

CANADIAN PACIFIC RAILWAY LTD/CN  
Form 6-K  
October 25, 2011

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**Form 6-K**

**Report of Foreign Private Issuer**

**Pursuant to Rule 13a-16 or 15d-16 under  
the Securities Exchange Act of 1934**

**For the month of October, 2011**

**CANADIAN PACIFIC RAILWAY LIMITED**

(Commission File No. 1-01342)

**CANADIAN PACIFIC RAILWAY COMPANY**

(Commission File No. 1-15272)

(translation of each Registrant's name into English)

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Suite 500, Gulf Canada Square, 401 - 9th Avenue, S.W., Calgary, Alberta, Canada, T2P 4Z4

(address of principal executive offices)

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

Form 20-F  Form 40-F

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

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

This Report furnished on Form 6-K shall be incorporated by reference into each of the following Registration Statements under the Securities Act of 1933 of the registrant: Form S-8 No. 333-140955 (Canadian Pacific Railway Limited), Form S-8 No. 333-127943 (Canadian Pacific Railway Limited) and Form S-8 No. 333-13962 (Canadian Pacific Railway Limited).

**SIGNATURES**

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

**CANADIAN PACIFIC RAILWAY LIMITED**

(Registrant)

Date: October 25, 2011

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

**CANADIAN PACIFIC RAILWAY COMPANY**

(Registrant)

Date: October 25, 2011

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

Release: Immediate October 25, 2011

**CANADIAN PACIFIC ANNOUNCES THIRD QUARTER 2011 RESULTS**

CALGARY Canadian Pacific Railway Limited (TSX: CP) (NYSE: CP) announced its third-quarter 2011 results today with reported net income of \$186.8 million and diluted earnings per share of \$1.10, inclusive of \$0.04 per share of expenses related to the early redemption of its 2013 Notes.

**THIRD-QUARTER 2011 RESULTS COMPARED WITH THIRD-QUARTER 2010**

Total revenues were \$1.3 billion, an increase of \$55.4 million  
Operating expenses were \$1.0 billion, an increase of \$68.5 million  
Average fuel price increased 47 per cent to \$3.44 U.S. dollars per U.S. gallon  
Operating income was \$324.6 million, a decrease of \$13.1 million  
Net income was \$186.8 million, a decrease of \$10.5 million  
Diluted earnings per share were \$1.10 per share, a decline of \$0.07 per share or a decline of \$0.03 per share exclusive of the early redemption of the 2013 Notes

We currently see strength in our bulk franchise, but remain vigilant in monitoring economic signals from Asia, stated Fred Green President and CEO. We are focused on sustaining and improving service and productivity through investments in locomotives, infrastructure, people and technology.

**Note on forward-looking information**

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

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

Discussion and Analysis in CP's annual and interim reports, Annual Information Form and Form 40-F.

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

### **About Canadian Pacific**

Canadian Pacific (CP:TSX)(NYSE:CP) operates a North American transcontinental railway providing freight transportation services, logistics solutions and supply chain expertise. Incorporating best-in-class technology and environmental practices, CP is re-defining itself as a modern 21st century transportation company built on safety, service reliability and operational efficiency. Visit [cpr.ca](http://cpr.ca) and see how Canadian Pacific is Driving the Digital Railway.

### **Contacts:**

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# CANADIAN PACIFIC RAILWAY LIMITED

## CONSOLIDATED STATEMENTS OF INCOME

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

(unaudited)

|   | For the three months<br>ended September 30 |                  | For the nine months<br>ended September 30 |                  |
|---|--|------------------|---|------------------|
|   | 2011                                       | 2010             | 2011                                      | 2010             |
| <b>Revenues</b>                                     |  |                  |   |                  |
| Freight   | \$ 1,308.4                                 | \$ 1,250.8       | \$ 3,676.8                                | \$ 3,591.2       |
| Other   | 33.2                                       | 35.4             | 92.7                                      | 96.0             |
|   | 1,341.6                                    | 1,286.2          | 3,769.5                                   | 3,687.2          |
| <b>Operating expenses</b>                           |  |                  |   |                  |
| Compensation and benefits                           | 336.4                                      | 365.2            | 1,037.0                                   | 1,068.7          |
| Fuel  | 237.8                                      | 166.1            | 700.9                                     | 525.7            |
| Materials   | 56.2                                       | 43.2             | 185.2                                     | 158.2            |
| Equipment rents                                     | 53.1                                       | 53.6             | 158.1                                     | 157.5            |
| Depreciation and amortization                       | 122.6                                      | 123.9            | 367.1                                     | 368.4            |
| Purchased services and other                        | 210.9                                      | 196.5            | 656.9                                     | 590.3            |
|   | 1,017.0                                    | 948.5            | 3,105.2                                   | 2,868.8          |
| <b>Operating income</b>                             | <b>324.6</b>                               | <b>337.7</b>     | <b>664.3</b>                              | <b>818.4</b>     |
| Less:   |  |                  |   |                  |
| Other (income) and charges (Note 5)                 | 14.1                                       | 1.0              | 8.6                                       | (7.3)            |
| Net interest expense                                | 64.3                                       | 60.6             | 191.0                                     | 192.1            |
| <b>Income before income tax expense</b>             | <b>246.2</b>                               | <b>276.1</b>     | <b>464.7</b>                              | <b>633.6</b>     |
| Income tax expense (Note 3)                         | 59.4                                       | 78.8             | 116.2                                     | 168.7            |
| <b>Net income</b>                                   | <b>\$ 186.8</b>                            | <b>\$ 197.3</b>  | <b>\$ 348.5</b>                           | <b>\$ 464.9</b>  |
| <b>Earnings per share (Note 4)</b>                  |  |                  |   |                  |
| Basic   | \$ 1.10                                    | \$ 1.17          | \$ 2.06                                   | \$ 2.76          |
| Diluted   | \$ 1.10                                    | \$ 1.17          | \$ 2.04                                   | \$ 2.75          |
| <b>Weighted average number of shares (millions)</b> |  |                  |   |                  |
| Basic   | 169.4                                      | 168.8            | 169.4                                     | 168.6            |
| Diluted   | 170.5                                      | 169.3            | 170.6                                     | 169.0            |
| <b>Dividends declared per share</b>                 | <b>\$ 0.3000</b>                           | <b>\$ 0.2700</b> | <b>\$ 0.8700</b>                          | <b>\$ 0.7875</b> |

See notes to Consolidated Financial Statements.

## CANADIAN PACIFIC RAILWAY LIMITED

### CONSOLIDATED BALANCE SHEETS

(in millions of Canadian dollars)

(unaudited)

|  | September 30<br>2011 | December 31<br>2010 |
|--|----------------------|---------------------|
| <b>Assets</b>  |                      |                     |
| <b>Current assets</b>                                      |                      |                     |
| Cash and cash equivalents                                  | \$ 97.0              | \$ 360.6            |
| Accounts receivable, net                                   | 530.5                | 459.0               |
| Materials and supplies                                     | 149.7                | 114.1               |
| Deferred income taxes                                      | 113.6                | 222.3               |
| Other current assets                                       | 59.8                 | 47.8                |
|  | 950.6                | 1,203.8             |
| Investments  | 166.0                | 144.9               |
| Net properties   | 12,535.4             | 11,996.8            |
| Goodwill and intangible assets                             | 198.8                | 189.8               |
| Other assets   | 156.7                | 140.6               |
| <b>Total assets</b>  | <b>\$ 14,007.5</b>   | <b>\$ 13,675.9</b>  |
| <b>Liabilities and shareholders equity</b>                 |                      |                     |
| <b>Current liabilities</b>                                 |                      |                     |
| Accounts payable and accrued liabilities                   | \$ 1,030.8           | \$ 1,007.8          |
| Long-term debt maturing within one year ( <i>Note 10</i> ) | 304.1                | 281.7               |
|  | 1,334.9              | 1,289.5             |
| Pension and other benefit liabilities                      | 973.0                | 1,115.7             |
| Other long-term liabilities                                | 411.8                | 468.0               |
| Long-term debt ( <i>Note 5</i> )                           | 4,042.5              | 4,033.2             |
| Deferred income taxes                                      | 2,046.0              | 1,944.8             |
| <b>Total liabilities</b>                                   | <b>8,808.2</b>       | <b>8,851.2</b>      |
| <b>Shareholders equity</b>                                 |                      |                     |
| Share capital  | 1,829.1              | 1,812.8             |
| Additional paid-in capital                                 | 88.6                 | 24.7                |
| Accumulated other comprehensive loss                       | (1,992.5)            | (2,085.8)           |
| Retained earnings  | 5,274.1              | 5,073.0             |
|  | 5,199.3              | 4,824.7             |
| <b>Total liabilities and shareholders equity</b>           | <b>\$ 14,007.5</b>   | <b>\$ 13,675.9</b>  |

Commitments and contingencies (*Note 9*)

See notes to Consolidated Financial Statements.



## CANADIAN PACIFIC RAILWAY LIMITED

### CONSOLIDATED STATEMENTS OF CASH FLOWS

(in millions of Canadian dollars)

(unaudited)

|  | For the three months<br>ended September 30 |                 | For the nine months<br>ended September 30 |                 |
|--|--|-----------------|---|-----------------|
|  | 2011                                       | 2010            | 2011                                      | 2010            |
| <b>Operating activities</b>  |  |                 |   |                 |
| Net income   | \$ 186.8                                   | \$ 197.3        | \$ 348.5                                  | \$ 464.9        |
| Reconciliation of net income to cash provided by operating activities: |  |                 |   |                 |
| Depreciation and amortization  | 122.6                                      | 123.9           | 367.1                                     | 368.4           |
| Deferred income taxes (Note 3)   | 58.6                                       | 75.4            | 118.4                                     | 160.4           |
| Pension funding in excess of expense (Note 8)                          | (14.8)                                     | (645.6)         | (39.5)                                    | (805.6)         |
| Other operating activities, net  | (33.5)                                     | (0.6)           | (46.7)                                    | 5.7             |
| Change in non-cash working capital balances related to operations      | 5.7  | (0.5)           | (75.1)                                    | (72.5)          |
| <b>Cash provided by (used in) operating activities</b>                 | <b>325.4</b>                               | <b>(250.1)</b>  | <b>672.7</b>                              | <b>121.3</b>    |
| <b>Investing activities</b>  |  |                 |   |                 |
| Additions to properties  | (351.9)                                    | (185.1)         | (703.5)                                   | (443.9)         |
| Proceeds from the sale of properties and other assets                  | 20.4                                       | 19.8            | 40.5                                      | 46.2            |
| Other  | (6.2)                                      | -               | (6.5)                                     | -               |
| <b>Cash used in investing activities</b>                               | <b>(337.7)</b>                             | <b>(165.3)</b>  | <b>(669.5)</b>                            | <b>(397.7)</b>  |
| <b>Financing activities</b>  |  |                 |   |                 |
| Dividends paid   | (50.8)                                     | (45.5)          | (142.2)                                   | (128.9)         |
| Issuance of CP common shares   | 2.2  | 20.0            | 13.0                                      | 26.9            |
| Collection of receivable from financial institution                    | -  | -               | -   | 219.8           |
| Issuance of long-term debt   | -  | 355.2           | -   | 355.2           |
| Repayment of long-term debt (Note 5)                                   | (125.5)                                    | (14.2)          | (143.5)                                   | (604.5)         |
| Other  | -  | 2.9             | -   | 3.1             |
| <b>Cash (used in) provided by financing activities</b>                 | <b>(174.1)</b>                             | <b>318.4</b>    | <b>(272.7)</b>                            | <b>(128.4)</b>  |
| <b>Effect of foreign currency fluctuations on U.S. dollar-</b>         |  |                 |   |                 |
| <b>denominated cash and cash equivalents</b>                           | <b>15.6</b>                                | <b>(8.8)</b>    | <b>5.9</b>                                | <b>(6.5)</b>    |
| <b>Cash position</b>   |  |                 |   |                 |
| Decrease in cash and cash equivalents                                  | (170.8)                                    | (105.8)         | (263.6)                                   | (411.3)         |
| Cash and cash equivalents at beginning of period                       | 267.8                                      | 373.6           | 360.6                                     | 679.1           |
| <b>Cash and cash equivalents at end of period</b>                      | <b>\$ 97.0</b>                             | <b>\$ 267.8</b> | <b>\$ 97.0</b>                            | <b>\$ 267.8</b> |

**Supplemental disclosures of cash flow information:**

|                   |          |         |          |          |
|-------------------|----------|---------|----------|----------|
| Income taxes paid | \$ (0.6) | \$ 0.3  | \$ 2.8   | \$ 6.5   |
| Interest paid     | \$ 40.0  | \$ 33.2 | \$ 179.7 | \$ 252.3 |

See notes to Consolidated Financial Statements.

## CANADIAN PACIFIC RAILWAY LIMITED

### CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

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

(unaudited)

|  | Common<br>shares<br><br>(in<br>millions) | Share<br>capital | Additional<br>paid-in<br>capital | Accumulated                    |                      | Total<br>shareholders<br>equity |
|--|--|------------------|----------------------------------|--------------------------------|----------------------|---------------------------------|
|  |  |                  |                                  | other<br>comprehensive<br>loss | Retained<br>earnings |                                 |
| <b>Balance at January 1, 2011</b>                        | 169.2                                    | \$ 1,812.8       | \$ 24.7                          | \$ (2,085.8)                   | \$ 5,073.0           | \$ 4,824.7                      |
| Net income   | -  | -                | -                                | -                              | 348.5                | 348.5                           |
| Other comprehensive income                               | -  | -                | -                                | 93.3                           | -                    | 93.3                            |
| Dividends declared                                       | -  | -                | -                                | -                              | (147.4)              | (147.4)                         |
| Effect of stock-based compensation expense               | -  | -                | 13.0                             | -                              | -                    | 13.0                            |
| Changes to stock compensation awards ( <i>Note</i><br>7) | -  | -                | 53.5                             | -                              | -                    | 53.5                            |
| Shares issued under stock option plans                   | 0.3                                      | 16.3             | (2.6)                            | -                              | -                    | 13.7                            |
| <b>Balance at September 30, 2011</b>                     | 169.5                                    | \$ 1,829.1       | \$ 88.6                          | \$ (1,992.5)                   | \$ 5,274.1           | \$ 5,199.3                      |

|   | Other<br>comprehensive<br>income | Net<br>income | Comprehensive<br>income |
|---|----------------------------------|---------------|-------------------------|
| <b>Comprehensive income<br/>three months ended September 30, 2011</b> | \$ 52.1                          | \$ 186.8      | \$ 238.9                |
| <b>Comprehensive income<br/>nine months ended September 30, 2011</b>  | \$ 93.3                          | \$ 348.5      | \$ 441.8                |

|  | Common<br>shares<br><br>(in<br>millions) | Share<br>capital | Additional<br>paid-in<br>capital | Accumulated                    |                      | Total<br>shareholders<br>equity |
|--|--|------------------|----------------------------------|--------------------------------|----------------------|---------------------------------|
|  |  |                  |                                  | other<br>comprehensive<br>loss | Retained<br>earnings |                                 |
| <b>Balance at January 1, 2010</b>          | 168.5                                    | \$ 1,771.1       | \$ 30.8                          | \$ (1,744.7)                   | \$ 4,600.9           | \$ 4,658.1                      |
| Net income                                 | -  | -                | -                                | -                              | 464.9                | 464.9                           |
| Other comprehensive income                 | -  | -                | -                                | 52.2                           | -                    | 52.2                            |
| Dividends declared                         | -  | -                | -                                | -                              | (132.9)              | (132.9)                         |
| Effect of stock-based compensation expense | -  | -                | 1.1                              | -                              | -                    | 1.1                             |
| Shares issued under stock option plans     | 0.6                                      | 34.8             | (6.4)                            | -                              | -                    | 28.4                            |

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|                                      |       |            |         |              |            |            |
|--------------------------------------|-------|------------|---------|--------------|------------|------------|
| <b>Balance at September 30, 2010</b> | 169.1 | \$ 1,805.9 | \$ 25.5 | \$ (1,692.5) | \$ 4,932.9 | \$ 5,071.8 |
|--------------------------------------|-------|------------|---------|--------------|------------|------------|

|   | <b>Other<br/>comprehensive<br/>income</b> | <b>Net<br/>income</b> | <b>Comprehensive<br/>income</b> |
|---|---|-----------------------|---------------------------------|
| <b>Comprehensive income<br/>three months ended September 30, 2010</b> | \$ 17.0                                   | \$ 197.3              | \$ 214.3                        |
| <b>Comprehensive income<br/>nine months ended September 30, 2010</b>  | \$ 52.2                                   | \$ 464.9              | \$ 517.1                        |

See notes to Consolidated Financial Statements.

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## CANADIAN PACIFIC RAILWAY LIMITED

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2011

(unaudited)

#### 1 Basis of presentation

These unaudited interim consolidated financial statements of Canadian Pacific Railway Limited ( CP , the Company or Canadian Pacific Railway ) reflect management's estimates and assumptions that are necessary for their fair presentation in conformity with accounting principles generally accepted in the United States of America ( GAAP ). They do not include all disclosures required under GAAP for annual financial statements and should be read in conjunction with the 2010 consolidated financial statements. The policies used are consistent with the policies used in preparing the 2010 consolidated financial statements. The Company's investments in which CP has significant influence, which are not consolidated, are accounted for using the equity method.

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

In management's opinion, the unaudited interim consolidated financial statements include all adjustments (consisting solely of normal 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

##### Fair value measurement and disclosure

In January 2010, the Financial Accounting Standards Board ( FASB ) amended the disclosure requirements related to fair value measurements. Most of the new disclosures and clarifications of existing disclosures were effective for interim and annual reporting periods beginning after December 15, 2009, except for the expanded disclosures in the Level 3 reconciliation, which are effective for fiscal years beginning after December 15, 2010. The Company has adopted the remaining guidance which did not impact the consolidated financial statements.

##### Future accounting changes

##### Fair value measurement

In May 2011, the FASB issued amended guidance on fair value measurement which updates some of the measurement guidance and includes enhanced disclosure requirements. The amended guidance is effective for interim and annual periods beginning after December 15, 2011. Adoption is not expected to have a material impact on the results of operations or financial position but increased quantitative and qualitative disclosure regarding Level 3 measurements is expected.

##### Other comprehensive income

In June 2011, the FASB issued an accounting standard update on the *Presentation of Comprehensive Income*, which eliminates the current option to report other comprehensive income and its components in the Consolidated Statement of Changes in Shareholders' Equity. The Company can elect to present items of net income and other comprehensive income in one continuous statement or in two separate, but consecutive, statements. As the new guidance does not change those components that are recognized in net income or those components that are recognized in other comprehensive income, adoption is expected to impact only the presentation of the financial statements. The guidance must be applied retrospectively for all periods presented in the financial statements. The Company has not yet determined which election will be made when the standard becomes effective for interim and annual periods beginning after December 15, 2011.

##### Intangibles - goodwill and other

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In September 2011, the FASB issued amended guidance on the testing of goodwill for impairment. The amendments allow an entity to first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. Under these amendments, an entity would not be required to calculate the fair value of a reporting unit unless the entity determines, based on a qualitative assessment, that it is more likely than not that its fair value is less than its carrying amount. The amended guidance is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Adoption is expected to impact the goodwill impairment testing process but not the results of operations or financial position of the Company.

## CANADIAN PACIFIC RAILWAY LIMITED

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2011

(unaudited)

#### 3 Income taxes

|                                   | For the three months       |                | For the nine months        |                 |
|-----------------------------------|----------------------------|----------------|----------------------------|-----------------|
|                                   | ended September 30<br>2011 | 2010           | ended September 30<br>2011 | 2010            |
| (in millions of Canadian dollars) |                            |                |                            |                 |
| Current income tax expense        | \$ 0.8                     | \$ 3.4         | \$ (2.2)                   | \$ 8.3          |
| Deferred income tax expense       | 58.6                       | 75.4           | 118.4                      | 160.4           |
| <b>Income tax expense</b>         | <b>\$ 59.4</b>             | <b>\$ 78.8</b> | <b>\$ 116.2</b>            | <b>\$ 168.7</b> |

The higher effective income tax rate for the three months and nine months ended September 30, 2010, compared to the same periods in 2011, is a result of non-taxable foreign exchange gains and losses related to long-term debt.

#### 4 Earnings per share

At September 30, 2011, the number of shares outstanding was 169.5 million (September 30, 2010 169.1 million).

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

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

|  | For the three months       |              | For the nine months        |              |
|--|----------------------------|--------------|----------------------------|--------------|
|  | ended September 30<br>2011 | 2010         | ended September 30<br>2011 | 2010         |
| (in millions)                                      |                            |              |                            |              |
| Weighted average shares outstanding                | 169.4                      | 168.8        | 169.4                      | 168.6        |
| Dilutive effect of stock options                   | 1.1                        | 0.5          | 1.2                        | 0.4          |
| <b>Weighted average diluted shares outstanding</b> | <b>170.5</b>               | <b>169.3</b> | <b>170.6</b>               | <b>169.0</b> |

For the three and nine months ended September 30, 2011, 2,305,458 and 1,739,167 options, respectively, were excluded from the computation of diluted earnings per share because their effects were not dilutive (three and nine months ended September 30, 2010 1,416,783 and 1,885,875, respectively).

**5 Long-term debt**

On September 30, 2011, the Company redeemed US\$101.4 million 5.75% Notes due in May 2013 with a carrying amount of \$106.7 million pursuant to a call offer for a total cost of \$112.5 million. Upon redemption of the Notes a net loss of \$8.8 million was recognized during the three months ended September 30, 2011, to Other income and charges . The loss consisted largely of a redemption premium paid to note holders to redeem the Notes.

**6 Financial instruments**

**A. Fair values of financial instruments**

The Company categorizes its financial assets and liabilities measured at fair value into one of three different levels depending on the observability of the inputs employed in the measurement.



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## CANADIAN PACIFIC RAILWAY LIMITED

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2011

(unaudited)

#### 6 Financial instruments (continued)

Level 1: Unadjusted quoted prices for identical assets and liabilities in active markets that are accessible at the measurement date.

Level 2: Directly or indirectly observable inputs other than quoted prices included within Level 1 or quoted prices for similar assets and liabilities. Derivative instruments in this category are valued using models or other industry standard valuation techniques derived from observable market data.

Level 3: Valuations based on inputs which are less observable, unavailable or where the observable data does not support a significant portion of the instruments' fair value. Generally, Level 3 valuations are longer dated transactions, occur in less active markets, occur at locations where pricing information is not available, or have no binding broker quote to support Level 2 classifications.

When possible, the estimated fair value is based on quoted market prices and, if not available, estimates from third party brokers. For non-exchange traded derivatives classified in Level 2, the Company uses standard valuation techniques to calculate fair value. Primary inputs to these techniques include observable market prices (interest, foreign exchange and commodity) and volatility, depending on the type of derivative and nature of the underlying risk. The Company uses inputs and data used by willing market participants when valuing derivatives and considers its own credit default swap spread as well as those of its counterparties in its determination of fair value. Wherever possible the Company uses observable inputs. All derivatives are classified as Level 2. The carrying values of financial instruments equal or approximate their fair values with the exception of long-term debt which has a carrying value of \$4,346.6 million at September 30, 2011 (December 31, 2010 \$4,314.9 million) and a fair value of approximately \$5,131.0 million at September 30, 2011 (December 31, 2010 \$4,773.0 million). The fair value of publicly traded long-term debt is determined based on market prices at September 30, 2011 and December 31, 2010, respectively.

A detailed analysis of the techniques used to value long-term floating rate notes, which are classified as Level 3, is discussed below:

#### Gain/loss in fair value of long-term floating rate notes

At September 30, 2011 and December 31, 2010, the Company held long-term floating rate notes with a total settlement value of \$105.0 million and \$117.0 million, respectively, and carrying values of \$77.3 million and \$69.5 million, respectively. At September 30, 2011, the long-term floating rate notes consisted of Master Asset Vehicle ( MAV ) 2 notes with eligible assets. The carrying values, being the estimated fair values, are reported in Investments .

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The valuation technique used by the Company to estimate the fair value of its investment in long-term floating rate notes at September 30, 2011 and December 31, 2010, incorporates probability weighted discounted cash flows considering the best available public information regarding market conditions and other factors that a market participant would consider for such investments. Accretion, redemption of notes and changes in assumptions have resulted in gains of \$3.7 million and \$14.2 million in the three and nine months ended September 30, 2011, respectively (three and nine months ended September 30, 2010 gains of \$2.0 million and \$7.6 million, respectively) which was reported in Other income and charges. During the second quarter of 2011 the Company sold all of its MAV 2 Class B and Class C and MAV 3 Class 9 notes for proceeds of \$6.4 million and recorded a gain of \$6.3 million. The interest rates and maturities of the various long-term floating rate notes, discount rates and credit losses modelled at September 30, 2011 and December 31, 2010, respectively, are:

|  | <b>September 30, 2011</b>          | December 31, 2010  |
|--|------------------------------------|--|
| Probability weighted average coupon interest rate    | 0.8%                               | 0.8%   |
| Weighted average discount rate                       | 6.2%                               | 7.1%   |
| Expected repayments of long-term floating rate notes | Approximately 5 1/3 years          | Approximately 6 years  |
| Credit losses  | MAV 2 eligible asset notes:<br>nil | MAV 2 eligible asset notes:<br>1% to 100%<br>MAV 3 Class 9 Traditional<br>Asset Tracking notes: 1% |

## CANADIAN PACIFIC RAILWAY LIMITED

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2011

(unaudited)

#### 6 Financial instruments (continued)

The probability weighted discounted cash flows resulted in an estimated fair value of the Company's long-term floating rate notes of \$77.3 million at September 30, 2011 (December 31, 2010 - \$69.5 million). The change in the original cost and estimated fair value of the Company's long-term floating rate notes is as follows (representing a roll-forward of assets measured at fair value using Level 3 inputs):

| (in millions of Canadian dollars) | 2011          |                      | 2010          |                      |
|-----------------------------------|---------------|----------------------|---------------|----------------------|
|                                   | Original cost | Estimated fair value | Original cost | Estimated fair value |
| <b>As at January 1</b>            | \$ 117.0      | \$ 69.5              | \$ 129.1      | \$ 69.3              |
| Redemption of notes               | (12.0)        | (0.1)                | (0.1)         | -                    |
| Accretion                         | -             | 4.1                  | -             | 4.4                  |
| Change in market assumptions      | -             | 3.8                  | -             | 3.1                  |
| <b>As at September 30</b>         | \$ 105.0      | \$ 77.3              | \$ 129.0      | \$ 76.8              |

#### B. Financial risk management

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

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

#### Foreign exchange management

The Company is exposed to fluctuations of financial commitments, assets, liabilities, income or cash flows due to changes in FX rates. The Company conducts business transactions and owns assets in both Canada and the United States; as a result, revenues and expenses are incurred in both Canadian and U.S. dollars. The Company enters into foreign exchange risk management transactions primarily to manage fluctuations in the exchange rate between Canadian and U.S. currencies. In terms of net income, excluding FX on long-term debt, mitigation of U.S. dollar FX exposure is provided primarily through offsets created by revenues and expenses incurred in the same currency. Where appropriate, the Company negotiates with customers and suppliers to reduce the net exposure.

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

**Net investment hedge**

The FX gains and losses on long-term debt are mainly unrealized and can only be realized when U.S. dollar denominated long-term debt matures or is settled. The Company also has long-term FX exposure on its investment in U.S. affiliates. The majority of the Company's U.S. dollar denominated long-term debt has been designated as a hedge of the net investment in foreign subsidiaries. This designation has the effect of mitigating volatility on net income by offsetting long-term FX gains and losses on long-term debt and gains

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## CANADIAN PACIFIC RAILWAY LIMITED

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2011

(unaudited)

#### 6 Financial instruments (continued)

and losses on its net investment. In addition, the Company may enter into FX forward contracts to lock-in the amount of Canadian dollars it has to pay on its U.S. denominated debt maturities.

##### Foreign exchange forward contracts

During the three months ended September 30, 2011, in anticipation of a cash tender to offer to redeem the Company's US\$101.4 million 5.75% May 2013 Notes the Company unwound a similar amount of FX forward contracts to fix the exchange rate on these Notes for total proceeds of \$1.5 million (see Note 5).

At September 30, 2011, the Company had remaining FX forward contracts to fix the exchange rate on US\$175.0 million of its 6.50% Notes due in May 2018, and US\$100.0 million of its 7.25% Notes due in May 2019. These derivatives, which are accounted for as cash flow hedges, guarantee the amount of Canadian dollars that the Company will repay when these Notes mature.

During the three and nine months ended September 30, 2011, a combined realized and unrealized gain of \$18.7 million and \$13.9 million, respectively, was recorded to Other income and charges associated with these derivatives. These gains largely offset realized and unrealized losses on the underlying debt which these derivatives are designated to hedge.

##### Interest rate management

The Company is exposed to interest rate risk, which is the risk that the fair value or future cash flows of a financial instrument will vary as a result of changes in market interest rates. In order to manage funding needs or capital structure goals, the Company enters into debt or capital lease agreements that are subject to either fixed market interest rates set at the time of issue or floating rates determined by on-going market conditions. Debt subject to variable interest rates exposes the Company to variability in interest expense, while debt subject to fixed interest rates exposes the Company to variability in the fair value of debt.

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

##### Interest rate swaps

At September 30, 2011 and December 31, 2010, the Company had no outstanding interest rate swaps.

Gains on interest rate swaps that were previously settled are deferred as a fair value adjustment to the underlying debts that were hedged and are amortized to Net interest expense until such time the debts are repaid through October 2011 (see Note 10).

##### Treasury rate locks

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At September 30, 2011, the Company had net unamortized losses related to interest rate locks, which are accounted for as cash flow hedges, settled in previous years totalling \$22.1 million (December 31, 2010 \$22.1 million). This amount is composed of various unamortized gains and losses related to specific debts which are reflected in Accumulated other comprehensive loss, net of tax, and are amortized to Net interest expense in the period that interest on the related debt is charged. At September 30, 2011, the Company expected that, during the next 12 months, pre-tax losses of \$0.1 million related to these previously settled derivatives will be reclassified to Net interest expense.

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## CANADIAN PACIFIC RAILWAY LIMITED

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2011

(unaudited)

#### 6 Financial instruments (continued)

##### Stock-based compensation expense management

The Company is exposed to stock-based compensation risk, which is the probability of increased compensation expense due to the increase in the Company's share price.

The Company entered into a Total Return Swap ( TRS ) to reduce the expense volatility on three types of stock-based compensation programs: tandem share appreciation rights ( TSARs ), deferred share units ( DSUs ), and restricted share units ( RSUs ). As the Company's share price appreciates, these instruments create increased compensation expense. The TRS is a derivative that provides price appreciation and dividends, in return for a charge by the counterparty. The swaps are intended to minimize volatility to Compensation and benefits expense by providing a gain to offset increased compensation expense as the share price increases and a loss to offset reduced compensation expense when the share price falls. If stock-based compensation share units fall out of the money after entering the program, the loss associated with the swap would no longer be fully offset by compensation expense reductions, which would reduce the effectiveness of the swap. This derivative was not designated as a hedge and changes in fair value were recognized in net income in the period in which the change occurs.

During the first quarter of 2011, the Company reduced the size of the TRS program for total proceeds of \$0.3 million to reflect the cancellation of SARs in Canada (see Note 7).

##### Fuel price management

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

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

Derivative instruments used by the Company to manage fuel expense risk may include, but are not limited to, swaps and options for crude oil, diesel and crack spreads.

At September 30, 2011, the Company had diesel futures contracts, which are accounted for as cash flow hedges, to purchase approximately 21.3 million US gallons during the period October 2011 to September 2012 at an average price of US\$ 3.00 per US gallon. This represents approximately 7% of estimated fuel purchases for this period.

## CANADIAN PACIFIC RAILWAY LIMITED

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2011

(unaudited)

#### 6 Financial instruments (continued)

The following table summarizes the fair values derivatives instruments on the Consolidated Balance Sheets at September 30, 2011 and December 31, 2010:

| (in millions of Canadian dollars)                        | Balance Sheet Location                   | Asset Derivatives        |                         | Liability Derivatives    |                         |
|--|--|--------------------------|-------------------------|--------------------------|-------------------------|
|  |  | As at September 30, 2011 | As at December 31, 2010 | As at September 30, 2011 | As at December 31, 2010 |
| <b>Derivatives designed as hedging instruments</b>       |  |                          |                         |                          |                         |
| Diesel future contracts <sup>(1)</sup>                   | Other current assets                     | \$ -                     | \$ 4.1                  | \$ -                     | \$ -                    |
|  | Accounts payable and accrued liabilities |                          |                         | 5.5                      | -                       |
| FX forward contracts <sup>(2)</sup>                      | Other assets                             | 14.7                     | -                       |                          |                         |
|  | Other long-term liabilities              |                          |                         | -                        | 1.6                     |
| <b>Derivatives not designated as hedging instruments</b> |  |                          |                         |                          |                         |
| Total return swap  | Accounts payable and accrued liabilities |                          |                         | 14.4                     | 6.0                     |
|  |  | \$ 14.7                  | \$ 4.1                  | \$ 19.9                  | \$ 7.6                  |

(1) At September 30, 2011, the Company had an unrealized pre-tax loss of \$5.5 million derived from these futures contracts reflected in Accumulated other comprehensive loss (December 31, 2010 pre-tax gain \$4.1 million). At September 30, 2011, the Company expected that, during the next 12 months, \$5.5 million of unrealized holding losses on diesel future contracts will be realized and recognized in Fuel expense as a result of these derivatives being settled.

(2) At September 30, 2011, the FX forward contracts reflected in Other assets had a related unrealized pre-tax gain of \$2.8 million that was reflected in Accumulated other comprehensive loss (December 31, 2010 pre-tax loss \$1.1 million). Amounts recorded in Accumulated other comprehensive loss will be reclassified to earnings during the terms of the 6.50% and 7.25% Notes.





# CANADIAN PACIFIC RAILWAY LIMITED

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2011

(unaudited)

### 6 Financial instruments (continued)

The following table summarizes information on the location and amounts of gains and losses, before tax, related to derivatives on the Consolidated Statements of Income and in comprehensive income for the three months and nine months ended September 30, 2011 and 2010:

| (in millions of Canadian dollars)                        | Location of gain (loss) recognized in income on derivatives | Amount of gain (loss) recognized in income on derivatives |          | Amount of gain (loss) recognized in other comprehensive income on derivatives |        |
|--|---|---|----------|---|--------|
|  |   | For the three months ended September 30                   |          | For the three months ended September 30                                       |        |
|  |   | 2011  | 2010     | 2011  | 2010   |
|  |   |   |          |   |        |
| <b>Derivatives designed as hedging instruments</b>       |   |   |          |   |        |
| <i>Effective portion</i>                                 |   |   |          |   |        |
| Diesel future contracts                                  | Fuel expense  | \$ 1.5  | \$ (0.2) | \$ (7.3)  | \$ 2.7 |
| Interest rate swap                                       | Net interest expense  | 1.7   | 1.4      | -   | -      |
|  | Other income and charges                                    | 1.6   | -        | -   | -      |
| Treasury rate locks                                      | Net interest expense  | 0.1   | 0.1      | (0.1)   | (0.1)  |
| FX forward contracts                                     | Other income and charges                                    | 18.7  | -        | 5.5   | -      |
| <b>Derivatives not designated as hedging instruments</b> |   |   |          |   |        |
| Total return swap  | Compensation and benefits                                   | (6.0)   | 8.8      | -   | -      |
|  |   | \$ 17.6   | \$ 10.1  | \$ (1.9)  | \$ 2.6 |
| (in millions of Canadian dollars)                        | Location of gain (loss) recognized in income on derivatives | Amount of gain (loss) recognized in income on derivatives |          | Amount of gain (loss) recognized in other comprehensive income on derivatives |        |

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**For the nine months**   **For the nine months**  
**ended September 30**   **ended September 30**  
**2011**   **2010**   **2011**   **2010**

| <b>Derivatives designed as hedging instruments</b>       |                           |         |         |          |          |
|--|---------------------------|---------|---------|----------|----------|
| <i>Effective portion</i>                                 |                           |         |         |          |          |
| Diesel future contracts                                  | Fuel expense              | \$ 8.3  | \$ 1.4  | \$ (9.6) | \$ (0.7) |
| Interest rate swap                                       | Net interest expense      | 5.0     | 3.6     | -        | -        |
|  | Other income and charges  | 1.6     | -       | -        | -        |
| Treasury rate locks                                      | Net interest expense      | -       | (1.6)   | -        | 1.6      |
| FX forward contracts                                     | Other income and charges  | 13.9    | -       | 3.9      | -        |
| <b>Derivatives not designated as hedging instruments</b> |                           |         |         |          |          |
| Total return swap  | Compensation and benefits | (8.1)   | 9.2     | -        | -        |
|  |                           | \$ 20.7 | \$ 12.6 | \$ (5.7) | \$ 0.9   |

There was no significant ineffectiveness related to derivatives designated as hedges.

## CANADIAN PACIFIC RAILWAY LIMITED

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2011

(unaudited)

#### 6 Financial instruments (continued)

The following table summarizes information on the effective and ineffective portions, before tax, of the Company's net investment hedge on the Consolidated Statements of Income and in comprehensive income for the three and nine months ended September 30, 2011 and 2010:

| (in millions of Canadian dollars)     | Location of ineffective<br>portion recognized in<br>income | Ineffective portion<br>recognized in income |        | Effective portion<br>recognized in other<br>comprehensive<br>income |         |
|---------------------------------------|--|---|--------|---|---------|
|                                       |  | For the three months                        |        | For the three months  |         |
|                                       |  | ended September 30                          |        | ended September 30  |         |
|                                       |  | 2011  | 2010   | 2011  | 2010    |
| FX on LTD within net investment hedge | Other income and charges                                   | \$ -  | \$ -   | \$ (237.9)  | \$ 56.6 |
|                                       |  | For the nine months                         |        | For the nine months   |         |
|                                       |  | ended September 30                          |        | ended September 30  |         |
|                                       |  | 2011  | 2010   | 2011  | 2010    |
| FX on LTD within net investment hedge | Other income and charges                                   | \$ -  | \$ 2.6 | \$ (148.0)  | \$ 31.4 |

#### 7 Stock-based compensation

At September 30, 2011, the Company had several stock-based compensation plans, including stock option plans, various cash settled liability plans and an employee stock savings plan. These plans resulted in an expense recovery of \$8.9 million for the three months ended September 30, 2011 and an expense of \$6.3 million for the nine months ended September 30, 2011 (three and nine months ended September 30, 2010 expense of \$27.5 million and \$58.3 million, respectively).

#### Tandem stock appreciation rights

As a result of changes to Canadian tax legislation, which eliminated the favourable tax treatment on cash settled compensation awards, the Company offered employees the option of cancelling the outstanding SAR and keeping in place the outstanding option. Effective January 31,

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2011, the Company cancelled 3.1 million SARs and reclassified the fair value of the previously recognized liability (\$69.8 million) and the recognized deferred tax asset (\$17.9 million) to Additional paid-in capital. Effective September 22, 2011, the Company cancelled a further 0.3 million SARs and reclassified the fair value of the previously recognized liability (\$2.1 million) and the recognized deferred tax asset (\$0.5 million) to Additional paid-in capital. The terms of the awards were not changed and as result no incremental cost was recognized. The weighted average fair value of the units cancelled at January 31, 2011 and September 22, 2011 was \$25.36 per unit and \$10.21 per unit, respectively. Compensation cost will continue to be recognized over the remaining vesting period for those options not yet vested.

### **Regular options**

In the first nine months of 2011, under CP's stock option plans, the Company issued 632,400 regular options at the weighted average price of \$65.03 per share, based on the closing price on the grant date.

Pursuant to the employee plan, these regular options may be exercised upon vesting, which is between 24 months and 36 months after the grant date, and will expire after 10 years.

# CANADIAN PACIFIC RAILWAY LIMITED

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2011

(unaudited)

### 7 Stock-based compensation (continued)

Under the fair value method, the fair value of the regular options at the grant date was \$12.3 million. The weighted average fair value assumptions were approximately:

|  | <b>For the nine months<br/>ended September 30<br/>2011</b> |         |
|--|--|---------|
| Grant price  | \$   | 65.03   |
| Expected life (years) <sup>(1)</sup>                                     |  | 6.30    |
| Risk-free interest rate <sup>(2)</sup>                                   |  | 2.79 %  |
| Expected stock price volatility <sup>(3)</sup>                           |  | 31.48 % |
| Expected annual dividends per share <sup>(4)</sup>                       | \$   | 1.20    |
| Expected forfeiture rate <sup>(5)</sup>                                  |  | 0.8 %   |
| Weighted average fair value of regular options granted during the period | \$   | 19.44   |

<sup>(1)</sup> Represents the period of time that awards are expected to be outstanding. Historical data on exercise behaviour was used to estimate the expected life of the option.

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

<sup>(3)</sup> Based on the historical stock price volatility of the Company's stock over a period commensurate with the expected term of the option.

<sup>(4)</sup> Determined by the current annual dividend. The Company does not employ different dividend yields throughout the year.

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

### Performance share unit ( PSU ) plan

In the first nine months of 2011, the Company issued 268,230 PSUs with a grant date fair value of \$15.7 million. These units attract dividend equivalents in the form of additional units based on the dividends paid on the Company's Common Shares. PSUs vest and are settled in cash approximately three years after the grant date contingent upon CP's performance (performance factor). The fair value of PSUs are measured, both on the grant date and each subsequent quarter until settlement, using a Monte Carlo simulation model. The model utilizes multiple input variables that determine the probability of satisfying the performance and market condition stipulated in the grant.

### 8 Pensions and other benefits

In the three and nine months ended September 30, 2011, the Company made contributions of \$26.2 million and \$73.7 million, respectively (2010 - \$654.8 million and \$833.2 million, respectively) to its defined benefit pension plans. The elements of net periodic benefit cost for defined benefit pension plans and other benefits recognized in the three and nine months ended September 30, 2011, included the following components:



**CANADIAN PACIFIC RAILWAY LIMITED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS***September 30, 2011**(unaudited)***8 Pension and other benefits (continued)**

| (in millions of Canadian dollars)                                 | <b>For the three months</b> |             |                           |             |
|---|-----------------------------|-------------|---------------------------|-------------|
|   | <b>ended September 30</b>   |             | <b>ended September 30</b> |             |
|   | <b>Pensions</b>             |             | <b>Other benefits</b>     |             |
|   | <b>2011</b>                 | <b>2010</b> | <b>2011</b>               | <b>2010</b> |
| Current service cost (benefits earned by employees in the period) | \$ 26.1                     | \$ 21.6     | \$ 4.1                    | \$ 3.9      |
| Interest cost on benefit obligation                               | 114.9                       | 116.1       | 6.4                       | 7.0         |
| Expected return on fund assets                                    | (168.3)                     | (149.6)     | (0.1)                     | (0.2)       |
| Recognized net actuarial loss                                     | 35.5                        | 17.8        | 1.2                       | 1.3         |
| Amortization of prior service costs                               | 3.2                         | 3.3         | (0.3)                     | (0.4)       |
| Net periodic benefit cost   | \$ 11.4                     | \$ 9.2      | \$ 11.3                   | \$ 11.6     |

| (in millions of Canadian dollars)                                 | <b>For the nine months</b> |             |                           |             |
|---|----------------------------|-------------|---------------------------|-------------|
|   | <b>ended September 30</b>  |             | <b>ended September 30</b> |             |
|   | <b>Pensions</b>            |             | <b>Other benefits</b>     |             |
|   | <b>2011</b>                | <b>2010</b> | <b>2011</b>               | <b>2010</b> |
| Current service cost (benefits earned by employees in the period) | \$ 78.3                    | \$ 64.8     | \$ 12.3                   | \$ 11.7     |
| Interest cost on benefit obligation                               | 344.7                      | 348.3       | 19.2                      | 21.0        |
| Expected return on fund assets                                    | (505.0)                    | (448.8)     | (0.4)                     | (0.6)       |
| Recognized net actuarial loss                                     | 106.6                      | 53.4        | 3.6                       | 3.9         |
| Amortization of prior service costs                               | 9.6                        | 9.9         | (0.9)                     | (1.2)       |
| Net periodic benefit cost   | \$ 34.2                    | \$ 27.6     | \$ 33.8                   | \$ 34.8     |



**9**     *Commitments and contingencies*

In the normal course of its operations, the Company becomes involved in various legal actions, including claims relating to injuries and damages to property. The Company maintains provisions it considers to be adequate for such actions. While the final outcome with respect to actions outstanding or pending at September 30, 2011, cannot be predicted with certainty, it is the opinion of management that their resolution will not have a material adverse effect on the Company's financial position or results of operations or cash flows.

At September 30, 2011, the Company had committed to total future capital expenditures amounting to \$475.3 million and operating expenditures amounting to \$1,843.1 million for the years 2011-2028.

Environmental remediation accruals cover site-specific remediation programs. Environmental remediation accruals are measured on an undiscounted basis and are recorded when the costs to remediate are probable and reasonably estimable. The estimate of the probable costs to be incurred in the remediation of properties contaminated by past railway use reflects the nature of contamination at individual sites according to typical activities and scale of operations conducted. CP has developed remediation strategies for each property based on the nature and extent of the contamination, as well as the location of the property and surrounding areas that may be adversely affected by the presence of contaminants, considering available technologies, treatment and disposal facilities and the acceptability of site-specific plans based on the local regulatory environment. Site-specific plans range from containment and risk management of the contaminants through to the removal and treatment of the contaminants and affected soils and ground water. The details of the estimates reflect the environmental liability at each property. Provisions for environmental remediation costs

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## CANADIAN PACIFIC RAILWAY LIMITED

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2011

(unaudited)

#### 9 Commitments and contingencies (continued)

are recorded in Other long-term liabilities, except for the current portion which is recorded in Accounts payable and accrued liabilities. The total amount provided at September 30, 2011 was \$105.0 million (December 31, 2010 - \$107.4 million). Payments are expected to be made over 10 years to 2021.

The accruals for environmental remediation represent CP's best estimate of its probable future obligation and includes 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, environmental laws and regulations evolve and advances are made in environmental remediation technology. The accruals may also vary as the courts decide legal proceedings against outside parties responsible for contamination. These potential charges, which cannot be quantified at this time, are not expected to be material to CP's financial position, but may materially affect income in the particular period in which a charge is recognized. Costs related to existing, but as yet unknown, or future contamination will be accrued in the period in which they become probable and reasonably estimable. Changes to costs are reflected as changes to Other long-term liabilities or Accounts payable and accrued liabilities and to Purchased services and other within operating expenses. The amount credited to income in the three months ended September 30, 2011 was \$0.6 million and charged to income in the nine months ended September 30, 2011 was \$1.3 million. The amounts charged to income in the three months and nine months ended September 30, 2010 was \$1.2 million and \$2.7 million, respectively.

The Dakota, Minnesota & Eastern Railroad Corporation (DME) was purchased in 2007 for \$1.5 billion resulting in goodwill of \$154.5 million (US\$147.4 million) as at September 30, 2011. As at September 30, 2011, future contingent payments of approximately US\$1.19 billion consisting of US\$425 million would become due if construction of the Powder River Basin expansion project starts prior to December 31, 2025 and approximately US\$765 million would become due upon the movement of specified volumes over the Powder River Basin extension prior to December 31, 2025. Certain interest and inflationary adjustments would also become payable up to December 31, 2025 upon achievement of certain milestones. The contingent payments would be accounted for as an increase in the purchase price.

#### 10 Subsequent events

On September 13, 2011, the Company announced a cash tender offer and consent solicitation for any or all its outstanding US\$245.8 million 6.25% Notes due October 15, 2011. Notes tendered with a principal value of US\$203.7 million were redeemed on October 12, 2011, and the remaining US\$42.1 million Notes not tendered were redeemed on October 17, 2011. Upon redemption of the Notes a net loss of approximately \$1.1 million was recognized to Other income and charges in October 2011.

On October 18, 2011, the Company issued US\$92.0 million 3.88% Senior Secured Notes for net proceeds of approximately \$92.9 million. These notes are secured by locomotives previously acquired by the Company.

**Summary of Rail Data**

|   | 000000               | 000000             | 000000    | 000000   |             | 000000              | 000000             | 000000    | 000000 |
|---|----------------------|--------------------|-----------|--|-------------|---------------------|--------------------|-----------|--------|
|   | <b>Third Quarter</b> |                    |           |  |             | <b>Year-to-date</b> |                    |           |        |
| <b>2011</b>                               | <b>2010</b>          | <b>Fav/(Unfav)</b> | <b>%</b>  | <b>Financial (millions, except per share data)</b> | <b>2011</b> | <b>2010</b>         | <b>Fav/(Unfav)</b> | <b>%</b>  |        |
| <b>Revenues</b>                           |                      |                    |           |  |             |                     |                    |           |        |
| \$ 1,308.4                                | \$ 1,250.8           | \$ 57.6            | 4.6       | Freight revenue                                    | \$ 3,676.8  | \$ 3,591.2          | \$ 85.6            | 2.4       |        |
| 33.2                                      | 35.4                 | (2.2)              | (6.2)     | Other revenue                                      | 92.7        | 96.0                | (3.3)              | (3.4)     |        |
| 1,341.6                                   | 1,286.2              | 55.4               | 4.3       |  | 3,769.5     | 3,687.2             | 82.3               | 2.2       |        |
| <b>Operating expenses</b>                 |                      |                    |           |  |             |                     |                    |           |        |
| 336.4                                     | 365.2                | 28.8               | 7.9       | Compensation and benefits                          | 1,037.0     | 1,068.7             | 31.7               | 3.0       |        |
| 237.8                                     | 166.1                | (71.7)             | (43.2)    | Fuel   | 700.9       | 525.7               | (175.2)            | (33.3)    |        |
| 56.2                                      | 43.2                 | (13.0)             | (30.1)    | Materials  | 185.2       | 158.2               | (27.0)             | (17.1)    |        |
| 53.1                                      | 53.6                 | 0.5                | 0.9       | Equipment rents                                    | 158.1       | 157.5               | (0.6)              | (0.4)     |        |
| 122.6                                     | 123.9                | 1.3                | 1.0       | Depreciation and amortization                      | 367.1       | 368.4               | 1.3                | 0.4       |        |
| 210.9                                     | 196.5                | (14.4)             | (7.3)     | Purchased services and other                       | 656.9       | 590.3               | (66.6)             | (11.3)    |        |
| 1,017.0                                   | 948.5                | (68.5)             | (7.2)     |  | 3,105.2     | 2,868.8             | (236.4)            | (8.2)     |        |
| 324.6                                     | 337.7                | (13.1)             | (3.9)     | Operating income                                   | 664.3       | 818.4               | (154.1)            | (18.8)    |        |
| Less:                                     |                      |                    |           |  |             |                     |                    |           |        |
| 14.1                                      | 1.0                  | (13.1)             | -         | Other (income) and charges                         | 8.6         | (7.3)               | (15.9)             | -         |        |
| 64.3                                      | 60.6                 | (3.7)              | (6.1)     | Net interest expense                               | 191.0       | 192.1               | 1.1                | 0.6       |        |
| 246.2                                     | 276.1                | (29.9)             | (10.8)    | Income before income tax expense                   | 464.7       | 633.6               | (168.9)            | (26.7)    |        |
| 59.4                                      | 78.8                 | 19.4               | 24.6      | Income tax expense                                 | 116.2       | 168.7               | 52.5               | 31.1      |        |
| \$ 186.8                                  | \$ 197.3             | \$ (10.5)          | (5.3)     | Net income   | \$ 348.5    | \$ 464.9            | \$ (116.4)         | (25.0)    |        |
| 75.8                                      | 73.7                 | (2.1)              | (210) bps | Operating ratio (%)                                | 82.4        | 77.8                | (4.6)              | (460) bps |        |
| \$ 1.10                                   | \$ 1.17              | \$ (0.07)          | (6.0)     | Basic earnings per share                           | \$ 2.06     | \$ 2.76             | \$ (0.70)          | (25.4)    |        |
| \$ 1.10                                   | \$ 1.17              | \$ (0.07)          | (6.0)     | Diluted earnings per share                         | \$ 2.04     | \$ 2.75             | \$ (0.71)          | (25.8)    |        |
| <b>Shares Outstanding</b>                 |                      |                    |           |  |             |                     |                    |           |        |
| Weighted average number of shares         |                      |                    |           |  |             |                     |                    |           |        |
| 169.4                                     | 168.8                | 0.6                | 0.4       | outstanding (millions)                             | 169.4       | 168.6               | 0.8                | 0.5       |        |
| Weighted average number of diluted shares |                      |                    |           |  |             |                     |                    |           |        |
| 170.5                                     | 169.3                | 1.2                | 0.7       | outstanding (millions)                             | 170.6       | 169.0               | 1.6                | 0.9       |        |

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**Foreign Exchange**

| Average foreign exchange rate |      |        |       |                   |      |      |        |       |  |
|-------------------------------|------|--------|-------|-------------------|------|------|--------|-------|--|
| 1.03                          | 0.96 | (0.07) | (7.3) | (US\$/Canadian\$) | 1.03 | 0.96 | (0.07) | (7.3) |  |
| Average foreign exchange rate |      |        |       |                   |      |      |        |       |  |
| 0.97                          | 1.04 | (0.07) | (6.7) | (Canadian\$/US\$) | 0.97 | 1.04 | (0.07) | (6.7) |  |

**Summary of Rail Data (Page 2)**

| Third Quarter                              |            |             |        | Year-to-date                                      |            |            |             |        |
|--|------------|-------------|--------|---|------------|------------|-------------|--------|
| 2011                                       | 2010       | Fav/(Unfav) | %      |   | 2011       | 2010       | Fav/(Unfav) | %      |
| <b>Commodity Data</b>                      |            |             |        |   |            |            |             |        |
| <b>Freight Revenues (millions)</b>         |            |             |        |   |            |            |             |        |
| \$ 290.6                                   | \$ 300.2   | \$ (9.6)    | (3.2)  | - Grain   | \$ 777.2   | \$ 835.9   | \$ (58.7)   | (7.0)  |
| 146.5                                      | 118.4      | 28.1        | 23.7   | - Coal  | 397.7      | 365.6      | 32.1        | 8.8    |
| 136.1                                      | 110.1      | 26.0        | 23.6   | - Sulphur and fertilizers                         | 415.6      | 342.8      | 72.8        | 21.2   |
| 50.7                                       | 47.1       | 3.6         | 7.6    | - Forest products                                 | 142.2      | 134.7      | 7.5         | 5.6    |
| 265.8                                      | 240.3      | 25.5        | 10.6   | - Industrial and consumer products                | 728.6      | 662.8      | 65.8        | 9.9    |
| 80.1                                       | 74.5       | 5.6         | 7.5    | - Automotive                                      | 244.3      | 241.1      | 3.2         | 1.3    |
| 338.6                                      | 360.2      | (21.6)      | (6.0)  | - Intermodal                                      | 971.2      | 1,008.3    | (37.1)      | (3.7)  |
| \$ 1,308.4                                 | \$ 1,250.8 | \$ 57.6     | 4.6    | Total Freight Revenues                            | \$ 3,676.8 | \$ 3,591.2 | \$ 85.6     | 2.4    |
| <b>Millions of Revenue Ton-Miles (RTM)</b> |            |             |        |   |            |            |             |        |
| 8,294                                      | 8,842      | (548)       | (6.2)  | - Grain   | 23,370     | 25,781     | (2,411)     | (9.4)  |
| 5,647                                      | 4,631      | 1,016       | 21.9   | - Coal  | 15,181     | 14,207     | 974         | 6.9    |
| 5,057                                      | 3,997      | 1,060       | 26.5   | - Sulphur and fertilizers                         | 15,569     | 12,724     | 2,845       | 22.4   |
| 1,313                                      | 1,241      | 72          | 5.8    | - Forest products <sup>(1)</sup>                  | 3,784      | 3,747      | 37          | 1.0    |
| 6,167                                      | 5,897      | 270         | 4.6    | - Industrial and consumer products <sup>(1)</sup> | 17,644     | 16,097     | 1,547       | 9.6    |
| 477  | 461        | 16          | 3.5    | - Automotive                                      | 1,545      | 1,566      | (21)        | (1.3)  |
| 6,113                                      | 6,848      | (735)       | (10.7) | - Intermodal                                      | 17,882     | 19,423     | (1,541)     | (7.9)  |
| 33,068                                     | 31,917     | 1,151       | 3.6    | Total RTMs  | 94,975     | 93,545     | 1,430       | 1.5    |
| <b>Freight Revenue per RTM (cents)</b>     |            |             |        |   |            |            |             |        |
| 3.50                                       | 3.40       | 0.10        | 2.9    | - Grain   | 3.33       | 3.24       | 0.09        | 2.8    |
| 2.59                                       | 2.56       | 0.03        | 1.2    | - Coal  | 2.62       | 2.57       | 0.05        | 1.9    |
| 2.69                                       | 2.75       | (0.06)      | (2.2)  | - Sulphur and fertilizers                         | 2.67       | 2.69       | (0.02)      | (0.7)  |
| 3.86                                       | 3.80       | 0.06        | 1.6    | - Forest products <sup>(1)</sup>                  | 3.76       | 3.59       | 0.17        | 4.7    |
| 4.31                                       | 4.07       | 0.24        | 5.9    | - Industrial and consumer products <sup>(1)</sup> | 4.13       | 4.12       | 0.01        | 0.2    |
| 16.79                                      | 16.16      | 0.63        | 3.9    | - Automotive                                      | 15.81      | 15.40      | 0.41        | 2.7    |
| 5.54                                       | 5.26       | 0.28        | 5.3    | - Intermodal                                      | 5.43       | 5.19       | 0.24        | 4.6    |
| 3.96                                       | 3.92       | 0.04        | 1.0    | Total Freight Revenue per RTM                     | 3.87       | 3.84       | 0.03        | 0.8    |
| <b>Carloads (thousands)</b>                |            |             |        |   |            |            |             |        |
| 116.9                                      | 119.9      | (3.0)       | (2.5)  | - Grain   | 329.1      | 349.0      | (19.9)      | (5.7)  |
| 84.7                                       | 83.2       | 1.5         | 1.8    | - Coal  | 226.0      | 253.8      | (27.8)      | (11.0) |
| 48.4                                       | 41.8       | 6.6         | 15.8   | - Sulphur and fertilizers                         | 151.2      | 129.3      | 21.9        | 16.9   |
| 18.8                                       | 18.2       | 0.6         | 3.3    | - Forest products                                 | 54.6       | 53.0       | 1.6         | 3.0    |
| 111.2                                      | 106.4      | 4.8         | 4.5    | - Industrial and consumer products                | 307.3      | 294.8      | 12.5        | 4.2    |
| 33.1                                       | 32.3       | 0.8         | 2.5    | - Automotive                                      | 106.4      | 103.3      | 3.1         | 3.0    |
| 255.2                                      | 283.9      | (28.7)      | (10.1) | - Intermodal                                      | 746.7      | 803.9      | (57.2)      | (7.1)  |

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|       |       |        |       |                |         |         |        |       |
|-------|-------|--------|-------|----------------|---------|---------|--------|-------|
| 668.3 | 685.7 | (17.4) | (2.5) | Total Carloads | 1,921.3 | 1,987.1 | (65.8) | (3.3) |
|-------|-------|--------|-------|----------------|---------|---------|--------|-------|

**Freight Revenue per Carload**

|    |       |    |       |    |      |       |                                    |    |       |    |       |    |      |       |
|----|-------|----|-------|----|------|-------|------------------------------------|----|-------|----|-------|----|------|-------|
| \$ | 2,486 | \$ | 2,504 | \$ | (18) | (0.7) | - Grain                            | \$ | 2,362 | \$ | 2,395 | \$ | (33) | (1.4) |
|    | 1,730 |    | 1,423 |    | 307  | 21.6  | - Coal                             |    | 1,760 |    | 1,441 |    | 319  | 22.1  |
|    | 2,812 |    | 2,634 |    | 178  | 6.8   | - Sulphur and fertilizers          |    | 2,749 |    | 2,651 |    | 98   | 3.7   |
|    | 2,697 |    | 2,588 |    | 109  | 4.2   | - Forest products                  |    | 2,604 |    | 2,542 |    | 62   | 2.4   |
|    | 2,390 |    | 2,258 |    | 132  | 5.8   | - Industrial and consumer products |    | 2,371 |    | 2,248 |    | 123  | 5.5   |
|    | 2,420 |    | 2,307 |    | 113  | 4.9   | - Automotive                       |    | 2,296 |    | 2,334 |    | (38) | (1.6) |
|    | 1,327 |    | 1,269 |    | 58   | 4.6   | - Intermodal                       |    | 1,301 |    | 1,254 |    | 47   | 3.7   |
| \$ | 1,958 | \$ | 1,824 | \$ | 134  | 7.3   | Total Freight Revenue per Carload  | \$ | 1,914 | \$ | 1,807 | \$ | 107  | 5.9   |

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

**Summary of Rail Data (Page 3)**

| 2011                          | Third Quarter       |             |        |   | 2011    | Year-to-date        |             |        |
|-------------------------------|---------------------|-------------|--------|---|---------|---------------------|-------------|--------|
|                               | 2010 <sup>(1)</sup> | Fav/(Unfav) | %      |   |         | 2010 <sup>(1)</sup> | Fav/(Unfav) | %      |
| <b>Operations Performance</b> |                     |             |        |   |         |                     |             |        |
| 1.60                          | 1.56                | (0.04)      | (2.6)  | Total operating expenses per GTM (cents) <sup>(2)</sup>             | 1.70    | 1.59                | (0.11)      | (6.9)  |
| 1.61                          | 1.56                | (0.05)      | (3.2)  | Operating expenses, less land sales, per GTM (cents) <sup>(3)</sup> | 1.70    | 1.59                | (0.11)      | (6.9)  |
| 63,485                        | 60,969              | 2,516       | 4.1    | Freight gross ton-miles (millions)                                  | 182,483 | 180,259             | 2,224       | 1.2    |
| 10,230                        | 9,967               | 263         | 2.6    | Train miles (thousands)   | 29,534  | 29,444              | 90          | 0.3    |
| 16,639                        | 16,046              | (593)       | (3.7)  | Average number of active employees - Total                          | 15,924  | 15,401              | (523)       | (3.4)  |
| 14,262                        | 13,961              | (301)       | (2.2)  | Average number of active employees - Expense                        | 14,073  | 13,866              | (207)       | (1.5)  |
| 16,675                        | 16,042              | (633)       | (3.9)  | Number of employees at end of period - Total                        | 16,675  | 16,042              | (633)       | (3.9)  |
| 14,295                        | 13,950              | (345)       | (2.5)  | Number of employees at end of period - Expense                      | 14,295  | 13,950              | (345)       | (2.5)  |
| 1.13                          | 1.12                | (0.01)      | (0.9)  | Fuel efficiency <sup>(4)</sup>                                      | 1.19    | 1.16                | (0.03)      | (2.6)  |
| 71.5                          | 67.9                | (3.6)       | (5.3)  | U.S. gallons of locomotive fuel consumed (millions) <sup>(5)</sup>  | 214.8   | 207.7               | (7.1)       | (3.4)  |
| 3.44                          | 2.34                | (1.10)      | (47.0) | Average fuel price (U.S. dollars per U.S. gallon)                   | 3.35    | 2.44                | (0.91)      | (37.3) |
| <b>Fluidity Data</b>          |                     |             |        |   |         |                     |             |        |
| 18.5                          | 19.6                | 1.1         | 5.6    | Average terminal dwell - AAR definition (hours)                     | 20.7    | 21.2                | 0.5         | 2.4    |
| 22.1                          | 23.0                | (0.9)       | (3.9)  | Average train speed - AAR definition (mph)                          | 20.6    | 23.1                | (2.5)       | (10.8) |
| 168.7                         | 169.1               | (0.4)       | (0.2)  | Car miles per car day   | 153.2   | 161.9               | (8.7)       | (5.4)  |
| 49.6                          | 47.9                | (1.7)       | (3.5)  | Average daily active cars on-line (thousands)                       | 53.0    | 49.8                | (3.2)       | (6.4)  |
| 1,081                         | 1,002               | (79)        | (7.9)  | Average daily active road locomotives on-line                       | 1,086   | 1,005               | (81)        | (8.1)  |
| <b>Safety</b>                 |                     |             |        |   |         |                     |             |        |
| 2.15                          | 1.53                | (0.62)      | (40.5) | FRA personal injuries per 200,000 employee-hours                    | 1.89    | 1.62                | (0.27)      | (16.7) |
| 1.81                          | 1.81                | -           | -      | FRA train accidents per million train-miles                         | 2.00    | 1.78                | (0.22)      | (12.4) |

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

(2) Gross Ton-Miles (GTM) is the movement of the combined tons (freight car tare, inactive locomotive tare, and contents) a distance of one mile.

(3) Operating expenses, exclusive of land sales, per GTM is calculated consistently with total operating expenses per GTM except for the exclusion of net gains on land sales of \$3.3 million and \$2.8 million for the three months ended September 30, 2011 and 2010, respectively, and \$5.1 million and \$6.0 million for the nine months ended September 30, 2011 and 2010, respectively.

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

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