

CANADIAN NATIONAL RAILWAY CO  
Form 6-K  
July 24, 2014

FORM 6-K  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
Report of Foreign Issuer

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

For the month of July 2014

Commission File Number: 001-02413

Canadian National Railway Company  
(Translation of registrant's name into English)

935 de la Gauchetiere Street West  
Montreal, Quebec  
Canada H3B 2M9  
(Address of principal executive offices)

Indicate by check mark whether the registrant files or will file annual reports under cover of Form 20-F or Form 40-F:

Form 20-F	Form 40-F	X
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Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(1):

Yes	No	X
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Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(7):

Yes	No	X
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Indicate by check mark whether by furnishing the information contained in this Form, the Registrant is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934:

Yes	No	X
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If "Yes" is marked, indicate below the file number assigned to the registrant in connection with Rule 12g3-2(b): N/A

Canadian National Railway Company

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Item 1 News Release dated July 21, 2014 entitled, "CN reports Q2-2014 net income of C\$847 million, up 18 per cent from year-earlier net income of C\$717 million"  
"Q2-2014 diluted earnings per share (EPS) of C\$1.03 increased 24 per cent over adjusted diluted Q2-2013 EPS of C\$0.83 (1) "

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Item 1

North America's Railroad

NEWS RELEASE

CN reports Q2-2014 net income of C\$847 million,  
up 18 per cent from year-earlier net income of C\$717 million

Q2-2014 diluted earnings per share (EPS) of C\$1.03 increased 24 per cent over adjusted diluted Q2-2013 EPS of C\$0.83 (1)

MONTREAL, July 21, 2014 — CN (TSX: CNR) (NYSE: CNI) today reported its financial and operating results for the second quarter and six-month period ended June 30, 2014.

Second-quarter 2014 financial highlights

- Net income was C\$847 million, or C\$1.03 per diluted share, compared with net income of C\$717 million, or C\$0.84 per diluted share, for the year-earlier quarter. The Q2-2013 results included a net gain of C\$13 million (C\$0.01 per diluted share) resulting from a gain on a non-monetary transaction with another railway that was partly offset by the effect of the enactment of higher provincial corporate income tax rates.
- Excluding the Q2-2013 net gain, Q2-2014 diluted EPS of C\$1.03 increased 24 per cent over last year's adjusted diluted EPS of C\$0.83. (1)
  - Operating income for the second-quarter of 2014 increased 21 per cent to C\$1,258 million.
- Second-quarter 2014 revenues increased 17 per cent to C\$3,116 million, revenue ton-miles grew by 14 per cent, and carloadings increased 11 per cent.
- CN's operating ratio for Q2-2014 improved by 1.3 points to 59.6 per cent from 60.9 per cent for the year-earlier quarter.
- Free cash flow for the first half of 2014 was C\$1,270 million, compared with C\$788 million for the year-earlier first half. (1)

Claude Mongeau, president and chief executive officer, said: "CN recovered swiftly from the first-quarter winter weather challenges – just as our customers would expect us to do – thanks to solid execution by our dedicated team of railroaders. CN delivered record volumes in the quarter by bringing its key supply chains back into sync and taking advantage of continued strength in several of our core markets. This solid operational recovery underscores our ability to accommodate growth at low incremental cost and to drive very strong financial results."

CN's Western Canada grain hopper car movements were particularly strong during the second quarter, up nearly 70 per cent from the year-earlier period. The Company expects such hopper car movements for the crop-year ending July 31, 2014, to be a new record and close to 25 per cent higher than average crop-year movements.

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Mongeau said: “We are pleased that the Canadian grain supply chain CN serves is now back in sync. Our wait-list of customer grain car orders represents only about one week of shipments from the Prairies, and grain vessel line-ups at all ports are back to normal.”

#### Revised 2014 financial outlook (1) (2)

CN’s strong second-quarter results and continued growth opportunities in intermodal, bulk and merchandise markets have prompted a positive revision to the Company’s 2014 financial outlook. Under its revised 2014 outlook, CN now expects to:

- Deliver solid double-digit EPS growth in 2014 over adjusted diluted 2013 EPS of C\$3.06, compared with its earlier forecast of aiming for double-digit 2014 EPS growth, and
- Generate free cash flow in the range of C\$1.8 billion to C\$2 billion, compared with the earlier free cash flow projection of C\$1.6 billion to C\$1.7 billion for 2014. (1)

Mongeau said: “The continuing success of our agenda of Operational and Service Excellence positions CN well to achieve this improved financial outlook for the year.”

#### Foreign currency impact on results

Although CN reports its earnings in Canadian dollars, a large portion of its revenues and expenses is denominated in U.S. dollars. As such, the Company’s results are affected by exchange-rate fluctuations. On a constant currency basis that excludes the impact of fluctuations in foreign currency exchange rates, CN’s second-quarter 2014 net income would have been lower by C\$28 million, or C\$0.03 per diluted share. (1)

#### Second-quarter 2014 revenues, traffic volumes and expenses

Revenues for the second quarter of 2014 increased by 17 per cent to C\$3,116 million. Revenues increased for grain and fertilizers (35 per cent), metals and minerals (20 per cent), intermodal (17 per cent), petroleum and chemicals (17 per cent) automotive (15 per cent), forest products (nine per cent), and coal (five per cent).

The increase in revenues was mainly attributable to higher freight volumes due to a record Canadian grain crop, strong energy markets and market share gains, particularly in intermodal; the positive translation impact of the weaker Canadian dollar on U.S.-dollar-denominated revenues; and freight rate increases.

Revenues in the second quarter of 2014 also benefited from increased volumes as the Company recovered from winter weather-related challenges that delayed shipments in the first quarter of 2014.

Carloadings for the second quarter rose 11 per cent to 1,463 thousand.

Revenue ton-miles, measuring the relative weight and distance of rail freight transported by CN, increased by 14 per cent over the year-earlier quarter. Rail freight revenue per revenue ton-mile, a measurement of yield defined as revenue earned on the movement of a ton of freight over one mile, increased by four per cent over the year-earlier period, driven by the positive translation impact of the weaker Canadian dollar and freight rate increases, partly offset by an increase in the average length of haul.

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Operating expenses for the quarter increased by 14 per cent to C\$1,858 million. That was mainly attributable to the negative translation impact of a weaker Canadian dollar on U.S.-dollar-denominated expenses, higher fuel costs, increased labor and fringe benefits expense and increased purchased services and material expense.

#### Forward-Looking Statements

Certain information included in this news release constitutes “forward-looking statements” within the meaning of the United States Private Securities Litigation Reform Act of 1995 and under Canadian securities laws. CN cautions that, by their nature, these forward-looking statements involve risks, uncertainties and assumptions. The Company cautions that its assumptions may not materialize and that current economic conditions render such assumptions, although reasonable at the time they were made, subject to greater uncertainty. Such forward-looking statements are not guarantees of future performance and involve known and unknown risks, uncertainties and other factors which may cause the actual results or performance of the Company or the rail industry to be materially different from the outlook or any future results or performance implied by such statements. To the extent that CN has provided guidance that are non-GAAP financial measures, the Company may not be able to provide a reconciliation to the GAAP measures, due to unknown variables and uncertainty related to future results. Key assumptions used in determining forward-looking information are set forth below.

#### Current 2014 key assumptions

CN has made a number of economic and market assumptions in preparing its 2014 outlook. The Company is forecasting that North American industrial production for the year will increase by about three to four percent, compared with three per cent growth as stated in its first-quarter 2014 financial results news release issued on April 22, 2014. CN also expects U.S. housing starts to be in the range of one million units, down slightly from its April 22, 2014, forecast of 1.1 million units. CN is also assuming U.S. motor vehicles sales will be approximately 16 million units. In addition, CN is assuming 2014/2015 grain crops in Canada and the United States will be in-line with their respective five-year averages. With these assumptions, CN now assumes mid to high single-digit carload growth, compared with mid-single digit carload growth stated on April 22, 2014, along with continued pricing improvement above inflation. CN also assumes that the value of the Canadian dollar in U.S. currency will be in the range of \$0.90 to \$0.95 and the price of crude oil (West Texas Intermediate) to be in the range of US\$95-\$105 per barrel. In 2014, CN plans to invest approximately C\$2.25 billion in capital program, of which approximately C\$1.2 billion is targeted toward maintaining the safety and integrity of the network, particularly track infrastructure. The capital program also includes funds for projects supporting growth and productivity.

Important risk factors that could affect the forward-looking statements include, but are not limited to, the effects of general economic and business conditions, industry competition, inflation, currency and interest rate fluctuations, changes in fuel prices, legislative and/or regulatory developments, compliance with environmental laws and regulations, actions by regulators, various events which could disrupt operations, including natural events such as severe weather, droughts, floods and earthquakes, labor negotiations and disruptions, environmental claims, uncertainties of investigations, proceedings or other types of claims and litigation, risks and liabilities arising from derailments, and other risks detailed from time to time in reports filed by CN with securities regulators in Canada and the United States. Reference should be made to “Management’s Discussion and Analysis” in CN’s annual and interim reports, Annual Information Form and Form 40-F filed with Canadian and U.S. securities regulators, available on CN’s website, for a summary of major risk factors.

CN assumes no obligation to update or revise forward-looking statements to reflect future events, changes in circumstances, or changes in beliefs, unless required by applicable Canadian securities laws. In the event CN does update any forward-looking statement, no inference should be made that CN will make additional updates with respect to that statement, related matters, or any other forward-looking statement.

- 1) See discussion and reconciliation of non-GAAP adjusted performance measures in the attached supplementary schedule, Non-GAAP Measures.
- 2) See Forward-Looking statements for a summary of the key assumptions and risks regarding CN's 2014 outlook.

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CN is a true backbone of the economy, transporting approximately C\$250 billion worth of goods annually for a wide range of business sectors, ranging from resource products to manufactured products to consumer goods, across a rail network spanning Canada and mid-America. CN – Canadian National Railway Company, along with its operating railway subsidiaries -- serves the cities and ports of Vancouver, Prince Rupert, B.C., Montreal, Halifax, New Orleans, and Mobile, Ala., and the metropolitan areas of Toronto, Edmonton, Winnipeg, Calgary, Chicago, Memphis, Detroit, Duluth, Minn./Superior, Wis., and Jackson, Miss., with connections to all points in North America. For more information on CN, visit the company's website at [www.cn.ca](http://www.cn.ca).

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## Consolidated Statement of Income - unaudited

## Item 2

In millions, except per share data	Three months ended June 30		Six months ended June 30	
	2014	2013	2014	2013
Revenues	\$ 3,116	\$ 2,666	\$ 5,809	\$ 5,132
<b>Operating expenses</b>				
Labor and fringe benefits	560	498	1,147	1,067
Purchased services and material	390	341	778	669
Fuel	484	402	952	807
Depreciation and amortization	257	250	513	485
Equipment rents	84	68	161	136
Casualty and other	83	65	180	146
Total operating expenses	1,858	1,624	3,731	3,310
Operating income	1,258	1,042	2,078	1,822
Interest expense	(91 )	(88 )	(183 )	(177 )
Other income (Note 3)	2	28	96	70
Income before income taxes	1,169	982	1,991	1,715
Income tax expense (Note 7)	(322 )	(265 )	(521 )	(443 )
Net income	\$ 847	\$ 717	\$ 1,470	\$ 1,272
<b>Earnings per share (Note 10)</b>				
Basic	\$ 1.03	\$ 0.85	\$ 1.78	\$ 1.50
Diluted	\$ 1.03	\$ 0.84	\$ 1.77	\$ 1.49
<b>Weighted-average number of shares (Note 10)</b>				
Basic	821.8	846.1	824.9	849.8
Diluted	825.3	849.1	828.3	852.8

See accompanying notes to unaudited consolidated financial statements.

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## Consolidated Statement of Comprehensive Income - unaudited

In millions	Three months ended		Six months ended	
	June 30		June 30	
	2014	2013	2014	2013
Net income	\$ 847	\$ 717	\$ 1,470	\$ 1,272
Other comprehensive income (loss) (Note 11)				
Net gain (loss) on foreign currency translation	(30 )	23	(5 )	35
Net change in pension and other postretirement benefit plans	30	56	63	116
Other comprehensive income before income taxes	-	79	58	151
Income tax recovery (expense)	(38 )	14	(14 )	12
Other comprehensive income (loss)	(38 )	93	44	163
Comprehensive income	\$ 809	\$ 810	\$ 1,514	\$ 1,435

See accompanying notes to unaudited consolidated financial statements.

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## Consolidated Balance Sheet - unaudited

In millions	June 30 2014	December 31 2013	June 30 2013
<b>Assets</b>			
<b>Current assets</b>			
Cash and cash equivalents	\$ 127	\$ 214	\$ 87
Restricted cash and cash equivalents (Note 4)	468	448	497
Accounts receivable (Note 4)	925	815	876
Material and supplies	355	274	330
Deferred and receivable income taxes	74	137	34
Other	93	89	81
<b>Total current assets</b>	<b>2,042</b>	<b>1,977</b>	<b>1,905</b>
Properties	26,478	26,227	25,305
Intangible and other assets	2,114	1,959	335
<b>Total assets</b>	<b>\$ 30,634</b>	<b>\$ 30,163</b>	<b>\$ 27,545</b>
<b>Liabilities and shareholders' equity</b>			
<b>Current liabilities</b>			
Accounts payable and other	\$ 1,601	\$ 1,477	\$ 1,469
Current portion of long-term debt (Note 4)	621	1,021	1,322
<b>Total current liabilities</b>	<b>2,222</b>	<b>2,498</b>	<b>2,791</b>
Deferred income taxes	6,709	6,537	5,867
Pension and other postretirement benefits, net of current portion	544	541	594
Other liabilities and deferred credits	776	815	767
<b>Long-term debt</b>	<b>7,040</b>	<b>6,819</b>	<b>6,141</b>
<b>Shareholders' equity</b>			
Common shares	3,975	4,015	4,063
Accumulated other comprehensive loss (Note 11)	(1,806 )	(1,850 )	(3,094 )
Retained earnings	11,174	10,788	10,416
<b>Total shareholders' equity</b>	<b>13,343</b>	<b>12,953</b>	<b>11,385</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$ 30,634</b>	<b>\$ 30,163</b>	<b>\$ 27,545</b>
See accompanying notes to unaudited consolidated financial statements.			

## Consolidated Statement of Changes in Shareholders' Equity - unaudited

In millions	Three months ended June 30		Six months ended June 30	
	2014	2013	2014	2013
<b>Common shares (1)</b>				
Balance, beginning of period	\$ 3,994	\$ 4,088	\$ 4,015	\$ 4,108
Stock options exercised and other	9	10	18	27
Share repurchase programs (Note 4)	(28 )	(35 )	(58 )	(72 )
Balance, end of period	\$ 3,975	\$ 4,063	\$ 3,975	\$ 4,063
<b>Accumulated other comprehensive loss (Note 11)</b>				
Balance, beginning of period	\$ (1,768 )	\$ (3,187 )	\$ (1,850 )	\$ (3,257 )
Other comprehensive income (loss)	(38 )	93	44	163
Balance, end of period	\$ (1,806 )	\$ (3,094 )	\$ (1,806 )	\$ (3,094 )
<b>Retained earnings</b>				
Balance, beginning of period	\$ 10,870	\$ 10,211	\$ 10,788	\$ 10,167
Net income	847	717	1,470	1,272
Share repurchase programs (Note 4)	(337 )	(330 )	(672 )	(658 )
Dividends	(206 )	(182 )	(412 )	(365 )
Balance, end of period	\$ 11,174	\$ 10,416	\$ 11,174	\$ 10,416

See accompanying notes to unaudited consolidated financial statements.

(1) During the three and six months ended June 30, 2014, the Company issued 0.2 million and 0.5 million common shares, respectively, as a result of stock options exercised and repurchased 5.6 million and 11.9 million common shares, respectively, under its current share repurchase program. At June 30, 2014, the Company had 819.2 million common shares outstanding.

During the three and six months ended June 30, 2013, the Company issued 0.3 million and 1.1 million common shares, respectively, as a result of stock options exercised and repurchased 7.2 million and 15.0 million common shares, respectively, under its previous share repurchase program. At June 30, 2013, the Company had 842.9 million common shares outstanding.



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Consolidated Statement of Cash Flows - unaudited

In millions	Three months ended June 30		Six months ended June 30	
	2014	2013	2014	2013
<b>Operating activities</b>				
Net income	\$ 847	\$ 717	\$ 1,470	\$ 1,272
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization	257	250	513	485
Deferred income taxes	53	73	148	156
Gain on disposal of property (Note 3)	-	(29 )	(80 )	(69 )
Changes in operating assets and liabilities:				
Accounts receivable	(47 )	39	(99 )	(20 )
Material and supplies	(27 )	(38 )	(81 )	(95 )
Accounts payable and other	143	118	96	(203 )
Other current assets	24	14	11	11
Pensions and other, net	23	(81 )	(60 )	(153 )
Net cash provided by operating activities	1,273	1,063	1,918	1,384
<b>Investing activities</b>				
Property additions	(482 )	(418 )	(730 )	(646 )
Disposal of property (Note 3)	-	-	97	52
Change in restricted cash and cash equivalents	3	15	(20 )	24
Other, net	(15 )	(8 )	(15 )	(2 )
Net cash used in investing activities	(494 )	(411 )	(668 )	(572 )
<b>Financing activities</b>				
Issuance of debt, excluding commercial paper (Note 4)	-	-	347	505
Repayment of debt, excluding commercial paper	(117 )	(156 )	(573 )	(896 )
Net issuance (repayment) of commercial paper	(180 )	(15 )	9	551
Issuance of common shares due to exercise of stock options and related excess tax benefits realized				
	6	9	13	23
Repurchase of common shares (Note 4)	(347 )	(351 )	(712 )	(712 )
Dividends paid	(206 )	(182 )	(412 )	(365 )
Net cash used in financing activities	(844 )	(695 )	(1,328 )	(894 )
Effect of foreign exchange fluctuations on US				

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dollar-denominated cash and cash equivalents	(6 )	2	(9 )	14
Net decrease in cash and cash equivalents	(71 )	(41 )	(87 )	(68 )
Cash and cash equivalents, beginning of period	198	128	214	155
Cash and cash equivalents, end of period	\$ 127	\$ 87	\$ 127	\$ 87
<b>Supplemental cash flow information</b>				
Net cash receipts from customers and other	\$ 3,060	\$ 2,656	\$ 5,732	\$ 5,165
Net cash payments for:				
Employee services, suppliers and other expenses	(1,512 )	(1,241 )	(3,196 )	(2,913 )
Interest	(105 )	(84 )	(210 )	(174 )
Personal injury and other claims	(11 )	(14 )	(24 )	(28 )
Pensions (Note 6)	(7 )	(109 )	(100 )	(210 )
Income taxes	(152 )	(145 )	(284 )	(456 )
Net cash provided by operating activities	\$ 1,273	\$ 1,063	\$ 1,918	\$ 1,384

See accompanying notes to unaudited consolidated financial statements.

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## Notes to Unaudited Consolidated Financial Statements

### 1 - Basis of presentation

In management's opinion, the accompanying unaudited Interim Consolidated Financial Statements and Notes thereto, expressed in Canadian dollars, and prepared in accordance with U.S. generally accepted accounting principles (U.S. GAAP) for interim financial statements, contain all adjustments (consisting of normal recurring accruals) necessary to present fairly Canadian National Railway Company's (the Company) financial position as at June 30, 2014, December 31, 2013 and June 30, 2013, and its results of operations, changes in shareholders' equity and cash flows for the three and six months ended June 30, 2014 and 2013.

To be consistent with the basis of presentation used in preparing the Company's 2013 Annual Consolidated Financial Statements, these unaudited Interim Consolidated Financial Statements and Notes thereto reflect the fourth quarter 2013 common stock split and net basis disclosure of commercial paper as described below.

On October 22, 2013, the Board of Directors of the Company approved a two-for-one common stock split in the form of a stock dividend of one additional common share of CN for each share outstanding, paid on November 29, 2013 to shareholders of record on November 15, 2013. At the effective date of the stock split, all equity-based benefit plans and share repurchase programs were adjusted to reflect the issuance of such additional shares. All share and per share data presented herein reflect the impact of the stock split.

Beginning with the fourth quarter of 2013, the Company revised the Consolidated Statement of Cash Flows to present on a net basis the issuances and repayments of commercial paper, all of which have a maturity of less than 90 days and which were previously reported on a gross basis.

These unaudited Interim Consolidated Financial Statements and Notes thereto have been prepared using accounting policies consistent with those used in preparing the Company's 2013 Annual Consolidated Financial Statements. While management believes that the disclosures presented are adequate to make the information not misleading, these unaudited Interim Consolidated Financial Statements and Notes thereto should be read in conjunction with the Company's 2013 Annual Consolidated Financial Statements and Notes thereto.

### 2 - Accounting change

On May 28, 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, Revenue from Contracts with Customers, which establishes principles for reporting the nature, amount, timing and uncertainty of revenues and cash flows arising from an entity's contracts with customers. The core principle of the new standard is that an entity recognizes revenue to represent the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This standard is effective for annual and interim reporting periods beginning after December 15, 2016 and will replace most existing revenue recognition guidance within U.S. GAAP. Early adoption is not permitted. The standard permits the use of either the retrospective or cumulative effect transition method. The Company is evaluating the effect that ASU 2014-09 will have on its Consolidated Financial Statements, related disclosures, as well as the transition method to apply the new standard.

### 3 - Disposal of property

2014

#### Deux-Montagnes

On February 28, 2014, the Company closed a transaction with Agence Métropolitaine de Transport to sell the Deux-Montagnes subdivision between Saint-Eustache and Montreal, Quebec, including the Mont-Royal tunnel, together with the rail fixtures (collectively the "Deux-Montagnes"), for cash proceeds of \$97 million before transaction costs. Under the agreement, the Company obtained the perpetual right to operate freight trains over the Deux-Montagnes at its then current level of operating activity, with the possibility of increasing its operating activity

for additional consideration. The transaction resulted in a gain on disposal of \$80 million (\$72 million after-tax) that was recorded in Other income under the full accrual method of accounting for real estate transactions.

2013

Exchange of easements

On June 8, 2013, the Company entered into an agreement with another Class I railroad to exchange perpetual railroad operating easements including the track and roadway assets on specific rail lines (collectively the “exchange of easements”) without monetary consideration. The Company has accounted for the exchange of easements at fair value pursuant to FASB Accounting Standards Codification (ASC) 845, Nonmonetary Transactions. The transaction resulted in a gain on exchange of easements of \$29 million (\$18 million after-tax) that was recorded in Other income.

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Notes to Unaudited Consolidated Financial Statements

Lakeshore West

On March 19, 2013, the Company entered into an agreement with Metrolinx to sell a segment of the Oakville subdivision in Oakville and Burlington, Ontario, together with the rail fixtures and certain passenger agreements (collectively the “Lakeshore West”), for cash proceeds of \$52 million before transaction costs. Under the agreement, the Company obtained the perpetual right to operate freight trains over the Lakeshore West at its then current level of operating activity, with the possibility of increasing its operating activity for additional consideration. The transaction resulted in a gain on disposal of \$40 million (\$36 million after-tax) that was recorded in Other income under the full accrual method of accounting for real estate transactions.

4 - Financing activities

Shelf prospectus and registration statement

On February 11, 2014, under its current shelf prospectus and registration statement which expires January 2016, the Company issued \$250 million 2.75% Notes due 2021 in the Canadian capital markets, which resulted in net proceeds of \$247 million, intended for general corporate purposes, including the redemption and refinancing of outstanding indebtedness and share repurchases.

Revolving credit facility

The Company has an \$800 million revolving credit facility agreement with a consortium of lenders. The agreement, which contains customary terms and conditions, allows for an increase in the facility amount, up to a maximum of \$1.3 billion, as well as the option to extend the term by an additional year at each anniversary date, subject to the consent of individual lenders. The Company exercised such option and on March 14, 2014, the expiry date of the agreement was extended by one year to May 5, 2019. The Company plans to use the credit facility for working capital and general corporate purposes, including backstopping its commercial paper program. As at June 30, 2014 and December 31, 2013, the Company had no outstanding borrowings under its revolving credit facility and there were no draws during the six months ended June 30, 2014.

Commercial paper

The Company has a commercial paper program, which is backed by its revolving credit facility, enabling it to issue commercial paper up to a maximum aggregate principal amount of \$800 million, or the US dollar equivalent. As at June 30, 2014, the Company had total borrowings of \$285 million (\$273 million as at December 31, 2013) presented in Current portion of long-term debt on the Consolidated Balance Sheet at a weighted-average interest rate of 1.14% (1.14% as at December 31, 2013).

Accounts receivable securitization program

The Company has a three-year agreement that expires on February 1, 2016 to sell an undivided co-ownership interest in a revolving pool of accounts receivable to unrelated trusts for maximum cash proceeds of \$450 million.

The Company accounts for the proceeds of its accounts receivable securitization program as a secured borrowing under ASC 860, Transfers and Servicing. As such, as at June 30, 2014, the Company recorded \$250 million (\$250 million as at December 31, 2013) of proceeds received under the accounts receivable securitization program in the Current portion of long-term debt on the Consolidated Balance Sheet at a weighted-average interest rate of 1.21% (1.18% as at December 31, 2013) which is secured by and limited to \$279 million (\$281 million as at December 31, 2013) of accounts receivable.

Bilateral letter of credit facilities and Restricted cash and cash equivalents

The Company has a series of bilateral letter of credit facility agreements with various banks to support its requirements to post letters of credit in the ordinary course of business. On March 14, 2014, the expiry date of these agreements was extended by one year to April 28, 2017. Under these agreements, the Company has the option from

time to time to pledge collateral in the form of cash or cash equivalents, for a minimum term of one month, equal to at least the face value of the letters of credit issued. As at June 30, 2014, the Company had letters of credit drawn of \$491 million (\$481 million as at December 31, 2013) from a total committed amount of \$510 million (\$503 million as at December 31, 2013) by the various banks. As at June 30, 2014, cash and cash equivalents of \$468 million (\$448 million as at December 31, 2013) were pledged as collateral and recorded as Restricted cash and cash equivalents on the Consolidated Balance Sheet.

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## Notes to Unaudited Consolidated Financial Statements

## Share repurchase programs

On October 22, 2013, the Board of Directors of the Company approved a share repurchase program which allows for the repurchase of up to 30.0 million common shares, between October 29, 2013 and October 23, 2014, pursuant to a normal course issuer bid at prevailing market prices plus brokerage fees, or such other prices as may be permitted by the Toronto Stock Exchange.

The following table provides the information related to the share repurchase programs for the three and six months ended June 30, 2014 and 2013:

In millions, except per share data	Three months ended June 30		Six months ended June 30	
	2014	2013	2014	2013
Number of common shares repurchased (1)	5.6	7.2	11.9	15.0
Weighted-average price per share (2)	\$ 64.70	\$ 50.52	\$ 61.29	\$ 48.71
Amount of repurchase	\$ 365	\$ 365	\$ 730	\$ 730

Includes common shares purchased in the first quarters of 2014 and 2013 pursuant to private

(1) agreements between the Company and arm's length third-party sellers.

(2) Includes brokerage fees.

## 5 - Stock plans

The Company has various stock-based incentive plans for eligible employees. A description of the Company's major plans is provided in Note 10 – Stock plans to the Company's 2013 Annual Consolidated Financial Statements. The following table provides total stock-based compensation expense for awards under all plans, as well as the related tax benefit recognized in income, for the three and six months ended June 30, 2014 and 2013:

In millions	Three months ended June 30		Six months ended June 30	
	2014	2013	2014	2013
Cash settled awards				
Share Unit Plan (1)	\$ 31	\$ 11	\$ 45	\$ 21
Voluntary Incentive Deferral Plan (VIDP)	20	(1 )	21	13
Total cash settled awards	51	10	66	34
Stock option awards	3	2	5	4
Total stock-based compensation expense	\$ 54	\$ 12	\$ 71	\$ 38
Tax benefit recognized in income	\$ 15	\$ 2	\$ 19	\$ 8

(1) The six months ended June 30, 2013 includes the reversal of approximately \$20 million of stock-based compensation expense related to the forfeiture of performance share units by former executives.

## Cash settled awards

## Share Unit Plan

Following approval by the Board of Directors in January 2014, the Company granted 0.8 million performance share units (PSUs), previously known as restricted share units to designated management employees entitling them to receive payout in cash based on the Company's share price. The PSUs granted are generally scheduled for payout after three years ("plan period") and vest conditionally upon the attainment of a target relating to return on invested capital over the plan period.

Payout is conditional upon the attainment of a minimum share price calculated using the average of the last three months of the plan period. In addition, commencing at various dates, for senior and executive management employees

(“executive employees”), payout on PSUs is also conditional on compliance with the conditions of their benefit plans, award or employment agreements, including but not limited to non-compete, non-solicitation, and non-disclosure of confidential information conditions. Current or former executive employees who breach such conditions of their benefit plans, award or employment agreements will forfeit the PSU payout. Should the Company reasonably determine that a current or former executive employee may have violated the conditions of their benefit plans, award or employment agreement, the Company may at its discretion change the manner of vesting of the PSUs to suspend payout on any PSUs pending resolution of such matter.

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## Notes to Unaudited Consolidated Financial Statements

The following table provides the 2014 activity for all cash settled awards:

In millions	PSUs		VIDP	
	Nonvested	Vested	Nonvested	Vested
Outstanding at December 31, 2013	1.7	0.9	-	2.3
Granted (Payout)	0.8	(0.9)	-	(0.1)
Outstanding at June 30, 2014	2.5	-	-	2.2

The following table provides valuation and expense information for all cash settled awards:

In millions, unless otherwise indicated	PSUs (1)						VIDP (2)	Total
	2014	2013	2012	2011	2010	2009		
Year of grant								
Stock-based compensation expense (recovery) recognized over requisite service period								
Six months ended June 30, 2014	\$ 11	\$ 18	\$ 18	\$ (2 )	\$ -	\$ -	\$ 21	\$ 66
Six months ended June 30, 2013 (3)	N/A	\$ 7	\$ 15	\$ 12	\$ (4 )	\$ (9 )	\$ 13	\$ 34
Liability outstanding								
June 30, 2014	\$ 11	\$ 52	\$ 79	\$ -	\$ -	\$ -	\$ 160	\$ 302
December 31, 2013	N/A	\$ 34	\$ 61	\$ 80	\$ -	\$ -	\$ 145	\$ 320
Fair value per unit								
June 30, 2014 (\$)	\$ 52.43	\$ 67.73	\$ 68.90	N/A	N/A	N/A	\$ 69.40	N/A
Fair value of awards vested during the period								
Six months ended June 30, 2014	\$ -	\$ -	\$ -	\$ -	N/A	N/A	\$ 1	\$ 1
Six months ended June 30, 2013	N/A	\$ -	\$ -	\$ -	\$ -	N/A	\$ 1	\$ 1
Nonvested awards at June 30, 2014								
Unrecognized compensation cost	\$ 27	\$ 24	\$ 9	\$ -	N/A	N/A	\$ 2	\$ 62
Remaining recognition period (years)	2.5	1.5	0.5	N/A	N/A	N/A	N/A (4)	N/A
Assumptions (5)								
Stock price (\$)	\$ 69.40	\$ 69.40	\$ 69.40	N/A	N/A	N/A	\$ 69.40	N/A
Expected stock price volatility (6)	15 % 2.5	13 % 1.5	13 % 0.5	N/A	N/A	N/A	N/A	N/A

Expected term (years)

(7)

Risk-free interest rate (8)	1.14 %	1.06 %	0.97 %	N/A	N/A	N/A	N/A	N/A
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Dividend rate (\$) (9)	\$ 1.00	\$ 1.00	\$ 1.00	N/A	N/A	N/A	N/A	N/A
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Compensation cost is based on the fair value of the awards at period-end using the lattice-based

(1) valuation model that uses the assumptions as presented herein.

(2) Compensation cost is based on intrinsic value.

(3) Includes the reversal of approximately \$20 million of stock-based compensation expense related to the forfeiture of PSUs by former executives.

(4) The remaining recognition period has not been quantified as it relates solely to the 25% Company grant and the dividends earned thereon, representing a minimal number of units.

(5) Assumptions used to determine fair value are at June 30, 2014.

(6) Based on the historical volatility of the Company's stock over a period commensurate with the expected term of the award.

(7) Represents the remaining period of time that awards are expected to be outstanding.

(8) Based on the implied yield available on zero-coupon government issues with an equivalent term commensurate with the expected term of the awards.

(9) Based on the annualized dividend rate.

#### Stock option awards

Following approval by the Board of Directors in January 2014, the Company granted 1.0 million conventional stock options to designated senior management employees. The stock option plan allows eligible employees to acquire common shares of the Company upon vesting at a price equal to the market value of the common shares at the date of grant. The options issued by the Company are conventional options that vest over a period of time. The right to exercise options generally accrues over a period of four years of continuous employment. Options are not generally exercisable during the first 12 months after the date of grant and expire after 10 years. At June 30, 2014, 19.2 million common shares remained authorized for future issuances under this plan. The total number of options outstanding at June 30, 2014 was 8.2 million.

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## Notes to Unaudited Consolidated Financial Statements

The following table provides the activity of stock option awards during 2014, and for options outstanding and exercisable at June 30, 2014, the weighted-average exercise price and the weighted-average years to expiration. The table also provides the aggregate intrinsic value for in-the-money stock options, which represents the value that would have been received by option holders had they exercised their options on June 30, 2014 at the Company's closing stock price of \$69.40 on the Toronto Stock Exchange.

	Number of options In millions	Options outstanding		Aggregate intrinsic value In millions
		Weighted-average exercise price	Weighted-average years to expiration	
Outstanding at December 31, 2013 (1)	7.7	\$ 30.97		
Granted	1.0	\$ 58.72		
Exercised	(0.5 )	\$ 24.53		
Outstanding at June 30, 2014 (1)	8.2	\$ 34.46	5.8	\$ 285
Exercisable at June 30, 2014 (1)	5.6	\$ 28.06	4.6	\$ 233

(1) Stock options with a US dollar exercise price have been translated to Canadian dollars using the foreign exchange rate in effect at the balance sheet date.

The following table provides valuation and expense information for all stock option awards:

In millions, unless otherwise indicated	2014	2013	2012	2011	2010	2009	Total
Year of grant							
Stock-based compensation expense recognized over requisite service period (1)							
Six months ended June 30, 2014	\$ 3	\$ 1	\$ -	\$ 1	\$ -	\$ -	\$ 5
Six months ended June 30, 2013	N/A	\$ 2	\$ 1	\$ 1	\$ -	\$ -	\$ 4
Fair value per unit At grant date (\$)	\$ 11.08	\$ 8.52	\$ 7.74	\$ 7.83	\$ 6.55	\$ 6.30	N/A
Fair value of awards vested during the period							
Six months ended June 30, 2014	\$ -	\$ 2	\$ 2	\$ 3	\$ 2	\$ -	\$ 9
Six months ended June 30, 2013	N/A	\$ -	\$ 2	\$ 3	\$ 2	\$ 4	\$ 11

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Nonvested awards at June 30, 2014

Unrecognized compensation cost	\$ 7	\$ 2	\$ 1	\$ 1	\$ -	\$ -	\$ 11
Remaining recognition period (years)	3.5	2.5	1.5	0.5	-	-	N/A
Assumptions							
Grant price (\$)	\$ 58.72	\$ 47.47	\$ 38.35	\$ 34.47	\$ 27.38	\$ 21.07	N/A
Expected stock price volatility (2)	23 %	23 %	26 %	26 %	28 %	39 %	N/A
Expected term (years) (3)	5.4	5.4	5.4	5.3	5.4	5.3	N/A
Risk-free interest rate (4)	1.51 %	1.41 %	1.33 %	2.53 %	2.44 %	1.97 %	N/A
Dividend rate (\$ (5))	\$ 1.00	\$ 0.86	\$ 0.75	\$ 0.65	\$ 0.54	\$ 0.51	N/A

Compensation cost is based on the grant date fair value using the Black-Scholes option-pricing model that uses

(1) the assumptions at the grant date.

Based on the average of the historical volatility of the Company's stock over a period commensurate with the

(2) expected term of the award and the implied volatility from traded options on the Company's stock.

Represents the period of time that awards are expected to be outstanding. The Company uses historical data to estimate option exercise and employee termination, and groups of employees that have similar historical

(3) exercise behavior are considered separately.

Based on the implied yield available on zero-coupon government issues with an equivalent term commensurate

(4) with the expected term of the awards.

(5) Based on the annualized dividend rate.

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## Notes to Unaudited Consolidated Financial Statements

## 6 - Pensions and other postretirement benefits

The Company has various retirement benefit plans under which substantially all of its employees are entitled to benefits at retirement age, generally based on compensation and length of service and/or contributions. Senior and executive management employees (“executive employees”) subject to certain minimum service and age requirements, are also eligible for an additional retirement benefit under their Special Retirement Stipend Agreements (SRS), the Supplemental Executive Retirement Plan (SERP) or the Defined Contribution Supplemental Executive Retirement Plan (DC SERP). Executive employees who breach the non-compete, non-solicitation and non-disclosure of confidential information conditions of the SRS, SERP or DC SERP plans or other employment agreement will forfeit the retirement benefit under these plans. Should the Company reasonably determine that a current or former executive employee may have violated the conditions of their SRS, SERP, or DC SERP plan or other employment agreement, the Company may at its discretion withhold or suspend payout of the retirement benefit pending resolution of such matter.

For the three and six months ended June 30, 2014 and 2013, the components of net periodic benefit cost (income) for pensions and other postretirement benefits were as follows:

## Components of net periodic benefit cost (income) for pensions

In millions	Three months ended June 30		Six months ended June 30	
	2014	2013	2014	2013
Service cost	\$31	\$37	\$66	\$78
Interest cost	177	165	355	329
Settlement gain	-	-	-	(1 )
Expected return on plan assets	(244 )	(240 )	(489 )	(479 )
Amortization of prior service cost	1	1	2	2
Amortization of net actuarial loss	30	54	62	113
Net periodic benefit cost (income)	\$(5 )	\$17	\$(4 )	\$42

## Components of net periodic benefit cost for other postretirement benefits

In millions	Three months ended June 30		Six months ended June 30	
	2014	2013	2014	2013
Service cost	\$-	\$-	\$1	\$1
Interest cost	4	3	6	5
Amortization of prior service cost	-	1	1	1
Amortization of net actuarial gain	(1 )	-	(2 )	-
Net periodic benefit cost	\$3	\$4	\$6	\$7

Company contributions to its various pension plans are made in accordance with the applicable legislation in Canada and the United States (U.S.) and are determined by actuarial valuations. Actuarial valuations are generally required on an annual basis both in Canada and the U.S. The latest actuarial valuations for funding purposes for the Company’s Canadian pension plans, based on a valuation date of December 31, 2013, were filed in June 2014 and identified a going-concern surplus of approximately \$1.6 billion and a solvency deficit of approximately \$1.7 billion calculated using the three-year average of the Company’s hypothetical wind-up ratio in accordance with the Pension Benefit Standards Regulations, 1985. Under Canadian legislation, the solvency deficit is required to be funded through special solvency payments, for which each annual amount is equal to one fifth of the solvency deficit, and is re-established at each valuation date.

Pension contributions made in the first six months of 2014 and 2013 of \$100 million and \$210 million, respectively, mainly represent contributions to the Company's main pension plan, the CN Pension Plan. These pension contributions are for the current service cost as determined under the Company's current actuarial valuations for funding purposes. The Company expects to make total cash contributions in 2014 of approximately \$130 million for all of the Company's pension plans. Voluntary contributions can be treated as a prepayment against the Company's required special solvency deficit payments. As at December 31, 2013, the Company had approximately \$470 million of accumulated prepayments available to offset future required solvency deficit payments. The Company applied approximately \$170 million of such prepayments during the first six months of 2014 and will apply approximately \$165 million for the remainder of the year.

Additional information relating to the pension plans is provided in Note 11 – Pensions and other postretirement benefits to the Company's 2013 Annual Consolidated Financial Statements.

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Notes to Unaudited Consolidated Financial Statements

7 - Income taxes

The Company recorded income tax expense of \$322 million and \$521 million for the three and six months ended June 30, 2014, respectively, compared to \$265 million and \$443 million, respectively, for the same periods in 2013.

Included in the 2014 figure was an income tax recovery of \$18 million resulting from a change in estimate of the deferred income tax liability related to properties, which was recorded in the first quarter.

Included in the 2013 figures was a net income tax recovery of \$26 million; consisting of a \$5 million income tax expense resulting from the enactment of higher provincial corporate income tax rates and a \$15 million income tax recovery resulting from the recognition of U.S. state income tax losses, which were both recorded in the second quarter; and a \$16 million income tax recovery resulting from a revision of the apportionment of U.S. state income taxes, which was recorded in the first quarter.

8 - Major commitments and contingencies

Commitments

As at June 30, 2014, the Company had commitments to acquire railroad ties, rail, freight cars, locomotives, and other equipment and services, as well as outstanding information technology service contracts and licenses, at an aggregate cost of \$763 million (\$482 million as at December 31, 2013). The Company also has estimated remaining commitments of approximately \$278 million (US\$260 million), in relation to the U.S. federal government legislative requirement to implement Positive Train Control (PTC) by December 31, 2015.

In addition, the Company has estimated remaining commitments, through to December 31, 2016, of approximately \$69 million (US\$65 million), in relation to the acquisition of the principal lines of the former Elgin, Joliet and Eastern Railway Company. These commitments are for railroad infrastructure improvements, grade separation projects as well as commitments under a series of agreements with individual communities and a comprehensive voluntary mitigation program established to address surrounding municipalities' concerns.

The Company also has agreements with fuel suppliers which allow but do not require the Company to purchase approximately 80% of its estimated remaining 2014 volume, 60% of its anticipated 2015 volume, 55% of its anticipated 2016 volume and 20% of its anticipated 2017 volume at market prices prevailing on the date of the purchase.

Contingencies

In the normal course of business, the Company becomes involved in various legal actions seeking compensatory and occasionally punitive damages, including actions brought on behalf of various purported classes of claimants and claims relating to employee and third-party personal injuries, occupational disease and property damage, arising out of harm to individuals or property allegedly caused by, but not limited to, derailments or other accidents.

Canada

Employee injuries are governed by the workers' compensation legislation in each province whereby employees may be awarded either a lump sum or a future stream of payments depending on the nature and severity of the injury. As such, the provision for employee injury claims is discounted. In the provinces where the Company is self-insured, costs related to employee work-related injuries are accounted for based on actuarially developed estimates of the ultimate cost associated with such injuries, including compensation, health care and third-party administration costs. A comprehensive actuarial study is generally performed at least on a triennial basis. For all other legal actions, the Company maintains, and regularly updates on a case-by-case basis, provisions for such items when the expected loss is both probable and can be reasonably estimated based on currently available information.

United States

Personal injury claims by the Company's employees, including claims alleging occupational disease and work-related injuries, are subject to the provisions of the Federal Employers' Liability Act (FELA). Employees are compensated

under FELA for damages assessed based on a finding of fault through the U.S. jury system or through individual settlements. As such, the provision is undiscounted. With limited exceptions where claims are evaluated on a case-by-case basis, the Company follows an actuarial-based approach and accrues the expected cost for personal injury, including asserted and unasserted occupational disease claims, and property damage claims, based on actuarial estimates of their ultimate cost. A comprehensive actuarial study is performed annually.

For employee work-related injuries, including asserted occupational disease claims, and third-party claims, including grade crossing, trespasser and property damage claims, the actuarial valuation considers, among other factors, the Company's historical patterns of claims filings and payments. For unasserted occupational disease claims, the actuarial study includes the projection of the Company's experience into the future considering the potentially exposed population. The Company adjusts its liability based upon management's assessment and the results of the study. On an ongoing basis, management reviews and compares the assumptions inherent in the latest actuarial study with the current claim experience and, if required, adjustments to the liability are recorded.

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## Notes to Unaudited Consolidated Financial Statements

As at June 30, 2014, the Company had aggregate reserves for personal injury and other claims of \$314 million, of which \$49 million was recorded as a current liability (\$316 million as at December 31, 2013, of which \$45 million was recorded as a current liability).

Although the Company considers such provisions to be adequate for all its outstanding and pending claims, the final outcome with respect to actions outstanding or pending at June 30, 2014, or with respect to future claims, cannot be reasonably determined. When establishing provisions for contingent liabilities the Company considers, where a probable loss estimate cannot be made with reasonable certainty, a range of potential probable losses for each such matter, and records the amount it considers the most reasonable estimate within the range. However, when no amount within the range is a better estimate than any other amount, the minimum amount in the range is accrued. For matters where a loss is reasonably possible but not probable, a range of potential losses cannot be estimated due to various factors which may include the limited availability of facts, the lack of demand for specific damages and the fact that proceedings were at an early stage. Based on information currently available, the Company believes that the eventual outcome of the actions against the Company will not, individually or in the aggregate, have a material adverse effect on the Company's consolidated financial position. However, due to the inherent inability to predict with certainty unforeseeable future developments, there can be no assurance that the ultimate resolution of these actions will not have a material adverse effect on the Company's results of operations, financial position or liquidity in a particular quarter or fiscal year.

### Environmental matters

The Company's operations are subject to numerous federal, provincial, state, municipal and local environmental laws and regulations in Canada and the U.S. concerning, among other things, emissions into the air; discharges into waters; the generation, handling, storage, transportation, treatment and disposal of waste, hazardous substances, and other materials; decommissioning of underground and aboveground storage tanks; and soil and groundwater contamination. A risk of environmental liability is inherent in railroad and related transportation operations; real estate ownership, operation or control; and other commercial activities of the Company with respect to both current and past operations.

### Known existing environmental concerns

The Company has identified approximately 270 sites at which it is or may be liable for remediation costs, in some cases along with other potentially responsible parties, associated with alleged contamination and is subject to environmental clean-up and enforcement actions, including those imposed by the United States Federal Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA), also known as the Superfund law, or analogous state laws. CERCLA and similar state laws, in addition to other similar Canadian and U.S. laws, generally impose joint and several liability for clean-up and enforcement costs on current and former owners and operators of a site, as well as those whose waste is disposed of at the site, without regard to fault or the legality of the original conduct. The Company has been notified that it is a potentially responsible party for study and clean-up costs at approximately 10 sites governed by the Superfund law (and analogous state laws) for which investigation and remediation payments are or will be made or are yet to be determined and, in many instances, is one of several potentially responsible parties.

The ultimate cost of addressing these known contaminated sites cannot be definitely established given that the estimated environmental liability for any given site may vary depending on the nature and extent of the contamination; the nature of anticipated response actions, taking into account the available clean-up techniques; evolving regulatory standards governing environmental liability; and the number of potentially responsible parties and their financial viability. As a result, liabilities are recorded based on the results of a four-phase assessment conducted on a site-by-site basis. A liability is initially recorded when environmental assessments occur, remedial efforts are probable, and when the costs, based on a specific plan of action in terms of the technology to be used and the extent of the corrective action required, can be reasonably estimated. The Company estimates the costs related to a particular site using cost scenarios established by external consultants based on the extent of contamination and expected costs for remedial efforts. In the case of multiple parties, the Company accrues its allocable share of liability taking into

account the Company's alleged responsibility, the number of potentially responsible parties and their ability to pay their respective share of the liability. Adjustments to initial estimates are recorded as additional information becomes available.

The Company's provision for specific environmental sites is undiscounted and includes costs for remediation and restoration of sites, as well as monitoring costs. Environmental expenses, which are classified as Casualty and other in the Consolidated Statement of Income, include amounts for newly identified sites or contaminants as well as adjustments to initial estimates. Recoveries of environmental remediation costs from other parties are recorded as assets when their receipt is deemed probable.

As at June 30, 2014, the Company had aggregate accruals for environmental costs of \$119 million, of which \$48 million was recorded as a current liability (\$119 million as at December 31, 2013, of which \$41 million was recorded as a current liability). The Company anticipates that the majority of the liability at June 30, 2014 will be paid out over the next five years. However, some costs may be paid out over a longer period. Based on the information currently available, the Company considers its provisions to be adequate.

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Notes to Unaudited Consolidated Financial Statements

Unknown existing environmental concerns

While the Company believes that it has identified the costs likely to be incurred for environmental matters in the next several years based on known information, the discovery of new facts, future changes in laws, the possibility of releases of hazardous materials into the environment and the Company's ongoing efforts to identify potential environmental liabilities that may be associated with its properties may result in the identification of additional environmental liabilities and related costs. The magnitude of such additional liabilities and the costs of complying with future environmental laws and containing or remediating contamination cannot be reasonably estimated due to many factors, including:

- (a) the lack of specific technical information available with respect to many sites;
- (b) the absence of any government authority, third-party orders, or claims with respect to particular sites;
- (c) the potential for new or changed laws and regulations and for development of new remediation technologies and uncertainty regarding the timing of the work with respect to particular sites; and
- (d) the determination of the Company's liability in proportion to other potentially responsible parties and the ability to recover costs from any third parties with respect to particular sites.

Therefore, the likelihood of any such costs being incurred or whether such costs would be material to the Company cannot be determined at this time. There can thus be no assurance that liabilities or costs related to environmental matters will not be incurred in the future, or will not have a material adverse effect on the Company's financial position or results of operations in a particular quarter or fiscal year, or that the Company's liquidity will not be adversely impacted by such liabilities or costs, although management believes, based on current information, that the costs to address environmental matters will not have a material adverse effect on the Company's financial position or liquidity. Costs related to any unknown existing or future contamination will be accrued in the period in which they become probable and reasonably estimable.

Guarantees and indemnifications

In the normal course of business, the Company, including certain of its subsidiaries, enters into agreements that may involve providing guarantees or indemnifications to third parties and others, which may extend beyond the term of the agreements. These include, but are not limited to, residual value guarantees on operating leases, standby letters of credit, surety and other bonds, and indemnifications that are customary for the type of transaction or for the railway business.

The Company is required to recognize a liability for the fair value of the obligation undertaken in issuing certain guarantees on the date the guarantee is issued or modified. In addition, where the Company expects to make a payment in respect of a guarantee, a liability will be recognized to the extent that one has not yet been recognized.

Guarantee of residual values of operating leases

The Company has guaranteed a portion of the residual values of certain of its assets under operating leases with expiry dates between 2014 and 2022, for the benefit of the lessor. If the fair value of the assets at the end of their respective lease term is less than the fair value, as estimated at the inception of the lease, then the Company must, under certain conditions, compensate the lessor for the shortfall. As at June 30, 2014, the maximum exposure in respect of these guarantees was \$189 million. There are no recourse provisions to recover any amounts from third parties.

Other guarantees

As at June 30, 2014, the Company, including certain of its subsidiaries, had granted \$491 million of irrevocable standby letters of credit and \$92 million of surety and other bonds, issued by highly rated financial institutions, to third parties to indemnify them in the event the Company does not perform its contractual obligations. As at June 30, 2014, the maximum potential liability under these guarantee instruments was \$583 million, of which \$523 million related to workers' compensation and other employee benefit liabilities and \$60 million related to other liabilities. The

letters of credit were drawn on the Company's bilateral letter of credit facilities. The Company had not recorded a liability as at June 30, 2014 with respect to these guarantee instruments as they related to the Company's future performance and the Company did not expect to make any payments under these guarantee instruments. The majority of the guarantee instruments mature at various dates between 2014 and 2016.

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Notes to Unaudited Consolidated Financial Statements

General indemnifications

In the normal course of business, the Company has provided indemnifications, customary for the type of transaction or for the railway business, in various agreements with third parties, including indemnification provisions where the Company would be required to indemnify third parties and others. Indemnifications are found in various types of contracts with third parties which include, but are not limited to:

- (a) contracts granting the Company the right to use or enter upon property owned by third parties such as leases, easements, trackage rights and sidetrack agreements;
- (b) contracts granting rights to others to use the Company's property, such as leases, licenses and easements;
- (c) contracts for the sale of assets;
- (d) contracts for the acquisition of services;
- (e) financing agreements;
- (f) trust indentures, fiscal agency agreements, underwriting agreements or similar agreements relating to debt or equity securities of the Company and engagement agreements with financial advisors;
- (g) transfer agent and registrar agreements in respect of the Company's securities;
- (h) trust and other agreements relating to pension plans and other plans, including those establishing trust funds to secure payment to certain officers and senior employees of special retirement compensation arrangements;
- (i) pension transfer agreements;
- (j) master agreements with financial institutions governing derivative transactions;
- (k) settlement agreements with insurance companies or other third parties whereby such insurer or third-party has been indemnified for any present or future claims relating to insurance policies, incidents or events covered by the settlement agreements; and
- (l) acquisition agreements.

To the extent of any actual claims under these agreements, the Company maintains provisions for such items, which it considers to be adequate. Due to the nature of the indemnification clauses, the maximum exposure for future payments may be material. However, such exposure cannot be reasonably determined.

During the period, the Company entered into various indemnification contracts with third parties for which the maximum exposure for future payments cannot be reasonably determined. As a result, no liability was recorded. There are no recourse provisions to recover any amounts from third parties.

9 - Financial instruments

For financial assets and liabilities measured at fair value on a recurring basis, fair value is the price the Company would receive to sell an asset or pay to transfer a liability in an orderly transaction with a market participant at the measurement date. In the absence of active markets for identical assets or liabilities, such measurements involve developing assumptions based on market observable data and, in the absence of such data, internal information that is believed to be consistent with what market participants would use in a hypothetical transaction that occurs at the measurement date. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Company's market assumptions. Preference is given to observable inputs. These two types of inputs create the following fair value hierarchy:

Level 1: Quoted prices for identical instruments in active markets.

Level 2: Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations whose inputs are observable or whose significant value drivers are observable.

Level 3: Significant inputs to the valuation model are unobservable.

The Company uses the following methods and assumptions to estimate the fair value of each class of financial instruments for which the carrying amounts are included in the Consolidated Balance Sheet under the following captions:

Cash and cash equivalents, Restricted cash and cash equivalents, Accounts receivable, Other current assets, Accounts payable and other

The carrying amounts approximate fair value because of the short maturity of these instruments. Cash and cash equivalents and Restricted cash and cash equivalents include highly liquid investments purchased three months or less from maturity and are classified as Level 1. Accounts receivable, Other current assets, and Accounts payable and other are classified as Level 2 as they may not be priced using quoted prices, but rather determined from market observable information.

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## Notes to Unaudited Consolidated Financial Statements

## Intangible and other assets

Included in Intangible and other assets are equity investments for which the carrying value approximates the fair value, with the exception of certain cost investments for which the fair value is estimated based on the Company's proportionate share of the underlying net assets. Investments are classified as Level 3 as their fair value is based on significant unobservable inputs.

## Debt

The fair value of the Company's debt is estimated based on the quoted market prices for the same or similar debt instruments, as well as discounted cash flows using current interest rates for debt with similar terms, company rating, and remaining maturity. The Company's debt is classified as Level 2.

The following table provides the carrying amounts and estimated fair values of the Company's financial instruments as at June 30, 2014 and December 31, 2013 for which the carrying values on the Consolidated Balance Sheet are different from their fair values:

In millions	June 30, 2014		December 31, 2013	
	Carrying amount	Fair value	Carrying amount	Fair value
Financial assets				
Investments	\$57	\$168	\$57	\$164
Financial liabilities				
Total debt	\$7,661	\$8,799	\$7,840	\$8,683

## 10 - Earnings per share

The following table provides a reconciliation between basic and diluted earnings per share:

In millions, except per share data	Three months ended June 30		Six months ended June 30	
	2014	2013	2014	2013
Net income	\$847	\$717	\$1,470	\$1,272
Weighted-average shares outstanding	821.8	846.1	824.9	849.8
Effect of stock options	3.5	3.0	3.4	3.0
Weighted-average diluted shares outstanding	825.3	849.1	828.3	852.8
Basic earnings per share	\$1.03	\$0.85	\$1.78	\$1.50
Diluted earnings per share	\$1.03	\$0.84	\$1.77	\$1.49

Basic earnings per share are calculated based on the weighted-average number of common shares outstanding over each period. Diluted earnings per share are calculated based on the weighted-average diluted shares outstanding using the treasury stock method, which assumes that any proceeds received from the exercise of in-the-money stock options would be used to purchase common shares at the average market price for the period.

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## Notes to Unaudited Consolidated Financial Statements

## 11 – Accumulated other comprehensive loss

The components of Accumulated other comprehensive loss are as follows:

In millions	Foreign currency translation adjustments	Pension and other postretirement benefit plans	Derivative instruments	Total before tax	Income tax recovery (expense)	Total net of tax
Balance at March 31, 2014	\$ (508)\$	(1,482)\$	8 \$	(1,982)\$	214 \$	(1,768)
Other comprehensive income (loss) before reclassifications:						
Unrealized foreign exchange loss on translation of net investment in foreign operations	(257)			(257)	-	(257)
Unrealized foreign exchange gain on translation of US dollar- denominated long-term debt designated as a hedge of the net investment in U.S. subsidiaries	227			227	(31)	196
Amounts reclassified from Accumulated other comprehensive loss:						
Amortization of net actuarial loss		29		29 (1)	(7)(2)	22
Amortization of prior service cost		1		1 (1)	- (2)	1
Other comprehensive income (loss)	(30)	30	-	-	(38)	(38)
Balance at June 30, 2014	\$ (538)\$	(1,452)\$	8 \$	(1,982)\$	176 \$	(1,806)
In millions	Foreign currency translation adjustments	Pension and other postretirement benefit plans	Derivative instruments	Total before tax	Income tax recovery (expense)	Total net of tax
Balance at December 31, 2013	\$ (533)\$	(1,515)\$	8 \$	(2,040)\$	190 \$	(1,850)

Other comprehensive  
income (loss) before  
reclassifications:

Unrealized foreign exchange gain on translation of net investment in foreign operations	19		19	-	19
Unrealized foreign exchange loss on translation of US dollar- denominated long-term debt designated as a hedge of the net investment in U.S. subsidiaries	(24)		(24)	1	(23)
Amounts reclassified from Accumulated other comprehensive loss:					
Amortization of net actuarial loss		60	60	(1)	(15) (2) 45
Amortization of prior service cost		3	3	(1)	- (2) 3
Other comprehensive income (loss)	(5)	63	-	58	(14) 44
Balance at June 30, 2014	\$ (538)\$	(1,452)\$	8 \$	(1,982)\$	176 \$ (1,806)

(1) Reclassified to Labor and fringe benefits on the Consolidated Statement of Income and included in components of net periodic benefit cost. See Note 6 - Pensions and other postretirement benefits.

(2) Included in Income tax expense on the Consolidated Statement of Income.

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## Notes to Unaudited Consolidated Financial Statements

In millions	Foreign currency translation adjustments	Pension and other postretirement benefit plans	Derivative instruments	Total before tax	Income tax recovery (expense)	Total net of tax
Balance at March 31, 2013	\$ (567)\$	(3,230)\$	8 \$	(3,789)\$	602 \$	(3,187)
Other comprehensive income (loss) before reclassifications:						
Unrealized foreign exchange gain on translation of net investment in foreign operations	225			225	-	225
Unrealized foreign exchange loss on translation of US dollar- denominated long-term debt designated as a hedge of the net investment in U.S. subsidiaries	(202)			(202)	28	(174)
Amounts reclassified from Accumulated other comprehensive loss:						
Amortization of net actuarial loss		54		54 (1)	(13)(2)	41
Amortization of prior service cost		2		2 (1)	(1) (2)	1
Other comprehensive income	23	56	-	79	14	93
Balance at June 30, 2013	\$ (544)\$	(3,174)\$	8 \$	(3,710)\$	616 \$	(3,094)

In millions	Foreign currency translation adjustments	Pension and other postretirement benefit plans	Derivative instruments	Total before tax	Income tax recovery (expense)	Total net of tax
Balance at December 31, 2012	\$ (579)\$	(3,290)\$	8 \$	(3,861)\$	604 \$	(3,257)
Other comprehensive income (loss) before reclassifications:						
	355			355	-	355

Unrealized foreign exchange gain on translation of net investment in foreign operations							
Unrealized foreign exchange loss on translation of US dollar-denominated long-term debt designated as a hedge of the net investment in U.S. subsidiaries	(320)		(320)	42		(278)	
Amounts reclassified from Accumulated other comprehensive loss:							
Amortization of net actuarial loss		113	113	(1)	(29)	(2)	84
Amortization of prior service cost		3	3	(1)	(1)	(2)	2
Other comprehensive income	35	116	-	151	12		163
Balance at June 30, 2013	\$ (544)\$	(3,174)\$	8 \$	(3,710)\$	602 \$		(3,094)

(1) Reclassified to Labor and fringe benefits on the Consolidated Statement of Income and included in components of net periodic benefit cost. See Note 6 - Pensions and other postretirement benefits.

(2) Included in Income tax expense on the Consolidated Statement of Income.

## Selected Railroad Statistics - unaudited

	Three months ended June 30		Six months ended June 30	
	2014	2013	2014	2013
<b>Statistical operating data</b>				
Rail freight revenues (\$ millions) (1)	2,942	2,493	5,520	4,848
Gross ton miles (GTM) (millions)	116,243	101,547	217,719	197,848
Revenue ton miles (RTM) (millions)	60,081	52,702	113,415	103,278
Carloads (thousands)	1,463	1,316	2,702	2,547
Route miles (includes Canada and the U.S.)	20,000	20,000	20,000	20,000
Employees (end of period)	24,875	23,925	24,875	23,925
Employees (average for the period)	24,565	23,926	24,161	23,681
<b>Productivity</b>				
Operating ratio (%)	59.6	60.9	64.2	64.5
Rail freight revenue per RTM (cents) (1)	4.90	4.73	4.87	4.69
Rail freight revenue per carload (\$) (1)	2,011	1,894	2,043	1,903
Operating expenses per GTM (cents)	1.60	1.60	1.71	1.67
Labor and fringe benefits expense per GTM (cents)	0.48	0.49	0.53	0.54
GTMs per average number of employees (thousands)	4,732	4,244	9,011	8,355
Diesel fuel consumed (US gallons in millions)	112.3	103.5	219.2	205.2
Average fuel price (\$/US gallon)	3.84	3.43	3.90	3.52
GTMs per US gallon of fuel consumed	1,035	981	993	964
<b>Safety indicators</b>				
Injury frequency rate (per 200,000 person hours) (2)	1.49	1.43	1.78	1.42
Accident rate (per million train miles) (2)	2.43	2.10	2.40	2.11
<b>Financial ratio</b>				
Debt-to-total capitalization ratio (% at end of period) (3)	36.5	39.6	36.5	39.6

Statistical data and related productivity measures are based on estimated data available at such time and are subject to change as more complete information becomes available, as such certain of the 2013 comparative statistical data and related productivity measures have been restated.

(1) In 2014, certain Other revenues were reclassified to the commodity groups within rail freight revenues. This change has no impact on the Company's previously reported results of operations as Total revenues remains unchanged. The 2013 comparative figures have been reclassified in order to be consistent with the 2014 presentation.

(2) Based on Federal Railroad Administration (FRA) reporting criteria.

(3) Debt-to-total capitalization is calculated as total long-term debt plus current portion of long-term debt, divided by the sum of total debt plus total shareholders' equity.

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Supplementary Information - unaudited

	Three months ended June 30				Six months ended June 30			
	2014	2013	% Change Fav (Unfav)	% Change at constant currency Fav (Unfav) (2)	2014	2013	% Change Fav (Unfav)	% Change at constant currency Fav (Unfav) (2)
Revenues (millions of dollars) (1)								
Petroleum and chemicals	564	481	17%	12%	1,132	942	20%	14%
Metals and minerals	370	309	20%	14%	678	597	14%	7%
Forest products	393	361	9%	4%	732	699	5%	(1%)
Coal	201	192	5%	2%	383	362	6%	2%
Grain and fertilizers	526	391	35%	31%	957	799	20%	15%
Intermodal	716	610	17%	15%	1,337	1,166	15%	12%
Automotive	172	149	15%	10%	301	283	6%	-
Total rail freight revenues	2,942	2,493	18%	14%	5,520	4,848	14%	9%
Other revenues	174	173	1%	(4%)	289	284	2%	(3%)
Total revenues	3,116	2,666	17%	13%	5,809	5,132	13%	8%
Revenue ton miles (millions)								
Petroleum and chemicals	12,779	10,841	18%	18%	25,658	21,395	20%	20%
Metals and minerals	6,018	5,207	16%	16%	11,027	10,197	8%	8%
Forest products	7,582	7,543	1%	1%	14,137	14,809	(5%)	(5%)
Coal	5,733	5,945	(4%)	(4%)	11,027	11,285	(2%)	(2%)
Grain and fertilizers	14,073	10,442	35%	35%	25,386	21,451	18%	18%
Intermodal	13,048	11,989	9%	9%	24,709	22,736	9%	9%
Automotive	848	735	15%	15%	1,471	1,405	5%	5%
Total revenue ton miles	60,081	52,702	14%	14%	113,415	103,278	10%	10%
Rail freight revenue / RTM (cents) (1)								
Petroleum and chemicals	4.41	4.44	(1%)	(5%)	4.41	4.40	-	(5%)
Metals and minerals	6.15	5.93	4%	(1%)	6.15	5.85	5%	(1%)
Forest products	5.18	4.79	8%	3%	5.18	4.72	10%	4%
Coal	3.51	3.23	9%	5%	3.47	3.21	8%	4%
Grain and fertilizers	3.74	3.74	-	(3%)	3.77	3.72	1%	(2%)
Intermodal	5.49	5.09	8%	6%	5.41	5.13	5%	3%
Automotive	20.28	20.27	-	(5%)	20.46	20.14	2%	(4%)
Total rail freight revenue per RTM	4.90	4.73	4%	-	4.87	4.69	4%	-

Carloads (thousands)									
Petroleum and chemicals	160	149	7%	7%	321	300	7%	7%	
Metals and minerals	267	274	(3%)	(3%)	474	518	(8%)	(8%)	
Forest products	113	113	-	-	213	224	(5%)	(5%)	
Coal	141	110	28%	28%	266	207	29%	29%	
Grain and fertilizers	172	133	29%	29%	312	275	13%	13%	
Intermodal	547	477	15%	15%	1,004	909	10%	10%	
Automotive	63	60	5%	5%	112	114	(2%)	(2%)	
Total carloads	1,463	1,316	11%	11%	2,702	2,547	6%	6%	
Rail freight revenue / carload (dollars) (1)									
Petroleum and chemicals	3,525	3,228	9%	5%	3,526	3,140	12%	7%	
Metals and minerals	1,386	1,128	23%	17%	1,430	1,153	24%	17%	
Forest products	3,478	3,195	9%	4%	3,437	3,121	10%	4%	
Coal	1,426	1,745	(18%)	(21%)	1,440	1,749	(18%)	(21%)	
Grain and fertilizers	3,058	2,940	4%	1%	3,067	2,905	6%	2%	
Intermodal	1,309	1,279	2%	-	1,332	1,283	4%	2%	
Automotive	2,730	2,483	10%	5%	2,688	2,482	8%	2%	
Total rail freight revenue per carload	2,011	1,894	6%	3%	2,043	1,903	7%	3%	

Statistical data and related productivity measures are based on estimated data available at such time and are subject to change as more complete information becomes available.

- (1) In 2014, certain Other revenues were reclassified to the commodity groups within rail freight revenues. This change has no impact on the Company's previously reported results of operations as Total revenues remains unchanged. The 2013 comparative figures have been reclassified in order to be consistent with the 2014 presentation.
- (2) See supplementary schedule entitled Non-GAAP Measures for an explanation of this non-GAAP measure.

## Non-GAAP Measures

## Adjusted performance measures

For the three and six months ended June 30, 2014, the Company reported adjusted net income of \$847 million, or \$1.03 per diluted share and \$1,398 million, or \$1.68 per diluted share, respectively. The adjusted figures for the six months ended June 30, 2014 exclude a gain on disposal of the Deux-Montagnes subdivision, including the Mont-Royal tunnel, together with the rail fixtures, of \$80 million, or \$72 million after-tax (\$0.09 per diluted share).

For the three and six months ended June 30, 2013, the Company reported adjusted net income of \$704 million, or \$0.83 per diluted share and \$1,223 million, or \$1.44 per diluted share, respectively. The adjusted figures for the three and six months ended June 30, 2013 exclude a gain on exchange of perpetual railroad operating easements including the track and roadway assets on specific rail lines of \$29 million, or \$18 million after-tax (\$0.02 per diluted share) and an income tax expense of \$5 million (\$0.01 per diluted share) resulting from the enactment of higher provincial corporate income tax rates. The adjusted figures for the six months ended June 30, 2013 also exclude a gain on disposal of a segment of the Oakville subdivision, together with the rail fixtures and certain passenger agreements, of \$40 million, or \$36 million after-tax (\$0.04 per diluted share).

Management believes that adjusted net income and adjusted earnings per share are useful measures of performance that can facilitate period-to-period comparisons, as they exclude items that do not necessarily arise as part of the normal day-to-day operations of the Company and could distort the analysis of trends in business performance. The exclusion of such items in adjusted net income and adjusted earnings per share does not, however, imply that such items are necessarily non-recurring. These adjusted measures do not have any standardized meaning prescribed by GAAP and therefore, may not be comparable to similar measures presented by other companies. The reader is advised to read all information provided in the Company's 2014 unaudited Interim Consolidated Financial Statements and Notes thereto. The following tables provide a reconciliation of net income and earnings per share, as reported for the three and six months ended June 30, 2014 and 2013, to the adjusted performance measures presented herein.

In millions, except per share data	Three months ended June 30, 2014			Six months ended June 30, 2014		
	Reported	Adjustments	Adjusted	Reported	Adjustments	Adjusted
Revenues	\$ 3,116	\$ -	\$ 3,116	\$ 5,809	\$ -	\$ 5,809
Operating expenses	1,858	-	1,858	3,731	-	3,731
Operating income	1,258	-	1,258	2,078	-	2,078
Interest expense	(91 )	-	(91 )	(183 )	-	(183 )
Other income	2	-	2	96	(80 )	16
Income before income taxes	1,169	-	1,169	1,991	(80 )	1,911
Income tax expense	(322 )	-	(322 )	(521 )	8	(513 )
Net income	\$ 847	\$ -	\$ 847	\$ 1,470	\$ (72 )	\$ 1,398
Operating ratio	59.6 %		59.6 %	64.2 %		64.2 %
Effective tax rate	27.5 %		27.5 %	26.2 %		26.8 %
Basic earnings per share	\$ 1.03	\$ -	\$ 1.03	\$ 1.78	\$ (0.09 )	\$ 1.69
Diluted earnings per share	\$ 1.03	\$ -	\$ 1.03	\$ 1.77	\$ (0.09 )	\$ 1.68

In millions, except per share data	Three months ended June 30, 2013			Six months ended June 30, 2013		
	Reported	Adjustments	Adjusted	Reported	Adjustments	Adjusted
Revenues	\$ 2,666	\$ -	\$ 2,666	\$ 5,132	\$ -	\$ 5,132
Operating expenses	1,624	-	1,624	3,310	-	3,310
Operating income	1,042	-	1,042	1,822	-	1,822

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Interest expense	(88 )	-	(88 )	(177 )	-	(177 )
Other income (loss)	28	(29 )	(1 )	70	(69 )	1
Income before income taxes	982	(29 )	953	1,715	(69 )	1,646
Income tax expense	(265 )	16	(249 )	(443 )	20	(423 )
Net income	\$ 717	\$ (13 )	\$ 704	\$ 1,272	\$ (49 )	\$ 1,223
Operating ratio	60.9 %		60.9 %	64.5 %		64.5 %
Effective tax rate	27.0 %		26.1 %	25.8 %		25.7 %
Basic earnings per share	\$ 0.85	\$ (0.01 )	\$ 0.84	\$ 1.50	\$ (0.05 )	\$ 1.45
Diluted earnings per share	\$ 0.84	\$ (0.01 )	\$ 0.83	\$ 1.49	\$ (0.05 )	\$ 1.44

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## Non-GAAP Measures

## Constant currency

Although CN conducts its business and reports its earnings in Canadian dollars, a large portion of revenues and expenses is denominated in US dollars. As such, the Company's results are affected by exchange rate fluctuations. Financial results at "constant currency" allow results to be viewed without the impact of fluctuations in foreign currency exchange rates, thereby facilitating period-to-period comparisons in the analysis of trends in business performance. Measures at constant currency are considered non-GAAP measures and do not have any standardized meaning prescribed by GAAP and therefore, may not be comparable to similar measures presented by other companies. Financial results at constant currency are obtained by translating the current period results denominated in US dollars at the foreign exchange rates of the comparable period of the prior year. The average foreign exchange rates were \$1.09 and \$1.10 per US\$1.00, respectively, for the three and six months ended June 30, 2014 and \$1.02 per US\$1.00 for both the three and six months ended June 30, 2013.

On a constant currency basis, the Company's net income for the three and six months ended June 30, 2014 would have been lower by \$28 million, or \$0.03 per diluted share and \$54 million, or \$0.07 per diluted share, respectively. The following table presents a reconciliation of 2014 net income as reported to net income on a constant currency basis:

In millions	Three months ended June 30, 2014	Six months ended June 30, 2014
Net income, as reported	\$ 847	\$ 1,470
Impact due to the weakening Canadian dollar included in net income	(26 )	(52 )
Decrease due to the weakening Canadian dollar on additional year-over-year US\$ net income	(2 )	(2 )
Impact of foreign exchange using constant currency rates	(28 )	(54 )
Net income, on a constant currency basis	\$ 819	\$ 1,416

## Free cash flow

Free cash flow does not have any standardized meaning prescribed by GAAP and therefore, may not be comparable to similar measures presented by other companies. The Company believes that free cash flow is a useful measure of performance as it demonstrates the Company's ability to generate cash for debt obligations and for discretionary uses such as payment of dividends and strategic opportunities.

The Company defines its free cash flow measure as the difference between net cash provided by operating activities and net cash used in investing activities; adjusted for changes in restricted cash and cash equivalents and the impact of major acquisitions, if any.

In millions	Three months ended June 30		Six months ended June 30	
	2014	2013	2014	2013
Net cash provided by operating activities	\$ 1,273	\$ 1,063	\$ 1,918	\$ 1,384
Net cash used in investing activities	(494 )	(411 )	(668 )	(572 )
Net cash provided before financing activities	779	652	1,250	812
Adjustment:				
Change in restricted cash and cash equivalents	(3 )	(15 )	20	(24 )
Free cash flow	\$ 776	\$ 637	\$ 1,270	\$ 788

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## Management's Discussion and Analysis

### Item 3

Management's discussion and analysis (MD&A) relates to the financial position and results of operations of Canadian National Railway Company, together with its wholly-owned subsidiaries, collectively "CN" or "the Company." Canadian National Railway Company's common shares are listed on the Toronto and New York stock exchanges. Except where otherwise indicated, all financial information reflected herein is expressed in Canadian dollars and determined on the basis of United States generally accepted accounting principles (U.S. GAAP). The Company's objective is to provide meaningful and relevant information reflecting the Company's financial position and results of operations. In certain instances, the Company may make reference to certain non-GAAP measures that, from management's perspective, are useful measures of performance. The reader is advised to read all information provided in the MD&A in conjunction with the Company's 2014 unaudited Interim Consolidated Financial Statements and Notes thereto as well as the 2013 Annual MD&A. On July 21, 2014, CN issued a press release announcing its financial results for the three and six months ended June 30, 2014 and updating its outlook for the year. The press release is available on SEDAR at [www.sedar.com](http://www.sedar.com) and on EDGAR at [www.sec.gov](http://www.sec.gov).

#### Business profile

CN is engaged in the rail and related transportation business. CN's network of approximately 20,000 route miles of track spans Canada and mid-America, connecting three coasts: the Atlantic, the Pacific and the Gulf of Mexico. CN's extensive network, and its co-production arrangements, routing protocols, marketing alliances, and interline agreements, provide CN customers access to all three North American Free Trade Agreement (NAFTA) nations.

CN's freight revenues are derived from seven commodity groups representing a diversified and balanced portfolio of goods transported between a wide range of origins and destinations. This product and geographic diversity better positions the Company to face economic fluctuations and enhances its potential for growth opportunities. For the six months ended June 30, 2014, no individual commodity group accounted for more than 23% of total revenues. From a geographic standpoint, 17% of revenues relate to United States (U.S.) domestic traffic, 32% transborder traffic, 19% Canadian domestic traffic and 32% overseas traffic. The Company is the originating carrier for approximately 85% of traffic moving along its network, which allows it both to capitalize on service advantages and build on opportunities to efficiently use assets.

#### Corporate organization

The Company manages its rail operations in Canada and the U.S. as one business segment. Financial information reported at this level, such as revenues, operating income and cash flow from operations, is used by the Company's corporate management in evaluating financial and operational performance and allocating resources across CN's network. The Company's strategic initiatives, which drive its operational direction, are developed and managed centrally by corporate management and are communicated to its regional activity centers (the Western Region, Eastern Region and Southern Region), whose role is to manage the day-to-day service requirements of their respective territories, control direct costs incurred locally, and execute the corporate strategy and operating plan established by corporate management.

See Note 14 – Segmented information to the Company's 2013 Annual Consolidated Financial Statements for additional information on the Company's corporate organization, as well as selected financial information by geographic area.

#### Strategy overview

CN's focus is on running a safe and efficient railroad. While remaining at the forefront of the rail industry, CN's goal is to be internationally regarded as one of the best-performing transportation companies.

CN's commitment is to create value for both its customers and shareholders. By deepening customer engagement, leveraging the strength of its franchise, and delivering operational and service excellence, the Company seeks to

provide quality and cost-effective service that creates value for its customers.

CN's corporate goals are generally based on five key financial performance targets: revenues, operating income, earnings per share, free cash flow and return on invested capital, as well as various key operating and customer service metrics that the Company focuses on to measure efficiency, safety and quality of service. By striving for sustainable financial performance through profitable growth, adequate free cash flow and return on invested capital, CN seeks to deliver increased shareholder value. On October 22, 2013, the Board of Directors of the Company approved a two-for-one common stock split in the form of a stock dividend of one additional common share of CN for each share outstanding, paid on November 29, 2013 to shareholders of record on November 15, 2013. At the effective date of the stock split, all equity-based benefit plans and share repurchase programs were adjusted to reflect the issuance of such additional shares. All share and per share data presented herein reflect the impact of the stock split.

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## Management's Discussion and Analysis

For 2014, the Company's Board of Directors approved a share repurchase program which allows for the repurchase of up to 30.0 million common shares, between October 29, 2013 and October 23, 2014. Share repurchases are made pursuant to a normal course issuer bid at prevailing market prices, plus brokerage fees, or such other prices as may be permitted by the Toronto Stock Exchange. In addition, the Company's Board of Directors approved an increase of 16% to the quarterly dividend to common shareholders, from \$0.215 per share in 2013 to \$0.250 per share in 2014.

CN's business model is anchored on five core principles: providing quality service, controlling costs, focusing on asset utilization, committing to safety and sustainability, and developing people. For many years, CN has operated with a mindset that drives efficiency. The CN Precision Railroading model, which focuses on improving every process that affects delivery of customers' goods, continues to guide the Company's performance. It is a highly disciplined process whereby CN handles individual rail shipments according to a specific trip plan and manages all aspects of railroad operations to meet customer commitments efficiently and profitably. It demands discipline to execute the trip plan, the relentless measurement of results, and the use of such results to generate further execution improvements in the service provided to customers. It also aims to increase velocity, improve reliability, lower costs, enhance asset utilization and, ultimately, help the Company to grow the top line. The Company maintains that philosophy today and works hard to run more efficient trains, reduce dwell times at terminals and improve overall network velocity. With CN's business model, fewer railcars and locomotives are needed to ship the same amount of freight in a tight, reliable and efficient operation. The railroad is run based on a disciplined operating methodology, executing with a sense of urgency and accountability. This philosophy has been a key contributor to CN's earnings growth and improved return on invested capital. The Company has also set its sights on becoming a true supply chain enabler by helping to elevate service performance end-to-end. CN is pursuing better end-to-end service and greater operating efficiencies while helping customers win in their own markets. While CN is a leader in fast and reliable service hub-to-hub, the Company strives to distinguish itself by bringing greater value to the entire range of customer touch points. The Company continues to strengthen its commitment to operational and service excellence through a wide range of innovations anchored on its continuous improvement philosophy. CN's major push in first-mile/last-mile activities is all about quality interaction with customers – from developing a sharper outside-in perspective to better monitoring of traffic forecasts; from the Company's car management distribution activities to higher and more responsive car order fulfillment; and from improving customer communication to iAdvise (proactive customer communication system at the local level). CN's broad-based service innovations benefit customers and support the Company's goal to grow the business faster than the overall economy. CN understands the importance of being the best operator in the business, and being the best service innovator as well. Service excellence means expanding CN's perspective, working more closely, and building on mutual trust, with customers and supply chain customers as well as involving all relevant areas of the Company in the process. The success of the business model is dependent on commercial principles and a supportive regulatory environment, both of which are key to an effective rail transportation marketplace throughout North America.

### Providing quality service, controlling costs and focusing on asset utilization

The basic driver of the Company's business is demand for reliable, efficient, and cost effective transportation. As such, the Company's focus is the pursuit of its long-term business plan, delivering operational and service excellence by providing a high level of service to customers while operating safely and efficiently, and meeting short- and long-term financial commitments.

In 2014, the Company expects North American industrial production to increase in the range of three to four percent as well as continued improvements in U.S. housing starts and U.S. automotive sales. For the 2014/2015 crop year, the Company assumes Canadian and U.S. grain production to be in line with their respective five-year averages.

To meet its business plan objectives, the Company's priority is to grow the business at low incremental cost. The Company's strategy to pursue deeper customer engagement and service improvements is expected to continue to drive growth. Improvements are coming from several key thrusts including first-mile/last-mile initiatives that improve customer service at origin and destination, and a supply chain perspective that emphasizes collaboration and better end-to-end service. The Company sees opportunities for growth across most markets, led by energy-related

commodities, particularly crude oil and frac sand; by overseas container traffic; by market share gains against truck in domestic intermodal; by a continued recovery in the U.S. housing market; as well as by strong offshore grain exports due to a record western Canadian crop. Longer term, the Company expects continued growth in offshore export markets including metallurgical and thermal coal as well as potash.

To grow the business at low incremental cost and to operate efficiently and safely while maintaining a high level of customer service, the Company continues to invest in capital programs to maintain a safe and fluid railway and pursue strategic initiatives to improve its franchise, as well as undertake productivity initiatives to reduce costs and leverage its assets. Opportunities to improve productivity extend across all functions in the organization. Train productivity is being improved through the acquisition of locomotives that are more fuel-efficient than the ones they replace, which will also improve service reliability for customers and reduce greenhouse gas emissions. In addition, the Company's locomotives are being equipped with distributed power capability, which allows the Company to run longer, more efficient trains, particularly in cold weather conditions, while improving train handling, reducing train separations and improving the overall safety of operations. These initiatives, combined with CN's investments in longer sidings over the years, offer train-mile savings, allow for efficient long-train operations and reduce wear on rail and wheels. Yard throughput is being improved through SmartYard, an innovative use of real-

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time traffic information to sequence cars effectively and get them out on the line more quickly in the face of constantly changing conditions. In Engineering, the Company is continuously working to increase the productivity of its field forces, through better use of traffic information and the optimization of work scheduling and as a result, better management of its engineering forces on the track. The Company also intends to continue focusing on the reduction of accidents and related costs, as well as costs for legal claims and health care. CN's capital expenditure programs support the Company's commitment to its core principles and strategy and its ability to grow the business profitably. In 2014, CN plans to invest approximately \$2.25 billion on capital programs, of which approximately \$1.2 billion is targeted toward maintaining the safety and integrity of the network, particularly track infrastructure. This investment will include the replacement of rail, ties, and other track materials, bridge improvements, as well as various branch line upgrades.

In 2014, CN's equipment capital expenditures are targeted to reach approximately \$350 million, allowing the Company to tap growth opportunities and improve the quality of the fleet. In order to handle expected traffic increase and improve operational efficiency, CN expects to take delivery of 60 new high-horsepower locomotives in 2014, in addition to the 44 new and 37 second-hand high-horsepower locomotives delivered in 2013.

In 2014, CN also expects to spend approximately \$700 million on facilities, such as transloads and distribution centers; to grow the business; and to improve the productivity and fluidity of the network. The investment includes funds for strategic initiatives, information technology to improve service and operating efficiency, and other projects to increase productivity.

To meet short- and long-term financial commitments, the Company pursues a solid financial policy framework with the goal of maintaining a strong balance sheet by monitoring its credit ratios and preserving an investment-grade credit rating to be able to maintain access to public financing. The Company's principal source of liquidity is cash generated from operations, which can be supplemented by its commercial paper program and its accounts receivable securitization program to meet short-term liquidity needs. The Company's primary uses of funds are for working capital requirements, including income tax installments, pension contributions, contractual obligations; capital expenditures relating to track infrastructure and other; acquisitions; dividend payouts; and the repurchase of shares through share buyback programs. The Company sets priorities on its uses of available funds based on short-term operational requirements, expenditures to continue to operate a safe railway and pursue strategic initiatives, while also considering its long-term contractual obligations and returning value to its shareholders.

### Delivering responsibly

The Company's commitment to safety is reflected in the wide range of initiatives that CN is pursuing and in the size of its capital programs. Comprehensive plans are in place to address safety, security, employee well-being and environmental management. CN's Safety Management Plan is the framework for putting safety at the center of its day-to-day operations. This proactive plan is designed to minimize risk and drive continuous improvement in the reduction of injuries and accidents, and engages employees at all levels of the organization.

The Company has made sustainability an integral part of its business strategy by aligning its sustainability agenda with its business model. As part of the Company's comprehensive sustainability action plan and to comply with the CN Environmental Policy, the Company engages in a number of initiatives, including the use of fuel-efficient locomotives that reduce greenhouse gas emissions; increasing operational and building efficiencies; investing in virtualization technologies, energy-efficient data centers and recycling programs for information technology systems; reducing, recycling and reusing waste at its facilities and on its network; engaging in modal shift agreements that favor low emission transport services; and participating in the Carbon Disclosure Project to gain a more comprehensive view of its carbon footprint.

The CN Environmental Policy aims to minimize the impact of the Company's activities on the environment. The Company strives to contribute to the protection of the environment by integrating environmental priorities into the Company's overall business plan and through the specific monitoring and measurement of such priorities against historical performance and in some cases, specific targets. All employees must demonstrate commitment to the CN Environmental Policy at all times and it is the Environment, Safety and Security Committee of the Board of Directors

that has the responsibility of overseeing this policy. This committee's responsibilities, powers and operation are further described in its charter, which is included in the Company's Corporate Governance Manual available on CN's website. Certain risk mitigation strategies, such as periodic audits, employee training programs and emergency plans and procedures, are in place to minimize the environmental risks to the Company.

The CN Environmental Policy, the Company's Carbon Disclosure Project report, and the Corporate Citizenship Report "Delivering Responsibly" are available on CN's website. In 2013, the Company's sustainability practices earned it a place as the leader in the Transportation and Transportation Infrastructure Industry sector of the Dow Jones Sustainability World Index (DJSI). This was the second consecutive year that the Company had been listed on the DJSI World Index and the fifth straight year on the DJSI North American Index.

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## Management's Discussion and Analysis

### Developing people

CN's ability to develop the best railroaders in the industry has been a key contributor to the Company's success. CN recognizes that without the right people – no matter how good a service plan or business model a company may have – it will not be able to fully execute. The Company is focused on recruiting the right people, developing employees with the right skills, motivating them to do the right thing, and training them to be the future leaders of the Company. As part of a new revitalized company-wide training program aimed at preparing railroaders to be highly skilled, safety conscious and confident in their work environment, CN opened a new state-of-the-art training center located in Winnipeg, Manitoba, in April 2014, and another one in suburban Chicago, Illinois, in July 2014. The Company continues to address changes in employee demographics that will span multiple years. The Human Resources and Compensation Committee of the Board of Directors reviews the progress made in developing current and future leaders through the Company's leadership development programs. These programs and initiatives provide a solid platform for the assessment and development of the Company's talent pool. The leadership development programs are tightly integrated with the Company's business strategy.

The forward-looking statements discussed in this MD&A are subject to risks and uncertainties that could cause actual results or performance to differ materially from those expressed or implied in such statements and are based on certain factors and assumptions which the Company considers reasonable, about events, developments, prospects and opportunities that may not materialize or that may be offset entirely or partially by other events and developments. See the section of this MD&A entitled Forward-looking statements for assumptions and risk factors affecting such forward-looking statements.

### Impact of foreign currency translation on reported results

Although the Company conducts its business and reports its earnings in Canadian dollars, a large portion of revenues and expenses is denominated in US dollars. As such, the Company's results are affected by exchange rate fluctuations. Management's discussion and analysis includes reference to "constant currency," which allows the financial results to be viewed without the impact of fluctuations in foreign exchange rates, thereby facilitating period-to-period comparisons in the analysis of trends in business performance. Financial results at constant currency are obtained by translating the current period results denominated in US dollars at the foreign exchange rate of the comparable period of the prior year. The average foreign exchange rates were \$1.09 and \$1.10 per US\$1.00, respectively, for the three and six months ended June 30, 2014, and \$1.02 per US\$1.00 for both the three and six months ended June 30, 2013. Measures at constant currency are considered non-GAAP measures and do not have any standardized meaning prescribed by GAAP and therefore may not be comparable to similar measures presented by other companies.

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Forward-looking statements

Certain information included in this MD&A are "forward-looking statements" within the meaning of the United States Private Securities Litigation Reform Act of 1995 and under Canadian securities laws. CN cautions that, by their nature, forward-looking statements involve risks, uncertainties and assumptions. The Company cautions that its assumptions may not materialize and that current economic conditions render such assumptions, although reasonable at the time they were made, subject to greater uncertainty. These forward-looking statements include, but are not limited to, statements with respect to growth opportunities; statements that the Company will benefit from growth in North American and global economies; the anticipation that cash flow from operations and from various sources of financing will be sufficient to meet debt repayments and future obligations in the foreseeable future; statements regarding future payments, including income taxes and pension contributions; as well as the projected capital spending program. Forward-looking statements could further be identified by the use of terminology such as the Company "believes," "expects," "anticipates," "assumes" or other similar words.

Such forward-looking statements are not guarantees of future performance and involve known and unknown risks, uncertainties and other factors which may cause the actual results or performance of the Company or the rail industry to be materially different from the outlook or any future results or performance implied by such statements. Key assumptions used in determining forward-looking information are set forth below.

Forward-looking statements	Key assumptions or expectations
<p>Statements relating to general economic and business conditions, including those referring to revenue growth opportunities</p>	<ul style="list-style-type: none"> <li>· North American and global economic growth</li> <li>· Long-term growth opportunities being less affected by current economic conditions</li> <li>· Year-over-year carload growth</li> </ul>
<p>Statements relating to the Company's ability to meet debt repayments and future obligations in the foreseeable future, including income tax payments, and capital spending</p>	<ul style="list-style-type: none"> <li>· North American and global economic growth</li> <li>· Adequate credit ratios</li> <li>· Investment grade credit rating</li> <li>· Access to capital markets</li> <li>· Adequate cash generated from operations and other sources of financing</li> </ul>
<p>Statements relating to pension contributions</p>	<ul style="list-style-type: none"> <li>· Adequate cash generated from operations and other sources of financing</li> <li>· Adequate long-term return on investment on pension plan assets</li> <li>· Level of funding as determined by actuarial valuations, particularly influenced by discount rates for funding purposes</li> </ul>

Important risk factors that could affect the forward-looking statements include, but are not limited to, the effects of general economic and business conditions; industry competition; inflation, currency and interest rate fluctuations; changes in fuel prices; legislative and/or regulatory developments; compliance with environmental laws and regulations; actions by regulators; various events which could disrupt operations, including natural events such as severe weather, droughts, floods and earthquakes; labor negotiations and disruptions; environmental claims; uncertainties of investigations, proceedings or other types of claims and litigation; risks and liabilities arising from

derailments; and other risks detailed from time to time in reports filed by CN with securities regulators in Canada and the U.S. See the section of this MD&A entitled Business risks for detailed information on major risk factors.

CN assumes no obligation to update or revise forward-looking statements to reflect future events, changes in circumstances, or changes in beliefs, unless required by applicable Canadian securities laws. In the event CN does update any forward-looking statement, no inference should be made that CN will make additional updates with respect to that statement, related matters, or any other forward-looking statement.

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## Management's Discussion and Analysis

## Financial and statistical highlights

\$ in millions, except per share data or unless otherwise indicated	Three months ended June 30		Six months ended June 30	
	2014	2013	2014	2013
<b>Financial results</b>				
Revenues	\$ 3,116	\$ 2,666	\$ 5,809	\$ 5,132
Operating income	\$ 1,258	\$ 1,042	\$ 2,078	\$ 1,822
Net income (1) (2)	\$ 847	\$ 717	\$ 1,470	\$ 1,272
Operating ratio	59.6 %	60.9 %	64.2 %	64.5 %
Basic earnings per share (1) (2)	\$ 1.03	\$ 0.85	\$ 1.78	\$ 1.50
Diluted earnings per share (1) (2)	\$ 1.03	\$ 0.84	\$ 1.77	\$ 1.49
Dividend declared per share	\$ 0.250	\$ 0.215	\$ 0.500	\$ 0.430
<b>Financial position</b>				
Total assets	\$ 30,634	\$ 27,545	\$ 30,634	\$ 27,545
Total long-term liabilities	\$ 15,069	\$ 13,369	\$ 15,069	\$ 13,369
<b>Statistical operating data and productivity measures (3)</b>				
Employees (average for the period)	24,565	23,926	24,161	23,681
Gross ton miles (GTM) per average number of employees (thousands)	4,732	4,244	9,011	8,355
GTMs per US gallon of fuel consumed	1,035	981	993	964

(1) The figures for the six months ended June 30, 2014 include a gain on disposal of the Deux-Montagnes subdivision of \$80 million, or \$72 million after-tax (\$0.09 per basic or diluted share).

(2) The figures for the three and six months ended June 30, 2013 include a gain on exchange of perpetual railroad operating easements on specific rail lines of \$29 million, or \$18 million after-tax (\$0.02 per basic or diluted share) and an income tax expense of \$5 million (\$0.01 per basic or diluted share) resulting from the enactment of higher provincial corporate income tax rates. The figures for the six months ended June 30, 2013 also include a gain on disposal of a segment of the Oakville subdivision of \$40 million, or \$36 million after-tax (\$0.04 per basic or diluted share).

(3) Based on estimated data available at such time and subject to change as more complete information becomes available.

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## Management's Discussion and Analysis

### Financial results

Second quarter and first half of 2014 compared to corresponding periods in 2013

Second quarter 2014 net income was \$847 million, an increase of \$130 million, or 18%, when compared to the same period in 2013, with diluted earnings per share rising 23% to \$1.03. Net income for the six months ended June 30, 2014 was \$1,470 million, an increase of \$198 million, or 16%, when compared to the same period in 2013, with diluted earnings per share rising 19% to \$1.77.

Included in the results for the six months ended June 30, 2014 was a gain on disposal of the Deux-Montagnes subdivision between Saint-Eustache and Montreal, Quebec, including the Mont-Royal tunnel, together with the rail fixtures (collectively the "Deux-Montagnes"), of \$80 million, or \$72 million after-tax (\$0.09 per diluted share). Included in the results for the three and six months ended June 30, 2013 was a gain on exchange of perpetual railroad operating easements including the track and roadway assets on specific rail lines (collectively the "exchange of easements") in the amount of \$29 million, or \$18 million after-tax (\$0.02 per diluted share) and an income tax expense of \$5 million (\$0.01 per diluted share) resulting from the enactment of higher provincial corporate income tax rates. Also included in the results for the six months ended June 30, 2013 was a gain on disposal of a segment of the Oakville subdivision, together with the rail fixtures and certain passenger agreements (collectively the "Lakeshore West") of \$40 million, or \$36 million after-tax (\$0.04 per diluted share).

Foreign exchange fluctuations have an impact on the comparability of the results of operations. The fluctuation of the Canadian dollar relative to the US dollar, which affects the conversion of the Company's US dollar-denominated revenues and expenses, resulted in a positive impact to net income for the second quarter and first half of 2014 of \$26 million (\$0.03 per diluted share) and \$52 million (\$0.06 per diluted share), respectively.

Revenues for the quarter ended June 30, 2014 totaled \$3,116 million compared to \$2,666 million in the same period in 2013, an increase of \$450 million, or 17%. Revenues for the first half of 2014 were \$5,809 million, an increase of \$677 million, or 13%, when compared to the same period in 2013. The increases were mainly attributable to higher freight volumes due to a record Canadian grain crop, strong energy markets and market share gains, particularly in intermodal; the positive translation impact of the weaker Canadian dollar on US dollar-denominated revenues; and freight rate increases. Fuel surcharge revenues increased by \$34 million in the second quarter and \$46 million in the first six months of 2014 when compared to the same periods in 2013, primarily due to higher freight volumes. Revenues in the second quarter of 2014 also benefited from increased volumes as the Company recovered from winter weather-related challenges that delayed shipments in the first quarter of 2014.

Operating expenses for the second quarter of 2014 amounted to \$1,858 million compared to \$1,624 million in the same quarter of 2013. Operating expenses for the first half of 2014 were \$3,731 million compared to \$3,310 million in the same period of 2013. The increase of \$234 million, or 14%, in the second quarter of 2014 was mainly attributable to the negative translation impact of a weaker Canadian dollar on US dollar-denominated expenses, higher fuel costs, increased labor and fringe benefits expense and increased purchased services and material expense. The increase of \$421 million, or 13%, in the first half of 2014 was mainly attributable to the negative translation impact of a weaker Canadian dollar on US dollar-denominated expenses, operational challenges in the first quarter of 2014 due to an unusually harsh winter resulting in increased purchased services and material expense, and higher fuel costs.

The operating ratio, defined as operating expenses as a percentage of revenues, was 59.6% in the second quarter of 2014, compared to 60.9% in the second quarter of 2013, a 1.3-point improvement. The six-month operating ratio was 64.2% in 2014, compared to 64.5% in 2013, a 0.3-point improvement.

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## Management's Discussion and Analysis

## Revenues

In millions, unless otherwise indicated	Three months ended June 30					Six months ended June 30				
	2014	2013	% Change	% Change at constant currency	%	2014	2013	% Change	% Change at constant currency	%
Rail freight revenues	\$2,942	\$2,493	18	% 14	%	\$5,520	\$4,848	14	% 9	%
Other revenues	174	173	1	% (4	%)	289	284	2	% (3	%)
Total revenues	\$3,116	\$2,666	17	% 13	%	\$5,809	\$5,132	13	% 8	%
Rail freight revenues										
Petroleum and chemicals	\$564	\$481	17	% 12	%	\$1,132	\$942	20	% 14	%
Metals and minerals	370	309	20	% 14	%	678	597	14	% 7	%
Forest products	393	361	9	% 4	%	732	699	5	% (1	%)
Coal	201	192	5	% 2	%	383	362	6	% 2	%
Grain and fertilizers	526	391	35	% 31	%	957	799	20	% 15	%
Intermodal	716	610	17	% 15	%	1,337	1,166	15	% 12	%
Automotive	172	149	15	% 10	%	301	283	6	% -	%
Total rail freight revenues	\$2,942	\$2,493	18	% 14	%	\$5,520	\$4,848	14	% 9	%
Revenue ton miles (RTM) (millions)	60,081	52,702	14	% 14	%	113,415	103,278	10	% 10	%
Rail freight revenue/RTM (cents)	4.90	4.73	4	% -	%	4.87	4.69	4	% -	%

In order to better represent rail freight and related revenues within the commodity groups and maintain non-rail services that support CN's rail business within Other revenues, certain other revenues were reclassified to the commodity groups within rail freight revenues. Revenues earned from trucking intermodal goods were reclassified from Other revenues to the Intermodal commodity group and services that relate to the movement of rail freight were reclassified from Other revenues to the related commodity groups. The 2013 comparative figures have been reclassified in order to be consistent with the 2014 presentation as discussed herein. This change has no impact on the Company's previously reported results of operations as Total revenues remains unchanged.

Revenues for the quarter ended June 30, 2014 totaled \$3,116 million compared to \$2,666 million in the same period in 2013, an increase of \$450 million, or 17%. Revenues for the first half of 2014 were \$5,809 million, an increase of \$677 million, or 13%, when compared to the same period in 2013. The increases were mainly attributable to higher freight volumes due to a record Canadian grain crop, strong energy markets and market share gains, particularly in intermodal; the positive translation impact of the weaker Canadian dollar on US dollar-denominated revenues; and freight rate increases. Fuel surcharge revenues increased by \$34 million in the second quarter and \$46 million in the first six months of 2014 when compared to the same periods in 2013, primarily due to higher freight volumes. Revenues in the second quarter of 2014 also benefited from increased volumes as the Company recovered from winter weather-related challenges that delayed shipments in the first quarter of 2014.

Revenue ton miles (RTM), measuring the relative weight and distance of rail freight transported by the Company, increased by 14% in the second quarter and 10% in the first half of 2014 when compared to the same periods in 2013. Rail freight revenue per revenue ton mile, a measurement of yield defined as revenue earned on the movement of a ton of freight over one mile, increased by 4% in both the second quarter and the first half of 2014, when compared to the same periods in 2013, driven by the positive translation impact of the weaker Canadian dollar and freight rate increases, partly offset by an increase in the average length of haul.

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Petroleum and chemicals

	Three months ended June 30				Six months ended June 30			
	2014	2013	% Change	% Change at constant currency	2014	2013	% Change	% Change at constant currency
Revenues (millions)	\$ 564	\$ 481	17 %	12 %	\$ 1,132	\$ 942	20 %	14 %
RTMs (millions)								