dividend of \$265.0 million to a wholly-owned subsidiary of CP. Periodic cash distributions may be made to a wholly-owned subsidiary of CP based upon cash generated, the timing of capital expenditures and working capital needs of the Company.

For the three and six months ended June 30, 2022, KCS reported \$12.5 million and \$25.3 million, respectively, of merger-related costs, which primarily related to incentive compensation costs. During the three and six months ended June 30, 2021, the Company recognized merger-related costs of \$720.8 million and \$740.1 million, respectively, which primarily related to the termination fee associated with the termination of the CP merger agreement by KCS of \$700.0 million in May 2021. These costs were recognized in merger costs within the consolidated statements of operations.

Ukraine Crisis

The invasion of Ukraine by Russia in February 2022 has led to disruption, instability, and volatility in global markets and industries. The U.S. government and other foreign governments have imposed severe economic sanctions and export controls against Russia, certain regions of Ukraine and particular entities and individuals, removed Russia from the Society for Worldwide Interbank Financial Telecommunication (“SWIFT”) system, and may impose additional sanctions and controls. The full impact of these sanctions and controls, as well as responses to them by Russia has and could in the future result in, among other things, severe or complete restrictions on exports to and other commerce and business dealings involving Russia, certain regions of Ukraine, and/or particular entities and individuals. In addition, this ongoing invasion has caused energy prices to rise, leading to increased inflationary impacts. To date, the Company has not experienced a material impact to operations or the consolidated financial statements as a result of the invasion of Ukraine; however, KCS will continue to monitor for events that could materially impact the Company.

Inflation

U.S. consumer price inflation rose at its fastest pace in over 40 years and Mexico inflation reached levels not seen for 20 years. Consumer price annual inflation rates as of June 30, 2022 were 9.1% and 8.0% in the U.S. and Mexico, respectively. KCS is closely monitoring the impact of rapidly increasing inflation on the Company's financial results and procurement supply chain. As of June 30, 2022, higher inflation has not had a material impact on the Company's financial results. Additionally, supply chain disruptions have not materially impacted the Company's ability to procure essential materials and services on a timely basis.

Inflation is expected to be elevated for the near future. Inflationary factors, such as increases in interest rates, overhead costs and transportation costs may adversely affect the Company's financial results. Although the Company does not believe that inflation has had a material impact on KCS's financial results to date, the Company may experience some effect in the near future due to supply chain constraints, consequences associated with COVID-19, and the ongoing invasion of Ukraine by Russia, employee availability and wage increases.

Second Quarter Highlights

For the three months ended June 30, 2022, revenues increased 13% compared to the same period in 2021, primarily due to a 9% increase in revenue per carload/unit, and a 3% increase in carload/unit volumes. Revenue per carload/unit increased due to higher fuel surcharge, positive pricing impacts, and longer average length of haul, partially offset by mix. Volumes increased due to strong demand, improved cycle times, and partial recovery of the global microchip shortage. These increases were partially offset by decreased volumes in chemicals and petroleum refined fuel products due to regulatory impacts.

Operating expenses decreased 55% during the three months ended June 30, 2022, as compared to the same period in 2021, primarily due to decreased merger costs related to the termination fee for the termination of the CP merger agreement by KCS of \$700.0 million recognized in the second quarter of 2021, partially offset by higher diesel fuel prices. Operating expenses as a percentage of revenues was 63.0% for the three months ended June 30, 2022, compared to 157.6% for the same period in 2021.

Results of Operations

The following summarizes KCS's consolidated statement of operations components (*in millions*):

	Three Months Ended		
	June 30,		
	2022	2021	Change
Revenues	\$ 845.5	\$ 749.5	\$ 96.0
Operating expenses	532.7	1,181.2	(648.5)
Operating income (loss)	312.8	(431.7)	744.5
Equity in net earnings (losses) of affiliates	(0.8)	3.4	(4.2)
Interest expense	(40.2)	(39.1)	(1.1)
Foreign exchange gain (loss)	(4.3)	6.8	(11.1)
Other income (expense), net	(0.8)	1.0	(1.8)
Income (loss) before income taxes	266.7	(459.6)	726.3
Income tax expense (benefit)	72.6	(81.6)	154.2
Net income (loss)	194.1	(378.0)	572.1
Less: Net income attributable to noncontrolling interest	—	0.5	(0.5)
Net income (loss) attributable to Kansas City Southern and subsidiaries	\$ 194.1	\$ (378.5)	\$ 572.6

	Six Months Ended		
	June 30,		Change
	2022	2021	
Revenues	\$ 1,623.7	\$ 1,455.5	\$ 168.2
Operating expenses	1,019.8	1,634.2	(614.4)
Operating income (loss)	603.9	(178.7)	782.6
Equity in net earnings of affiliates	8.0	9.4	(1.4)
Interest expense	(79.1)	(78.1)	(1.0)
Foreign exchange loss	(5.7)	(0.5)	(5.2)
Other income, net	0.1	0.2	(0.1)
Income (loss) before income taxes	527.2	(247.7)	774.9
Income tax expense (benefit)	145.1	(23.1)	168.2
Net income (loss)	382.1	(224.6)	606.7
Less: Net income attributable to noncontrolling interest	0.6	0.9	(0.3)
Net income (loss) available to common stockholder(s)	\$ 381.5	\$ (225.5)	\$ 607.0

Operating Metrics

The Company has established the following key metrics to measure precision scheduled railroading (“PSR”) progress and performance:

	Three Months Ended		Improvement/ (Deterioration)	Six Months Ended		Improvement/ (Deterioration)
	June 30, 2022	June 30, 2021		June 30, 2022	June 30, 2021	
Gross velocity (mph) (i)	13.7	12.2	12%	14.6	12.6	16%
Terminal dwell (hours) (ii)	21.9	26.1	16%	20.8	26.4	21%
Train length (feet) (iii)	6,421	6,778	(5)%	6,443	6,800	(5)%
Fuel efficiency (gallons per 1,000 GTM's) (iv)	1.25	1.22	(2)%	1.25	1.24	(1)%

(i) Gross velocity is the average train speed between origin and destination in miles per hour calculated as the sum of the miles traveled divided by the sum of total transit hours. Transit hours are measured as the difference between a train’s origin departure and destination arrival date and times broken down by segment across the train route (includes all time spent including crew changes, terminal dwell, delays, and incidents).

(ii) Terminal dwell is the average amount of time in hours between car arrival to and departure from the yard (excludes cars that move through a terminal on a run-through train, stored, bad ordered, and maintenance-of-way cars). Calculated by dividing the total number of hours cars spent in terminals by the total count of car dwell events.

(iii) Train length is the average length of a train across its reporting stations, including the origin and intermediate stations. Length of a train is the sum of car and locomotive lengths measured in feet.

(iv) Fuel efficiency is calculated by taking locomotive fuel consumed in gallons divided by thousand gross ton miles (“GTM’s”) net of detours with no associated fuel gallons. GTM’s are the movement of one ton of train weight over one mile calculated by multiplying total train weight by distance the train moved. GTM’s exclude locomotive gross ton miles.

For the three months ended June 30, 2022, the improvement in velocity and dwell, as compared to the same period in 2021, were due to efforts to improve network fluidity including reductions in train length, along with other operating initiatives and new capacity projects.

Revenues

The following summarizes revenues (*in millions*), carload/unit statistics (*in thousands*) and revenue per carload/unit:

	Revenues			Carloads and Units			Revenue per Carload/Unit		
	Three Months Ended June 30,			Three Months Ended June 30,			Three Months Ended June 30,		
	2022	2021	% Change	2022	2021	% Change	2022	2021	% Change
Chemical and petroleum	\$ 200.3	\$ 232.5	(14 %)	81.9	103.4	(21 %)	\$ 2,446	\$ 2,249	9 %
Industrial and consumer products	174.5	144.6	21 %	86.0	74.4	16 %	2,029	1,944	4 %
Agriculture and minerals	172.5	139.9	23 %	73.2	65.9	11 %	2,357	2,123	11 %
Energy	71.9	54.5	32 %	63.1	63.1	—	1,139	864	32 %
Intermodal	117.5	91.1	29 %	265.5	250.3	6 %	443	364	22 %
Automotive	66.4	49.4	34 %	33.1	27.7	19 %	2,006	1,783	13 %
Carload revenues, carloads and units	803.1	712.0	13 %	602.8	584.8	3 %	\$ 1,332	\$ 1,218	9 %
Other revenue	42.4	37.5	13 %						
Total revenues (i)	\$ 845.5	\$ 749.5	13 %						

(i) Included in revenues:

Fuel surcharge	\$ 128.5	\$ 69.9
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	Revenues			Carloads and Units			Revenue per Carload/Unit		
	Six Months Ended June 30,			Six Months Ended June 30,			Six Months Ended June 30,		
	2022	2021	% Change	2022	2021	% Change	2022	2021	% Change
Chemical and petroleum	\$ 387.7	\$ 463.8	(16 %)	162.3	205.0	(21 %)	\$ 2,389	\$ 2,262	6 %
Industrial and consumer products	335.2	278.6	20 %	164.3	146.7	12 %	2,040	1,899	7 %
Agriculture and minerals	335.9	264.3	27 %	146.2	126.6	15 %	2,298	2,088	10 %
Energy	143.5	112.0	28 %	130.3	124.7	4 %	1,101	898	23 %
Intermodal	213.4	172.4	24 %	510.8	483.1	6 %	418	357	17 %
Automotive	120.7	93.5	29 %	64.1	54.1	18 %	1,883	1,728	9 %
Carload revenues, carloads and units	1,536.4	1,384.6	11 %	1,178.0	1,140.2	3 %	\$ 1,304	\$ 1,214	7 %
Other revenue	87.3	70.9	23 %						
Total revenues (i)	\$ 1,623.7	\$ 1,455.5	12 %						

(i) Included in revenues:

Fuel surcharge	\$ 216.3	\$ 120.8
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For the three months ended June 30, 2022, revenues increased 13% compared to the same period in 2021. Revenues increased due to a 9% increase in revenue per carload/unit and a 3% increase in carload/unit volumes. Revenue per carload/unit increased due to higher fuel surcharge, positive pricing impacts, and longer average length of haul, partially offset by mix. Volumes increased due to strong demand, improved cycle times, and partial recovery of the global microchip shortage. These increases were partially offset by decreased volumes in chemicals and petroleum refined fuel products due to regulatory impacts.

For the six months ended June 30, 2022, revenues increased 12% compared to the same period in 2021. Revenues increased due to a 7% increase in revenue per carload/unit and a 3% increase in carload/unit volumes. Revenue per carload/unit increased due to higher fuel surcharge, positive pricing impacts, and longer average length of haul, partially offset by mix. Volumes increased due to improved cycle times, strong demand, favorable comparable volumes as a result of network congestion driven by weather impacts in 2021, and partial recovery of the global microchip shortage. These increases were partially offset by decreased volumes in chemicals and petroleum refined fuel products due to regulatory impacts.

The fluctuations of the Mexican peso against the U.S. dollar during the three and six months ended June 30, 2022, resulted in an immaterial change compared to the same periods in 2021, for revenue transactions denominated in Mexican pesos. The average exchange rate of Mexican pesos per U.S. dollar was Ps.20.0 and Ps. 20.3 for the three and six months ended June 30, 2022, respectively, compared to Ps.20.1 and Ps. 20.2 for the same periods in 2021.

KCS's fuel surcharges are a mechanism to adjust revenue based upon changes in fuel prices above fuel price thresholds set in KCS's tariffs or contracts. Fuel surcharge revenue is calculated using a fuel price from a prior time period that can be up to 60 days earlier. In a period of volatile fuel prices or changing customer business mix, changes in fuel expense and fuel surcharge revenue may differ.

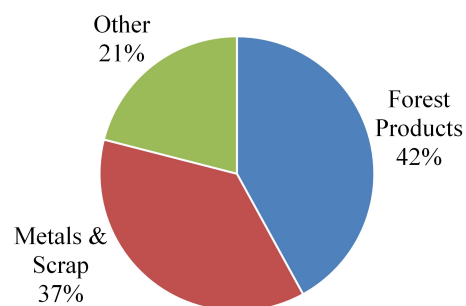
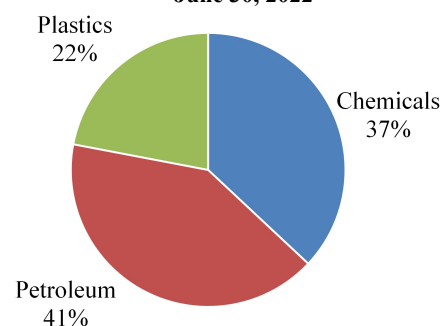
For the three and six months ended June 30, 2022, fuel surcharge revenue increased \$58.6 million and \$95.5 million, respectively, compared to the same periods in 2021, primarily due to higher fuel prices.

The following discussion provides an analysis of revenues by commodity group:

Chemical and petroleum. Revenues decreased \$32.2 million for the three months ended June 30, 2022, compared to the same period in 2021, due to a 21% decrease in carload/unit volumes, partially offset by a 9% increase in revenue per carload/unit. Revenues decreased \$76.1 million for the six months ended June 30, 2022, compared to the same period in 2021, due to a 21% decrease in carload/unit volumes, partially offset by a 6% increase in revenue per carload/unit. Volumes decreased due to refined fuel product shipments into Mexico being negatively impacted by supply chain disruptions as a result of increased regulation. Refer to Mexico Regulatory and Legal Updates for further discussion. Revenue per carload/unit increased for the three months ended June 30, 2022 due to higher fuel surcharge, mix, positive pricing impacts, and longer average length of haul. Revenue per carload/unit increased for the six months ended June 30, 2022 due to higher fuel surcharge and positive pricing impacts.

Industrial and consumer products. Revenues increased \$29.9 million for the three months ended June 30, 2022, compared to the same period in 2021, due to a 16% increase in carload/unit volumes and a 4% increase in revenue per carload/unit. Revenues increased \$56.6 million for the six months ended June 30, 2022, compared to the same period in 2021, due to a 12% increase in carload/unit volumes and a 7% increase in revenue per carload/unit. Metal volumes increased due to higher demand and new steel plants that opened on the KCSM network in 2021. Forest product volumes increased due to demand, improved cycle times, and equipment availability. Revenue per carload/unit increased for the three months ended June 30, 2022 due to higher fuel surcharge and positive pricing impacts, partially offset by mix and shorter average length of haul. Revenue per carload/unit increased for the six months ended June 30, 2022 due to higher fuel surcharge, positive pricing impacts, and longer average length of haul, partially offset by mix.

**Revenues by commodity group
for the three months ended
June 30, 2022**



Agriculture and minerals. Revenues increased \$32.6 million for the three months ended June 30, 2022, compared to the same period in 2021, due to an 11% increase in both carload/unit volumes and revenue per carload/unit. Volumes increased due to improved cycle times. Revenue per carload/unit increased due to higher fuel surcharge, positive pricing impacts, and longer average length of haul, partially offset by mix.

Revenues increased \$71.6 million for the six months ended June 30, 2022, compared to the same period in 2021, due to a 15% increase in carload/unit volumes and a 10% increase in revenue per carload/unit. Volumes increased due to improved cycle times and favorable comparable volumes as a result of network congestion driven by weather impacts in 2021. Revenue per carload/unit increased due to higher fuel surcharge and positive pricing impacts, partially offset by mix.

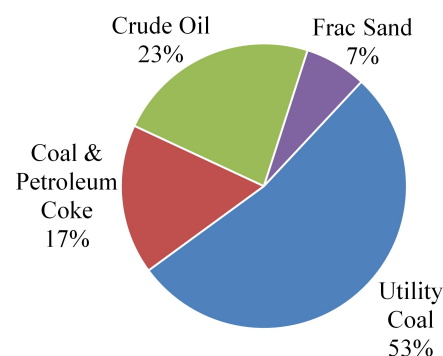
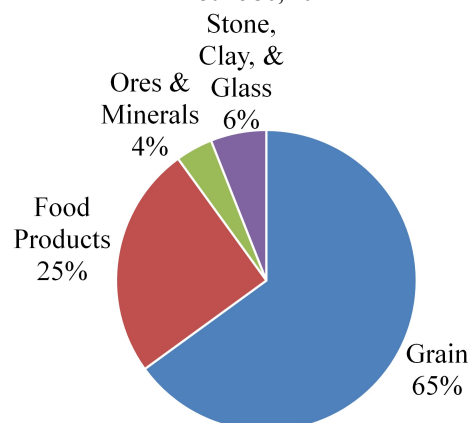
Energy. Revenues increased \$17.4 million for the three months ended June 30, 2022, compared to the same period in 2021, due to a 32% increase in revenue per carload/unit. Revenue per carload/unit increased due to longer average length of haul, higher fuel surcharge, and positive pricing impacts, partially offset by mix.

Revenues increased \$31.5 million for the six months ended June 30, 2022, compared to the same period in 2021, due to a 23% increase in revenue per carload/unit and a 4% increase in carload/unit volumes. Revenue per carload/unit increased due to higher fuel surcharge, longer average length of haul, and positive pricing impacts. Volumes increased in crude oil due to new business, partially offset by a decline in utility coal as a result of deteriorated interchange cycle times and utility plant maintenance outages.

Intermodal. Revenues increased \$26.4 million for the three months ended June 30, 2022, compared to the same period in 2021, due to a 22% increase in revenue per carload/unit and a 6% increase in carload/unit volumes. Revenues increased \$41.0 million for the six months ended June 30, 2022, compared to the same period in 2021, due to a 17% increase in revenue per carload/unit and a 6% increase in carload/unit volumes. Revenue per carload/unit increased due to higher fuel surcharge, mix, positive pricing impacts, and longer average length of haul. Volumes increased due to stronger demand, new business, and partial recovery of the global microchip shortage affecting auto parts shipments, partially offset by weaker Mexico domestic demand. Additionally for the six months ended June 30, 2022, volumes increased due to favorable comparable volumes as a result of network congestion driven by weather impacts in 2021.

Automotive. Revenues increased \$17.0 million for the three months ended June 30, 2022, compared to the same period in 2021, due to a 19% increase in carload/unit volumes and a 13% increase in revenue per carload/unit. Revenues increased \$27.2 million for the six months ended June 30, 2022, compared to the same period in 2021, due to a 18% increase in carload/unit volumes and a 9% increase in revenue per carload/unit. Volumes increased due to partial recovery of the global microchip shortage. Revenue per carload/unit increased due to higher fuel surcharge, positive pricing impacts, and longer average length of haul, partially offset by mix.

**Revenues by commodity group
for the three months ended
June 30, 2022**



Operating Expenses

Operating expenses, as shown below (*in millions*), decreased \$648.5 million and \$614.4 million for the three and six months ended June 30, 2022, respectively, compared to the same periods in 2021, primarily due to decreased merger costs related to the termination fee for the termination of the CP merger agreement by KCS of \$700.0 million recognized in the second quarter of 2021, partially offset by higher diesel fuel prices. The fluctuations of the Mexican peso against the U.S. dollar during the three and six months ended June 30, 2022, resulted in an immaterial change compared to the same periods in 2021, for expense transactions denominated in Mexican pesos. The average exchange rate of Mexican pesos per U.S. dollar was Ps.20.0 and Ps. 20.3 for the three and six months ended June 30, 2022, respectively, compared to Ps.20.1 and Ps. 20.2 for the same periods in 2021.

	Three Months Ended June 30,		Change	
	2022	2021	Dollars	Percent
Compensation and benefits	\$ 136.4	\$ 128.4	\$ 8.0	6 %
Purchased services	54.5	55.8	(1.3)	(2 %)
Fuel	123.0	79.0	44.0	56 %
Equipment costs	23.1	24.1	(1.0)	(4 %)
Depreciation and amortization	97.7	91.2	6.5	7 %
Materials and other	85.5	81.9	3.6	4 %
Merger costs	12.5	720.8	(708.3)	(98 %)
Total operating expenses	\$ 532.7	\$ 1,181.2	\$ (648.5)	(55 %)

	Six Months Ended June 30,		Change	
	2022	2021	Dollars	Percent
Compensation and benefits	\$ 269.4	\$ 257.9	\$ 11.5	4 %
Purchased services	105.8	109.6	(3.8)	(3 %)
Fuel	220.1	149.9	70.2	47 %
Equipment costs	41.7	45.2	(3.5)	(8 %)
Depreciation and amortization	193.9	183.2	10.7	6 %
Materials and other	163.6	148.3	15.3	10 %
Merger costs	25.3	740.1	(714.8)	(97 %)
Total operating expenses	\$ 1,019.8	\$ 1,634.2	\$ (614.4)	(38 %)

Compensation and benefits. Compensation and benefits increased \$8.0 million for the three months ended June 30, 2022, compared to the same period in 2021, due to wage and benefit inflation of approximately \$5.0 million and costs relating to Mexico outsourcing reform of approximately \$3.0 million.

Compensation and benefits increased \$11.5 million for the six months ended June 30, 2022, compared to the same period in 2021, due to wage and benefit inflation of approximately \$11.0 million, an increase in headcount and hours worked of approximately \$5.0 million, and costs relating to Mexico outsourcing reform of approximately \$5.0 million, partially offset by decreased incentive compensation of approximately \$8.0 million and decreased costs due to COVID-19 of approximately \$1.0 million.

Purchased services. Purchased services expense decreased \$1.3 million for the three months ended June 30, 2022, compared to the same period in 2021, due to cost reductions of approximately \$5.0 million as a result of Mexico outsourcing reform, and lower trackage rights expense of approximately \$2.0 million, partially offset by an increase in repairs and maintenance of approximately \$3.0 million and increased software and programming expense of approximately \$2.0 million.

Purchased services expense decreased \$3.8 million for the six months ended June 30, 2022 compared to the same period in 2021, due to cost reductions of approximately \$11.0 million as a result of Mexico outsourcing reform, and lower corporate services of approximately \$3.0 million, partially offset by an increase in software and programming expense of approximately \$5.0 million and higher repairs and maintenance of approximately \$2.0 million.

Fuel. Fuel increased \$44.0 million for the three months ended June 30, 2022, compared to the same period in 2021, due to higher diesel fuel prices in the U.S. and Mexico of approximately \$30.0 million and \$11.0 million, respectively, decreased efficiency of approximately \$2.0 million, and increased consumption of approximately \$2.0 million. These increases were partially offset by the weakening of the Mexican peso against the U.S. dollar of approximately \$1.0 million.

Fuel increased \$70.2 million for the six months ended June 30, 2022, compared to the same period in 2021, due to higher diesel fuel prices in the U.S. and Mexico of approximately \$48.0 million and \$18.0 million, respectively, increased consumption of approximately \$3.0 million, and decreased efficiency of approximately \$2.0 million, partially offset by the weakening of the Mexican peso against the U.S. dollar of approximately \$1.0 million. The average price per gallon was \$3.70 and \$3.36 for the three and six months ended June 30, 2022, respectively, compared to \$2.51 and \$2.38 for the same periods in 2021.

Equipment costs. Equipment costs decreased \$1.0 million for the three months ended June 30, 2022, compared to the same period in 2021, due to lower lease expense.

Equipment costs decreased \$3.5 million for the six months ended June 30, 2022, compared to the same period in 2021, due to lower car hire expense of approximately \$3.0 million due to decreased cycle times and rate, and lower lease expense of approximately \$1.0 million.

Depreciation and amortization. Depreciation and amortization expense increased \$6.5 million and \$10.7 million for the three and six months ended June 30, 2022, respectively, compared to the same periods in 2021, due to a larger asset base and an increase in depreciation rates on equipment as a result of an updated depreciation study.

Materials and other. Materials and other expense increased \$3.6 million for the three months ended June 30, 2022 compared to the same period in 2021, due to higher employee expenses of approximately \$4.0 million, increased material purchases resulting from Mexico outsourcing reform of approximately \$4.0 million, increased expense of approximately \$3.0 million related to the non-creditable VAT due to VAT law changes in Mexico, and increased materials and supplies expense of approximately \$2.0 million. These increases were partially offset by a one-time contract dispute of approximately \$9.0 million recognized in 2021.

Materials and other expense increased \$15.3 million for the six months ended June 30, 2022, respectively, compared to the same period in 2021, due to increased expense of approximately \$8.0 million related to the non-creditable VAT due to VAT law changes in Mexico, higher employee expenses of approximately \$8.0 million, and increased material purchases resulting from Mexico outsourcing reform of approximately \$7.0 million. These increases were partially offset by a one-time contract dispute of approximately \$9.0 million recognized in 2021.

Merger costs. During the three and six months ended June 30, 2022, the Company recognized merger costs of \$12.5 million and \$25.3 million, respectively, which are primarily related to incentive compensation. During the three and six months ended June 30, 2021, the Company recognized merger costs of \$720.8 million and \$740.1 million, respectively, which are primarily related to the termination fee associated with the termination of the CP merger agreement by KCS of \$700.0 million. See Note 2, Merger Agreement for more information.

Non-Operating Income and Expenses

Equity in net earnings of affiliates. For the three months ended June 30, 2022, equity in net earnings of affiliates decreased \$4.2 million, compared to the same period in 2021, primarily due to decreased net earnings from unrealized depreciation of investments held in a fifteen percent-owned equity investment.

For the six months ended June 30, 2022, equity in net earnings of affiliates decreased \$1.4 million, compared to the same period in 2021, primarily due to a decrease in net earnings from the operations of TFCM, S. de R.L. de C.V. ("TCM") due to decreased interest and tax expense in 2021, partially offset by increased net earnings from unrealized appreciation of investments held in a fifteen percent-owned equity investment.

Interest expense. For the three and six months ended June 30, 2022, interest expense increased \$1.1 million and \$1.0 million, respectively, compared to the same periods in 2021 due to higher average debt balances. During both the three and six months ended June 30, 2022, the average debt balance (including commercial paper) was \$3,812.5 million, compared to \$3,810.5 million and \$3,807.5 million for the same periods in 2021. The average interest rate during both the three and six months ended June 30, 2022 was 4.1%, compared to 4.1% for the same periods in 2021.

Foreign exchange gain (loss). For the three and six months ended June 30, 2022, the Company incurred a foreign exchange loss of \$4.3 million and \$5.7 million, respectively, compared to a foreign exchange gain of \$6.8 million and a loss of \$0.5 million, for the

same periods in 2021. Foreign exchange gain (loss) includes the re-measurement and settlement of net monetary assets denominated in Mexican pesos and the gain (loss) on foreign currency derivative contracts.

For the three and six months ended June 30, 2022, the re-measurement and settlement of monetary assets and liabilities denominated in Mexican pesos resulted in a foreign exchange loss of \$1.6 million and a gain of \$5.1 million, respectively, compared to a gain of \$8.5 million and \$3.6 million for the same periods in 2021.

The Company enters into foreign currency derivative contracts to hedge its net exposure to fluctuations in foreign currency caused by fluctuations in the value of the Mexican peso against the U.S. dollar. For the three and six months ended June 30, 2022, the Company incurred a foreign exchange loss on foreign currency derivative contracts of \$2.7 million and \$10.8 million, respectively, compared to a loss of \$1.7 million and \$4.1 million, for the same periods in 2021.

Other income, net. Other income (expense), net decreased \$1.8 million and \$0.1 million for the three and six months ended June 30, 2022, compared to the same periods in 2021, due to a decrease in miscellaneous income.

Income tax expense. Income tax expense increased \$154.2 million and \$168.2 million for the three and six months ended June 30, 2022, respectively, compared to the same periods in 2021, primarily due to higher pre-tax income resulting from the recognition of the CP termination fee during the three and six months ended June 30, 2021. A discrete tax benefit of \$147.0 million was recognized on the CP termination fee resulting in a tax benefit for the three and six months ended June 30, 2021.

See the discussion regarding the Company's tax contingencies in Item 1, Financial Statements and Supplementary Data — Note 9, Commitments and Contingencies.

The components of the effective tax rates for the three and six months ended June 30, 2022, compared to the same periods in 2021, are as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2022	2021	2022	2021
Statutory rate in effect	21.0 %	21.0 %	21.0 %	21.0 %
Tax effect of:				
Difference between U.S. and foreign tax rate	5.7 %	(3.0 %)	5.6 %	(10.6 %)
Inflation	(2.4 %)	0.2 %	(1.9 %)	0.9 %
State and local income tax provision, net	1.3 %	(0.7 %)	1.3 %	(2.3 %)
Foreign exchange (i)	0.9 %	(0.5 %)	1.0 %	(1.3 %)
Other, net	0.7 %	0.8 %	0.5 %	1.6 %
Effective tax rate	27.2 %	17.8 %	27.5 %	9.3 %

- (i) The Company's Mexican subsidiaries have net U.S. dollar-denominated monetary liabilities which, for Mexican income tax purposes, are subject to periodic revaluation based on changes in the value of the Mexican peso against the U.S. dollar. This revaluation creates fluctuations in the Company's Mexican income tax expense in the consolidated income statements and the amount of income taxes paid in Mexico. The Company also has net monetary assets denominated in Mexican pesos, that are subject to periodic re-measurement and settlement that creates fluctuations in foreign currency gains and losses in the consolidated income statements. The Company hedges its net exposure to variations in earnings by entering into foreign currency forward contracts. The foreign currency forward contracts involve the Company's agreement to buy or sell pesos at an agreed-upon exchange rate on a future date. Refer to Note 6, Derivative Instruments for more information.

Mexico Regulatory and Legal Updates

Hydrocarbons Law. On May 5, 2021, new legislation pertaining to the transport and handling of hydrocarbons in Mexico became effective. This legislation addresses a wide array of issues related to the storage, transportation and handling of petroleum products, as well as the illegal import of hydrocarbons. The legislation is being challenged in the court system by a number of stakeholders and is currently subject to a court-ordered injunction, resulting in a suspension of the implementation and enforcement of this new law. To date, this law has not had a material effect on the Company or its operations. However, the Company is continuing to monitor this law and is evaluating the effect on the Company and its business operations.

Inspections Related to Imports and Terminals. During 2021, the Ministry of Infrastructure, Communications, and Transportation ("SICT") and other relevant Mexican authorities increased inspections of imports and enforcement of various regulations and permit requirements related to terminal operations, with specific focus on imports of refined products and refined fuel transloading terminals and freight terminals, in order to prevent the illegal importation of refined fuel products. These inspections resulted in delays related to

the import of shipments into Mexico as well as the shutdown of several refined fuel terminals in the second half of 2021. The SICT has instructed KCSM to provide railway service only to those terminals that have the applicable permits. If KCSM were to fail to comply with the SICT requirements, the Company could be subject to fines and potential revocation of the Concession. As a result, KCS's freight revenue from refined products decreased in the second half of 2021 and continued to decrease in the first half of 2022. See further discussion in the Revenues section.

Value-Added Tax Law. KCSM is not required to charge its customers value added tax ("VAT") on international import or export transportation services, which prior to 2022 resulted in KCSM paying more VAT on its expenses than it collected from customers. These excess VAT payments are refundable by the Mexican government. Prior to 2019, Mexican companies could offset their monthly refundable VAT balance with other tax obligations. In January 2019, Mexico tax reform eliminated the ability to offset other tax obligations with refundable VAT. Over 2019 through 2021, KCSM generated a refundable VAT balance and filed refund claims with the Servicio de Administración Tributaria (the "SAT"), which have not been refunded.

In November 2021, changes to the VAT law were announced and became effective beginning January 1, 2022. These changes reduced the recoverability of VAT paid by KCSM on its expenditures that support international import transportation service revenues that are not subject to a VAT charge. VAT that is unrecoverable from the Mexican government results in incremental VAT expense for KCSM. Beginning in 2022, KCSM changed certain service offerings to either require VAT to be charged to customers on revenue, or impose a rate increase to offset the incremental VAT expense. These measures implemented by KCSM increased the VAT to be collected from customers and payable to the Mexican government.

As of June 30, 2022 and December 31, 2021, the KCSM refundable VAT balance was \$119.6 million and \$152.2 million, respectively. KCSM has prior favorable Mexican court decisions and a legal opinion supporting its right under Mexican law to recover the refundable VAT balance from the Mexican government and believes the VAT to be fully recoverable. KCSM will recover the refundable VAT balance as VAT billed to customers exceeds creditable VAT charged by vendors. As of June 30, 2022 and December 31, 2021, \$79.0 million and \$78.0 million, respectively, of the refundable VAT balance was classified as a short-term asset.

Carta Porte. In the second quarter of 2021, KCSM was notified by the SAT that shipping companies (cargo airlines, trucks, maritime, railroads, and other similar companies) must include additional bill of lading information (referred to in Mexico as "Carta Porte") with the invoice for all merchandise shipped in Mexico, including cross-border, international and Mexico domestic shipments. The Carta Porte requirements and deadline were modified several times throughout 2021. The effective date of January 1, 2022 included a three month grace period during which penalties and fines for inaccurate information would not be imposed. In the first quarter of 2022, the grace period was extended to September 30, 2022. KCSM adapted its systems to comply with the Carta Porte requirements, which delayed KCSM's invoicing and cash collections by approximately 60 days in the second quarter of 2022.

Failure to comply with Carta Porte requirements subsequent to the grace period could result in penalties and fines imposed by the SAT, shipping delays causing network congestion and delayed invoicing and cash collections. In addition, in the event of repeated noncompliance with Carta Porte requirements, the SAT has the power to preventively shut down operations of a company.

Liquidity and Capital Resources

Overview

The Company focuses its cash and capital resources on investing in the business, shareholder returns and optimizing its capital structure.

The Company believes, based on current expectations, that cash and other liquid assets, operating cash flows, and other available financing resources will be sufficient to fund anticipated operating expenses, capital expenditures, debt service costs, dividends, and other commitments for the foreseeable future.

During the six months ended June 30, 2022, the Company invested \$219.9 million in capital expenditures. See the Capital Expenditures section for further details.

In the first quarter of 2022, pursuant to the Merger Agreement, KCS paid a cash dividend of \$265.0 million, to a wholly-owned subsidiary of CP. KCS plans to make further periodic cash distributions based upon cash generated, the timing of capital expenditures and working capital needs of the Company.

The Company's current financing instruments contain restrictive covenants that limit or preclude certain actions; however, the covenants are structured such that the Company expects to have sufficient flexibility to conduct its operations. The Company has been, and expects to continue to be, in compliance with all of its debt covenants. For additional discussion of the agreements representing the indebtedness of KCS, see Note 11, Short-Term Borrowings and Note 12, Long-Term Debt in the "Notes to the Consolidated Financial Statements" section of the Company's Annual Report on Form 10-K for the year ended December 31, 2021.

KCS believes it has a strong liquidity position to continue business operations and service its debt obligations. The Company has total available liquidity of \$722.5 million as of June 30, 2022, consisting of cash on hand and a revolving credit facility, compared to available liquidity at December 31, 2021 of \$939.3 million.

As of June 30, 2022, the total cash and cash equivalents held outside of the U.S. in foreign subsidiaries was \$22.7 million, after repatriating \$42.9 million during 2022. The Company expects that this cash will be available to fund operations without incurring significant additional income taxes.

On January 1, 2022, KCSM complied with Carta Porte requirements, providing customers with additional bill of lading information with the invoice for all merchandise shipped in Mexico. KCSM adapted its systems to comply with the Carta Porte requirements, which delayed KCSM's invoicing and cash collections by approximately 60 days in the second quarter of 2022, resulting in the accounts receivable as of June 30, 2022 to be elevated compared to historical levels. The Company believes cash collections will normalize in the second half of 2022.

Cash Flow Information

Summary cash flow data follows (*in millions*):

	Six Months Ended June 30,	
	2022	2021
Cash flows provided by (used for):		
Operating activities	\$ 283.0	\$ 507.3
Investing activities	(227.8)	(279.0)
Financing activities	(270.0)	(90.3)
Effect of exchange rate changes on cash	(2.0)	(0.4)
Net increase (decrease) in cash and cash equivalents	(216.8)	137.6
Cash and cash equivalents beginning of year	339.3	188.2
Cash and cash equivalents end of period	\$ 122.5	\$ 325.8

Cash flows from operating activities decreased \$224.3 million for the six months ended June 30, 2022, compared to the same period in 2021, primarily due to a delay in invoicing and decreased cash collections resulting from implementation of Carta Porte regulations, partially offset by lower Mexican value added tax payments.

Net cash used for investing activities decreased \$51.2 million for the six months ended June 30, 2022, compared to the same period in 2021, primarily due to a decrease in capital expenditures of \$53.2 million.

Net cash used for financing activities increased \$179.7 million for the six months ended June 30, 2022, compared to the same period in 2021, primarily due to the cash dividend payment of \$265.0 million to a wholly-owned subsidiary of CP.

Capital Expenditures

KCS has funded, and expects to continue to fund capital expenditures with operating cash flows and short and long-term debt.

The following table summarizes capital expenditures by type (*in millions*):

	Six Months Ended June 30,	
	2022	2021
Roadway capital program	\$ 132.1	\$ 116.9
Locomotives and freight cars	24.6	44.1
Capacity	36.0	57.1
Information technology	24.0	19.3
Positive train control	1.9	9.6
Other	1.3	2.2
Total capital expenditures (accrual basis)	219.9	249.2
Change in capital accruals	(22.6)	1.3
Total cash capital expenditures	\$ 197.3	\$ 250.5

Supplemental Guarantor Financial Information

The following is a description of the terms and conditions of the guarantees with respect to senior notes for which KCS is an issuer or provides full and unconditional guarantee.

Note Guarantees

As of June 30, 2022, KCS had outstanding \$3,736.2 million principal amount of senior notes due through 2069. KCSR had outstanding \$2.7 million principal amount of senior notes due through 2045 (together, the “Senior Notes”). The senior notes for which KCS is the issuer are unconditionally guaranteed, jointly and severally, on an unsecured senior basis, by each of KCS’s current and future domestic consolidated subsidiaries that from time to time guarantees certain of KCS’s credit agreements, or any other debt of KCS, or any of KCS’s significant subsidiaries that is a guarantor (each, a “Guarantor Subsidiary,” and collectively, the “Guarantor Subsidiaries”). In addition, the senior notes for which KCSR is the issuer are unconditionally guaranteed, jointly and severally, on an unsecured senior basis, by KCS and each of its current and future domestic consolidated subsidiaries that from time to time guarantees KCSR’s credit agreement, or any other debt of KCSR or any of KCSR’s significant subsidiaries that is a Guarantor Subsidiary. The obligations of each Guarantor Subsidiary under its note guarantee are limited as necessary to prevent such note guarantee from constituting a fraudulent conveyance under applicable law. A guarantee of the Senior Notes by KCS or a Guarantor Subsidiary is subject to release in the following circumstances: (i) the sale, disposition, exchange or other transfer (including through merger, consolidation, amalgamation or otherwise) of the capital stock of the Guarantor Subsidiary made in a manner not in violation of the indenture; (ii) the designation of the subsidiary as an “Unrestricted Subsidiary” under the indenture; (iii) the legal defeasance or covenant defeasance of the Senior Notes in accordance with the terms of the indenture; or (iv) the Guarantor Subsidiary ceasing to be KCS’s subsidiary as a result of any foreclosure of any pledge or security interest securing KCS’s Revolving Credit Facility or other exercise of remedies in respect thereof.

KCSM and any other foreign subsidiaries of KCS do not and will not guarantee the Senior Notes (“Non-Guarantor Subsidiaries”).

The following tables present summarized financial information for KCS and the Guarantor Subsidiaries on a combined basis after intercompany transactions have been eliminated, including adjustments to remove the receivable and payable balances, investment in, and equity in earnings from the Non-Guarantor Subsidiaries.

Summarized Financial Information

Income Statements

	KCS and Guarantor Subsidiaries	
	Six Months Ended June 30, 2022	Twelve Months Ended December 31, 2021
Revenues	\$ 865.2	\$ 1,561.3
Operating expenses	555.2	1,200.8
Operating income	310.0	360.5
Income before income taxes	237.0	207.7
Net income	189.1	182.7

Balance Sheets

	KCS and Guarantor Subsidiaries	
	June 30, 2022	December 31, 2021
Assets:		
Current assets	\$ 561.2	\$ 524.6
Property and equipment (including concession assets), net	4,888.4	4,876.5
Other non-current assets	63.6	125.8
Liabilities and equity:		
Current liabilities	\$ 802.5	\$ 316.5
Non-current liabilities	4,504.2	4,942.7
Noncontrolling interest	330.0	328.2

Excluded from current assets in the table above are \$278.5 million and \$199.8 million of current intercompany receivables due to KCS and the Guarantor Subsidiaries from the Non-Guarantor Subsidiaries as of June 30, 2022 and December 31, 2021, respectively. Excluded from current liabilities in the table above are \$206.4 million and \$267.5 million of current intercompany payables due to the Non-Guarantor Subsidiaries from KCS and the Guarantor Subsidiaries as of June 30, 2022 and December 31, 2021, respectively.

The Senior Notes are structurally subordinated to the indebtedness and other liabilities of the Non-Guarantor Subsidiaries. The Non-Guarantor Subsidiaries are separate and distinct legal entities and have no obligation, contingent or otherwise, to pay any amounts due pursuant to the Senior Notes or the indentures, or to make any funds available therefor, whether by dividends, loans, distributions or other payments. Any right that KCS or the Guarantor Subsidiaries have to receive any assets of any of the Non-Guarantor Subsidiaries upon the liquidation or reorganization of any Non-Guarantor Subsidiary, and the consequent rights of holders of Senior Notes to realize proceeds from the sale of any of a Non-Guarantor Subsidiary's assets, would be effectively subordinated to the claims of such Non-Guarantor Subsidiary's creditors, including trade creditors and holders of preferred equity interests, if any, of such Non-Guarantor Subsidiary. Accordingly, in the event of a bankruptcy, liquidation or reorganization of any of the Non-Guarantor Subsidiaries, the Non-Guarantor Subsidiaries will pay the holders of their debts, holders of preferred equity interests, if any, and their trade creditors before they will be able to distribute any of their assets to KCS or any Guarantor Subsidiary.

If a Guarantor Subsidiary were to become a debtor in a case under the U.S. Bankruptcy Code or encounter other financial difficulty, under federal or state fraudulent transfer or conveyance law, a court may avoid, subordinate or otherwise decline to enforce its guarantee of the Senior Notes. A court might do so if it is found that when such Guarantor Subsidiary entered into its guarantee of the Senior Notes, or in some states when payments became due under the Senior Notes, such Guarantor Subsidiary received less than reasonably equivalent value or fair consideration and either:

- was insolvent or rendered insolvent by reason of such incurrence;
- was left with unreasonably small or otherwise inadequate capital to conduct its business; or
- believed or reasonably should have believed that it would incur debts beyond its ability to pay.

The court might also avoid the guarantee of the Senior Notes without regard to the above factors, if the court found that a Guarantor Subsidiary entered into its guarantee with actual intent to hinder, delay or defraud its creditors.

A court would likely find that a Guarantor Subsidiary did not receive reasonably equivalent value or fair consideration for its guarantee of the Senior Notes, if such Guarantor Subsidiary did not substantially benefit directly or indirectly from the funding made available by the issuance of the Senior Notes. If a court were to avoid a guarantee of the Senior Notes provided by a Guarantor Subsidiary, holders of the Senior Notes would no longer have any claim against such Guarantor Subsidiary. The measures of insolvency for purposes of these fraudulent transfer or conveyance laws will vary depending upon the law applied in any proceeding to determine whether a fraudulent transfer or conveyance has occurred, such that the Company cannot predict what standards a court would use to determine whether or not a Guarantor Subsidiary was solvent at the relevant time or, regardless of the standard that a court uses, that the guarantee of a Guarantor Subsidiary would not be subordinated to such Guarantor Subsidiary's other debt. As noted above, each guarantee provided by a Guarantor Subsidiary includes a provision intended to limit the Guarantor Subsidiary's liability to the maximum amount that it could incur without causing the incurrence of obligations under its guarantee to be a fraudulent transfer or conveyance. This provision may not be effective to protect those guarantees from being avoided under fraudulent transfer or conveyance law, or it may reduce that Guarantor Subsidiary's obligation to an amount that effectively makes its guarantee worthless, and the Company cannot predict whether a court will ultimately find it to be effective.

On the basis of historical financial information, operating history and other factors, the Company believes that each of the Guarantor Subsidiaries, after giving effect to the issuance of its guarantee of the Senior Notes when such guarantee was issued, was not insolvent, did not have unreasonably small capital for the business in which it engaged and did not and has not incurred debts beyond its ability to pay such debts as they mature. The Company cannot predict, however, as to what standard a court would apply in making these determinations or that a court would agree with the Company's conclusions in this regard.

Other Matters

Collective Bargaining

KCSR participates in industry-wide multi-employer bargaining as a member of the National Carriers' Conference Committee ("NCCC"), as well as local bargaining for agreements that are limited to KCSR's property. Approximately 71% of KCSR employees are covered by collective bargaining agreements. Long-term agreements were reached voluntarily or through the arbitration process during 2017 and 2018 covering all of the participating unions. The terms of these agreements will remain in effect until new agreements are reached in the current national bargaining round. In November 2019, KCSR and its unions commenced negotiations in connection with the 2020 bargaining round.

On July 15, 2022, President Biden signed an executive order creating a Presidential Emergency Board (“PEB”) to assist the railroads and its unions in ongoing national labor negotiations. The PEB will review the parties’ proposals, hold hearings and has thirty days to issue non-binding settlement recommendations to the President. The parties will have until September 18, 2022 to reach a voluntary settlement based on those recommendations.

KCSM union employees are covered by one labor agreement, which was signed on April 16, 2012, between KCSM Servicios, a previously wholly-owned subsidiary of KCS that was merged into KCSM in 2021, and the Sindicato de Trabajadores Ferrocarrileros de la República Mexicana (“Mexican Railroad Union”). This labor agreement remains in effect during the period of the Concession for the purpose of regulating the relationship between the parties. Approximately 77% of KCSM employees are covered by this labor agreement. The compensation terms under this labor agreement are subject to renegotiation on an annual basis and all other benefits are subject to negotiation every two years. The parties finalized negotiations over compensation terms and benefits that applied until June 30, 2021, along with other terms, and will remain in effect until new terms have been negotiated.

Union labor negotiations have not historically resulted in any strike, boycott, or other disruption in the Company’s business operations.

Item 3. *Quantitative and Qualitative Disclosures about Market Risk*

There was no material change during the quarter from the information set forth in Part II, Item 7A. “Quantitative and Qualitative Disclosure about Market Risk” in the Annual Report on Form 10-K for the year ended December 31, 2021.

Item 4. *Controls and Procedures*

(a) Disclosure Controls and Procedures

The Company maintains disclosure controls and procedures (as that term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”)) that are designed to ensure that information required to be disclosed in the Company’s reports under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms, and that such information is accumulated and communicated to the Company’s management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosures. Any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. The Company’s management, with the participation of the Company’s Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the design and operation of the Company’s disclosure controls and procedures as of the end of the quarterly period covered by this Quarterly Report on Form 10-Q. Based upon that evaluation, the Company’s Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the fiscal quarter ended June 30, 2022, the design and operation of the Company’s disclosure controls and procedures were effective to accomplish their objectives at a reasonable assurance level.

(b) Changes in Internal Control over Financial Reporting

In 2020, KCS began a multi-year SAP Enterprise Resource Planning (“ERP”) system upgrade from the ECC platform to the SAP S/4 HANA platform (“SAP Upgrade”). During the second quarter of 2022, KCS implemented the SAP Upgrade, which involved changes in business processes and organizational training. Management has taken the necessary steps to implement, monitor and maintain appropriate internal controls. There were no significant changes in the Company’s internal controls over financial reporting resulting from the completion of this upgrade. There have been no other changes in the Company’s internal control over financial reporting (as that term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the fiscal quarter ended June 30, 2022 that have materially affected, or are reasonably likely to materially affect, the Company’s internal control over financial reporting.

PART II — OTHER INFORMATION

Item 1. *Legal Proceedings*

For information related to the Company’s legal proceedings, see Note 9, Commitments and Contingencies, under Part I, Item 1 of this quarterly report on Form 10-Q.

Item 1A. *Risk Factors*

There were no material changes during the quarter to the Risk Factors disclosed in Item 1A - “Risk Factors” in the Company’s Annual Report on Form 10-K for the year ended December 31, 2021.

Item 2. *Unregistered Sales of Equity Securities and Use of Proceeds*

None.

Item 3. *Defaults upon Senior Securities*

None.

Item 4. *Mine Safety Disclosures*

Not applicable.

Item 5. *Other Information*

None.

Item 6. Exhibits

Exhibit No.	Exhibits
10.1*	English translation of amendment no. 6, dated July 14, 2022, of concession title granted by SICT in favor of KCSM, formerly known as FNE, December 2, 1996, as amended February 12, 2001, November 22, 2006, December 31, 2013, December 20, 2017, and April 27, 2018, is attached to this Form 10-Q as Exhibit 10.1.
22.1	List of Issuers and Guarantor Subsidiaries, filed as Exhibit 22.1 to the Company's Form 10-Q for the quarter ended March 31, 2020, filed on April 17, 2020 (File No. 1-4717), is incorporated herein by reference as Exhibit 22.1.
31.1*	Principal Executive Officer's Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 is attached to this Form 10-Q as Exhibit 31.1.
31.2*	Principal Financial Officer's Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 is attached to this Form 10-Q as Exhibit 31.2.
32.1**	Principal Executive Officer's Certification furnished Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 is attached to this Form 10-Q as Exhibit 32.1.
32.2**	Principal Financial Officer's Certification furnished Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 is attached to this Form 10-Q as Exhibit 32.2.
101.INS	XBRL Instance Document - the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document.
101.SCH	Inline XBRL Taxonomy Extension Schema Document.
101.CAL	Inline XBRL Taxonomy Extension Calculation Linkbase Document.
101.DEF	Inline XBRL Taxonomy Extension Definition Linkbase Document.
101.LAB	Inline XBRL Taxonomy Extension Label Linkbase Document.
101.PRE	Inline XBRL Taxonomy Extension Presentation Linkbase Document.
104	Cover Page Interactive Data File (formatted as an Inline XBRL document and included in Exhibit 101).

* Filed herewith.

** Furnished herewith.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Company has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized and in the capacities indicated on July 28, 2022.

Kansas City Southern

/s/ MICHAEL W. UPCHURCH

Michael W. Upchurch
Executive Vice President and Chief Financial Officer
(Principal Financial Officer)

/s/ SUZANNE M. GRAFTON

Suzanne M. Grafton
Vice President and Chief Accounting Officer
(Principal Accounting Officer)



AMENDMENT TO THE CONCESSION TITLE GRANTED ON DECEMBER 2nd, 1996, BY THE FEDERAL GOVERNMENT, THROUGH THE MINISTRY OF COMMUNICATIONS AND TRANSPORTATION, CURRENTLY MINISTRY OF INFRASTRUCTURE, COMMUNICATIONS AND TRANSPORTATION, IN FAVOR OF FERROCARRIL DEL NORESTE, S.A. DE C.V., CURRENTLY KANSAS CITY SOUTHERN DE MÉXICO, S.A. DE C.V., IN ACCORDANCE WITH THE FOLLOWING RECITALS AND CLAUSES:

RECITALS

I. - On December 2nd, 1996, the Federal Government, through the then Ministry of Communications and Transportation, currently Ministry of Infrastructure, Communications and Transportation, hereinafter **“THE MINISTRY”**, granted Ferrocarril del Noreste, S.A. de C.V., currently Kansas City Southern de México, S.A. de C.V., hereinafter **“THE CONCESSIONAIRE”**, the Concession title to i) operate and exploit the general railway communication route corresponding to the Northeast Trunk Road described in Annex One, which configuration, areas, limits and routes are detailed in Annex Two, with the exception of the areas indicated in Annex Four, which includes the Trunk Road, the right of way, the traffic control centers and the signals for its railroad operation; ii) the use, utilization and exploitation of the public domain assets described in Annex Three, with the exception of the areas indicated in Annex Four; and iii) the provision of the public service of rail freight transport in that General Railway Communication Route, which includes the permits to provide the auxiliary services indicated in Annex Five, under the terms set forth in the title itself, which was published in the Official Gazette of the Federation on February 3rd, 1997, instrument that hereinafter shall be referred to as **“THE CONCESSION TITLE”**.

“THE CONCESSION TITLE” was amended on February 12th, 2001, November 22nd, 2006, December 31st, 2013, December 20th, 2017 and April 27th, 2018, amendments that were published in the Official Gazette of the Federation on March 20th, 2001, December 29th, 2006, March 26th, 2014, March 22nd, 2018 and June 1st, 2018, respectively.

II. - The railroads are one of the priority areas for national development and, therefore, the Mexican State is responsible for guiding their development in terms of the provisions of Articles 25 and 28, fourth paragraph, of the Political Constitution of the United Mexican States.

III. - The National Development Plan 2019-2024, published in the Official Gazette of the Federation on July 12th, 2019, states in its Epilogue: Vision 2024, as a responsibility of the Federal Government, to carry out a major transformation in the administrative apparatus and to redirect the public policies, governmental priorities and budgets; it also establishes the following General Axes: I. Politics and Government, II. Social Policy and III. Economy, foreseeing to achieve its fulfillment, among others, as a guiding principle: “the economy for welfare”, resuming the path of growth with austerity and without corruption.

IV. - According to the National Agreement on Infrastructure Investment in the Private Sector, released by the Federal Government in November 2019, Mexico requires infrastructure to promote



its development in an inclusive manner, and bring opportunities to the most lagging regions, among others, in railroads. In the same National Agreement, the Government of Mexico states its commitment to promote and facilitate the participation of private investment in infrastructure to conclude and initiate new private investment projects, both domestic and foreign, to reactivate economic activity.

V. - The Sectorial Program of Communications and Transportation 2020-2024, published in the Official Gazette of the Federation on July 2nd, 2020, establishes, among its priority objectives, to contribute to the development of the country by strengthening transport with a long-term vision, promoting, among others, a greater participation of railroad freight transportation as compared to auto-transportation.

VI. - In the city of Celaya, Guanajuato, the “NB” Line, on the the Acámbaro-Escobedo section that goes from km NB-0+000 to km NB-85+447 of the Mexico-Lázaro Cárdenas corridor, which is part of **“THE CONCESSION TITLE”**, crosses with Line “A”, on the Mariscala-Irapuato section that goes from km A-263+922 to km A-354+516 of the México-Ciudad Juárez corridor, which is part of the concession title granted in favor of the company called Ferrocarril Mexicano S.A de C.V (Ferromex); likewise, the switchyard of Celaya, hereinafter **“CELAYA SWITCHYARD”**, is part of the concession of Ferromex and extends from east to west; the railroad tracks of **“THE CONCESSIONAIRE”** are located from north to south.

The exchange of loaded and empty cars between **“THE CONCESSIONAIRE”** and Ferromex takes place in the **“CELAYA SWITCHYARD”**, causing constant blockages to the population in the urban area of the city of Celaya, which generates a problem in the region that constitutes an area of opportunity for the efficiency of the provision of the public railroad transportation service in said area.

VII. - In order to solve this problem, as of 2012, **“THE MINISTRY”** started the construction of a by-pass, hereinafter referred to as **“THE CELAYA BY-PASS”**, which considers the modification of the routes of Lines “A” and “NB” through a new infrastructure composed of two by-passes called “AM” and “NBA” lines, respectively. The purpose of the second of said by-passes is to replace the operation of the railway section of the “NB” Line, from km 61+727 to km 82+405 for its subsequent disincorporation from **“THE CONCESSION TITLE”**.

VIII. - By means of a letter dated June 2nd, 2022, **“THE CONCESSIONAIRE”** declared to **“THE MINISTRY”** its interest and willingness to finance and carry out the conclusion of the construction of the works related to **“THE CELAYA BY-PASS”** in the section of the “NBA” line from km 0+000 to km 20+966.30, hereinafter **“THE CELAYA-NBA LINE BY-PASS”**, in accordance with the terms and conditions described in the executive project of the work, which is part of this amendment as **Annex A**.

IX. - In addition to the construction works of **“THE CELAYA-NBA LINE BY-PASS”**, **“THE MINISTRY”** and **“THE CONCESSIONAIRE”** jointly, have evaluated and agreed on the convenience of carrying out certain additional infrastructure construction works, hereinafter **“ADDITIONAL INFRASTRUCTURE WORKS”**, which are listed in the document attached to this amendment as **Annex E**, with the purpose of expanding the capacity of the Northeast General



Railroad Communication Route, improving the quality of railroad freight transportation services, making the transit of goods transported by train more efficient and improving urban-railroad coexistence for the direct benefit of the national logistics chain.

The agreement reached between **“THE MINISTRY”** and **“THE CONCESSIONAIRE”** includes the contribution and execution of the resources for the release of the right of way necessary to conclude the construction of **“THE CELAYA-NBA LINE BY-PASS”**, as well as for the execution of the **“ADDITIONAL INFRASTRUCTURE WORKS”** in accordance with **Annexes A through F**.

X. - Based on the foregoing, **“THE MINISTRY”** determined appropriate to modify **“THE CONCESSION TITLE”**, including also the increase to the exclusivity period to provide the public freight railroad transportation public service, for an additional period of ten years, in such a way that the exclusivity in the terms and with the exceptions set forth in **“THE CONCESSION TITLE”**, shall be for a total of forty years, counted from the beginning of the term of its concession, based on the financial analysis called “Valuation of the increase in the exclusivity” (Annex G), which establishes the term of recovery of the investment to conclude the construction of **“THE CELAYA-NBA LINE BY-PASS”** and the construction of the **“ADDITIONAL INFRASTRUCTURE WORKS”**.

LEGAL GROUNDS

By virtue of the foregoing, pursuant to Articles 36, Sections I, VII, VIII and XXVII of the Organic Law of the Federal Public Administration; 1, 6, 7, 8, 14 and 30 of the Regulatory Law of the Railroad Service; 1, 4, 15 and 36 of the Railroad Service Regulations; 4 and 5, Sections XI and XXIII of the Internal Regulations of the Ministry of Communications and Transportation, and Conditions 1.2.1, 1.4.2, 1.5, 2.5 and 5.2 of **“THE CONCESSION TITLE”**, this Entity of the Executive Branch grants the present amendment to **“THE CONCESSION TITLE”**, in accordance with the following:

CLAUSES

FIRST. - A third paragraph is added to condition 1.2.1 of **“THE CONCESSION TITLE”**, to read as follows:

“1.2.1. This title includes: (i) the conclusion of the construction of the works related to the by-pass in the city of Celaya, Guanajuato, in the section of the “NBA” line from km 0+000 to km 20+966.30, hereinafter **“THE CELAYA-NBA LINE BY-PASS”** according to the executive project integrated to the same as **Annex A**; and, (ii) the construction of the additional infrastructure works identified in **Annex E**, hereinafter the **“ADDITIONAL INFRASTRUCTURE WORKS”**, according to the executive projects that the Ministry and the CONCESSIONAIRE integrate to this instrument by mutual agreement as **Annex F**.”

SECOND. - The first paragraph of condition 1.4.2. of **“THE CONCESSION TITLE”** is amended to read as follows:



“1.4.2. This title confers exclusive rights to the CONCESSIONAIRE to provide the public railroad freight transportation service referred to in the first paragraph of section 1.2.3 for a period of forty years, counted as of the beginning of the effective date of **“THE CONCESSION TITLE”**, except for the way and drag along rights detailed in Annex Nine and in section 2.13 of this Concession.”

THIRD. - A fifth and sixth paragraphs are added to condition 2.5 of **“THE CONCESSION TITLE”**, to read as follows:

“2.5. The CONCESSIONAIRE shall provide and exercise the resources for the completion of the construction of **“THE CELAYA-NBA LINE BY-PASS”** and for the release of the missing right-of-way for the construction of said beltway, in accordance with **Annex D**, under the terms referred to in **Annex A** and **Annex B** and in accordance with the construction budget contained in **Annex C**.

Likewise, the CONCESSIONAIRE shall contribute and exercise the resources for the construction of the **“ADDITIONAL INFRASTRUCTURE WORKS”**, in terms of **Annex F**.

FOURTH. - The **Annexes** indicated below are added in terms of the documents attached to this amendment under the corresponding names, and become an integral part of this Concession:

- A. Executive project of **“THE CELAYA-NBA LINE BY-PASS”**.
- B. General work program for **“THE CELAYA-NBA LINE BY-PASS”**.
- C. Construction budget for **“THE CELAYA-NBA LINE BY-PASS”**.
- D. Release of right-of-way of **“THE CELAYA-NBA LINE BY-PASS”**.
- E. List and Description of the **“ADDITIONAL INFRASTRUCTURE WORKS”**.
- F. Executive Projects, programs and budgets of the **“ADDITIONAL INFRASTRUCTURE WORKS”**
- G. Valuation of the increase in exclusivity.

Annex F, which is incorporated as a result of this amendment, shall be included in **“THE CONCESSION TITLE”** within 90 days after **“THE CONCESSIONAIRE”** notifies **“THE MINISTRY”** of the completion of the construction of **“THE CELAYA-NBA LINE BY-PASS”**.

Annexes **A, B, C, D, E, F** and **G** may be modified in accordance with the applicable legal and administrative provisions, without this implying an amendment to this Concession.”

FIFTH. - The **Annexes** indicated below are modified to remain in the terms of the documents attached under the corresponding numbers and names, and are an integral part of **“THE CONCESSION TITLE”**:

- One.** - Description of the licensed railroad.
- Two.** - Specifications of the configuration, areas, limits and routes of the railroad - track charts.
- Three.** - Specifications of the goods.
- Four.** - Areas excluded from the licensed railroad and list of properties with historical, cultural or artistic value.
- Seven** - Business Plan.



COMUNICACIONES

SECRETARÍA DE INFRAESTRUCTURA, COMUNICACIONES Y TRANSPORTES



Nine.- Drag along rights and rights of way that the CONCESSIONAIRE is obliged to grant.

Ten.- Drag along rights and rights of way in favor of the CONCESSIONAIRE.

Eleven.-Northeast Railroad right-of-way letters.

Annexes Two and Three, which are hereby amended, shall be integrated to **“THE CONCESSION TITLE”** within 90 days after **“THE CONCESSIONAIRE”** notifies **“THE MINISTRY”** of the conclusion of the construction works of **“THE CELAYA-NBA LINE BY-PASS”**.

SIXTH. - This amendment shall become effective as of its signature and shall become part of **“THE CONCESSION TITLE”**.

Apart from the provisions of this Amendment, the other conditions of **“THE CONCESSION TITLE”** and its remaining **Annexes**, subsist in their terms, without this Amendment constituting in any way a novation in the rights and obligations previously acquired by **“THE CONCESSIONAIRE”**.

SEVENTH. - **“THE CONCESSIONAIRE”** unconditionally accepts the amendment to **“THE CONCESSION TITLE”** subject of this instrument, in the terms expressed above.

EIGHTH. - **“THE CONCESSIONAIRE”** shall arrange, at its own expense, the publication of this amendment to **“THE CONCESSION TITLE”** in the Official Gazzette of the Federation, within a term not exceeding 60 (sixty) calendar days as from the date of granting of this amendment.

This Amendment to **“THE CONCESSION TITLE”** is granted in Mexico City on July 14, 2022.

For **“THE MINISTRY”**

For **“THE CONCESSIONAIRE”**.

Eng. Jorge Arganis Díaz Leal
Ministry of Infrastructure, Communications and Transportation

Mr. Oscar Augusto del Cueto Cuevas
Legal Representative of Kansas City Southern
de México, S.A. de C.V.

**PRINCIPAL EXECUTIVE OFFICER'S CERTIFICATION
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Patrick J. Ottensmeyer, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Kansas City Southern (the "registrant");
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ PATRICK J. OTTENSMEYER

Patrick J. Ottensmeyer

President and Chief Executive Officer

Date: July 28, 2022

**PRINCIPAL FINANCIAL OFFICER'S CERTIFICATION
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Michael W. Upchurch, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Kansas City Southern (the "registrant");
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ MICHAEL W. UPCHURCH

Michael W. Upchurch

Executive Vice President and Chief Financial Officer

Date: July 28, 2022

**PRINCIPAL EXECUTIVE OFFICER'S CERTIFICATION
PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Kansas City Southern (the "Company") on Form 10-Q for the period ended June 30, 2022, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Patrick J. Ottensmeyer, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ PATRICK J. OTTENSMEYER

Patrick J. Ottensmeyer

President and Chief Executive Officer

Date: July 28, 2022

A signed original of this written statement required by Section 906 has been provided to Kansas City Southern and will be retained by Kansas City Southern and furnished to the Securities and Exchange Commission or its staff upon request.

**PRINCIPAL FINANCIAL OFFICER'S CERTIFICATION
PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Kansas City Southern (the "Company") on Form 10-Q for the period ended June 30, 2022, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Michael W. Upchurch, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ MICHAEL W. UPCHURCH

Michael W. Upchurch

Executive Vice President and Chief Financial Officer

Date: July 28, 2022

A signed original of this written statement required by Section 906 has been provided to Kansas City Southern and will be retained by Kansas City Southern and furnished to the Securities and Exchange Commission or its staff upon request.