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, 2023 in Item 1. Financial Statements, other information in this report, and Item 8. Financial Statements and Supplementary Data of the Company's 2022 Annual Report on Form 10-K. Except where otherwise indicated, all financial information reflected herein is expressed in Canadian dollars.

Available Information

The Company makes available on or through its website www.cpkcr.com 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 the Company 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's ("CEO") and Chief Financial Officer's certifications regarding the Company's public disclosure required by Section 302 of the Sarbanes-Oxley Act of 2002 as Exhibits to this report.

KCS Acquisition

On March 15, 2023, the United States ("U.S.") Surface Transportation Board ("STB") issued a final decision approving the Canadian Pacific Railway Limited ("CPRL" or "CP") and Kansas City Southern ("KCS") joint merger application, subject to certain conditions. On March 17, 2023 CP announced its acceptance of the STB final decision and its intent to assume control of KCS on April 14, 2023 (the "Control Date"). On the Control Date, the voting trust was terminated and CP assumed control of KCS (through an indirect wholly owned subsidiary), and changed CPRL's name to Canadian Pacific Kansas City Limited ("CPKC").

CPKC owns and operates the only freight railway spanning Canada, the U.S. and Mexico. CPKC provides rail and intermodal transportation services over a network of approximately 20,000 miles, directly serving principal business centres in Canada, the U.S. and Mexico.

In this Quarterly Report on Form 10-Q, unless the context indicates otherwise, references to "CPKC", "the Company", 'we", "our", or "us" are to Canadian Pacific Kansas City Limited and its subsidiaries, which includes KCS as a consolidated subsidiary on and from April 14, 2023. Prior to April 14, 2023, KCS was held as an equity investment accounted for by the equity method of accounting.

Specific risk factors related to the KCS acquisition are included in Item 1A. Risk Factors of this Quarterly Report on Form 10-Q.

Executive Summary

Second Quarter of 2023 Results

- *Financial performance* - In the second quarter of 2023, the Company reported Diluted earnings per share ("EPS") of $1.42, an increase of 73% compared to the same period of 2022 due to the net impact of the derecognition of the investment in KCS upon consolidation. Core adjusted combined diluted EPS was $0.83, a decrease of 13% compared to the same period of 2022. The Company reported an Operating ratio of 70.3%, a 970 basis point increase compared to the same period of 2022. Core adjusted combined operating ratio was 64.6%, a 430 basis point increase compared to the same period of 2022. Core adjusted combined diluted EPS and Core adjusted combined 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.

  In the second quarter of 2023, Equity earnings of KCS prior to the Control Date was $26 million and Net income from KCS from the Control Date to June 30, 2023 was $138 million, compared to KCS equity earnings of $208 million in the same period of 2022. The lower overall contribution from KCS was primarily due to increased acquisition-related costs driven by restructuring charges. This was partially offset by a decrease in net interest expense due to the completion of the debt exchange. In the second quarter of 2023, KCS contributed $216 million and 3.7% to Operating income and Operating ratio respectively.

- *Total revenues* - Total revenues increased by 44% in the second quarter of 2023 to $3,174 million, compared to the same period of 2022. This increase was primarily due to the impact of the KCS acquisition, increased freight revenue per RTM, and higher volumes of Canadian grain, partially offset by lower volumes of U.S grain, Potash, and Energy, chemicals and plastics.

Recent Developments

- On June 28, 2023, CPKC, CSX Corporation ("CSX"), and Genesee & Wyoming Inc. ("G&W") announced they have reached agreements that, when completed, will create a new direct CPKC-CSX interchange connection in Alabama. As part of the series of proposed transactions, CPKC and CSX will each acquire or operate portions of Meridian & Bigbee Railroad, L.L.C., a G&W-owned railway in Mississippi and Alabama, to establish a new freight corridor for shippers that connects Mexico, Texas, and the U.S. Southeast. Certain portions of the transactions are subject to regulatory review and approval from, or exemption by, the U.S. STB.

- On April 14, 2023, CPKC announced the appointment of David Garza-Santos, Ambassador Antonio Garza (Ret.), Henry Maier and Janet Kennedy, each former directors of KCS, to the Board of Directors of CPRC, effective immediately. Mr. Garza-Santos, Mr. Garza, Mr. Maier and Ms. Kennedy were also elected, along with all nine other director nominees, to the board of CPKC at CPKC's 2023 Annual Meeting of Shareholders, which was held on June 15, 2023.

Prior Developments

- On March 20, 2023, the Company announced the commencement of offers to exchange any and all validly tendered (and not validly withdrawn notes) and accepted notes of seven series, each previously issued by KCS (the "Old Notes") for notes to be issued by Canadian Pacific Railway Company ("CPRC") (the "CPRC" Notes"), a wholly-owned subsidiary of CPKC, and to be unconditionally guaranteed on an unsecured basis by CPKC. The exchange offers expired on April 17, 2023. On April 19, 2023, U.S. $3,014 million of Old Notes of such seven series were tendered and accepted in exchange for U.S. $3,014 million of CPRC Notes in seven corresponding series. Each series of CPRC Notes has the same interest rates, interest payment dates, maturity dates, and substantively the same optional redemption provisions as the corresponding series of Old Notes.

  On April 24, 2023, KCS irrevocably deposited U.S. $647 million of non-callable government securities with the trustee of two series of notes that mature in 2023 and were not included within the KCS debt exchange (the "KCS 2023 Notes") to satisfy and discharge KCS's obligations under two series of notes that mature in 2023 and were not included within the KCS debt exchange. The remaining KCS 2023 Notes are presented on the Company's Consolidated Balance Sheets until their maturity date. This transaction, along with the debt exchange offers mentioned above, relieved KCS from continuous disclosure obligations.

- On March 17, 2023, the Company announced the executive leadership team that will lead CPKC.

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		
	2023	2022	% Change	**2023**	2022	% Change
Operations Performance						
Gross ton-miles ("GTMs") (millions)	**88,650**	68,847	29	**156,099**	131,030	19
Train miles (thousands)	**10,577**	7,259	46	**17,834**	14,152	26
Fuel efficiency (U.S. gallons of locomotive fuel consumed / 1,000 GTMs)	**1.036**	0.930	11	**1.009**	0.960	5
Total employees (average)	**19,579**	12,509	57	**16,257**	12,138	34

These key measures are used by management 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 the Company's management is at controlling costs and executing the Company's operating plan and strategy. Continued monitoring of these key measures enables the Company to take appropriate actions to deliver superior service and grow its business at low incremental cost.

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. The increase in GTMs in the second quarter of 2023 was primarily due to the impact of the KCS acquisition and higher volumes of Canadian grain, partially offset by lower volumes of U.S. grain, Potash, and Energy, chemicals and plastics.

The increase in GTMs in the first six months of 2023 was primarily due to the impact of the KCS acquisition and higher volumes of Canadian grain, and Metals, minerals and consumer products, partially offset by lower volumes of U.S. grain and Potash.

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. The increase in train miles in the second quarter of 2023 reflects the impact of a 29% increase in workload (GTMs), and an 11% decrease in average train weights, which was primarily due to the impact of the KCS acquisition.

The increase in train miles in the first six months of 2023 reflected the impact of a 19% increase in workload (GTMs) and a 4% decrease in average train weights, which was primarily due to the impact of the KCS acquisition.

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. The decrease in fuel efficiency in the second quarter and in the first six months of 2023 was due to a decrease in average train weights by 11% and 4% respectively, which was primarily due to the impact of the KCS acquisition.

An **employee** is defined as an individual currently engaged in full-time, part-time, or seasonal employment with the Company. 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 employees increased by 57% and 34% for the three and six months ended June 30, 2023, respectively, compared to the same period of 2022. The increase in the average number of employees was due to the acquisition of KCS and to support anticipated future volume growth.

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, 2023 and the comparative figures in 2022. 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)	**2023**	2022	**2023**	2022
Financial Performance				
Total revenues	**$ 3,174**	$ 2,202	**$ 5,440**	$ 4,040
Operating income	**944**	868	**1,773**	1,403
Net income attributable to controlling shareholders	**1,324**	765	**2,124**	1,355
Basic EPS	**1.42**	0.82	**2.28**	1.46
Diluted EPS	**1.42**	0.82	**2.28**	1.45
Core adjusted combined diluted EPS[(1)]	**0.83**	0.95	**1.73**	1.62
Dividends declared per share	**0.190**	0.190	**0.380**	0.380
Financial Ratios				
Operating ratio[(2)]	**70.3%**	60.6%	**67.4%**	65.3%
Core adjusted combined operating ratio[(1)]	**64.6%**	60.3%	**64.0%**	63.3%

[(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.

Results of Operations

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; interline switching fees; and other arrangements, including contracts with passenger service operators and logistical services.

For the three months ended June 30	**2023**	2022	Total Change	% Change
Freight revenues (in millions)	**$ 3,101**	$ 2,154	$ 947	44
Non-freight revenues (in millions)	**73**	48	25	52
Total revenues (in millions)	**$ 3,174**	$ 2,202	$ 972	44
Carloads (in thousands)	**1,069.7**	712.7	357.0	50
Revenue ton-miles (in millions)	**47,360**	38,093	9,267	24
Freight revenue per carload (in dollars)	**$ 2,899**	$ 3,022	$ (123)	(4)
Freight revenue per revenue ton-mile (in cents)	**6.55**	5.65	0.90	16

Total Revenues
The increase in Freight revenues in the second quarter of 2023 was primarily due to the impact of the KCS acquisition of $979 million, increased freight revenue per RTM, and higher volumes of Canadian grain, partially offset by lower volumes of U.S. grain, Potash, and Energy, chemicals and plastics. The increase in Non-freight revenues was primarily due to the impact of the KCS acquisition of $19 million and higher leasing revenue.

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. The increase in RTMs in the second quarter of 2023 was primarily due to the impact of the KCS acquisition and higher volumes of Canadian grain, partially offset by lower volumes of U.S. grain, Potash, and Energy, chemicals and plastics. Carloads have increased more than RTMs due to the impact of the KCS acquisition, which has a shorter average length of haul.

Freight revenue per RTM
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. The increase in freight revenue per RTM in the second quarter of 2023 was primarily due to higher freight rates and the favourable impact of the change in FX of $62 million, partially offset by the unfavourable impact to fuel surcharge revenue as a result of lower fuel prices of $94 million.

For the six months ended June 30	**2023**	2022	Total Change	% Change
Freight revenues (in millions)	**$ 5,318**	$ 3,950	$ 1,368	35
Non-freight revenues (in millions)	**122**	90	32	36
Total revenues (in millions)	**$ 5,440**	$ 4,040	$ 1,400	35
Carloads (in thousands)	**1,749.2**	1,338.4	410.8	31
Revenue ton-miles (in millions)	**84,909**	71,786	13,123	18
Freight revenue per carload (in dollars)	**$ 3,040**	$ 2,951	$ 89	3
Freight revenue per revenue ton-mile (in cents)	**6.26**	5.50	0.76	14

Total Revenues
The increase in Freight revenues in the first six months of 2023 was primarily due to the impact of the KCS acquisition of $979 million, increased freight revenue per RTM, and higher volumes as measured by RTMs. The increase in Non-freight revenues was primarily due to the impact of the KCS acquisition of $19 million, higher leasing revenue, and higher interline switching fees.

RTMs
The increase in RTMs in the first six months of 2023 was primarily due to the impact of the KCS acquisition and higher volumes of Canadian grain and Metals, minerals and consumer products, partially offset by lower volumes of U.S. grain and Potash. Carloads have increased more than RTMs due to the impact of the KCS acquisition, which has a shorter average length of haul.

Freight revenue per RTM
The increase in freight revenue per RTM in the first six months of 2023 was primarily due to higher freight rates, the favourable impact of the change in FX of $127 million, and the favourable impact to fuel surcharge revenue as a result of the timing of recoveries under the Company's fuel cost adjustment program of $7 million.

Fuel Cost Adjustment Program

Freight revenues include fuel surcharge revenues associated with the Company'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 $403 million in the second quarter of 2023, an increase of $44 million, or 12%, from $359 million in the same period of 2022. This increase was primarily due to the impact of the KCS acquisition, the favourable impact of the timing of recoveries under the Company's fuel cost adjustment program, and the favourable impact of the change in FX, partially offset by lower fuel prices.

In the first six months of 2023, fuel surcharge revenues were $715 million, an increase of $167 million, or 30%, from $548 million in the same period of 2022. This increase was primarily due to the impact of the KCS acquisition, the favourable impact of the timing of recoveries under the Company's fuel cost adjustment program, the favourable impact of the change in FX, and higher volumes, partially offset by lower fuel prices.

Lines of Business

Grain

For the three months ended June 30	2023	2022	Total Change	% Change
Freight revenues (in millions)	**$ 537**	$ 370	$ 167	45
Carloads (in thousands)	**117.0**	84.1	32.9	39
Revenue ton-miles (in millions)	**10,947**	7,784	3,163	41
Freight revenue per carload (in dollars)	**$ 4,590**	$ 4,400	$ 190	4
Freight revenue per revenue ton-mile (in cents)	**4.91**	4.75	0.16	3

The increase in Grain revenue in the second quarter of 2023 was primarily due to the impact of the KCS acquisition, higher volumes of Canadian grain to Vancouver, British Columbia ("B.C.") and eastern Canada due to prior year drought conditions that impacted the 2021-2022 crop size, and increased freight revenue per RTM. This increase was partially offset by moving lower volumes of U.S. corn from the U.S. Midwest to western Canada primarily due to an improved Canadian harvest for the 2022-2023 crop year and the unfavourable impact to fuel surcharge revenue as a result of lower fuel prices. Freight revenue per RTM increased due to the favourable impact of the change in FX and higher freight rates.

For the six months ended June 30	2023	2022	Total Change	% Change
Freight revenues (in millions)	**$ 1,052**	$ 730	$ 322	44
Carloads (in thousands)	**221.8**	167.8	54.0	32
Revenue ton-miles (in millions)	**20,961**	15,758	5,203	33
Freight revenue per carload (in dollars)	**$ 4,743**	$ 4,350	$ 393	9
Freight revenue per revenue ton-mile (in cents)	**5.02**	4.63	0.39	8

The increase in Grain revenue in the first six months of 2023 was primarily due to higher volumes of Canadian grain to Vancouver and eastern Canada due to prior year drought conditions that impacted the 2021-2022 crop size, the impact of the KCS acquisition, and increased freight revenue per RTM. This increase was partially offset by moving lower volumes of U.S. corn from the U.S. Midwest to western Canada primarily due to an improved Canadian harvest for the 2022-2023 crop year. Freight revenue per RTM increased due to the favourable impact of the change in FX and higher freight rates.

Coal

For the three months ended June 30	2023	2022	Total Change	% Change
Freight revenues (in millions)	**$ 219**	$ 163	$ 56	34
Carloads (in thousands)	**114.8**	71.7	43.1	60
Revenue ton-miles (in millions)	**5,694**	4,183	1,511	36
Freight revenue per carload (in dollars)	**$ 1,908**	$ 2,273	$ (365)	(16)
Freight revenue per revenue ton-mile (in cents)	**3.85**	3.90	(0.05)	(1)

The increase in Coal revenue in the second quarter of 2023 was primarily due to the impact of the KCS acquisition, higher volumes of Canadian coal to Vancouver and Thunder Bay, Ontario, higher freight rates, and the favourable impact of the change in FX. This increase was partially offset by lower volumes of Canadian coal to Kamloops, B.C. and decreased freight revenue per RTM. Freight revenue per RTM decreased due to the unfavourable impact to fuel surcharge revenue as a result of lower fuel prices.

For the six months ended June 30		2023		2022		Total Change	% Change
Freight revenues (in millions)	$	**374**	$	302	$	72	24
Carloads (in thousands)		**187.2**		141.6		45.6	32
Revenue ton-miles (in millions)		**9,619**		8,180		1,439	18
Freight revenue per carload (in dollars)	$	**1,998**	$	2,133	$	(135)	(6)
Freight revenue per revenue ton-mile (in cents)		**3.89**		3.69		0.20	5

The increase in Coal revenue in the first six months of 2023 was primarily due to the impact of the KCS acquisition, increased freight revenue per RTM, higher volumes of U.S. coal, and higher volumes of Canadian coal to Kamloops and Thunder Bay, partially offset by lower volumes of Canadian coal to Vancouver. Freight revenue per RTM increased due to higher freight rates and the favourable impact of the change in FX.

Potash

For the three months ended June 30		2023		2022		Total Change	% Change
Freight revenues (in millions)	$	**144**	$	171	$	(27)	(16)
Carloads (in thousands)		**39.8**		47.3		(7.5)	(16)
Revenue ton-miles (in millions)		**4,490**		5,481		(991)	(18)
Freight revenue per carload (in dollars)	$	**3,618**	$	3,615	$	3	—
Freight revenue per revenue ton-mile (in cents)		**3.21**		3.12		0.09	3

The decrease in Potash revenue in the second quarter of 2023 was primarily due to lower volumes of export potash to the U.S. Pacific Northwest as a result of an equipment failure at the Port of Portland, lower volumes of export potash to Vancouver and Thunder Bay, and the unfavourable impact to fuel surcharge revenue as a result of lower fuel prices. This decrease was partially offset by increased freight revenue per RTM and higher volumes of domestic potash. Freight revenue per RTM increased due to the favourable impact of the change in FX and higher freight rates.

For the six months ended June 30		2023		2022		Total Change	% Change
Freight revenues (in millions)	$	**276**	$	275	$	1	—
Carloads (in thousands)		**76.7**		79.4		(2.7)	(3)
Revenue ton-miles (in millions)		**8,500**		9,133		(633)	(7)
Freight revenue per carload (in dollars)	$	**3,598**	$	3,463	$	135	4
Freight revenue per revenue ton-mile (in cents)		**3.25**		3.01		0.24	8

The increase in Potash revenue in the first six months of 2023 was primarily due to increased freight revenue per RTM and higher volumes of domestic potash. This increase was offset by lower volumes of export potash to the U.S. Pacific Northwest as a result of an equipment failure at the Port of Portland and lower volumes of export potash to Vancouver and Thunder Bay. Freight revenue per RTM increased due to the favourable impact of the change in FX and higher freight rates. RTMs decreased more than carloads due to moving lower volumes of export potash, which has a longer length of haul.

Fertilizers and Sulphur

For the three months ended June 30		2023		2022		Total Change	% Change
Freight revenues (in millions)	$	**89**	$	85	$	4	5
Carloads (in thousands)		**15.2**		16.0		(0.8)	(5)
Revenue ton-miles (in millions)		**1,107**		1,228		(121)	(10)
Freight revenue per carload (in dollars)	$	**5,855**	$	5,313	$	542	10
Freight revenue per revenue ton-mile (in cents)		**8.04**		6.92		1.12	16

The increase in Fertilizers and sulphur revenue in the second quarter of 2023 was primarily due to increased freight revenue per RTM, the impact of the KCS acquisition, and higher volumes of wet fertilizers. This increase was partially offset by lower volumes of sulphur and dry fertilizers and the unfavourable impact to fuel surcharge revenue as a result of lower fuel prices. Freight revenue per RTM increased due to the favourable impact of the change in FX and higher freight rates. RTMs decreased more than carloads due to moving lower volumes of sulphur, which has a longer length of haul.

For the six months ended June 30	**2023**	2022	Total Change	% Change
Freight revenues (in millions)	**$ 185**	$ 163	$ 22	13
Carloads (in thousands)	**32.2**	31.9	0.3	1
Revenue ton-miles (in millions)	**2,447**	2,447	—	—
Freight revenue per carload (in dollars)	**$ 5,745**	$ 5,110	$ 635	12
Freight revenue per revenue ton-mile (in cents)	**7.56**	6.66	0.90	14

The increase in Fertilizers and sulphur revenue in the first six months of 2023 was primarily due to increased freight revenue per RTM, the impact of the KCS acquisition, and higher volumes of wet fertilizers, partially offset by lower volumes of sulphur. Freight revenue per RTM increased due to the favourable impact of the change in FX and higher freight rates.

Forest Products

For the three months ended June 30	**2023**	2022	Total Change	% Change
Freight revenues (in millions)	**$ 187**	$ 104	$ 83	80
Carloads (in thousands)	**34.8**	19.4	15.4	79
Revenue ton-miles (in millions)	**2,134**	1,517	617	41
Freight revenue per carload (in dollars)	**$ 5,374**	$ 5,361	$ 13	—
Freight revenue per revenue ton-mile (in cents)	**8.76**	6.86	1.90	28

The increase in Forest products revenue in the second quarter of 2023 was primarily due to the impact of the KCS acquisition, increased freight revenue per RTM, and higher volumes of lumber from Alberta to the U.S. Midwest. This increase was partially offset by lower volumes of newsprint from Saint John, New Brunswick, lower volumes of panel products, and the unfavourable impact to fuel surcharge revenue as a result of lower fuel prices. Freight revenue per RTM increased due to the favourable impact of the change in FX and higher freight rates.

For the six months ended June 30	**2023**	2022	Total Change	% Change
Freight revenues (in millions)	**$ 290**	$ 190	$ 100	53
Carloads (in thousands)	**52.5**	36.8	15.7	43
Revenue ton-miles (in millions)	**3,512**	2,878	634	22
Freight revenue per carload (in dollars)	**$ 5,524**	$ 5,163	$ 361	7
Freight revenue per revenue ton-mile (in cents)	**8.26**	6.60	1.66	25

The increase in Forest products revenue in the first six months of 2023 was primarily due to the impact of the KCS acquisition, increased freight revenue per RTM, and higher volumes of lumber from Alberta to the U.S Midwest. This increase was partially offset by lower volumes of panel products, lower volumes of newsprint from Saint John, and the unfavourable impact to fuel surcharge revenue as a result of lower fuel prices. Freight revenue per RTM increased due to higher freight rates and the favourable impact of the change in FX.

Energy, Chemicals and Plastics

For the three months ended June 30	**2023**	2022	Total Change	% Change
Freight revenues (in millions)	**$ 575**	$ 340	$ 235	69
Carloads (in thousands)	**127.5**	73.5	54.0	73
Revenue ton-miles (in millions)	**8,005**	6,028	1,977	33
Freight revenue per carload (in dollars)	**$ 4,510**	$ 4,626	$ (116)	(3)
Freight revenue per revenue ton-mile (in cents)	**7.18**	5.64	1.54	27

The increase in Energy, chemicals and plastics revenue in the second quarter of 2023 was primarily due to the impact of the KCS acquisition and increased freight revenue per RTM. This increase was partially offset by lower volumes of crude and liquified petroleum gas ("L.P.G."), and the unfavourable impact to fuel surcharge revenue as a result of lower fuel prices. Freight revenue per RTM increased due to the favourable impact of the change in FX and higher freight rates.

For the six months ended June 30	**2023**	2022	Total Change	% Change
Freight revenues (in millions)	**$ 941**	$ 650	$ 291	45
Carloads (in thousands)	**202.7**	146.1	56.6	39
Revenue ton-miles (in millions)	**14,212**	11,935	2,277	19
Freight revenue per carload (in dollars)	**$ 4,642**	$ 4,449	$ 193	4
Freight revenue per revenue ton-mile (in cents)	**6.62**	5.45	1.17	21

The increase in Energy, chemicals and plastics revenue in the first six months of 2023 was primarily due to the impact of the KCS acquisition, increased freight revenue per RTM, and higher volumes of diluents and plastics. This increase was partially offset by lower volumes of crude and L.P.G., and the unfavourable impact to fuel surcharge revenue as a result of lower fuel prices. Freight revenue per RTM increased due to higher freight rates and the favourable impact of the change in FX.

Metals, Minerals and Consumer Products

For the three months ended June 30	**2023**	2022	Total Change	% Change
Freight revenues (in millions)	**$ 440**	$ 228	$ 212	93
Carloads (in thousands)	**129.3**	66.6	62.7	94
Revenue ton-miles (in millions)	**5,152**	3,108	2,044	66
Freight revenue per carload (in dollars)	**$ 3,403**	$ 3,423	$ (20)	(1)
Freight revenue per revenue ton-mile (in cents)	**8.54**	7.34	1.20	16

The increase in Metals, minerals and consumer products revenue in the second quarter of 2023 was primarily due to the impact of the KCS acquisition, increased freight revenue per RTM, higher volumes of frac sand to the Bakken shale formation, and higher volumes of cement. This increase was partially offset by the unfavourable impact to fuel surcharge revenue as a result of lower fuel prices and lower volumes of steel. Freight revenue per RTM increased due to the favourable impact of the change in FX and higher freight rates.

For the six months ended June 30	**2023**	2022	Total Change	% Change
Freight revenues (in millions)	**$ 673**	$ 409	$ 264	65
Carloads (in thousands)	**191.1**	121.2	69.9	58
Revenue ton-miles (in millions)	**8,063**	5,627	2,436	43
Freight revenue per carload (in dollars)	**$ 3,522**	$ 3,375	$ 147	4
Freight revenue per revenue ton-mile (in cents)	**8.35**	7.27	1.08	15

The increase in Metals, minerals and consumer products revenue in the first six months of 2023 was primarily due to the impact of the KCS acquisition, higher volumes of frac sand to the Bakken shale formation, higher volumes of cement, higher volumes of steel, and increased freight revenue per RTM. This increase was partially offset by the unfavourable impact to fuel surcharge revenue as a result of lower fuel prices. Freight revenue per RTM increased due to higher freight rates and the favourable impact of the change in FX.

Automotive

For the three months ended June 30		2023		2022		Total Change	% Change
Freight revenues (in millions)	**$**	**257**	$	120	$	137	114
Carloads (in thousands)		**56.2**		28.8		27.4	95
Revenue ton-miles (in millions)		**1,004**		487		517	106
Freight revenue per carload (in dollars)	**$**	**4,573**	$	4,167	$	406	10
Freight revenue per revenue ton-mile (in cents)		**25.60**		24.64		0.96	4

The increase in Automotive revenue in the second quarter of 2023 was primarily due to the impact of the KCS acquisition, higher volumes from Chicago, Illinois, various origins in Ontario, Vancouver, and Kansas City, Missouri to various destinations in Canada, and increased freight revenue per RTM. This increase was partially offset by the unfavourable impact to fuel surcharge revenue as a result of lower fuel prices. Freight revenue per RTM increased due to higher freight rates and the favourable impact of the change in FX. RTMs increased more than carloads due to moving higher volumes from Chicago, Ontario, and Kansas City to western Canada, which have longer lengths of haul.

For the six months ended June 30		2023		2022		Total Change	% Change
Freight revenues (in millions)	**$**	**382**	$	211	$	171	81
Carloads (in thousands)		**84.9**		52.9		32.0	60
Revenue ton-miles (in millions)		**1,478**		890		588	66
Freight revenue per carload (in dollars)	**$**	**4,499**	$	3,989	$	510	13
Freight revenue per revenue ton-mile (in cents)		**25.85**		23.71		2.14	9

The increase in Automotive revenue in the first six months of 2023 was primarily due to the impact of the KCS acquisition, higher volumes as a result of the prior year global supply chain challenges, higher volumes from Chicago, various origins in Ontario, Vancouver, and Kansas City to various destinations in Canada, and increased freight revenue per RTM. Freight revenue per RTM increased due to higher freight rates and the favourable impact of the change in FX. RTMs increased more than carloads due to moving higher volumes from Chicago, Ontario, and Kansas City to western Canada, which have longer lengths of haul.

Intermodal

For the three months ended June 30		2023		2022		Total Change	% Change
Freight revenues (in millions)	**$**	**653**	$	573	$	80	14
Carloads (in thousands)		**435.1**		305.3		129.8	43
Revenue ton-miles (in millions)		**8,827**		8,277		550	7
Freight revenue per carload (in dollars)	**$**	**1,501**	$	1,877	$	(376)	(20)
Freight revenue per revenue ton-mile (in cents)		**7.40**		6.92		0.48	7

The increase in Intermodal revenue in the second quarter of 2023 was primarily due to the impact of the KCS acquisition, higher international intermodal volumes primarily to and from the Port of Vancouver as a result of onboarding a new customer, higher freight rates, and the favourable impact of the change in FX. This increase was partially offset by lower domestic intermodal cross-border and retail volumes, lower intermodal ancillary revenue, and the unfavourable impact to fuel surcharge revenue as a result of lower fuel prices.

For the six months ended June 30	2023	2022	Total Change	% Change
Freight revenues (in millions)	**$ 1,145**	$ 1,020	$ 125	12
Carloads (in thousands)	**700.1**	560.7	139.4	25
Revenue ton-miles (in millions)	**16,117**	14,938	1,179	8
Freight revenue per carload (in dollars)	**$ 1,635**	$ 1,819	$ (184)	(10)
Freight revenue per revenue ton-mile (in cents)	**7.10**	6.83	0.27	4

The increase in Intermodal revenue in the first six months of 2023 was primarily due to the impact of the KCS acquisition, higher international intermodal volumes primarily to and from the Port of Vancouver, the Port of Saint John, and the Port of Montreal including onboarding a new customer, higher domestic intermodal wholesale and food volumes, higher freight rates, higher fuel surcharge revenue, and the favourable impact of the change in FX. This increase was partially offset by lower domestic intermodal cross-border and retail volumes and lower intermodal ancillary revenue.

Operating Expenses

For the three months ended June 30 (in millions of Canadian dollars)	2023	2022	Total Change	% Change
Compensation and benefits	**$ 659**	$ 348	$ 311	89
Fuel	**397**	370	27	7
Materials	**98**	63	35	56
Equipment rents	**80**	29	51	176
Depreciation and amortization	**410**	211	199	94
Purchased services and other	**586**	313	273	87
Total operating expenses	**$ 2,230**	$ 1,334	$ 896	67

For the six months ended June 30 (in millions of Canadian dollars)	2023	2022	Total Change	% Change
Compensation and benefits	**$ 1,097**	$ 761	$ 336	44
Fuel	**723**	643	80	12
Materials	**170**	125	45	36
Equipment rents	**110**	64	46	72
Depreciation and amortization	**635**	421	214	51
Purchased services and other	**932**	623	309	50
Total operating expenses	**$ 3,667**	$ 2,637	$ 1,030	39

Compensation and Benefits

Compensation and benefits expense includes employee wages, salaries, fringe benefits, and stock-based compensation. The increase in Compensation and benefits expense in the second quarter of 2023 was primarily due to:

- the impact of the KCS acquisition of $238 million, including acquisition related costs of $56 million made up primarily of restructuring charges of $50 million;
- increased stock-based compensation of $29 million, excluding stock-based compensation grants related to the KCS acquisition, primarily driven by the change in share price, and an increase in incentive compensation;
- the impact of wage and benefit inflation;
- reduced labour efficiencies, including the impact of a reduction in train weights;
- the increase in new hire training; and
- the unfavourable impact of the change in FX of $5 million.

This increase was partially offset by lower defined benefit pension current service cost of $20 million.

The increase in Compensation and benefits expense in the first six months of 2023 was primarily due to:

- the impact of the KCS acquisition of $238 million, including acquisition related costs of $56 million made up primarily of restructuring charges of $50 million;
- the impact of wage and benefit inflation;
- the increase in new hire training;

- increased stock-based compensation of $17 million, excluding stock-based compensation grants related to the KCS acquisition, primarily driven by the change in share price, and an increase in incentive compensation;
- the unfavourable impact of the change in FX of $12 million;
- reduced labour efficiencies, including the impact of a reduction in train weights; and
- higher volume variable expense as a result of an increase in workload as measured by GTMs.

This increase was partially offset by lower defined benefit pension current service cost of $39 million.

Fuel

Fuel expense consists mainly of fuel used by locomotives and includes provincial, state, and federal fuel taxes. The increase in Fuel expense in the second quarter of 2023 was primarily due to the impact of the KCS acquisition of $124 million and the unfavourable impact of the change in FX of $16 million.

This increase was partially offset by the favourable impact of lower fuel prices of $114 million.

The increase in Fuel expense in the first six months of 2023 was primarily due to:
- the impact of the KCS acquisition of $124 million;
- the unfavourable impact of the change in FX of $32 million; and
- an increase in workload, as measured by GTMs.

This increase was partially offset by the favourable impact of lower fuel prices of $97 million.

Materials

Materials expense includes the cost of materials used for the maintenance of track, locomotives, freight cars, and buildings, as well as software sustainment. The increase in material expenses in the second quarter and in the first six months of 2023 was primarily due to the impact of the KCS acquisition of $31 million and the unfavorable impact of inflation.

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 the Company’s equipment. The increase in Equipment rents expense in the second quarter of 2023 was primarily due to:
- the impact of the KCS acquisition of $34 million;
- slower cycle times;
- a greater usage of pooled freight cars; and
- lower recoveries from other railway's use of the Company's locomotives.

The increase in Equipment rents expense in the first six months of 2023 was primarily due to:
- the impact of the KCS acquisition of $34 million;
- slower cycle times; and
- a greater usage of pooled freight cars.

This increase was partially offset by greater recoveries from other railway's use of the Company's locomotives.

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. The increase in Depreciation and amortization expense in the second quarter and in the first six months of 2023 was primarily due to the acquisition of KCS of $186 million, including the unfavourable impact of purchase accounting of $68 million, a higher depreciable asset base, as well as the unfavourable impact of the change in FX.

Purchased Services and Other

For the three months ended June 30 (in millions of Canadian dollars)	**2023**	2022	Total Change	% Change
Support and facilities	**$ 92**	$ 84	$ 8	9
Track and operations	**68**	74	(6)	(8)
Intermodal	**53**	57	(4)	(7)
Equipment	**27**	28	(1)	(3)
Casualty	**75**	30	45	149
Property taxes	**37**	35	2	4
Other	**235**	5	230	4,609
Land sales	**—**	—	—	—
Total Purchased services and other	**$ 586**	$ 313	$ 273	87

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, and insurance. The increase in Purchased services and other expense in the second quarter of 2023 was primarily due to:

- the impact of the KCS acquisition of $170 million, including acquisition-related costs incurred by KCS of $5 million;
- higher expenses primarily due to the severity of casualty incidents and higher personal injury costs, reported in Casualty;
- higher acquisition-related costs incurred by CPKC, excluding KCS's acquisition-related costs, of $28 million including community investment agreements entered into to mitigate the societal impact of the merger to various communities, reported in Other; and
- lower claim recoveries compared to the same period of 2022, reported in Other.

This increase was partially offset by lower expenses from lower volumes compared to the same period in 2022, reported in Intermodal.

For the six months ended June 30 (in millions of Canadian dollars)	**2023**	2022	Total Change	% Change
Support and facilities	**$ 186**	$ 166	$ 20	12
Track and operations	**149**	149	—	—
Intermodal	**110**	108	2	2
Equipment	**58**	56	2	4
Casualty	**104**	50	54	108
Property taxes	**73**	71	2	3
Other	**253**	33	220	667
Land sales	**(1)**	(10)	9	(88)
Total Purchased services and other	**$ 932**	$ 623	$ 309	50

The increase in Purchased services and other expense in the first six months of 2023 was primarily due to:

- the impact of the KCS acquisition of $170 million, including acquisition-related costs incurred by KCS of $5 million;
- higher expenses primarily due to the severity of casualty incidents and higher personal injury costs, reported in Casualty;
- higher acquisition-related costs incurred by CPKC, excluding KCS's acquisition-related costs, of $21 million including community investment agreements entered into to mitigate the societal impact of the merger to various communities, reported in Other;
- the unfavourable impact of the change in FX of $15 million;
- lower claim recoveries compared to the same period of 2022, reported in Other;
- lower gains on land sales; and
- cost inflation.

This increase was partially offset by lower expenses from lower volumes compared to the same period in 2022, reported in Intermodal.

Other Income Statement Items

Equity Earnings of Kansas City Southern

For the period from April 1 to April 13, 2023, the Company recognized $26 million (U.S. $19 million) of equity earnings of KCS, a decrease of $182 million, or 88%, from $208 million (U.S $163 million) in the second quarter of 2022. This amount is net of amortization of basis differences of $6 million (U.S. $4 million) associated with KCS purchase accounting, a decrease of $33 million or 85%, from $39 million (U.S $31 million) in the second quarter of 2022, and net of acquisition related costs incurred by KCS. Acquisition related costs (net of tax) incurred by KCS in the period from April 1 to April 13, 2023 were $1 million (U.S $1 million), a decrease of $13 million (U.S $10 million), or 93% from $14 million (U.S $11 million) in the second quarter of 2022. These decreases are attributable to the derecognition of KCS as an equity investment following the acquisition of control by CPKC on April 14, 2023. These values have been translated at the average FX rate for the period from April 1 to April 13, 2023 and the three months ended June 30, 2022 of $1.00 USD = $1.35 CAD and $1.00 USD = $1.28 CAD, respectively.

For the period from January 1 to April 13, 2023, the Company recognized $230 million (U.S. $170 million) of equity earnings of KCS, a decrease of $176 million or 43%, from $406 million (U.S $319 million) in the six months ended June 30, 2022. This amount is net of amortization of basis differences of $48 million (U.S. $35 million) associated with KCS purchase accounting, a decrease of $31 million or 39%, from $79 million (U.S $62 million) in the first six months of 2022, and is net of acquisition related costs incurred by KCS. Acquisition related costs (net of tax) incurred by KCS in the period from January 1 to April 13, 2023 were $11 million (U.S $8 million), a decrease of $16 million (U.S $13 million), or 59% from $27 million (U.S $21 million) in the first six months of 2022. These decreases are attributable to the derecognition of KCS as an equity investment following the acquisition of control by CPKC on April 14, 2023. These values have been translated at the average FX rate for the period from January 1 to April 13, 2023 and the six months ended June 30, 2022 of $1.00 USD= $1.35 CAD and $1.00 USD = $1.27 CAD, respectively.

Other Expense

Other expense consists of gains and losses from the change in FX on working capital, the impact of foreign currency forwards, costs related to financing, shareholder costs, equity income, and other non-operating expenditures. Other expense was $21 million in the second quarter of 2023, an increase of $14 million, or 200%, compared to Other expense of $7 million in the same period of 2022. The increase was primarily due to $15 million resulting from the acquisition of KCS, and net acquisition-related costs of $3 million driven by the KCS debt exchange.

Other expense was $23 million in the first six months of 2023, an increase of $17 million, or 283%, from $6 million in the same period of 2022. The increase was primarily due to $15 million resulting from the acquisition of KCS, and net acquisition-related costs of $6 million driven by the KCS debt exchange.

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 obligation, expected return on plan assets, recognized net actuarial loss, and amortization of prior service costs. Other components of net periodic benefit recovery was $83 million and $169 million for the three and six months ended June 30, 2023, a decrease of $18 million or 18%, and $33 million or 16%, respectively, compared to the same periods of 2022. These decreases were primarily due to an increase in the interest cost on benefit obligation for the three and six months ended June 30, 2023 of $28 million and $54 million, respectively, and a decrease in the expected return on plan assets of $18 million and $38 million, respectively, partially offset by a decrease in the recognized net actuarial loss of $30 million and $61 million, respectively.

Net Interest Expense

Net interest expense includes interest on long-term debt and finance leases. Net interest expense was $204 million in the second quarter of 2023, an increase of $44 million, or 28%, from $160 million in the same period of 2022. The increase was primarily due to interest of $39 million incurred on debt issued under the KCS debt exchange, higher interest on commercial paper of $8 million as a result of higher interest rates along with a higher average outstanding balance, and additional interest of $5 million resulting from the acquisition of KCS. These increases were partially offset by higher interest income.

Net interest expense was $358 million in the first six months of 2023, an increase of $38 million, or 12%, from $320 million in the same period of 2022. The increase was primarily due to interest of $39 million incurred on debt issued under the KCS debt exchange, an unfavourable impact of the change in FX of $15 million, additional interest of $5 million resulting from the acquisition of KCS, and higher interest on commercial paper of $7 million as a result of higher interest rates. These increases were partially offset by $9 million of higher interest income, and the favourable impact of $7 million following the repayment of maturing long-term debt.

Remeasurement Loss of Kansas City Southern

On April 14, 2023, the Company assumed control of KCS and began accounting for its acquisition as a business combination achieved in stages. The initial investment was accounted for using the equity method of accounting prior to assuming control. On control, the carrying value of the previously held equity investment in KCS was remeasured to its fair value and upon derecognition, a loss of $7,175 million was recognized in the Company's Interim Consolidated Statements of Income. This loss was primarily due to the outside basis tax initially recognized upon investment in KCS.

Income Tax (Recovery) Expense

Income tax recovery was $7,672 million in the second quarter of 2023, a change of $7,917 million, or 3231%, from $245 million income tax expense in the same period of 2022. This change was primarily due to:

- a deferred tax recovery of $7,832 million on the derecognition of the deferred tax liability on the outside basis difference of the investment in KCS upon acquiring control;
- a deferred tax recovery of $51 million on the revaluation of deferred income tax balances on unitary state apportionment changes;
- an outside basis deferred tax expense of $49 million, recorded in the second quarter of 2022, 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;
- lower taxable earnings resulting in a decrease to current tax expense; and
- higher current tax recoveries on acquisition-related costs of $12 million associated with the KCS acquisition incurred by legacy CP.

This decrease was partially offset by a higher effective tax rate and the impact of the KCS acquisition of $57 million, including deferred tax recovery on the amortization relating to purchase accounting fair value adjustments of $20 million and current tax recoveries on acquisition related costs of $4 million. As a result of the KCS debt exchange an offsetting current tax expense and deferred tax recovery of $101 million is included in income tax expense.

Income tax recovery was $7,509 million in the first six months of 2023, a change of $7,839 million, or 2375%, from $330 million income tax expense in the same period of 2022. This change was primarily due to:

- a deferred tax recovery of $7,832 million on the derecognition of the deferred tax liability on the outside basis difference of the investment in KCS upon acquiring control;
- a deferred tax recovery of $51 million on the revaluation of deferred income tax balances on unitary state apportionment changes;
- lower outside basis deferred tax expense of $40 million arising from the change in the carrying amount of CP's investment in KCS for financial reporting; and
- higher current tax recoveries on acquisition-related costs of $12 million associated with the KCS acquisition incurred by legacy CP.

This decrease was partially offset by a higher current tax expense due to higher taxable earnings, a higher effective tax rate, and the impact of the KCS acquisition of $57 million, including deferred tax recovery on the amortization relating to purchase accounting fair value adjustments of $20 million and current tax recoveries on acquisition-related costs of $4 million. As a result of the KCS debt exchange an offsetting current tax expense and deferred tax recovery of $101 million is included in income tax expense.

The effective tax rate in the second quarter of 2023 and first six months of 2023 was 120.88% and 139.47%, respectively, compared to 24.21% and 19.59% in the same periods of 2022. The Core adjusted effective income tax rate in the second quarter of 2023 and first six months of 2023 was 25.18% and 24.88% compared to 24.25% for the same periods in 2022. The Core adjusted effective tax rate is a Non-GAAP measure, calculated as the effective tax rate adjusted for significant items as they are not considered indicative of future financial trends either by nature or amount nor provide improved comparability to past performance. The Core adjusted effective tax rate also excludes equity earnings of KCS and KCS purchase accounting. This Non-GAAP measure does not have a standardized meaning and is not defined by GAAP and, therefore, may not be comparable to similar measures presented by other companies. Significant items and KCS purchase accounting are discussed further in Non-GAAP Measures of this Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations.

Following the acquisition of control of KCS, the Company's 2023 Core adjusted effective tax rate is expected to be approximately 25.50%, which excludes discrete tax items, the impact of the change in the equity investment in KCS, and associated deferred tax on the outside basis difference during the year. The Company’s 2023 outlook for its Core adjusted 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 the Company's 2022 Annual Report on Form 10-K.

Impact of FX on Earnings and Foreign Exchange Risk

Although the Company is headquartered in Canada and reports in Canadian dollars, a significant portion of its revenues, expenses, assets and liabilities including debt are denominated in U.S. dollars and Mexican pesos. In addition, equity earnings or losses of KCS are denominated in U.S. dollars. The value of the Canadian dollar is affected by a number of domestic and international factors, including, without limitation, economic performance, commodity prices, and Canadian, U.S., and international monetary policies. Fluctuations in FX affect the Company's results because revenues and expenses denominated in U.S. dollars and Mexican pesos 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. Mexican peso-denominated revenues and expenses increase (decrease) when the U.S. dollar weakens (strengthens) in relation to the Mexican peso.

In the second quarter of 2023, the U.S. dollar has strengthened to an average rate of $1.34 Canadian/U.S. dollar, compared to $1.28 Canadian/U.S. dollar in the second quarter of 2022, resulting in an increase in Total revenues of $62 million, an increase in Total operating expenses of $33 million, and an increase in Net interest expense of $7 million from the same period of 2022.

In the first six months of 2023, the U.S. dollar has strengthened to an average rate of $1.35 Canadian/U.S. dollar, compared to $1.27 Canadian/U.S. dollar in the first six months of 2022, resulting in an increase in Total revenues of $128 million, an increase in Total operating expenses of $71 million, and an increase in interest expense of $16 million from the same period of 2022.

On an annualized basis, the Company expects that every $0.01 weakening (or strengthening) of the Canadian dollar relative to the U.S. dollar, positively (or negatively) impacts Total revenues by approximately $71 million (December 31, 2022 – approximately $37 million), negatively (or positively) impacts Operating expenses by approximately $44 million (December 31, 2022 – approximately $18 million), and negatively (or positively) impacts Net interest expense by approximately $6 million (December 31, 2022 – approximately $4 million).

On an annualized basis, the Company expects that every Ps.0.10 strengthening (or weakening) of the Mexican peso relative to the Canadian dollar, positively (or negatively) impacts Total revenues by approximately $9 million and negatively (or positively) impacts Operating expenses by approximately $7 million.

To manage its exposure to fluctuations in exchange rates between Canadian dollars, U.S. dollars, and or Mexican pesos, the Company may sell or purchase U.S. dollar or Mexican peso forwards at fixed rates in future periods. In addition, changes in the exchange rate between the Canadian dollar and other currencies (including the U.S. dollar and Mexican peso) make the goods transported by the Company more or less competitive in the world marketplace and may in turn positively or negatively affect revenues.

Impact of Fuel Price on Earnings

Fluctuations in fuel prices affect the Company's results because fuel expense constitutes a significant portion of the Company's operating costs. As fuel prices fluctuate, there will be an impact on earnings due to the timing of recoveries from the Company's fuel cost adjustment program.

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 2023, the favourable impact of fuel prices on Operating income was $20 million. Lower fuel prices resulted in a decrease in Total operating expenses of $114 million from the same period in 2022. Lower fuel prices, partially offset by the favourable impact of the timing of recoveries under the Company's fuel cost adjustment program, resulted in a decrease in Total revenues of $94 million.

In the first six months of 2023, the favourable impact of fuel prices on Operating income was $104 million. Lower fuel prices resulted in a decrease in Total operating expenses of $97 million from the same period of 2022. The favourable impact of the timing of recoveries under the Company's fuel cost adjustment program, partially offset by lower fuel prices, resulted in an increase in Total revenues of $7 million.

Impact of Share Price on Earnings and Stock-Based Compensation

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".

In the second quarter of 2023, the change in Common Share prices resulted in an increase in stock-based compensation expense of $6 million, a change of $30 million, compared to a decrease of $24 million in the same period of 2022.

In the first six months of 2023, the change in Common Share prices resulted in an increase in stock-based compensation expense of $10 million, a change of $13 million, compared to a decrease of $3 million in the same period of 2022.

Based on information available at June 30, 2023, for every $1.00 change in share price, stock-based compensation expense has a corresponding change of approximately $1.6 million to $2.0 million (December 31, 2022 - approximately $1.2 million to $1.8 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 15 Stock-based compensation.

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, 2023, the Company had $325 million of Cash and cash equivalents compared to $451 million at December 31, 2022.

Effective May 11, 2023, the Company entered into a second amended and restated credit agreement to extend the maturity dates and increase the total amount available under the facility. The amended revolving credit facility increased the aggregate commitments under the second amended and restated credit agreement from U.S. $1.3 billion to U.S. $2.2 billion, and extended the maturity dates of the five year facility and two year facility from September 27, 2026 to May 11, 2028, and September 27, 2023 to May 11, 2025, respectively. The company also terminated the legacy KCS credit facility effective May 11, 2023. As at June 30, 2023, the Company's existing revolving credit facility was undrawn. The revolving credit facility agreement requires the Company to maintain a financial covenant. As at June 30, 2023, 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 (as at June 30, 2023) in the form of unsecured promissory notes. The Company also terminated the legacy KCS commercial paper program effective May 19, 2023. The Company's existing commercial paper program is backed by the revolving credit facility. As at June 30, 2023 the Company had total commercial paper borrowings outstanding of U.S. $405 million (December 31, 2022 - $nil). On July 12, 2023, the Company increased the maximum aggregate principal amount of commercial paper available to be issued to U.S $1.5 billion.

As at June 30, 2023, under its bilateral letter of credit facilities, the Company had letters of credit drawn of $74 million from a total available amount of $300 million (December 31, 2022 - $75 million). The company also has additional letters of credit of $11 million available that were undrawn at June 30, 2023. 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. These agreements permit the Company to withdraw amounts posted as collateral at any time; therefore, the amounts posted as collateral are presented as "Cash and cash equivalents" on the Consolidated Balance Sheet. As at June 30, 2023 the Company had $70 million collateral posted on its bilateral letter of credit facilities (December 31, 2022 - $nil).

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, 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 $1,919 million, $791 million and $78 million within the next 12 months, respectively, with the remaining amounts committed thereafter of $22,072 million, $16,914 million and $nil, respectively. Future capital commitments amount to $528 million within the next 12 months, and $791 million committed thereafter.

Supplier purchase agreements, operating leases, and other long-term liabilities amount to $501 million, $112 million, and $70 million within the next 12 months, respectively, and $358 million, $278 million and $565 million committed thereafter, respectively. Other long-term liabilities include 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 Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations of the Company's 2022 Annual Report on Form 10-K.

Concession Duty

Under Kansas City Southern de México, S.A. de C.V. (also known as Canadian Pacific Kansas City Mexico) ("CPKCM")'s 50-year Concession, which could expire in 2047 unless extended, CPKCM pays annual concession duty expense of 1.25% of gross revenues.

Guarantees

The Company accrues for all guarantees that it expects to pay. As at June 30, 2023, these accruals amounted to $10 million (December 31, 2022 - $5 million).

Operating Activities

Cash provided by operating activities was $892 million in the second quarter of 2023, an increase of $185 million, or 26%, compared to $707 million in the same period of 2022. This increase was primarily due to an increase in cash generating income driven by the consolidation of KCS compared to 2022 when no dividends were received from KCS, and a favourable change in working capital compared to the same period of 2022.

Cash provided by operating activities was $1,774 million in the first six months of 2023, an increase of $454 million, or 34%, compared to $1,320 million in the same period of 2022. The increase was primarily due to higher cash generating income driven by the consolidation of KCS, and a favourable change in working capital compared to the same period of 2022.

Investing Activities

Cash used in investing activities was $617 million in the second quarter of 2023, an increase of $255 million, or 70%, compared to $362 million in the same period of 2022. Cash used in investing activities was $1,019 million in the first six months of 2023, an increase of $451 million, or 79%, compared to $568 million in the same period of 2022. These increases were primarily due to higher capital additions resulting from the consolidation of KCS along with the investment in government securities towards satisfaction and discharge of debt, partially offset by cash acquired on control of KCS.

Financing Activities

Cash used in financing activities was $233 million in the second quarter of 2023, a decrease of $64 million, or 22%, compared to $297 million in the same period of 2022. This decrease was primarily due to a higher net issuance of commercial paper of $550 million in the second quarter of 2023 compared to a net issuance of $20 million in the second quarter of 2022, principal repayments of $132 million (U.S. $100 million) on a term loan during the second quarter of 2022, while there were no such repayments in the in the second quarter of 2023. This decrease was partially offset by principal repayments of $592 million (U.S. $439 million) of 3.00% 10-year Senior Notes at maturity during the second quarter of 2023 compared to $10 million during the same period of 2022.

Cash used in financing activities was $878 million in the first six months of 2023, an increase of $190 million, or 28%, compared to $688 million in the same period of 2022. This increase was primarily due to repayments of long-term debt of $592 million (U.S. $439 million) of 3.00% 10-year Senior Notes and $479 million (U.S. $350 million) of 4.45% 12.5-year Notes at maturity during the first six months of 2023 compared to repayments of $125 million of 5.100% 10-year Medium Term Notes, $313 million (U.S. $250 million) of 4.500% 10-year Notes, and $97 million (U.S. $76 million) of 6.99% Finance lease at maturity during the same period of 2022. This increase was partially offset by a net issuance of commercial paper of $550 million during the six months ended June 30, 2023 compared to a net issuance of $340 million during the first six months of 2022, and principal repayments of $132 million (U.S. $100 million) on a term loan during the first six months of 2022, while there were no such repayments in 2023.

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. The applicable margin that applies to outstanding loans under the Company's revolving credit facility is based on the credit rating assigned to the Company's senior unsecured and unsubordinated debt.

If the Company's credit ratings were to decline to below investment-grade levels, the Company could experience a significant increase in its interest cost for new debt along with a negative effect on its ability to readily issue new debt.

Credit ratings and outlooks are based on the rating agencies' methodologies and can change from time to time to reflect their views of the Company. 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, 2023, the Company's credit ratings from Standard & Poor's Rating Services ("Standard & Poor's") and Moody's Investor Service ("Moody's") remain unchanged from December 31, 2022. The following table shows the ratings issued for the

Company by the rating agencies noted herein as of June 30, 2023 and is being presented as it relates to the Company's cost of funds and liquidity.

Credit ratings as at June 30, 2023[(1)]

Long-term debt		Outlook
Standard & Poor's	**BBB+**	stable
Moody's	**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.

Supplemental Guarantor Financial Information

CPRC, a 100%-owned subsidiary of CPKC, is the issuer of certain securities which are fully and unconditionally guaranteed by CPKC 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 CPKC provides a full and unconditional guarantee.

As of the date of the filing of the Form 10-Q, CPRC had U.S. $14,714 million principal amount of debt securities outstanding due through 2115 which includes the debt exchanged for KCS debt as described below; and U.S. $30 million and GBP £3 million in perpetual 4% consolidated debenture stock, for all of which CPKC is the guarantor subject to Section 13(a) or Section 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.

CPKC 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 CPKC's unsubordinated and unsecured obligation and ranks equally with all of CPKC's other unsecured, unsubordinated obligations.

CPKC 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.

On March 20, 2023, CPKC and CPRC announced offers to exchange any and all validly tendered (and not validly withdrawn) and accepted notes of seven series, previously issued by KCS (the "Old Notes") for notes to be issued by CPRC (the "CPRC Notes"). As of April 19, 2023, U.S. $3,014 million of Old Notes of such seven series were tendered and accepted in exchange for U.S. $3,014 million of CPRC Notes in seven corresponding series.

Each series of CPRC Notes has the same interest rates, interest payment dates, maturity dates, and substantively the same optional redemption provisions as the corresponding series of Old Notes.

In exchange for each U.S. $1,000 principal amount of Old Notes that was validly tendered prior to June 30, 2023 (the "Early Participation Date"), holders of Old Notes received consideration consisting of U.S. $1,000 principal amount of CPRC Notes and a cash amount of U.S. $1.00. The total consideration included an early participation premium, consisting of U.S. $30 principal amount of CPRC Notes per U.S. $1,000 principal amount of Old Notes. In exchange for each U.S. $1,000 principal amount of Old Notes that was validly tendered after the Early Participation Date but prior to the expiration of the exchange offers on April 17, 2023 (the "Expiration Date") and not validly withdrawn, holders of Old Notes received consideration consisting of U.S. $970 principal amount of CPRC Notes and a cash amount of U.S. $1.00.

CPKC has fully and unconditionally guaranteed the payment of the principal (and premium, if any) and interest, on the CPRC Notes, and any additional amounts payable with respect to the CPRC Notes, when they become due and payable, whether at the stated maturity thereof or by declaration of acceleration, call for redemption or otherwise. The CPRC Notes and the related guarantees are part of CPRC's and CPKC's respective unsecured obligations and rank equally with all of CPRC's and CPKC's existing and future unsecured and unsubordinated indebtedness.

Additional information is included in Item 1. Financial Statements, Note 12 Debt.

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 CPKC (Parent Guarantor) on a combined basis after elimination of (i) intercompany transactions and balances among CPRC and CPKC; (ii) equity in earnings from and investments in the Non-Guarantor Subsidiaries; and (iii) intercompany dividend income.

Statements of Income

	CPRC (Subsidiary Issuer) and CPKC (Parent Guarantor)	
(in millions of Canadian dollars)	**For the six months ended June 30, 2023**	For the year ended December 31, 2022
Total revenues	**$ 3,137**	$ 6,384
Total operating expenses	**2,045**	4,110
Operating income[(1)]	**1,092**	2,274
Less: Other[(2)]	**166**	234
Income before income tax expense	**926**	2,040
Net income	**$ 653**	$ 1,533

(1) Includes net lease costs incurred from non-guarantor subsidiaries for the six months ended June 30, 2023 and for the year ended December 31, 2022 of $206 million and $410 million, respectively.

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

Balance Sheets

	CPRC (Subsidiary Issuer) and CPKC (Parent Guarantor)	
(in millions of Canadian dollars)	**As at June 30, 2023**	As at December 31, 2022
Assets		
Current assets	**$ 1,139**	$ 1,395
Properties	**12,134**	11,791
Other non-current assets	**3,498**	3,337
Liabilities		
Current liabilities	**$ 2,744**	$ 2,759
Long-term debt	**21,165**	18,137
Other non-current liabilities	**3,326**	3,178

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

Transactions with Non-Guarantor Subsidiaries

	CPRC (Subsidiary Issuer) and CPKC (Parent Guarantor)	
(in millions of Canadian dollars)	**For the six months ended June 30, 2023**	For the year ended December 31, 2022
Dividend income from non-guarantor subsidiaries	**$ 100**	$ 133
Capital contributions to non-guarantor subsidiaries	**(4,322)**	—
Redemption of capital from non-guarantor subsidiaries	**—**	115

Balances with Non-Guarantor Subsidiaries

(in millions of Canadian dollars)	CPRC (Subsidiary Issuer) and CPKC (Parent Guarantor) As at June 30, 2023	As at December 31, 2022
Assets		
Accounts receivable, intercompany	**$ 168**	$ 186
Short-term advances to affiliates	**1,798**	2,209
Long-term advances to affiliates	**7,111**	7,502
Liabilities		
Accounts payable, intercompany	**$ 218**	$ 199
Short-term advances from affiliates	**2,617**	2,649
Long-term advances from affiliates	**86**	88

Share Capital

At July 26, 2023, the latest practicable date, there were 931,460,732 Common Shares and no preferred shares issued and outstanding, which consists of 14,816 holders of record of the Common Shares. In addition, the Company has a Management Stock Option Incentive Plan (“MSOIP”), under which key officers and employees are granted options to purchase the Common Shares. All number of options presented herein are shown on the basis of the number of shares subject to the options. At July 26, 2023, 7,200,325 options were outstanding under the MSOIP and stand-alone option agreements entered into with Mr. Keith Creel. There are 21,702,829 options available to be issued by the Company’s MSOIP in the future. The Company also 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, including Core adjusted combined operating ratio and Core adjusted combined diluted earnings per share, to provide an additional basis for evaluating underlying earnings trends in the Company's current periods' financial results that can be compared with the results of operations in prior periods. Management believes these Non-GAAP measures facilitate a multi-period assessment of long-term profitability, including assessing future profitability.

These Non-GAAP measures have no standardized meaning and are not defined 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. 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

On the Control Date, CP obtained control of KCS and CPKC began consolidating KCS, which had been accounted for under the equity method of accounting between December 14, 2021 and April 13, 2023. On the Control Date, CPKC’s previously-held interest in KCS was remeasured to its Control Date fair value. CPKC is presenting Core adjusted combined operating ratio and Core adjusted combined diluted earnings per share to give effect to results while isolating and removing the impact of the acquisition of KCS on those results. These measures provide a comparison to prior period financial information as adjusted to exclude certain significant items and are used to evaluate CPKC’s operating performance and for planning and forecasting future business operations and future profitability.

Management believes the use of Non-GAAP measures provides meaningful supplemental information about our 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's 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, KCS's gain on unwinding of interest rate hedges (net of CPKC's associated purchase accounting basis differences and tax), as recognized within Equity earnings of Kansas City Southern in the Company's Consolidated Statements of Income, the foreign exchange ("FX") impact of translating the Company’s debt and lease liabilities (including borrowings under the credit facility), loss on derecognition of CPKC’s previously held equity method investment in KCS, discrete tax items, changes in the outside basis tax difference between the carrying amount of CPKC's equity investment in KCS and its tax basis of this investment, a deferred tax recovery related to the elimination of the deferred tax liability on the outside basis difference of the 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, debt exchange transaction costs, community investments, 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, restructuring, employee retention and synergy incentive costs, and transaction and integration costs incurred by KCS. These items may not be non-recurring. However, management believes excluding these significant items from GAAP results provides an additional viewpoint which may give users a consistent understanding of CPKC's financial performance when performing a multi-period assessment including assessing the likelihood of future results. Accordingly, these Non-GAAP financial measures may provide additional insight to investors and other external users of CPKC's financial information.

In addition, Core adjusted combined operating ratio and Core adjusted combined diluted earnings per share exclude KCS purchase accounting. KCS purchase accounting represents the amortization of basis differences being the incremental depreciation and amortization in relation to fair value adjustments to properties and intangible assets, incremental amortization in relation to fair value adjustments to KCS's investments, and amortization of the change in fair value of debt of KCS assumed on the Control Date, as recognized within Depreciation and amortization, Other expense, and Net interest expense, respectively, in the Company's Consolidated Statements of Income. During the periods that KCS was equity accounted for, from December 14, 2021 to April 13, 2023, 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, net of tax, as recognized within Equity (earnings) loss of Kansas City Southern in the Company's Interim Consolidated Statements of Income. All assets subject to KCS purchase accounting contribute to income generation and will continue to amortize over their estimated useful lives. Excluding KCS purchase accounting from GAAP results provides financial statement users with additional transparency by isolating for the impact of KCS purchase accounting.

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:

Core Adjusted Combined Diluted Earnings per Share

Core adjusted combined diluted earnings per share is calculated using Net income attributable to controlling shareholders reported on a GAAP basis adjusted for significant items less KCS purchase accounting, divided by the weighted-average diluted number of Common Shares outstanding during the period as determined in accordance with GAAP. Between December 14, 2021 and April 13, 2023, KCS was accounted for in CPKC's diluted earnings per share reported on a GAAP basis using the equity method of accounting and on a consolidated basis beginning April 14, 2023. As the equity method of accounting and consolidation both provide the same diluted earnings per share for CPKC, no adjustment is required to pre-control diluted earnings per share to be comparable on a consolidated basis.

In the first six months of 2023, there were four significant items included in the Net income attributable to controlling shareholders as reported on a GAAP basis as follows:

- in the second quarter, a remeasurement loss of KCS of $7,175 million recognized in Remeasurement loss of Kansas City Southern due to the derecognition of CPKC's previously held equity method investment in KCS and remeasurement at its Control Date fair value that unfavourably impacted Diluted EPS by $7.68;
- in the second quarter, a deferred tax recovery of $51 million due to CPKC unitary state apportionment changes that favourably impacted Diluted EPS by 5 cents;
- Deferred tax recovery of $7,855 million that favourably impacted Diluted EPS by $8.42 cents as follows:
  - in the second quarter, a deferred tax recovery of $7,832 million related to the elimination of the deferred tax liability on the outside basis difference of the investment in KCS that favourably impacted Diluted EPS by $8.39; and
  - in the first quarter, a deferred tax recovery of $23 million on changes in the outside basis difference of the equity investment in KCS that favourably impacted Diluted EPS by 3 cents; and
- acquisition-related costs of $145 million in connection with the KCS acquisition ($122 million after current tax recovery of $23 million), including an expense of $128 million recognized in Purchased services and other, $6 million recognized in Other expense, and $11 million recognized in Equity earnings of KCS that unfavourably impacted Diluted EPS by 13 cents as follows:
  - in the second quarter, acquisition-related costs of $120 million ($101 million after current tax recovery of $19 million), including costs of $53 million recognized in Purchased services and other, $63 million recognized in Compensation and benefits, $3 million recognized in Other expense, and $1 million recognized in Equity earnings of KCS that unfavourably impacted Diluted EPS by 11 cents; and
  - in the first quarter, acquisition-related costs of $25 million ($21 million after current tax recovery of $4 million), including costs of $12 million recognized in Purchased services and other, $3 million recognized in Other expense, and $10 million recognized in Equity earnings of KCS that unfavourably impacted Diluted EPS by 2 cents.

In the first six months of 2022, there were two significant items included in Net income attributable to controlling shareholders as reported on a GAAP basis 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 $49 million expense that unfavourably impacted Diluted EPS by 5 cents; and
  - in the first quarter, a $32 million recovery that favourably impacted Diluted EPS by 3 cents; and
- 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 ($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.

KCS purchase accounting included in Net income attributable to controlling shareholders as reported on a GAAP basis was as follows:

2023:
- during the first six months ended June 30, 2023, KCS purchase accounting of $123 million ($103 million after deferred tax recovery of $20 million), including costs of $68 million recognized in Depreciation and amortization, $6 million recognized in Net interest expense, $1 million recognized in Other expense, and $48 million recognized in Equity earnings of KCS that unfavourably impacted Diluted EPS by 11 cents as follows:
  - in the second quarter, KCS purchase accounting of $81 million ($61 million after deferred tax recovery of $20 million), including costs of $68 million recognized in Depreciation and amortization, $6 million recognized in Net interest expense, $1 million recognized in Other expense, and $6 million recognized in Equity earnings of KCS that unfavourably impacted Diluted EPS by 6 cents; and
  - in the first quarter, KCS purchase accounting of $42 million recognized in Equity earnings of KCS that unfavourably impacted Diluted EPS by 5 cents.

2022:
- during the first six months ended June 30, 2022, KCS purchase accounting of $79 million expense recognized in Equity earnings of KCS that unfavourably impacted Diluted EPS by 9 cents as follows:
  - in the second quarter, KCS purchase accounting of $39 million that unfavourably impacted Diluted EPS by 5 cents; and
  - in the first quarter, KCS purchase accounting of $40 million that unfavourably impacted Diluted EPS by 4 cents.

	For the three months ended June 30		For the six months ended June 30	
	2023	2022	**2023**	2022
CPKC diluted earnings per share as reported	**$ 1.42**	$ 0.82	**$ 2.28**	$ 1.45
Less:				
Significant items (pre-tax):				
KCS net gain on unwind of interest rate hedges	**—**	—	**—**	—
Remeasurement loss of KCS	**(7.68)**	—	**(7.68)**	—
Acquisition-related costs	**(0.13)**	(0.03)	**(0.16)**	(0.07)
KCS purchase accounting	**(0.09)**	(0.05)	**(0.14)**	(0.09)
Add:				
Tax effect of adjustments[(1)]	**(0.05)**	—	**(0.06)**	(0.01)
Income tax rate changes	**(0.05)**	—	**(0.05)**	—
Deferred tax (recovery) expense on the outside basis difference of the investment in KCS	**(8.39)**	0.05	**(8.42)**	0.02
Reversal of provision for uncertain tax item	**—**	—	**—**	—
Core adjusted combined diluted earnings per share[(2)]	**$ 0.83**	$ 0.95	**$ 1.73**	$ 1.62

(1) The tax effect of adjustments was calculated as the pre-tax effect of the significant items and KCS purchase accounting listed above multiplied by the applicable tax rate for the above items of 0.54% and 0.58% for the three and six months ended June 30, 2023, respectively, 4.70% and 4.32% for the three and six months ended June 30, 2022, respectively. The applicable tax rates reflect the taxable jurisdictions and nature, being on account of capital or income, of the adjustments.

(2) The Company previously used the non-GAAP measure Core adjusted diluted earnings per share, which was calculated as diluted earnings per share adjusted for significant items less KCS purchase accounting. Core adjusted diluted earnings per share was $0.95 and $1.62 for the three and six months ended June 30, 2022, respectively, which are the same as the revised measure Core adjusted combined diluted earnings per share, as KCS was equity accounted for within CPKC's results.

Core Adjusted Combined Operating Ratio

Core adjusted combined operating ratio is calculated from reported GAAP revenue and operating expenses adjusted for (1) KCS operating income prior to the Control Date and giving effect to transaction accounting adjustments in a consistent manner with Regulation S-X Article 11 ("Article 11"), where applicable, (2) significant items (acquisition-related costs) that are reported within Operating income, and (3) KCS purchase accounting recognized in Depreciation and amortization.

This combined measure does not purport to represent what the actual consolidated results of operations would have been had the Company obtained control of KCS and consolidation actually occurred on January 1, 2022, nor is it indicative of future results. This information is based on information as of the date hereof and upon assumptions that CPKC believes reasonably reflect the impact to CPKC's historical financial information, on a supplemental basis, of obtaining control of KCS had it occurred as of January 1, 2022. This information does not include anticipated costs related to integration activities, cost savings or synergies that may be achieved by the combined company.

In the first six months of 2023, acquisition-related costs were $141 million in connection with the KCS acquisition and unfavourably impacted operating ratio on a combined basis, calculated in a manner consistent with Article 11, by 2.1%:

- in the second quarter, acquisition-related costs of $116 million that unfavourably impacted operating ratio by 3.5%; and
- in the first quarter, acquisition-related costs of $25 million that unfavourably impacted operating ratio by 0.7%.

In the first six months of 2022, acquisition-related costs were $104 million in connection with the KCS acquisition and unfavourably impacted operating ratio on a combined basis, calculated in a manner consistent with Article 11, by 1.7%:

- in the second quarter, acquisition-related costs of $35 million that unfavourably impacted operating ratio by 1.1%; and
- in the first quarter, acquisition-related costs of $69 million that unfavourably impacted operating ratio by 2.5%.

KCS purchase accounting included in operating ratio on a combined basis, calculated in a manner consistent with Article 11, was as follows:

2023:

- during the first six months ended June 30, 2023, KCS purchase accounting of $160 million recognized in Depreciation and amortization that unfavourably impacted operating ratio by 2.4% as follows:
  - In the second quarter, KCS purchase accounting of $80 million that unfavourably impacted operating ratio by 2.4%; and
  - In the first quarter, KCS purchase accounting of $80 million that unfavourably impacted operating ratio by 2.3%.

2022:

- during the first six months ended June 30, 2022, KCS purchase accounting of $152 million recognized in Depreciation and amortization that unfavourably impacted operating ratio by 2.5% as follows:
  - in the second quarter, KCS purchase accounting of $76 million that unfavourably impacted operating ratio by 2.3%; and
  - in the first quarter, KCS purchase accounting of $76 million that unfavourably impacted operating ratio by 2.7%.

	For the three months ended June 30		For the six months ended June 30	
	2023	2022[(3)]	**2023**	2022[(3)]
CPKC operating ratio as reported	**70.3 %**	60.6 %	**67.4 %**	65.3 %
Add:				
KCS operating income as reported prior to Control Date[(1)]	**(0.2)%**	0.8 %	**(0.3)%**	(0.8)%
Pro forma Article 11 transaction accounting adjustments[(2)]	**0.4 %**	2.3 %	**1.4 %**	3.0 %
	70.5 %	63.7 %	**68.5 %**	67.5 %
Less:				
Acquisition-related costs	**3.5 %**	1.1 %	**2.1 %**	1.7 %
KCS purchase accounting in Depreciation and amortization	**2.4 %**	2.3 %	**2.4 %**	2.5 %
Core adjusted combined operating ratio	**64.6 %**	60.3 %	**64.0 %**	63.3 %

(1) KCS results were translated into Canadian dollars at the Bank of Canada monthly average rate for April 1 through April 13, 2023 and the three months ended June 30, 2022, as well for January 1 through April 13, 2023 and the six months ended June 30, 2022 of $1.35, $1.28, $1.35, and $1.27, respectively.

(2) Pro forma Article 11 transaction accounting adjustments represent adjustments made in a manner consistent with Article 11, these include:

- For April 1 through April 13, 2023 in the three months ended June 30, 2023, depreciation and amortization of differences between the historic carrying values and the provisional fair values of KCS's tangible and intangible assets and investments prior to the Control Date of 0.4% operating ratio and miscellaneous immaterial amounts that have been reclassified across revenue, operating expenses, and non-operating income or expense, consistent with CPKC's financial statement captions;
- For January 1 through April 13, 2023 in the six months ended June 30, 2023, depreciation and amortization of differences between the historic carrying values and the provisional fair values of KCS's tangible and intangible assets and investments prior to the Control Date of 1.4% operating ratio and miscellaneous immaterial amounts that have been reclassified across revenue, operating expenses, and non-operating income or expense, consistent with CPKC's financial statement captions;
- For the three months ended June 30, 2022, depreciation and amortization of differences between the historic carrying values and the provisional fair values of KCS's tangible and intangible assets and investments prior to the Control Date of 2.3% operating ratio and miscellaneous immaterial amounts that have been reclassified across revenue, operating expenses, and non-operating income or expense, consistent with CPKC's financial statement captions; and
- For the six months ended June 30, 2022, depreciation and amortization of differences between the historic carrying values and the provisional fair values of KCS's tangible and intangible assets and investments prior to the Control Date of 2.5% operating ratio, the estimated transaction costs expected to be incurred by the Company of 0.5% operating ratio and miscellaneous immaterial amounts that have been reclassified across revenue, operating expenses, and non-operating income or expense, consistent with CPKC's financial statement captions.

For more information about these pro forma transaction accounting adjustments for the three months ended March 31, 2023, June 30, 2022 and March 31, 2022, please see Exhibit 99.1 “Selected Unaudited Combined Summary of Historical Financial Data” of CPKC’s Current Report on Form 8-K furnished with the Securities and Exchange Commission (“SEC”) on May 15, 2023.

(3) The Company previously used the non-GAAP measure Adjusted operating ratio, which was defined as operating ratio excluding those significant items that are reported within Operating income. Adjusted operating ratio was 59.7% and 64.3% for the three and six months ended June 30, 2022, respectively, which was changed to the revised measure Core adjusted combined operating ratio. The differences were due to the addition of KCS historical operating income less KCS acquisition-related costs (as defined above) prior to the Control Date. For the three and six months ended June 30, 2023, CPKC has presented the non-GAAP measure of Core adjusted combined operating ratio, as defined above, to provide a comparison to prior period combined information calculated in a manner consistent with Article 11 as further adjusted to conform to CPKC’s core adjusted measures.

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 business acquisitions, 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 2022 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.

Business acquisitions

As described in Item 1. Financial Statements, Note 8 Business Acquisition and Note 9 Investment in KCS, the Company assumed control of KCS and commenced consolidation of KCS on the Control Date, accounting for the acquisition as a business combination achieved in stages.

In accounting for the business combination, the Company's previously held interest in KCS was remeasured to its Control Date fair value. The identifiable assets acquired, and liabilities and non-controlling interest assumed are measured at their provisional fair values at the Control Date, with certain exceptions. The results from operations and cash flows are consolidated in the financial statements.

The disclosure of the business combination presented in Item 1. Financial Statements, Note 8 Business Acquisitions is prepared on a provisional basis using the best available information at this time. A provisional purchase price allocation was determined at the Control Date. This provisional purchase price allocation may be subject to adjustment during the measurement period resulting in additional assets or liabilities being recognized to reflect new information obtained about facts and circumstances that existed as of the Control Date that, if known, would affect the amounts recognized as of that date. The measurement period is not to exceed a year. Changes to the provisional amounts may impact the amount of goodwill recognized.

The Company believes the provisional fair values of the assets acquired and the liabilities and non-controlling interest assumed are based on reasonable assumptions and applying known information and estimates at the Control Date. Measurement uncertainty in these estimates exists due to the characteristics of the assumptions and facts used to generate these estimates. Changes to assumptions and estimates, as a result of new information that may arise about the facts and circumstances as of the Control Date could materially change the fair value estimates.

The Company recognized goodwill arising from the business acquisition. Goodwill is the residual value after allocating the fair value of KCS to the assets acquired and liabilities and non-controlling interest assumed. Through the measurement period, there may be adjustments to the fair value of these assets and liabilities as a result of new information obtained about facts and circumstances that existed as of the Control Date that, if known at that time, would have affected the amounts recognized as of the Control Date. Any changes to the fair value of the asset and liabilities in the measurement period will result in changes in the value of goodwill.

The table below outlines changes in those key estimates that management believes could result from new and more precise information relating to facts and conditions at the Control Date. The table includes estimates of the related impacts to the provisional fair values:

(in billions of dollars, except percentages)	Provisional Estimate at Control Date	Sensitivity Range		Value Range	
Previously held equity investment in KCS	**$ 37.2**				
Revenue growth rate		-1%	1%	$ 36.2	$ 38.3
Terminal EBITDA multiple		-0.5x	0.5x	$ 35.6	$ 38.8
EBITDA margin		-1%	1%	$ 36.7	$ 37.8
Discount rate		-1%	1%	$ 38.9	$ 35.6
Intangible assets including Mexican concession[(1)]	**$ 12.2**				
Terminal growth rate		-0.5%	0.5%	$ 11.4	$ 13.1
Discount rate		-1%	1%	$ 14.4	$ 10.6
Mexican concession[(1)]	**$ 9.2**				
Renewal probability of Mexican concession[(1)]		-10%	10%	$ 8.9	$ 9.4

(1) Concession rights and related assets held under the terms of a concession from the Mexican government are presented with acquired Properties.

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”, "project", "estimate", "forecast", “plan”, "intend", "target", “will”, “outlook”, "guidance", “should” or similar words suggesting future outcomes. All statements other than statements of historical fact may be forward-looking statements. To the extent that the Company 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. dollar and Mexican peso exchange rates relative to the Canadian dollar, 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; financial guidance for 2023; geopolitical conditions; applicable laws, regulations and government policies; the availability and cost of labour, services and infrastructure; and the satisfaction by third parties of their obligations to the Company. 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 KCS business combination, there can be no guarantee of the satisfaction of the conditions imposed by the STB in its March 15, 2023 final decision, successful integration of KCS or that the combined company will realize the anticipated benefits of the business combination, whether financial, strategic or otherwise, and this may be exacerbated by changes to the economic, political and global environment in which the merged company will operate.

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 the Company; 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 outbreak of a pandemic or contagious disease and the 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 the Company's 2022 Annual Report on Form 10-K. Other risks are detailed from time to time in reports filed by the Company 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, the Company 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

Interest Rate Risk

Information concerning market risk sensitive instruments is set forth under Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations – Impact of FX on Earnings and Foreign Exchange Risk and Impact of Share Price on Earnings and Stock-Based Compensation.

Debt financing forms part of the Company's capital structure. The debt agreements entered into expose the Company to increased interest costs on future fixed debt instruments and existing variable rate debt instruments, should market rates increase. As at June 30, 2023, 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, the Company 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. The Company 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, 2023 would result in an increase of approximately $1.9 billion to the fair value of the Company's debt as at June 30, 2023 (June 30, 2022 - approximately $1.6 billion). Fair values of the Company'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, 2023, an evaluation was carried out under the supervision of and with the participation of the Company'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, 2023, 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

Other than related to the acquisition of KCS, there were no changes in internal controls over financial reporting during the second quarter of 2023 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting. The Company will continue the process of integrating internal controls over financial reporting throughout the remainder of the year.

PART II

ITEM 1. LEGAL PROCEEDINGS

For further details refer to Item 1. Financial Statements, Note 16 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.

From time to time, the Company or its subsidiaries may be subject to information requests from U.S. State or Federal environmental regulatory authorities inquiring as to the Company’s compliance or remediation practices in the U.S. In September 2020, the Company received an initial request for information from the U.S. Environmental Protection Agency ("EPA") inquiring into the Company’s compliance with the mobile source provisions of the Clean Air Act (“CAA”). The Company has been providing information in response to the EPA’s initial and follow-up requests, and the EPA has issued Notices of Violations, which preliminarily identify certain categories of alleged non-compliance with civil provisions of the CAA pertaining to locomotives and locomotive engines. As previously disclosed in the Company's 2022 Annual Report on Form 10-K, in December 2022, the U.S. Department of Justice (“DOJ”) sent a communication requesting a meeting with the Company to discuss potentially resolving any alleged noncompliance which included an initial draft consent decree from the DOJ. That initial meeting occurred in January 2023 and communications are ongoing. Neither the EPA nor the DOJ has issued a final compendium of alleged violations, demand for corrective or mitigating actions, or articulated a preliminary civil penalty assessment, and it remains too early to provide a fulsome evaluation of the likely outcome with respect to either the nature of any alleged violations or the amount of any potential civil penalty. The Company will continue to fully cooperate and engage in discussions to resolve the matter.

ITEM 1A. RISK FACTORS

There have been no material changes to the risk factors from the information provided in Item 1A. Risk Factors of the Company's 2022 Annual Report on Form 10-K, with the exception of those discussed below.

Risks Related to the Kansas City Southern Transaction

The conditions imposed by the STB’s March 15, 2023 final decision could have an adverse effect on the Company’s businesses, results of operations, financial condition, cash flows or the market value of the Company’s common stock and debt securities, or reduce the anticipated benefits of the combination. In connection with the STB's March 15, 2023 final decision, the STB imposed a number of conditions, including among others (i) commitments by the combined company to keep gateways open on commercially reasonable terms and create no new bottlenecks, (ii) numerous environmental-related conditions, (iii) extensive data reporting and retention requirements, and (iv) a seven-year oversight period for the STB to monitor adherence to these conditions. In addition, the Company inherits conditions previously imposed by the STB on KCS in connection with various prior KCS acquisitions, including in relation to KCS’s commitment to keep the Laredo gateway open on commercially reasonable terms in connection with its prior acquisition of The Texas Mexican Railway. Furthermore, the STB has noted its authority to issue supplemental orders to address issues or concern that may arise in the future. These conditions could disrupt the Company’s businesses, and uncertainty about the outcome of that review could divert management’s attention and resources, and reduce the anticipated benefits of the combination, and may have an adverse effect on the combined company. Further, the combination may give rise to potential liabilities, including as a result of pending and future shareholder lawsuits and other litigation relating to the combination. In addition, the Company has incurred, and expects to incur additional, material non-recurring expenses in connection with the completion of the combination. Any of these matters could adversely affect the businesses of, or harm the results of operations, financial condition or cash flows of the Company and the market value of the Company’s common stock and debt securities.

The Company may be unable to integrate KCS successfully, and the Company may not experience the growth being sought from the combination. CPRL and KCS operated independently until the Control Date. Integrating KCS with CPKC will involve operational, technological and personnel-related challenges. This process will be time-consuming and expensive, may disrupt the businesses of either or both of the companies and may reduce the growth opportunities sought from the combination. There can be no guarantee of the successful integration of KCS or that the combined company will realize the anticipated benefits of the business combination, whether financial, strategic or otherwise, and this may be exacerbated by changes to the economic, political and global environment in which the merged company would operate.

Risks related to Operations in Mexico

The Mexican Concession of CPKCM is subject to revocation or termination in certain circumstances, which would prevent CPKCM from conducting rail operations under the Concession and would have a material adverse effect on the Company’s consolidated financial statements. CPKCM operates under the Concession granted by the Mexican government until June 2047, which is renewable for an additional period of up to 50 years, subject to certain conditions. The Concession gives CPKCM exclusive rights to provide freight transportation services over its rail lines through 2037 (the first 40 years of the 50-year Concession), subject to certain trackage and haulage rights granted to other concessionaires.

The Secretaría de Infraestructura, Comunicaciones y Transportes (also known as Secretariat of Infrastructure, Communications and Transportation) ("SICT") and Agencia Reguladora del Transporte Ferroviario (also known as Mexico's Railway Transport Regulatory Agency) ("ARTF"), which are principally responsible for regulating railroad services in Mexico, have broad powers to monitor CPKCM's compliance with the Concession, and they can require CPKCM to supply them with any technical, administrative and financial information they request. Among other obligations, CPKCM must comply with the investment commitments established in its business plan, which forms an integral part of the Concession, and must update the plan every three years. The SICT treats CPKCM's business plans confidentially. The SICT and ARTF also monitor CPKCM's compliance with efficiency and safety standards established in the Concession. The SICT and ARTF review, and may amend, these standards from time to time.

Under the Concession, CPKCM has the right to operate its rail lines, but it does not own the land, roadway or associated structures. If the Mexican government legally terminates the Concession, it would own, control, and manage such public domain assets used in the operation of CPKCM's rail lines. All other property not covered by the Concession, including all locomotives and railcars otherwise acquired, would remain CPKCM's property. In the event of early termination, or total or partial revocation of the Concession, the Mexican government would have the right to cause the Company to lease all service related assets to it for a term of at least one year, automatically renewable for additional one-year terms for up to five years. The amount of rent would be determined by experts appointed by CPKCM and the Mexican government. The Mexican government must exercise this right within four months after early termination or revocation of the Concession.

In addition, the Mexican government would also have a right of first refusal with respect to certain transfers by CPKCM of railroad equipment within 90 days after revocation of the Concession. The Mexican government may also temporarily seize control of CPKCM's rail lines and its assets in the event of a natural disaster, war, significant public disturbance or imminent danger to the domestic peace or economy. In such a case, the SICT may restrict CPKCM's ability to operate under the Concession in such manner as the SICT deems necessary under the circumstances, but only for the duration of any of the foregoing events. Mexican law requires that the Mexican government pay compensation if it effects a statutory appropriation for reasons of the public interest. With respect to a temporary seizure due to any cause other than international war, the Mexican Regulatory Railroad Service Law and regulations provide that the Mexican government will indemnify an affected concessionaire for an amount equal to damages caused and losses suffered. However, these payments may not be sufficient to compensate CPKCM for its losses and may not be made timely.

The SICT may revoke the Concession if CPKCM is sanctioned for the same cause at least three times within a period of five years for any of the following: unjustly interrupting the operation of its rail lines or rendering its public services for charging rates higher than those it has registered with the ARTF; unlawfully restricting the ability of other Mexican rail operators to use its rail lines; failing to make payments for damages caused during the performance of services; failing to comply with any term or condition of the Mexican Regulatory Railroad Service Law and regulations or the Concession; failing to make the capital investments required under its three-year business plan filed with the SICT; or failing to maintain an obligations compliance bond and insurance coverage as specified in the Mexican Regulatory Railroad Service Law and regulations. In addition, the Concession would terminate automatically if CPKCM changes its nationality or assigns or creates any lien on the Concession, or if there is a change in control of CPKCM without the SICT's approval.

The SICT may also terminate the Concession as a result of CPKCM's surrender of its rights under the Concession, or for reasons of public interest or upon CPKCM's liquidation or bankruptcy. If the Concession is terminated or revoked by the SICT for any reason, CPKCM would receive no compensation and its interest in its rail lines, and all other fixtures covered by the Concession, as well as all improvements made by it, would revert to the Mexican government. Revocation or termination of the Concession could have a material adverse effect on the Company's consolidated financial statements.

The Company's ownership of CPKCM and operations in Mexico subject it to Mexican economic and political risks. The Mexican government has exercised, and continues to exercise, significant influence over the Mexican economy. Accordingly, Mexican governmental actions concerning the economy and state-owned enterprises could have a significant impact on Mexican private sector entities in general and on CPKCM's operations in particular. For example, CPKCM operations could be impacted with the introduction of new legislation or policies to regulate the railway industry, the energy market, or labor and tax conditions. The Company cannot predict the impact that the political landscape, including multiparty rule, social unrest and civil disobedience, will have on the Mexican economy or CPKCM's operations. For example, from time to time, social unrest in Mexico has resulted in service interruptions on CPKCM's right of ways due to blockages from teachers' protests. The Company's consolidated financial statements and prospects may be adversely affected by currency fluctuations, inflation, interest rates, regulation, taxation and other political, social and economic developments in or affecting Mexico. For example, the Company has several tax contingencies including, multiple tax periods subject to current examination, audit assessments for the CPKCM 2009, 2010, 2013, 2014, and 2015 Mexico tax returns, and a receivable for refundable VAT. An adverse resolution of these matters could have a material adverse effect on the Company's consolidated financial statements in a particular quarter or period. Tax contingencies are further discussed in Notes 4 and 16 of Item 1. Financial Statements, and within Exhibit 99.1 included in the Company's 2022 Annual Report on Form 10-K.

The social and political situation in Mexico could adversely affect the Mexican economy and CPKCM's operations, and changes in laws, public policies and government programs could be enacted, each of which could also have a material adverse effect on the Company's consolidated financial statements.

The Mexican economy in the past has suffered balance of payment deficits and shortages in foreign exchange reserves. Although Mexico has imposed foreign exchange controls in the past, there are currently no exchange controls in Mexico. Any restrictive exchange control policy could adversely affect the Company's ability to obtain U.S. dollars or to convert Mexican pesos into dollars for purposes of making payments. This could have a material adverse effect on the Company's consolidated financial statements.

Downturns in the United States economy or in trade between the United States and Asia or Mexico and fluctuations in the peso-dollar exchange rates could have material adverse effects on the Company's consolidated financial statements. The level and timing of the Company's Mexican business activity is heavily dependent upon the level of United States-Mexican trade and the effects of current or future multinational trade agreements on such trade. The Mexican operations depend on the United States and Mexican markets for the products CPKCM transports, the relative position of Mexico and the United States in these markets at any given time, and tariffs or other barriers to trade. Failure to preserve trade provisions conducive to trade, or any other action imposing import duties or border taxes, could negatively impact KCS customers and the volume of rail shipments, and could have a material adverse effect on the Company's consolidated financial statements.

Downturns in the United States or Mexican economies or in trade between the United States and Mexico could have material adverse effects on the Company's consolidated financial statements and the Company's ability to meet debt service obligations. In addition, the Company has invested significant amounts in developing its intermodal operations, including the Port of Lazaro Cardenas, in part to provide Asian importers with an alternative to the west coast ports of the United States, and the level of intermodal traffic depends, to an extent, on the volume of Asian shipments routed through Lazaro Cardenas. Reductions in trading volumes, which may be caused by factors beyond the Company's control, including increased government regulations regarding the safety and quality of Asian-manufactured products, could have a material adverse effect on the Company's consolidated financial statements.

Additionally, fluctuations in the peso-dollar exchange rates could lead to shifts in the types and volumes of Mexican imports and exports. Although a decrease in the level of exports of some of the commodities that CPKCM transports to the United States may be offset by a subsequent increase in imports of other commodities CPKCM hauls into Mexico and vice versa, any offsetting increase might not occur on a timely basis, if at all. Future developments in United States-Mexican trade beyond the Company's control may result in a reduction of freight volumes or in an unfavorable shift in the mix of products and commodities CPKCM carries.

Extreme volatility in the peso-dollar exchange rate may result in disruption of the international foreign exchange markets and may limit the ability to transfer or convert Mexican pesos into U.S. dollars. Although the Mexican government currently does not restrict, and for many years has not restricted, the right or ability of Mexican or foreign persons or entities to convert pesos into U.S. dollars or to transfer foreign currencies out of Mexico, the Mexican government could, as in the past, institute restrictive exchange rate policies that could limit the ability to transfer or convert pesos into U.S. dollars or other currencies for the purpose of making timely payments and meeting contractual commitments. Fluctuations in the peso-dollar exchange rates also have an effect on the Company's consolidated financial statements. A weakening of the peso against the U.S. dollar would cause reported peso-denominated revenues and expenses to decrease, and could increase reported foreign exchange loss due to the Company's net monetary assets that are peso-denominated. Exchange rate variations also affect the calculation of taxes under Mexican income tax law, and a strengthening of the peso against the U.S. dollar could cause an increase in the Company's cash tax obligation and effective income tax rate.