

Management's discussion and analysis (MD&A) relates to the financial condition and results of operations of Canadian National Railway Company (CN or the Company) together with its wholly owned subsidiaries, including the railroads and related holdings of Great Lakes Transportation LLC (GLT) as of May 10, 2004 and BC Rail Partnership and the former BC Rail Ltd. (collectively BC Rail) as of July 14, 2004. As used herein, the word "Company" means, as the context requires, CN and its subsidiaries. CN'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). Prior to 2005, the Company also prepared consolidated financial statements in accordance with Canadian generally accepted accounting principles (Canadian GAAP), which differed in some respects from financial statements in accordance with U.S. GAAP, principally in the treatment of track replacement costs, expenditures relating to improvements of bridges and other structures and freight cars, derivative instruments and stock-based compensation. For 2005, pursuant to the regulations under the Canadian Business Corporations Act, the Company has provided a reconciliation of the U.S. to Canadian GAAP financial statements in Note 21 to the Company's Consolidated Financial Statements. As of 2006, the Company will be reporting solely in accordance with U.S. GAAP. The Company's objective is to provide meaningful and relevant information reflecting the Company's financial condition 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 2005 Annual Consolidated Financial Statements and notes thereto.

Business profile

CN, directly and through its subsidiaries, is engaged in the rail and related transportation business. CN's network of approximately 19,200 route miles of track (at December 31, 2005) spans Canada and mid-America, connecting three coasts: the Atlantic, the Pacific and the Gulf of Mexico. CN's marketing alliances, interline agreements, co-production arrangements and routing protocols, in addition to its extensive network, give 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 diverse origins and destinations. This product and geographic diversity positions the Company well to face economic fluctuations and enhances its potential for growth opportunities. In 2005, no individual commodity group accounted for more than 24% of revenues. CN is equally well diversified from a geographic standpoint. In 2005, 22% of revenues came from U.S. domestic traffic, 33% from transborder traffic, 24% from Canadian domestic traffic and 21% from overseas traffic. The Company originates approximately 87% 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 United States as one business segment. Financial information reported at this level, such as revenues, operating income, operating ratio 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 Canada, Eastern Canada and U.S. regions), whose role is to manage the day-to-day service requirements of their territory, service small customer accounts within their region, control direct costs incurred locally, and execute the corporate strategy and operating plan established by corporate management.

See Note 16 – Segmented information, to the Company's 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 goal is to remain at the forefront of the rail industry and its challenge is to be regarded as the continent's best-performing transportation company.

CN is committed to creating value for both its customers and shareholders. By providing quality and cost-effective service, CN seeks to create value for its customers, which solidifies existing customer relationships, while enabling it to pursue new ones. Sustainable financial performance is a critical element of shareholder value, which CN strives to achieve by pursuing revenue growth, steadily increasing profitability, solid free cash flow generation and an adequate return on investment. CN has a unique business model, which is anchored on five core values: providing good service, controlling costs, focusing on asset utilization, committing to safety and developing employees.

The "scheduled railroad" is the foundation for the Company's business model. For CN's merchandise business, the scheduled

railroad, which is defined as a trip plan for every car measured in hours, has reduced transit times, improved the consistency of CN's transportation product, dramatically improved productivity and helped to improve network capacity. In 2003, the Company began to apply the same principles of scheduled railroading to its intermodal business through the Intermodal Excellence (IMX) initiative. IMX is designed to smooth demand and balance the flow of intermodal traffic through pre-defined daily train capacity, slot, gate and equipment reservations, and day-of-the-week pricing. In early 2005, the Company began applying the additional principles learned from IMX to its carload business, launching Carload Excellence (CX), in order to improve asset utilization and optimize capacity.

CN's acquisition and control of Illinois Central and Wisconsin Central, in 1999 and 2001, respectively, extended the Company's reach into the central and southern United States. Among the benefits of single-line service afforded by these transactions are improved transit and cycle times for freight cars and the penetration of new markets.

The acquisition of GLT in May 2004 has permitted new efficiencies in train operations north of Duluth/Superior in the key Winnipeg-Chicago corridor and positioned CN as a major player in the supply chain for the steel industry in the United States. The purchase of BC Rail in July 2004 not only added to CN's forest products business substantially, but also expanded the railroad's capacity in British Columbia.

In 2006, the Company plans to spend approximately \$1,525 million on capital programs. Of this, more than \$1,000 million is targeted for rail infrastructure integrity and safety maintenance, including rail, tie, ballast, and other track material replacements, as well as bridges and signaling systems upgrades. This allotment also includes strategic initiatives, such as siding extensions in western Canada; the reconfiguration of Johnston Yard in Memphis, Tennessee for increased network fluidity and efficiency; and investments in the Company's Prince Rupert, B.C. corridor, to capitalize on the Port of Prince Rupert's potential as an important traffic gateway between Asia and the North American heartland.

The remaining \$500 million is targeted for equipment expenditures, including new locomotive and car purchases, plus existing fleet refurbishments; as well as for facilities, information technology and other projects. These will enable the Company to tap new growth opportunities and improve overall efficiency.

The Company strives to offer transportation services that deliver value to its customers. It does so with the belief that better service benefits customers while improving CN's yields, operating efficiency and earnings. The Company foresees a number of business-growth opportunities. In the Intermodal area, there is growth potential in international markets because of increasing North American-Asian container trade, as well as the projected 2007 opening of the Prince Rupert container terminal. In the Bulk

area, western Canadian growth prospects are enhanced by continued coal mine expansion. In Merchandise, the Company sees growth potential for a number of commodities, particularly wood products and metals. The Company's business prospects are based on the continuation of positive economic trends in North America and Asia.

The Company foresees improvements in productivity, particularly in yards and terminals. The Company also intends to pursue further operating efficiencies by continuing to improve labor productivity and to focus on reducing accidents and related costs, legal claims and health care costs. The Company partners with connecting carriers to implement routing protocol agreements and pursues co-production initiatives to further improve service and generally reduce costs.

Financial and statistical highlights

\$ in millions, except per share data, or unless otherwise indicated

	2005	2004	2003
Financial results			
Revenues	\$ 7,240	\$ 6,548	\$ 5,884
Operating income	\$ 2,624	\$ 2,168	\$ 1,777
Net income	\$ 1,556	\$ 1,258	\$ 1,014
Operating ratio	63.8%	66.9%	69.8%
Basic earnings per share	\$ 5.64	\$ 4.41	\$ 3.54
Diluted earnings per share	\$ 5.54	\$ 4.34	\$ 3.49
Dividend declared per share	\$ 1.00	\$ 0.78	\$ 0.67
Financial position			
Total assets	\$ 22,188	\$ 22,365	\$ 20,337
Total long-term financial liabilities	\$ 10,981	\$ 10,822	\$ 9,928
Statistical operating data and productivity measures			
Employees (average during period)	22,246	22,470	22,012
Gross ton miles (GTM) per average number of employees (thousands)	15,414	14,811	14,246
GTM per U.S. gallon of fuel consumed	851	851	838

Financial Results

2005 compared to 2004

In 2005, net income increased by \$298 million, or 24%, to \$1,556 million, when compared to 2004, with diluted earnings per share rising 28%, to \$5.54. Revenues increased by \$692 million, or 11%, to \$7,240 million, mainly due to freight rate increases, an important part of which was due to a higher fuel surcharge as a result of increases in crude oil prices, the inclusion of a full year of GLT and BC Rail revenues, and a return to normal intermodal volumes following the first quarter 2004 Canadian Auto Workers (CAW) strike. Partly offsetting these gains was the translation impact of the stronger Canadian dollar on U.S. dollar-denominated revenues of \$260 million.

Operating expenses increased by \$236 million, or 5%, to \$4,616 million, primarily due to increased fuel costs, the inclusion of a full year of GLT and BC Rail expenses, and increased purchased services and material costs. Partly offsetting these factors was the translation impact of the stronger Canadian dollar on U.S. dollar-denominated expenses of \$155 million, lower equipment rents, and lower casualty and other expense.

The operating ratio, defined as operating expenses as a percentage of revenues, was 63.8% in 2005 compared to 66.9% in 2004, a 3.1-point betterment.

The years ended December 31, 2005 and 2004 included items affecting the comparability of the results of operations. The Company acquired and consolidated GLT and BC Rail effective May 10, 2004 and July 14, 2004, respectively. Accordingly, in the

discussions herein, the Company's results of operations for 2005 include the results of operations of both GLT and BC Rail. The Company's results for 2004 included the results of operations of GLT as of May 10, 2004 and BC Rail as of July 14, 2004.

In 2005, the continued appreciation in the Canadian dollar relative to the U.S. dollar, which has impacted the conversion of the Company's U.S. dollar-denominated revenues and expenses, resulted in a reduction to net income of approximately \$60 million.

For the year ended December 31, 2004, a first-quarter strike by the Company's employees represented by the CAW union negatively impacted operating income and net income by \$35 million and \$24 million, respectively.

Revenues

<i>Year ended December 31,</i>	2005	2004	% Δ
Total revenues (<i>millions</i>)	\$ 7,240	\$ 6,548	11%
Rail freight:			
Revenues (<i>millions</i>)	\$ 6,905	\$ 6,252	10%
RTMs (<i>millions</i>)	179,701	174,240	3%
Revenue/RTM (<i>cents</i>)	3.84	3.59	7%
Carloads (<i>thousands</i>)	4,841	4,578	6%
Revenue/Carload (<i>dollars</i>)	1,426	1,366	4%

Revenues for the year ended December 31, 2005 totaled \$7,240 million compared to \$6,548 million in 2004. The increase of \$692 million, or 11%, was mainly due to freight rate increases, an important part of which was due to a higher fuel surcharge as a result of increases in crude oil prices, the inclusion of a full year of GLT and BC Rail revenues, and a return to normal intermodal volumes following the first-quarter 2004 CAW strike. Partly offsetting these gains was the translation impact of the stronger Canadian dollar on U.S. dollar-denominated revenues.

In 2005, revenue ton miles, measuring the volume of rail freight transported by the Company, increased by 3% relative to 2004. 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 7% for 2005 when compared to 2004, largely due to freight rate increases.

Petroleum and chemicals

<i>Year ended December 31,</i>	2005	2004	% Δ
Revenues (<i>millions</i>)	\$ 1,096	\$ 1,059	3%
RTMs (<i>millions</i>)	31,235	31,421	(1%)
Revenue/RTM (<i>cents</i>)	3.51	3.37	4%

Petroleum and chemicals comprise a wide range of commodities, including chemicals, sulfur, plastics, petroleum and gas products. Although offshore markets have been growing strongly, the primary markets for these commodities are still within North America. As such, the performance of this commodity group is closely correlated with the North American economy. Most of the Company's petroleum and chemicals shipments originate in the Louisiana petrochemical corridor between New Orleans and Baton Rouge; in northern Alberta, which is a major center for natural gas, feedstock, and petrochemicals and plastics complex derivatives; and in eastern Canadian regional plants; and are destined for customers in Canada, the United States and overseas. For the year ended December 31, 2005, revenues for this commodity group increased by \$37 million, or 3%, from 2004. The improvement was mainly due to freight rate increases, the inclusion of a full year of BC Rail revenues, and an improved market position in petroleum products.

These gains were partly offset by the translation impact of the stronger Canadian dollar, soft market conditions for plastics and liquefied petroleum gases, continued weakness in the U.S. molten sulfur market and reduced shipments of U.S. petrochemicals. Freight revenue per revenue ton mile increased by 4% as freight rate increases were partly offset by the translation impact of the stronger Canadian dollar.

	Percentage of revenues
Chemicals	40%
Petroleum	60%

	2001	2002	2003	2004	2005
Carloads* (<i>In thousands</i>)	474	543	564	596	594

*Includes Wisconsin Central Transportation Corporation (WC) from October 9, 2001, GLT from May 10, 2004 and BC Rail from July 14, 2004.

Metals and minerals

<i>Year ended December 31,</i>	2005	2004	% Δ
Revenues (<i>millions</i>)	\$ 837	\$ 714	17%
RTMs (<i>millions</i>)	16,848	16,352	3%
Revenue/RTM (<i>cents</i>)	4.97	4.37	14%

The metals and minerals commodity group consists primarily of nonferrous base metals, iron ore, steel, equipment and parts and construction materials. The Company's unique rail access to major mines, ports and smelters throughout North America has made the Company a transportation leader of copper, lead, zinc concentrates, iron ore, refined metals and aluminum. Construction materials are mainly aggregates (stone and sand) and cement. The Company has access to major cement producers and aggregate mines in Canada as well as in the U.S. Metals and minerals traffic is sensitive to fluctuations in the economy. For the year ended December 31, 2005, revenues for this commodity group increased by \$123 million, or 17%, from 2004. The increase was mainly due to freight rate increases, the inclusion of a full year of GLT and BC Rail revenues, strong shipments of construction materials, aluminum and Canadian steel products, and an improvement in traffic mix. Partly offsetting these gains was the translation impact of the stronger Canadian dollar. Revenue per revenue ton mile increased by 14% in 2005, mainly due to shorter-haul traffic, particularly related to GLT, and freight rate increases. Partly offsetting these factors was the translation impact of the stronger Canadian dollar.

	Percentage of revenues
Metals	53%
Minerals	24%
Iron ore	23%

	2001	2002	2003	2004	2005
Carloads*	287	388	396	801	994

(In thousands)

*Includes WC from October 9, 2001, GLT from May 10, 2004 and BC Rail from July 14, 2004.

Forest products

	Year ended December 31,	2005	2004	% Δ
Revenues (millions)	\$	1,738	\$ 1,505	15%
RTMs (millions)		42,330	39,369	8%
Revenue/RTM (cents)		4.11	3.82	8%

The forest products commodity group includes various types of lumber, panels, wood chips, wood pulp, printing paper, linerboard and newsprint. The Company has superior rail access to the western and eastern Canadian fiber-producing regions, which are among the largest fiber source areas in North America. In the United States, the Company is strategically located to serve both the midwest and southern U.S. corridors with interline capabilities to other Class I railroads. The key drivers for the various commodities are: for newsprint, advertising lineage and overall economic conditions, primarily in the United States; for fibers (mainly wood pulp), the consumption of paper worldwide; and for lumber and panels, housing starts and renovation activities in the United States. Although demand for forest products can be cyclical, the Company's geographical advantages and product diversity tend to reduce the impact of market fluctuations. For the year ended December 31, 2005, revenues for this commodity group increased by \$233 million, or 15%, from 2004. The increase was mainly due to freight rate increases, continued solid demand for Canadian lumber and panels, the inclusion of a full year of BC Rail revenues, improvements in traffic mix and an improved market position for paper. The translation impact of the stronger Canadian dollar partly offset these gains. Revenue per revenue ton mile increased by 8% in 2005 mainly due to freight rate increases and a positive change in traffic mix, which were partly offset by the translation impact of the stronger Canadian dollar.

	Percentage of revenues
Lumber	33%
Fibers	39%
Paper	16%
Panels	12%

	2001	2002	2003	2004	2005
Carloads*	523	626	618	678	712

(In thousands)

*Includes WC from October 9, 2001, GLT from May 10, 2004 and BC Rail from July 14, 2004.

Coal

	Year ended December 31,	2005	2004	% Δ
Revenues (millions)	\$	331	\$ 284	17%
RTMs (millions)		13,576	12,684	7%
Revenue/RTM (cents)		2.44	2.24	9%

The coal commodity group consists primarily of thermal grades of bituminous coal. Canadian thermal coal is delivered to power utilities primarily in eastern Canada, while in the United States, thermal coal is transported from mines served in southern Illinois, or from western U.S. mines via interchange with other railroads, to major utilities in the midwest and southeast United States. The coal business also includes the transport of Canadian metallurgical coal, which is largely exported to Asian steel producers. The strong global market for metallurgical coal facilitated the opening of three mines along the Company's network in late 2004. The renewed strength in this market is expected to continue as strong Asian demand for metallurgical coal drives increased Canadian production. For the year ended December 31, 2005, revenues for this commodity group increased by \$47 million, or 17%, from 2004. The increase was mainly due to new metallurgical coal mines in western Canada, freight rate increases and the inclusion of a full year of GLT and BC Rail revenues. Partly offsetting these gains was the translation impact of the stronger Canadian dollar. The revenue per revenue ton mile increase of 9% was mainly due to freight rate increases, which were partly offset by the translation impact of the stronger Canadian dollar.

	Percentage of revenues
Coal	83%
Petroleum coke	17%

	2001	2002	2003	2004	2005
Carloads*	459	435	406	429	448

(In thousands)

*Includes WC from October 9, 2001, GLT from May 10, 2004 and BC Rail from July 14, 2004.

Grain and fertilizers

	Year ended December 31,		
	2005	2004	% Δ
Revenues (millions)	\$ 1,119	\$ 1,063	5%
RTMs (millions)	40,393	40,091	1%
Revenue/RTM (cents)	2.77	2.65	5%

The grain and fertilizers commodity group depends primarily on crops grown and fertilizers processed in western Canada and the U.S. midwest. The grain segment consists of three primary commodities: food grains, mainly wheat; oilseeds and oilseed products, primarily canola seed, oil and meal; and feed grains, including feed barley, feed wheat and corn. Production of grain varies considerably from year to year, affected primarily by weather conditions. Grain exports are volatile, reflecting the size and quality of the crop produced, international market conditions and foreign government policy. The majority of grain produced in western Canada and moved by CN is exported via the ports of Vancouver, Prince Rupert and Thunder Bay. Certain of these rail movements are subject to government regulation and to a "revenue cap," which effectively establishes a maximum revenue entitlement that railways can earn. In the U.S., grain grown in Illinois and Iowa is exported, as well as transported to domestic processing facilities and feed markets. The Company also serves major producers of potash in Canada, as well as producers of ammonium nitrate, urea and other fertilizers across Canada and the U.S. For the year ended December 31, 2005, revenues for this commodity group increased by \$56 million, or 5%, from 2004. The increase was mainly due to freight rate increases, higher export shipments of U.S. corn in a generally weak market, increased shipments of Canadian barley and canola and an improvement in traffic mix. These gains were partly offset by the translation impact of the stronger Canadian dollar and the decreased availability of high-quality Canadian wheat for export markets via west coast ports. Revenue per revenue ton mile increased by 5% in 2005 largely due to freight rate increases and a positive change in traffic mix, partly offset by the translation impact of the stronger Canadian dollar.

Percentage of revenues

Food grain	25%
Oilseeds	24%
Feed grain	27%
Fertilizers	12%
Potash	12%

	2001	2002	2003	2004	2005
Carloads* (In thousands)	593	539	552	577	566

*Includes WC from October 9, 2001, GLT from May 10, 2004 and BC Rail from July 14, 2004.

Intermodal

	Year ended December 31,		
	2005	2004	% Δ
Revenues (millions)	\$ 1,270	\$ 1,117	14%
RTMs (millions)	32,184	31,002	4%
Revenue/RTM (cents)	3.95	3.60	10%

The intermodal commodity group is comprised of two segments: domestic and international. The domestic segment is responsible for consumer products and manufactured goods, operating through both retail and wholesale channels while the international segment handles import and export container traffic, directly serving the major ports of Vancouver, Montreal, Halifax and New Orleans. The domestic segment is driven by consumer markets, with growth generally tied to the economy. The international segment is driven by North American economic and trade conditions. For the year ended December 31, 2005, revenues for this commodity group increased by \$153 million, or 14%, from 2004. The increase was mainly due to freight rate increases, strong imports into the Port of Vancouver and an improvement in traffic mix. Also contributing to the increase during the year was the return to normal traffic levels following the first-quarter 2004 CAW strike. Partly offsetting these gains were the translation impact of the stronger Canadian dollar and a change in port of call for an overseas shipper. The revenue per revenue ton mile increase of 10% in 2005 was largely due to freight rate increases and a positive change in traffic mix, which were partly offset by the translation impact of the stronger Canadian dollar and an increase in the average length of haul.

Percentage of revenues

Domestic	50%
International	50%

	2001	2002	2003	2004	2005
Carloads* (In thousands)	1,061	1,237	1,276	1,202	1,248

*Includes WC from October 9, 2001, GLT from May 10, 2004 and BC Rail from July 14, 2004.

Automotive

<i>Year ended December 31,</i>	2005	2004	% Δ
Revenues (<i>millions</i>)	\$ 514	\$ 510	1%
RTMs (<i>millions</i>)	3,135	3,321	(6%)
Revenue/RTM (<i>cents</i>)	16.40	15.36	7%

The automotive commodity group moves both finished vehicles and parts, originating in southern Ontario, Michigan and Mississippi, and destined for the United States, Canada and Mexico. The Company's broad coverage, including its access to all of the Canadian assembly plants, enables it to consolidate full trainloads of automotive traffic for delivery to connecting railroads at key interchange points. The Company also serves shippers of import vehicles via the ports of Halifax and Vancouver, and through interchange with other railroads. The Company's automotive revenues are closely correlated to automotive production and sales in North America. For the year ended December 31, 2005, revenues for this commodity group increased by \$4 million, or 1%, from 2004. The increase was driven by freight rate increases, higher import vehicles via the Ports of Vancouver and Halifax, and the benefit of new finished vehicle traffic in the southern U.S. that began in the second half of 2004. These gains were partly offset by the translation impact of the stronger Canadian dollar and a reduction in automotive production at CN-served facilities in southern Ontario and Michigan. Revenue per revenue ton mile increased 7% in 2005 largely due to freight rate increases, which were partly offset by the translation impact of the stronger Canadian dollar.

Percentage of revenues

Finished vehicles	82%
Auto parts	18%

	2001	2002	2003	2004	2005
Carloads*	288	307	288	295	279
<i>(In thousands)</i>					

*Includes WC from October 9, 2001, GLT from May 10, 2004 and BC Rail from July 14, 2004.

Other

In 2005, other revenues increased by \$39 million, when compared to 2004, mainly due to the inclusion of a full year of revenues from GLT's maritime division.

Operating expenses

Operating expenses amounted to \$4,616 million in 2005 compared to \$4,380 million in 2004. The increase of \$236 million, or 5%, in 2005 was mainly due to increased fuel costs, the inclusion of a full year of GLT and BC Rail expenses and increased purchased services and material costs. Partly offsetting these factors was the translation impact of the stronger Canadian dollar on U.S. dollar-denominated expenses, lower equipment rents, and lower casualty and other expense.

<i>In millions</i>	<i>Year ended December 31,</i>		<i>2005</i>		<i>2004</i>	
	<i>Amount</i>	<i>% of revenue</i>	<i>Amount</i>	<i>% of revenue</i>	<i>Amount</i>	<i>% of revenue</i>
Labor and fringe benefits	\$ 1,841	25.4%	\$ 1,819	27.8%	\$ 1,819	27.8%
Purchased services and material	814	11.2%	746	11.4%	746	11.4%
Depreciation and amortization	627	8.7%	598	9.1%	598	9.1%
Fuel	725	10.0%	528	8.1%	528	8.1%
Equipment rents	192	2.7%	244	3.7%	244	3.7%
Casualty and other	417	5.8%	445	6.8%	445	6.8%
<i>Total</i>	<i>\$ 4,616</i>	<i>63.8%</i>	<i>\$ 4,380</i>	<i>66.9%</i>	<i>\$ 4,380</i>	<i>66.9%</i>

Labor and fringe benefits: Labor and fringe benefits includes wages, payroll taxes, and employee benefits such as incentive compensation, stock-based compensation, health and welfare, pensions and other post-employment benefits. Certain incentive and stock-based compensation plans are based on financial and market performance targets and the related expense is recorded in the period in which there is an expectation that the targets will be attained. Labor and fringe benefits increased by \$22 million, or 1%, in 2005 as compared to 2004. The increase was attributable to higher stock-based compensation expense, the inclusion of a full year of GLT and BC Rail expenses, wage increases and a return to normal wage levels following the first-quarter 2004 CAW strike. Partly offsetting these factors was the translation impact of the stronger Canadian dollar, the impact of a reduced workforce, and adjustments made in 2004 to the workforce reduction provision.

Purchased services and material: Purchased services and material primarily includes the costs of services purchased from outside contractors, materials used in the maintenance of the Company's track, facilities and equipment, transportation and lodging for train crew employees, utility costs and the net costs of operating facilities jointly used by the Company and other railroads. These expenses increased by \$68 million, or 9%, in 2005 as compared to 2004. The increase was primarily due to the inclusion of a full year of GLT and BC Rail expenses, and higher expenses for material and maintenance on rolling stock and track repairs. These factors were partly offset by the translation impact of the stronger Canadian dollar.

Depreciation and amortization: Depreciation and amortization relates to the Company's rail operations. These expenses increased by \$29 million, or 5%, in 2005 as compared to 2004. The increase was mainly due to the impact of net capital additions and to the inclusion of a full year of GLT and BC Rail depreciation expense,

which were partly offset by the translation impact of the stronger Canadian dollar.

Fuel: Fuel expense includes the cost of fuel consumed by locomotives, intermodal equipment and other vehicles. These expenses increased by \$197 million, or 37%, in 2005 as compared to 2004. The increase was mainly due to a 32% increase in the average price per U.S. gallon of fuel, net of the benefits from CN's fuel hedging program, from \$1.30 in 2004 to \$1.72 in 2005; higher volumes, particularly in the first quarter; the inclusion of a full year of GLT and BC Rail fuel expense; and a second-quarter 2004 fuel excise tax refund. Partly offsetting these factors was the translation impact of the stronger Canadian dollar.

Equipment rents: Equipment rents includes rental expense for the use of freight cars owned by other railroads or private companies and for the short- or long-term lease of freight cars, locomotives and intermodal equipment, net of rental income from other railroads for the use of the Company's cars and locomotives. These expenses decreased by \$52 million, or 21%, in 2005 as compared to 2004. The decrease was mainly due to lower car hire expense and higher car hire income, mainly as a result of the integration of the BC Rail fleet, and the translation impact of the stronger Canadian dollar. These factors were partly offset by higher car lease expense due to an increased fleet size, higher rates and the inclusion of a full year of BC Rail car lease expense.

Casualty and other: Casualty and other includes expenses for personal injuries, environmental, freight and property damage, insurance, bad debt and operating taxes, as well as travel and travel-related expenses. These expenses decreased by \$28 million, or 6%, in 2005 as compared to 2004. The decrease was mainly due to a reduction to the provision for U.S. personal

injuries following the 2005 actuarial valuation, a 2004 adjustment made to the provision for personal injuries in Canada and the translation impact of the stronger Canadian dollar. Partly offsetting these factors were higher derailment-related expenses, in particular, \$28 million related to the incident at Wabamun Lake (See Note 18 – Major commitments and contingencies, to the Company's Annual Consolidated Financial Statements), the inclusion of a full year of GLT and BC Rail expenses and higher property taxes in the U.S.

Other

Interest expense: Interest expense increased by \$5 million, or 2%, for the year ended December 31, 2005 as compared to 2004, mainly due to the financing related to the Company's acquisitions in 2004 and higher interest rates on commercial paper borrowings. Partly offsetting these factors was the translation impact of the stronger Canadian dollar and the benefit of the repayment of matured Notes in March 2004 and May 2005.

Other income (loss): In 2005, the Company recorded income of \$12 million compared to a loss of \$20 million in 2004. The change from loss to income in 2005 was due to improvements in real estate and other business activities, realized foreign exchange gains and a first-quarter 2004 restructuring charge related to the Company's investment in English Welsh and Scottish Railway (EWS). Partly offsetting these factors were lower investment income, lower gains on disposal of surplus properties, and higher costs related to the securitization program.

Income tax expense: The Company recorded income tax expense of \$781 million for the year ended December 31, 2005 compared to \$596 million in 2004. The effective tax rate for the year ended December 31, 2005 was 33.4% compared to 32.1% in 2004. The increase in the effective tax rate was mainly due to higher provincial tax rates enacted in the current year.

2004 compared to 2003

In 2004, net income increased by \$244 million, or 24%, to \$1,258 million, when compared to 2003, with diluted earnings per share rising 24%, to \$4.34. Revenues increased by \$664 million, or 11%, to \$6,548 million, due to the inclusion of \$351 million of GLT and BC Rail revenues, core business growth in a strong North American economy, and an improved Canadian grain crop, which were partly offset by the translation impact of the stronger Canadian dollar on U.S. dollar-denominated revenues of \$255 million.

Operating expenses increased by \$273 million, or 7%, to \$4,380 million, driven mainly by the inclusion of \$228 million of GLT and BC Rail expenses, higher labor and fringe benefits,

increased fuel costs and higher casualty and other expense, which were partly offset by the translation impact of the stronger Canadian dollar on U.S. dollar-denominated expenses of \$170 million and lower equipment rents.

The operating ratio, defined as operating expenses as a percentage of revenues, was 66.9% in 2004 compared to 69.8% in 2003, a 2.9-point betterment.

The results for the year ended December 31, 2004 included the results of operations of GLT as of May 10, 2004 and BC Rail as of July 14, 2004. Also in 2004, a strike by the Company's employees represented by the CAW in the first quarter, negatively impacted operating income and net income by \$35 million and \$24 million, respectively. The significant appreciation in the Canadian dollar relative to the U.S. dollar impacted the conversion of the Company's U.S. dollar-denominated revenues and expenses, resulting in a reduction to net income of approximately \$45 million for 2004.

For the year ended December 31, 2003, the Company's results of operations included a fourth-quarter deferred income tax expense of \$79 million resulting from the enactment of higher corporate tax rates in the province of Ontario. Also included in 2003 was a cumulative benefit of \$75 million, \$48 million after tax, resulting from a change in the accounting for removal costs for certain track structure assets pursuant to the requirements of Statement of Financial Accounting Standards (SFAS) No. 143, "Accounting for Asset Retirement Obligations," as explained in Note 2 - Accounting changes, to the Company's Annual Consolidated Financial Statements. This change in policy results in lower depreciation expense and higher labor and fringe benefits and other expenses in the period in which removal costs are incurred. For the year ended December 31, 2003, this change in policy resulted in an increase to net income of \$2 million (\$0.01 per basic and diluted share).

2004 compared to 2003 – Adjusted performance measures

The year ended December 31, 2003 included items impacting the comparability of the results of operations (see reconciliation of adjusted performance measures presented herein).

In 2003, the Company recorded a fourth-quarter deferred income tax expense of \$79 million resulting from the enactment of higher corporate tax rates and a cumulative benefit of \$75 million, \$48 million after tax, as discussed herein.

Excluding these items, net income was \$1,258 million (\$4.41 per basic share or \$4.34 per diluted share) in 2004 compared to adjusted net income of \$1,045 million (\$3.65 per basic share or \$3.60 per diluted share) in 2003, an increase of \$213 million, or 20%.

Reconciliation of adjusted performance measures

Management believes that non-GAAP measures such as adjusted net income and the resulting adjusted performance measures for such items as operating income, operating ratio and per share data are useful measures of performance that can facilitate period-to-period comparisons as they exclude items that do not arise as part of the normal day-to-day operations or that could potentially distort the analysis of trends in business performance. The exclusion of specified items in the adjusted measures below does not imply that they are necessarily non-recurring. These adjusted measures do not have any standardized meaning prescribed by GAAP and may, therefore, not be comparable to similar measures presented by other companies. The reader is advised to read all information provided in the MD&A in conjunction with the Company's Annual Consolidated Financial Statements and notes thereto.

In millions, except per share data, or unless otherwise indicated

Year ended December 31,	2004		2003		
	Reported	Reported	Change in policy	Rate enactment	Adjusted
Revenues	\$ 6,548	\$ 5,884	\$ -	\$ -	\$ 5,884
Operating expenses	4,380	4,107	-	-	4,107
Operating income	2,168	1,777	-	-	1,777
Interest expense	(294)	(315)	-	-	(315)
Other income (loss)	(20)	21	-	-	21
Income before income taxes and cumulative effect of change in accounting policy	1,854	1,483	-	-	1,483
Income tax expense	(596)	(517)	-	79	(438)
Income before cumulative effect of change in accounting policy	1,258	966	-	79	1,045
Cumulative effect of change in accounting policy, net of applicable taxes	-	48	(48)	-	-
Net income	\$ 1,258	\$ 1,014	\$ (48)	\$ 79	\$ 1,045
Operating ratio	66.9%	69.8%			69.8%
Basic earnings per share	\$ 4.41	\$ 3.54			\$ 3.65
Diluted earnings per share	\$ 4.34	\$ 3.49			\$ 3.60

Revenues

Year ended December 31,	2004	2003	% Δ
Total revenues (millions)	\$ 6,548	\$ 5,884	11%
Rail freight:			
Revenues (millions)	\$ 6,252	\$ 5,694	10%
RTMs (millions)	174,240	162,152	7%
Revenue/RTM (cents)	3.59	3.51	2%
Carloads (thousands)	4,578	4,100	12%
Revenue/Carload (dollars)	1,366	1,389	(2%)

Revenues for the year ended December 31, 2004 totaled \$6,548 million compared to \$5,884 million in 2003. The increase of \$664 million, or 11%, was mainly due to the inclusion of GLT and BC Rail revenues of \$351 million, strong merchandise revenue, an improved Canadian grain crop, and a higher fuel surcharge. Partly offsetting these gains was the translation impact of the stronger Canadian dollar on U.S. dollar-denominated revenues. Revenue ton miles, measuring the volume of freight transported by the Company, increased by 7% relative to 2003. Freight revenue per

revenue ton mile increased by 2% when compared to 2003. In 2004, freight revenue per revenue ton mile was positively affected by freight rate increases and an overall decrease in the average length of haul, and was negatively affected by the translation impact of the stronger Canadian dollar.

Petroleum and chemicals

Year ended December 31,	2004	2003	% Δ
Revenues (millions)	\$ 1,059	\$ 1,013	5%
RTMs (millions)	31,421	29,693	6%
Revenue/RTM (cents)	3.37	3.41	(1%)

Revenues for the year ended December 31, 2004 increased by \$46 million, or 5%, from 2003. The increase was due to freight rate improvements in several key segments, particularly in the first half of the year, the inclusion of \$25 million of BC Rail revenues (primarily sulfur), higher offshore demand for Canadian sulfur, a shift from offshore to Canadian suppliers for petroleum gas and a higher fuel surcharge. These gains were partly offset

by the translation impact of the stronger Canadian dollar. Freight revenue per revenue ton mile decreased by 1% due to the translation impact of the stronger Canadian dollar, partly offset by freight rate improvements and a decrease in the average length of haul.

Metals and minerals

<i>Year ended December 31,</i>	2004	2003	% Δ
Revenues (<i>millions</i>)	\$ 714	\$ 527	35%
RTMs (<i>millions</i>)	16,352	13,873	18%
Revenue/RTM (<i>cents</i>)	4.37	3.80	15%

Revenues for the year ended December 31, 2004 increased by \$187 million, or 35%, from 2003. The increase is mainly due to the inclusion of \$126 million of GLT revenues, higher volumes of iron ore, largely from new business, freight rate improvements, and increased shipments of raw materials and metal bars. Partly offsetting these gains was the translation impact of the stronger Canadian dollar. Revenue per revenue ton mile increased by 15% in 2004, mainly due to GLT shorter-haul traffic, which was partly offset by the translation impact of the stronger Canadian dollar.

Forest products

<i>Year ended December 31,</i>	2004	2003	% Δ
Revenues (<i>millions</i>)	\$ 1,505	\$ 1,320	14%
RTMs (<i>millions</i>)	39,369	35,483	11%
Revenue/RTM (<i>cents</i>)	3.82	3.72	3%

Revenues for the year ended December 31, 2004 increased by \$185 million, or 14%, from 2003. The increase was largely due to the inclusion of \$85 million of BC Rail revenues (mainly lumber and panels), continued solid demand for lumber, freight rate improvements and a higher fuel surcharge. The translation impact of the stronger Canadian dollar partly offset these gains. Revenue per revenue ton mile increased by 3% in 2004 as the benefit of freight rate improvements and a positive change in traffic mix were partly offset by the translation impact of the stronger Canadian dollar.

Coal

<i>Year ended December 31,</i>	2004	2003	% Δ
Revenues (<i>millions</i>)	\$ 284	\$ 261	9%
RTMs (<i>millions</i>)	12,684	13,044	(3%)
Revenue/RTM (<i>cents</i>)	2.24	2.00	12%

Revenues for the year ended December 31, 2004 increased by \$23 million, or 9%, from 2003. The increase was due to higher coal

shipments to U.S. utilities and the inclusion of GLT and BC Rail revenues of \$20 million, partly offset by metallurgical mine closures in western Canada and the translation impact of the stronger Canadian dollar. The revenue per revenue ton mile increase of 12% was mainly due to a decrease in the average length of haul and a positive change in traffic mix that were partly offset by the translation impact of the stronger Canadian dollar.

Grain and fertilizers

<i>Year ended December 31,</i>	2004	2003	% Δ
Revenues (<i>millions</i>)	\$ 1,063	\$ 947	12%
RTMs (<i>millions</i>)	40,091	35,666	12%
Revenue/RTM (<i>cents</i>)	2.65	2.66	-

Revenues for the year ended December 31, 2004 increased by \$116 million, or 12%, from 2003. The increase reflects higher Canadian wheat and barley exports, which was partly offset by weak shipments of U.S. soybeans due to tight supply, a shift in exports from the Gulf to the Pacific Northwest and the translation impact of the stronger Canadian dollar. Revenue per revenue ton mile remained flat as the benefit of freight rate improvements was offset by an increase in the average length of haul and the translation impact of the stronger Canadian dollar.

Intermodal

<i>Year ended December 31,</i>	2004	2003	% Δ
Revenues (<i>millions</i>)	\$ 1,117	\$ 1,101	1%
RTMs (<i>millions</i>)	31,002	31,168	(1%)
Revenue/RTM (<i>cents</i>)	3.60	3.53	2%

Revenues for the year ended December 31, 2004 increased by \$16 million, or 1%, from 2003. Revenues for 2004 benefited from heavy import volumes through the Port of Vancouver, freight rate improvements and a higher fuel surcharge. Revenues were negatively affected by the first-quarter 2004 CAW strike, the closure of the Company's smaller terminal facilities in the U.S., the discontinuance of the Roadrailer service and the translation impact of the stronger Canadian dollar. Revenue per revenue ton mile increased by 2% in 2004 driven by a positive change in traffic mix and freight rate improvements that were partly offset by an increase in the average length of haul and the translation impact of the stronger Canadian dollar.

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Automotive

<i>Year ended December 31,</i>	2004	2003	% Δ
Revenues (<i>millions</i>)	\$ 510	\$ 525	(3%)
RTMs (<i>millions</i>)	3,321	3,225	3%
Revenue/RTM (<i>cents</i>)	15.36	16.28	(6%)

Revenues for the year ended December 31, 2004 decreased by \$15 million, or 3%, from 2003. The decrease was due to the translation impact of the stronger Canadian dollar that was partly offset by the benefit of new finished vehicle traffic that began in late 2003. Revenue per revenue ton mile decreased by 6% in 2004 due to the translation impact of the stronger Canadian dollar.

Other

In 2004, other revenues increased by \$106 million, when compared to 2003, mainly due to revenues from GLT's maritime division of \$90 million.

Operating expenses

Operating expenses amounted to \$4,380 million in 2004 compared to \$4,107 million in 2003. The increase of \$273 million, or 7%, in 2004 was mainly due to the inclusion of \$228 million of GLT and BC Rail expenses, higher expenses for labor and fringe benefits, increased fuel costs and higher casualty and other expense. Partly offsetting the increase was the translation impact of the stronger Canadian dollar on U.S. dollar-denominated expenses and lower equipment rents. The month-long CAW strike had a minimal impact on overall operating expenses for the year ended December 31, 2004 as the benefit from lower labor and fringe benefit expenses was mostly offset by increases in other expense categories.

<i>In millions</i>	Year ended December 31,		2003	
	2004	% of revenue	2003	% of revenue
Labor and fringe benefits	\$ 1,819	27.8%	\$ 1,698	28.9%
Purchased services and material	746	11.4%	703	11.9%
Depreciation and amortization	598	9.1%	554	9.4%
Fuel	528	8.1%	469	8.0%
Equipment rents	244	3.7%	293	5.0%
Casualty and other	445	6.8%	390	6.6%
Total	\$ 4,380	66.9%	\$ 4,107	69.8%

Labor and fringe benefits: Labor and fringe benefits in 2004 increased by \$121 million, or 7%, as compared to 2003. The increase was attributable to the inclusion of GLT and BC Rail labor expense of \$91 million, higher wages and employee benefits, including increased costs for stock-based compensation, and charges and adjustments relating to the workforce reduction provision. Partly offsetting these factors were the translation impact of the stronger Canadian dollar, the effects of a reduced workforce, lower expenses for pensions and other post-retirement benefits and wage and benefits savings during the CAW strike.

Purchased services and material: Purchased services and material expenses in 2004 increased by \$43 million, or 6%, as compared to 2003. The increase was due to the inclusion of \$77 million of GLT and BC Rail expenses, higher repair and maintenance expenses, partly related to the CAW strike, and other strike-related costs. Partly offsetting the increase was the translation impact of the stronger Canadian dollar and lower net expenses for operating joint facilities.

Depreciation and amortization: Depreciation and amortization expenses in 2004 increased by \$44 million, or 8%, as compared to 2003. The increase was mainly due to the inclusion of GLT and BC Rail expenses of \$30 million and the impact of net capital additions, partly offset by the translation impact of the stronger Canadian dollar.

Fuel: Fuel expense in 2004 increased by \$59 million, or 13%, as compared to 2003. The increase was mainly due to a higher average price per U.S. gallon, net of the benefits from CN's fuel hedging program, the inclusion of GLT and BC Rail expenses of \$21

million and higher volumes. The increase was partly offset by the translation impact of the stronger Canadian dollar, increased productivity and a fuel excise tax refund in the second quarter.

Equipment rents: Equipment rents in 2004 decreased by \$49 million, or 17%, as compared to 2003. The decrease was due to higher car hire income, including that of BC Rail, the translation impact of the stronger Canadian dollar and a reduction in car hire expenses that were partly offset by higher lease expense for freight cars.

Casualty and other: Casualty and other expenses in 2004 increased by \$55 million, or 14%, as compared to 2003. The increase was due to higher expenses for personal injuries, the inclusion of GLT and BC Rail expenses of \$14 million, increased environmental expenses and favorable adjustments to U.S. property taxes in 2003. Partly offsetting the increase was the translation impact of the stronger Canadian dollar.

Other

Interest expense: Interest expense decreased by \$21 million, or 7%, for the year ended December 31, 2004 as compared to 2003 as the benefit of lower interest rates on issued debt to replace matured debt and the translation impact of the stronger Canadian dollar were partly offset by interest expense on debt related to the Company's acquisitions in 2004.

Other income (loss): In 2004, the Company recorded a loss of \$20 million compared to income of \$21 million in 2003. The change from income to loss in 2004 was due to lower gains on

disposal of surplus properties and lower equity income from the Company's investment in EWS as a result of restructured operations.

Income tax expense: The Company recorded income tax expense of \$596 million for the year ended December 31, 2004 compared to \$517 million in 2003. The effective tax rate for the year ended

December 31, 2004 was 32.1% compared to 34.9% in 2003. The decrease in the effective tax rate in 2004 was mainly due to higher deferred income tax expense in 2003 resulting from the enactment of higher corporate tax rates in the province of Ontario, which was partly offset by net favorable adjustments relating to the resolution of matters pertaining to prior years' income taxes.

Summary of quarterly financial data - unaudited

In millions, except per share data

	2005 Quarters				2004 Quarters			
	Fourth	Third	Second	First	Fourth	Third	Second	First
Revenues	\$ 1,886	\$ 1,810	\$ 1,838	\$ 1,706	\$ 1,736	\$ 1,709	\$ 1,665	\$ 1,438
Operating income	\$ 720	\$ 665	\$ 713	\$ 526	\$ 607	\$ 591	\$ 575	\$ 395
Net income	\$ 430	\$ 411	\$ 416	\$ 299	\$ 376	\$ 346	\$ 326	\$ 210
Basic earnings per share	\$ 1.59	\$ 1.50	\$ 1.50	\$ 1.06	\$ 1.32	\$ 1.21	\$ 1.14	\$ 0.74
Diluted earnings per share	\$ 1.56	\$ 1.47	\$ 1.47	\$ 1.04	\$ 1.29	\$ 1.19	\$ 1.13	\$ 0.73
Dividend declared per share	\$ 0.250	\$ 0.250	\$ 0.250	\$ 0.250	\$ 0.195	\$ 0.195	\$ 0.195	\$ 0.195

Revenues generated by the Company during the year are influenced by seasonal weather conditions, general economic conditions, cyclical demand for rail transportation, and competitive forces in the transportation marketplace. Operating expenses reflect the impact of freight volumes, seasonal weather conditions, labor costs, fuel prices, and the Company's productivity initiatives.

The Company's quarterly results included items that affect the quarter-over-quarter comparability of the results of operations. The Company's results of operations for 2004 included GLT as of May 10, 2004 and BC Rail as of July 14, 2004. First-quarter 2004 results were affected by the month-long CAW strike, which negatively impacted operating income and net income by \$35 million and \$24 million, respectively. The continued appreciation in the Canadian dollar relative to the U.S. dollar has impacted the conversion of the Company's U.S. dollar-denominated revenues and expenses and resulted in varying reductions in net income in the rolling eight quarters presented above.

Liquidity and capital resources

The Company's principal source of liquidity is cash generated from operations. The Company also has the ability to fund liquidity requirements through its revolving credit facility, the issuance of debt and/or equity, and the sale of a portion of its accounts receivable through a securitization program. In addition, from time to time, the Company's liquidity requirements can be supplemented by the disposal of surplus properties and the monetization of assets.

Operating activities: Cash provided from operating activities was \$2,705 million for the year ended December 31, 2005 compared to \$2,139 million for 2004. Net cash receipts from customers and other were \$7,375 million for the year ended December 31, 2005 compared to \$6,501 million in 2004. In 2005, payments for employee services, suppliers and other expenses were \$3,872 million, an increase of \$244 million when compared to 2004. Also

consuming cash in 2005 were payments for interest, workforce reductions and personal injury and other claims of \$306 million, \$87 million and \$92 million, respectively, compared to \$282 million, \$93 million and \$106 million, respectively, in 2004. In 2005, pension contributions and payments for income taxes were \$127 million and \$186 million, respectively, compared to \$161 million and \$92 million, respectively, in 2004. The Company increased the level of accounts receivable sold under its accounts receivable securitization program by \$54 million in 2005 and \$12 million in 2004. Payments in 2006 for workforce reductions are expected to be \$49 million, while pension contributions are expected to be approximately \$100 million.

As at December 31, 2005, the Company had outstanding information technology service contracts of \$18 million.

Investing activities: Cash used by investing activities in 2005 amounted to \$1,075 million compared to \$2,411 million in 2004. The Company's investing activities in 2005 included net proceeds

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of £26 million (Cdn\$61 million) related to the Company's 8% note receivable from EWS. The Company's investing activities in 2004 included \$984 million related to the acquisition of BC Rail and \$547 million related to the acquisition of GLT, net proceeds of \$141 million from the EWS capital reorganization and \$52 million from the sale of its Canac Inc. and Beltpack subsidiaries. Net capital expenditures for the year ended December 31, 2005 amounted to \$1,180 million, an increase of \$108 million over 2004. The following table details capital expenditures for 2005 and 2004.

<i>In millions</i>	<i>Year ended December 31,</i>	2005	2004
Track and roadway	\$	868	\$ 769
Rolling stock		338	253
Buildings		125	132
Other		71	78
Capital expenditures		1,402	1,232
<i>Less: capital leases</i>		222	160
Net capital expenditures	\$	1,180	\$ 1,072

The Company expects to spend approximately \$1,525 million on capital expenditures in 2006 due to increased expenditures required for ongoing renewal of the basic plant, the acquisition of rolling stock and other acquisitions and investments required to improve the Company's operating efficiency and customer service.

As at December 31, 2005, the Company had commitments to acquire railroad ties, rail, freight cars, locomotives and other equipment at an aggregate cost of \$578 million (\$194 million at December 31, 2004).

Dividends: During 2005, the Company paid dividends totaling \$275 million to its shareholders at the quarterly rate of \$0.25 per share compared to \$222 million at the quarterly rate of \$0.195 per share, in 2004.

Free cash flow

The Company generated \$1,301 million of free cash flow for the year ended December 31, 2005, compared to \$1,025 million in 2004. Free cash flow does not have any standardized meaning prescribed by GAAP and may, therefore, 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 after the payment of capital expenditures and dividends. The Company defines free cash flow as cash provided from operating activities, excluding changes in the level of accounts receivable sold under the securitization program, less investing activities and dividends paid, and adjusted for significant acquisitions as they are not indicative of normal day-to-day investments in the Company's asset base, calculated as follows:

<i>In millions</i>	<i>Year ended December 31,</i>	2005	2004
Cash provided from operating activities		\$ 2,705	\$ 2,139
<i>Less:</i>			
Investing activities		(1,075)	(2,411)
Dividends paid		(275)	(222)
Cash provided (used) before financing activities		1,355	(494)
<i>Adjustments:</i>			
Change in accounts receivable sold		(54)	(12)
Acquisition of BC Rail		-	984
Acquisition of GLT		-	547
Free cash flow		\$ 1,301	\$ 1,025

Financing activities: Cash used by financing activities totaled \$1,440 million for the year ended December 31, 2005 compared to cash provided from financing activities of \$511 million in 2004. In May 2005, the Company repaid U.S.\$100 million (Cdn\$125 million) of 7.75% 10-year Notes with cash on hand. In July 2004, the Company issued U.S.\$300 million (Cdn\$395 million) of 4.25% Notes due 2009 and U.S.\$500 million (Cdn\$658 million) of 6.25% Debentures due 2034. In March 2004, the Company had repaid U.S.\$266 million (Cdn\$355 million) of 7.00% 10-year Notes with cash on hand and the proceeds received from the issuance of commercial paper. In 2005 and 2004, issuances and repayments of long-term debt related principally to the Company's commercial paper program.

During 2005, the Company recorded \$222 million in assets it acquired through equipment leases (\$160 million in 2004), for which an equivalent amount was recorded in debt.

In 2005, the Company repurchased 18.0 million common shares under its share repurchase programs; 8.0 million common shares for \$670 million (average price of \$83.81 per share) under its new 16.0 million share repurchase program and 10.0 million common shares for \$748 million (average price of \$74.78 per share) under its previous 14.0 million share repurchase program, which was completed by the second quarter of 2005. In 2004, the Company used \$273 million to repurchase 4.0 million common shares under its 14.0 million share repurchase program.

CN's debt-to-total capitalization ratio was 35.5% at December 31, 2005, compared to 35.7% at December 31, 2004. As at December 31, 2005, the adjusted debt-to-total capitalization ratio was 41.1% compared to 40.9% at December 31, 2004. Management believes that adjusted debt-to-total capitalization is a useful measure of performance and aims to show the true leverage of the Company. However, since this adjusted measure does not have any standardized meaning prescribed by GAAP, it may not be comparable to similar measures presented by other companies and, as such, should not be considered in isolation.

	Year ended December 31,	
	2005	2004
Debt-to-total capitalization ratio (a)	35.5%	35.7%
Add:		
Present value of operating lease commitments and securitization financing (b)	5.6%	5.2%
Adjusted debt-to-total capitalization ratio (c)	41.1%	40.9%

- (a) Debt-to-total capitalization is calculated as total long-term debt plus current portion of long-term debt divided by the sum of debt plus total shareholders' equity.
- (b) The operating lease commitments have been discounted using the Company's implicit interest rate for each of the years presented.
- (c) Adjusted debt-to-total capitalization is calculated as adjusted debt (total long-term debt plus current portion of long-term debt plus the present value of operating lease commitments and securitization financing) divided by the sum of adjusted debt plus total shareholders' equity.

The Company has access to various financing arrangements:

Revolving credit facility

In March 2005, the Company refinanced, by way of amendment, its U.S.\$1,000 million revolving credit facility, which was scheduled to mature in December 2005, for a five-year period to March 2010. The credit facility is available for general corporate purposes, including back-stopping the Company's commercial paper program, and provides for borrowings at various interest rates, including the Canadian prime rate, bankers' acceptance rates, the U.S. federal funds effective rate and the London Interbank Offer Rate, plus applicable margins. The amended credit facility agreement retained one financial covenant, the customary limitation on debt as a percentage of total capitalization, with which the Company has been in compliance. The Company's borrowings under its previous revolving credit facility of U.S.\$90

million (Cdn\$108 million) outstanding at December 31, 2004 (average interest rate of 2.77%) were entirely repaid in the first quarter of 2005. At December 31, 2005, the Company had borrowings under its revolving credit facility of U.S.\$15 million (Cdn\$17 million) at an interest rate of 4.66% and letters of credit drawn of \$316 million.

Commercial paper

The Company has a commercial paper program, which is backed by a portion of its revolving credit facility, enabling it to issue commercial paper up to a maximum aggregate principal amount of \$800 million, or the U.S. dollar equivalent. Commercial paper debt is due within one year but is classified as long-term debt, reflecting the Company's intent and contractual ability to refinance the short-term borrowings through subsequent issuances of commercial paper or drawing down on the long-term revolving credit facility. As at December 31, 2005, the Company had U.S.\$367 million (Cdn\$427 million) of commercial paper outstanding at an average interest rate of 4.40%, and U.S.\$211 million (Cdn\$254 million) at an average rate of 2.37%, as at December 31, 2004.

Shelf prospectus and registration statement

On October 29, 2005, the Company's shelf prospectus and registration statement filed in October 2003 expired with an unused balance of U.S.\$200 million.

The Company's access to current and alternate sources of financing at competitive costs is dependent on its credit rating. The Company is not currently aware of any adverse trend, event or condition that would affect the Company's credit rating.

Contractual obligations

In the normal course of business, the Company incurs contractual obligations. The following table sets forth the Company's contractual obligations for the following items as at December 31, 2005:

<i>In millions</i>	Total	2006	2007	2008	2009	2010	2011 & thereafter
Long-term debt obligations (a)	\$ 4,214	\$ 296	\$ 58	\$ 203	\$ 351	\$ 444	\$ 2,862
Interest on long-term debt obligations	4,399	253	234	224	217	188	3,283
Capital lease obligations (b)	1,231	159	154	71	113	54	680
Operating lease obligations	1,058	238	196	165	136	103	220
Purchase obligations (c)	596	446	54	49	29	18	-
Other long-term liabilities reflected on the balance sheet (d)	1,083	103	72	59	51	44	754
Total obligations	\$ 12,581	\$ 1,495	\$ 768	\$ 771	\$ 897	\$ 851	\$ 7,799

(a) Presented net of unamortized discounts, of which \$836 million relates to non-interest bearing notes due in 2094 assumed as part of the BC Rail acquisition and excludes capital lease obligations of \$1,231 million which are included in "Capital lease obligations."

(b) Includes \$360 million of imputed interest on capital leases at rates ranging from approximately 3.00% to 13.13%.

(c) Includes commitments for railroad ties, rail, freight cars, locomotives and other equipment and outstanding information technology service contracts.

(d) Includes expected payments for workers' compensation, workforce reductions, post-retirement benefits and environmental liabilities that have been classified as contractual settlement agreements.

For 2006 and the foreseeable future, the Company expects cash flow from operations and from its various sources of financing to be sufficient to meet its debt repayments and future obligations, and to fund anticipated capital expenditures.

Acquisitions

The Company completed its acquisitions of GLT and BC Rail on May 10, 2004 and July 14, 2004, respectively.

The Company accounted for the acquisitions using the purchase method of accounting as required by SFAS No.141, "Business Combinations," and SFAS No. 142, "Goodwill and Other Intangible Assets." As such, the consolidated financial statements of the Company include the assets, liabilities and results of operations of GLT and BC Rail as of the dates of acquisition, May 10, 2004 and July 14, 2004, respectively. The Company's GLT acquisition cost of U.S.\$395 million (Cdn\$547 million) and BC Rail acquisition cost of \$991 million, included purchase price adjustments and transaction costs.

The Company had estimated, on a preliminary basis, the fair value of GLT's and BC Rail's assets acquired, owned and leased, and liabilities assumed at acquisition based on then current available information. The Company has since finalized the allocations of the GLT and BC Rail purchase price and has not made any significant adjustments to the preliminary purchase price allocations. See Note 3 – Acquisitions, to the Company's Annual Consolidated Financial Statements for the final fair values of BC Rail's and GLT's assets acquired, owned and leased, and liabilities assumed at acquisition.

Investment in English Welsh and Scottish Railway (EWS)

In January 2004, EWS shareholders had approved a plan to reduce the EWS share capital to enable cash to be returned to the shareholders by offering them the ability to cancel a portion of their EWS shares in exchange for a combination of cash and notes receivable. The Company elected to have the maximum allowable number of shares cancelled under the plan, thereby reducing its ownership interest in EWS to approximately 31% on a fully diluted basis (13.7 million shares) compared to approximately 37% on a fully diluted basis (43.7 million shares) prior to the capital reorganization. In the first quarter of 2004, the Company received £57.7 million (Cdn\$141 million) in cash and an 8% note receivable due 2009 of £23.9 million (Cdn\$58 million) from EWS. In April 2005, EWS fully redeemed the Company's note receivable. The Company received £26 million (Cdn\$61 million), which included principal and accrued but unpaid interest to the date of redemption.

Off balance sheet arrangements

Accounts receivable securitization program

The Company has an accounts receivable securitization program, expiring in June 2006, under which it may sell, on a revolving

basis, eligible freight trade and other receivables outstanding at any point in time, to an unrelated trust. The Company has a contingent residual interest of approximately 10% of receivables sold, which is recorded in Other current assets.

In February 2005, the Company amended the agreement to increase the maximum amount it may sell from \$450 million to \$500 million and modified certain reporting requirements.

The Company is subject to customary reporting requirements for which failure to perform could result in termination of the program. In addition, the trust is subject to customary credit rating requirements, which if not met, could also result in termination of the program. The Company monitors these reporting and credit rating requirements for any trends, events or conditions that could cause such termination.

The accounts receivable securitization program provides the Company with readily available short-term financing for general corporate use. In the event the program is terminated before its scheduled maturity, the Company expects to meet its future payment obligations through its various sources of financing, including its revolving credit facility and commercial paper program, and/or access to capital markets.

At December 31, 2005, pursuant to the agreement, \$489 million had been sold compared to \$445 million at December 31, 2004.

Guarantees and indemnifications

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

The nature of these guarantees or indemnifications, the maximum potential amount of future payments, the carrying amount of the liability, if any, and the nature of any recourse provisions are disclosed in Note 18 – Major commitments and contingencies, to the Company's Annual Consolidated Financial Statements.

Financial instruments

The Company has limited involvement with derivative financial instruments and does not use them for trading purposes. Collateral or other security to support financial instruments subject to credit risk is usually not obtained. While the Company is exposed to counterparty credit risk in the event of non-performance, the credit standing of counterparties or their guarantors is regularly monitored, and losses due to counterparty non-performance are not anticipated.

Fuel

To mitigate the effects of fuel price changes on its operating margins and overall profitability, the Company has a hedging program which calls for entering into swap positions on crude and heating oil to cover a target percentage of future fuel consumption up to two years in advance. However, with an increased application of fuel surcharge on revenues, no additional swap positions were entered into since September 2004 and the Company has now suspended this program. At December 31, 2005, the Company's remaining hedge positions covered approximately 17% of the estimated 2006 fuel consumption, representing approximately 69 million U.S. gallons at an average price of U.S.\$0.89 per U.S. gallon.

Realized gains from the Company's fuel hedging activities were \$177 million, \$112 million and \$49 million for the years ended December 31, 2005, 2004 and 2003, respectively.

At December 31, 2005, Accumulated other comprehensive loss included unrealized gains of \$57 million, \$39 million after tax (\$92 million, \$62 million after tax at December 31, 2004), which relate to derivative instruments that will mature within the next year and are presented in Other current assets.

Interest rate

In the first quarter of 2004, in anticipation of future debt issuances, the Company had entered into treasury lock transactions for a notional amount of U.S.\$380 million to fix the treasury component on these future debt issuances. The Company settled these treasury locks at a gain of U.S.\$9 million (Cdn\$12 million) upon the pricing of the U.S.\$500 million 6.25% Debentures due 2034, subsequently issued on July 9, 2004. These derivatives were accounted for as cash flow hedges whereby the cumulative change in the market value of the derivative instruments was recorded in Other comprehensive loss. The realized gain of \$12 million accumulated in other comprehensive income (loss) is being recorded into income, as a reduction of interest expense, over the term of the debt based on the interest payment schedule.

At December 31, 2005, Accumulated other comprehensive loss included an unamortized gain of \$12 million, \$8 million after tax (\$12 million, \$8 million after tax at December 31, 2004).

Recent accounting pronouncement

In December 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123(R), "Share-Based Payment," which requires expensing of all options issued, modified or settled based on the grant-date fair value, over the period during which an employee is required to provide service (vesting period). The standard also requires that cash settled awards be measured at fair value at each reporting date until ultimate settlement. In April 2005, the U.S. Securities and Exchange Commission extended the effective application date of this standard from interim or annual reporting periods beginning after June 15, 2005 to annual reporting periods beginning after December 15, 2005. The Company has elected to apply the modified prospective approach, which requires compensation cost to be recognized for unvested awards based on their grant-date fair value. The Company does not expect this standard to have a significant impact on its results of operations.

Common stock

Share repurchase programs

In July 2005, the Board of Directors of the Company approved a share repurchase program which allows for the repurchase of up to 16.0 million common shares between July 25, 2005 and July 24, 2006 pursuant to a normal course issuer bid, at prevailing market prices. As at December 31, 2005, 8.0 million common shares had been repurchased for \$670 million, at an average price of \$83.81 per share.

The Company's previous share repurchase program, initiated in 2004, allowed for the repurchase of up to 14.0 million common shares between November 1, 2004 and October 31, 2005 pursuant to a normal course issuer bid, at prevailing market prices. By the second quarter of 2005, the Company had completed this share repurchase program, repurchasing 14.0 million common shares for \$1,021 million, at an average price of \$72.94 per share (10.0 million and 4.0 million in 2005 and 2004, respectively).

Outstanding share data

As at January 24, 2006, the Company had 268.4 million common shares outstanding.

Common stock split

On January 24, 2006, the Board of Directors of the Company approved a two-for-one common stock split which is to be effected in the form of a stock dividend of one additional common share of CN for each share outstanding, payable on February 28, 2006, to shareholders of record on February 22,

2006. All equity-based benefit plans and the current share repurchase program will be adjusted to reflect the issuance of additional shares or options due to the declaration of the stock split. All share and per share data for future periods will reflect the stock split.

Critical accounting policies

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of revenues and expenses during the period, the reported amounts of assets and liabilities, and the disclosure of contingent assets and liabilities at the date of the financial statements. On an ongoing basis, management reviews its estimates, including those related to personal injury and other claims, environmental claims, depreciation, pensions and other post-retirement benefits, and income taxes, based upon currently available information. Actual results could differ from these estimates. The following accounting policies require management's more significant judgments and estimates in the preparation of the Company's consolidated financial statements and, as such, are considered to be critical. The following information should be read in conjunction with the Company's Annual Consolidated Financial Statements and notes thereto.

Management discusses the development and selection of the Company's critical accounting estimates with the Audit Committee of the Company's Board of Directors, and the Audit Committee has reviewed the Company's related disclosures.

Personal injury and other claims

In the normal course of its operations, the Company becomes involved in various legal actions, including claims relating to personal injuries, occupational disease and damage to property.

In Canada, employee injuries are governed by the workers' compensation legislation in each province whereby employees may be awarded either a lump sum or future stream of payments depending on the nature and severity of the injury. Accordingly, the Company accounts for costs related to employee work-related injuries based on actuarially developed estimates of the ultimate cost associated with such injuries, including compensation, health care and administration costs. 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.

At December 31, 2005, 2004 and 2003, the Company's provision for personal injury and other claims in Canada was as follows:

<i>In millions</i>	2005	2004	2003
Balance January 1,	\$ 204	\$ 169	\$ 183
Accruals and other	46	64	25
Payments	(45)	(29)	(39)
Balance December 31,	\$ 205	\$ 204	\$ 169

Assumptions used in estimating the ultimate costs for Canadian employee injury claims consider, among others, the discount rate, the rate of inflation, wage increases and health care costs. The Company periodically reviews its assumptions to reflect currently available information. Over the past three years, the Company has not significantly changed any of these assumptions. For all other legal claims in Canada, estimates are based on case history, trends and judgment.

In the United States, employee work-related injuries, including occupational disease claims, are compensated according to the provisions of the Federal Employers' Liability Act (FELA), which requires either the finding of fault through the U.S. jury system or individual settlements, and represent a major liability for the railroad industry. The Company follows an actuarial-based approach and accrues the expected cost for personal injury and property damage claims and asserted and unasserted occupational disease claims, based on actuarial estimates of their ultimate cost. Prior to 2005, the Company's provisions for unasserted occupational disease claims constituted the minimum amount that could be reasonably estimated, reflecting a 25-year horizon as the Company expected that a large majority of the cases would be received over such period. In 2005, changes in the legislative and judicial environment, as well as in the methodology used by the courts and the Company to diagnose claims, enabled the Company to actuarially determine a best estimate for unasserted occupational disease claims, thereby increasing the expected number of claims to be received. These changes have also rendered the recent claim experience to be more representative of future anticipated settlements for asserted occupational disease claims, thereby reducing the average cost per claim. Accordingly, the Company recorded an increase in the provision for unasserted occupational disease claims, which was substantially offset by a reduction in the provision for asserted occupational disease claims.

Due to the inherent uncertainty involved in projecting future events related to occupational diseases, which include but are not limited to, the number of expected claims, the average cost per claim and the legislative and judicial environment, the Company's future obligations may differ from current amounts recorded.

At December 31, 2005, 2004 and 2003, the Company's provision for U.S. personal injury and other claims was as follows:

<i>In millions</i>		2005		2004		2003
Balance January 1,	\$	438	\$	421	\$	481
Accruals and other		61		94		27
Payments		(47)		(77)		(87)
Balance December 31,	\$	452	\$	438	\$	421

For the U.S. personal injury and other claims liability, historical claim data is used to formulate assumptions relating to the expected number of claims and average cost per claim (severity) for each year. Changes in any one of these assumptions could materially affect Casualty and other expense as reported in the Company's results of operations. For example, a 5% change in the number of claims or severity would have the effect of changing the provision by approximately \$30 million and the annual expense by approximately \$5 million.

Environmental claims

Regulatory compliance

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. As a result, the Company incurs significant compliance and capital costs, on an ongoing basis, associated with environmental regulatory compliance and clean-up requirements in its railroad operations and relating to its past and present ownership, operation or control of real property. Environmental expenditures that relate to current operations are expensed unless they relate to an improvement to the property. Expenditures that relate to an existing condition caused by past operations and which are not expected to contribute to current or future operations are expensed.

Known existing environmental concerns

The Company is subject to environmental clean-up and enforcement actions. In particular, the Federal Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA), also known as the Superfund law, as well as similar state laws generally impose joint and several liability for clean-up and enforcement costs on current and former owners and operators of a 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 17 sites governed by Superfund (and other similar Federal and 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 known contaminated sites cannot be definitely established, and the estimated environmental liability for any given site may vary depending on the nature and extent of the contamination, the available clean-up techniques, the Company's share of the costs and evolving regulatory standards governing environmental liability. As a result, liabilities are recorded based on the results of a four-phase assessment conducted on a site-by-site basis. Cost scenarios established by external consultants based on extent of contamination and expected costs for remedial efforts are used by the Company to estimate the costs related to a particular site. A liability is initially recorded when environmental assessments occur and/or remedial efforts are likely, and when 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. Adjustments to initial estimates are recorded as additional information becomes available. Based on the information currently available, the Company considers its provisions to be adequate.

In the third quarter of 2005, the Company recorded an expense of \$28 million, of which \$25 million was for environmental matters, related to the derailment at Wabamun Lake, Alberta, as explained in Note 18 – Major commitments and contingencies, to the Company's Annual Consolidated Financial Statements. This amount represents the Company's retention under its insurance policies and other uninsured costs. The ultimate liability for clean-up costs could differ from the current amount recorded, but such a change is expected to be offset by a corresponding change in the insurance receivable.

At December 31, 2005, most of the Company's properties not acquired through recent acquisitions have reached the final assessment stage and therefore costs related to such sites have been anticipated. The final assessment stage can span multiple years. For properties acquired through recent acquisitions, the Company obtains assessments from both external and internal consultants and a liability has been or will be accrued based on such assessments.

Unknown existing environmental concerns

The Company's ongoing efforts to identify potential environmental concerns that may be associated with its properties may lead to future environmental investigations, which may result in the identification of additional environmental costs and liabilities. The magnitude of such additional liabilities and costs cannot be reasonably estimated due to:

- (i) the lack of specific technical information available with respect to many sites;
- (ii) the absence of any government authority, third-party orders, or claims with respect to particular sites;

(iii) 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;

(iv) the ability to recover costs from any third parties with respect to particular sites;

and as such, costs related to future remediation will be accrued in the period they become known.

Future occurrences

In railroad and related transportation operations, it is possible that derailments, explosions or other accidents may occur that could cause harm to human health or to the environment. As a result, the Company may incur costs in the future, which may be material, to address any such harm, including costs relating to the performance of clean-ups, natural resource damages and compensatory or punitive damages relating to harm to individuals or property.

In 2005, the Company's expenses relating to environmental matters, net of recoveries, were \$34 million (\$10 million in 2004 and \$6 million in 2003). Payments for such matters were \$24 million, net of potential insurance recoveries for 2005 (\$8 million in 2004 and \$12 million in 2003). As at December 31, 2005, the Company had aggregate accruals for environmental costs of \$124 million (\$113 million as at December 31, 2004). The Company anticipates that the majority of the liability will be paid out over the next five years.

Depreciation

Railroad properties are carried at cost less accumulated depreciation including asset impairment write-downs. The Company follows the group method of depreciation for railroad properties and, as such, depreciates the cost of railroad properties, less net salvage value, on a straight-line basis over their estimated useful lives. In addition, under the group method of depreciation, the cost of railroad properties, less net salvage value, retired or disposed of in the normal course of business, is charged to accumulated depreciation.

Assessing the reasonableness of the estimated useful lives of properties requires judgment and is based on currently available information, including periodic depreciation studies conducted by the Company. The Company's U.S. properties are subject to comprehensive depreciation studies conducted by external consultants as required by the Surface Transportation Board (STB). Depreciation studies for Canadian properties are not required by regulation and are therefore conducted internally. Studies are performed on specific asset groups on a periodic basis. The studies consider, among others, the analysis of historical

retirement data using recognized life analysis techniques, and the forecasting of asset life characteristics. Changes in circumstances, such as technological advances, changes to the Company's business strategy, changes in the Company's capital strategy or changes in regulations can result in the actual useful lives differing from the Company's estimates.

A change in the remaining useful life of a group of assets, or their estimated net salvage, will affect the depreciation rate used to amortize the group of assets and thus affect depreciation expense as reported in the Company's results of operations. A change of one year in the composite useful life of the Company's fixed asset base would impact annual depreciation expense by approximately \$13 million.

Depreciation studies are a means of ensuring that the assumptions used to estimate the useful lives of particular asset groups are still valid and where they are not, they serve as the basis to establish the new depreciation rates to be used on a prospective basis. In 2004, the Company conducted a comprehensive study for its Canadian properties and certain U.S. rolling stock and equipment. The study did not have a significant impact on depreciation expense. In 2006, the Company expects to complete a depreciation study for certain U.S. rolling stock and equipment.

In 2005, the Company recorded total depreciation and amortization expense of \$630 million (\$602 million in 2004 and \$560 million in 2003). At December 31, 2005, the Company had Properties of \$20,078 million, net of accumulated depreciation of \$9,347 million (\$19,715 million in 2004, net of accumulated depreciation of \$9,232 million).

Pensions and other post-retirement benefits

The Company has several pension plans with measurement dates of December 31 for the Canadian plans, and September 30 for the U.S. plans. The descriptions in the following paragraphs pertaining to pensions relate generally to the Company's main pension plan, the CN Pension Plan (the Plan), unless otherwise specified.

The Company accounts for pensions and other post-retirement benefits as required by SFAS No. 87, "Employers' Accounting for Pensions," and SFAS No. 106, "Employers' Accounting for Post-retirement Benefits Other Than Pensions," respectively. Under these accounting standards, assumptions are made regarding the valuation of benefit obligations and performance of plan assets. Deferred recognition of differences between actual results and those assumed is a guiding principle of these standards. This approach allows for a gradual recognition of changes in benefit obligations and fund performance over the expected average remaining service life of the employee group covered by the plans.

For pensions and other post-retirement benefits, assumptions are required for, among others, the discount rate, the expected long-term rate of return on plan assets, the rate of compensation increase, health care cost trend rates, mortality rates, employee early retirements, terminations and disability. Changes in these assumptions result in actuarial gains or losses which in accordance with SFAS No. 87 and SFAS No. 106, the Company has elected to amortize over the expected average remaining service life of the employee group covered by the plans only to the extent that the unrecognized net actuarial gains and losses are in excess of the corridor threshold, which is calculated as 10% of the greater of the beginning of year balances of the projected benefit obligation or market-related value of plan assets. The future effect on the Company's results of operations is dependent on demographic experience, economic conditions and investment performance. Recent demographic experience has revealed no material net gains or losses on termination, retirement, disability and mortality. Experience with respect to economic conditions and investment performance are further discussed herein.

The Company's discount rate assumption, which is set annually at the end of each year, is used to determine the projected benefit obligation at the end of the year and the net periodic benefit cost for the following year. The discount rate is used to measure the single amount that, if invested at the measurement date in a portfolio of high-quality debt instruments with a rating of AA or better, would provide the necessary cash flows to pay for pension benefits as they become due. The discount rate is determined by management with the aid of third-party actuaries. The Company's methodology for determining the discount rate is based on a zero-coupon bond yield curve, which is derived from a semi-annual bond yield curve provided by a leading Canadian financial institution. The portfolio of hypothetical zero-coupon bonds is expected to generate cash flows that match the estimated future benefit payments of the plans as the bond rate for each maturity year is applied to the plans' corresponding expected benefit payments of that year. A discount rate of 5.0%, based on bond yields prevailing at December 31, 2005 (5.75% at December 31, 2004), was considered appropriate by the Company to match the approximately 12-year average duration of estimated future benefit payments. As a result, in 2006, the Company's net periodic benefit cost for all plans is expected to increase by approximately \$60 million, since the cumulative unrecognized actuarial loss of \$2,145 million, mainly resulting from a decrease in the level of interest rates, was in excess of the plans' corridor threshold as at December 31, 2005. The current estimate for the expected average remaining service life of the employee group covered by the plans is approximately nine years.

For the year ended December 31, 2005, a one-percentage-point decrease in the discount rate used to determine net periodic benefit cost at January 1, 2005 of 5.75%, would have resulted in

an increase of approximately \$131 million in net periodic benefit cost, whereas a one-percentage-point increase would not have caused a material change to net periodic benefit cost as the Company amortizes actuarial gains and losses over the expected average remaining service life of the employee group covered by the plans, only to the extent they are in excess of the corridor threshold.

To develop its expected long-term rate of return assumption used in the calculation of net periodic benefit cost applicable to the market-related value of assets, the Company considers both its past experience and future estimates of long-term investment returns, the expected composition of the plans' assets as well as the expected long-term market returns in the future. The Company has elected to use a market-related value of assets, whereby realized and unrealized gains/losses and appreciation/depreciation in the value of the investments are recognized over a period of five years, while investment income is recognized immediately. If the Company had elected to use the market value of assets, which at December 31, 2005 exceeded the market-related value of Plan assets by approximately \$2,300 million, net periodic benefit cost would decrease by approximately \$50 million for 2005, assuming all other assumptions remained constant. The Company follows a disciplined investment strategy, which limits concentration of investments by asset class, foreign currency, sector or company. The Investment Committee of the Board of Directors has approved an investment policy that establishes long-term asset mix targets based on a review of historical returns achieved by worldwide investment markets. Investment managers may deviate from these targets but their performance is evaluated in relation to the market performance of the target mix. The Company does not anticipate the return on plan assets to fluctuate materially from related capital market indices. The Investment Committee reviews investments regularly with specific approval required for major investments in illiquid securities. The policy also permits the use of derivative financial instruments to implement asset mix decisions or to hedge existing or anticipated exposures. The Plan does not invest in the securities of the Company or its subsidiaries. During the last 10 years ended December 31, 2005, the Plan earned an annual average rate of return of 10.6%. The actual and market-related value rates of return on plan assets for the last five years were as follows:

Rates of return	2005	2004	2003	2002	2001
<i>Actual</i>	20.5%	11.7%	9.6%	(0.3)%	(1.4)%
<i>Market-related value</i>	8.6%	6.3%	7.0%	7.4%	10.2%

For that same period, the Company used a long-term rate of return assumption on the market-related value of plan assets not exceeding 9% to compute net periodic benefit cost. In 2003, the

Company had reduced the expected long-term rate of return on plan assets from 9% to 8% to reflect management's view of long-term investment returns. The effect of this change in management's assumption was to increase annual net periodic benefit cost by approximately \$55 million for all years presented.

Based on the fair value of the assets held as at December 31, 2005, the Plan assets are comprised of 56% in Canadian and foreign equities, 32% in debt securities, 2% in real estate assets and 10% in other assets. The long-term asset allocation percentages are not expected to differ materially from the current composition.

The rate of compensation increase of 3.75%, used to determine both the benefit obligation and the net periodic benefit cost, is another significant assumption in the actuarial model for pension accounting and is determined by the Company based upon its long-term plans for such increases.

For other post-retirement benefits, the Company reviews external data and its own historical trends for health care costs to determine the health care cost trend rates. For measurement purposes, the projected health care cost trend rate for prescription drugs was 14% in the current year, and it is assumed that the rate will decrease gradually to 6% in 2013 and remain at that level thereafter. For the year ended December 31, 2005, a one-percentage-point change in either the rate of compensation increase or the health care cost trend rate would not cause a material change to the Company's net periodic benefit cost for both pensions and other post-retirement benefits.

For pension funding purposes, an actuarial valuation is required at least on a triennial basis. However, the Company has conducted actuarial valuations on an annual basis to account for pensions. The latest actuarial valuation of the CN Pension Plan was conducted as at December 31, 2004 and indicated a funding excess. Total contributions for all of the Company's pension plans are expected to be approximately \$100 million in each of 2006, 2007, and 2008 based on the plans' current position. The assumptions discussed above are not expected to have a significant impact on the cash funding requirements of the pension plans. The Canadian Institute of Actuaries (CIA) has adopted a new standard that will be used to calculate the values that pension plan members are entitled to receive upon termination of employment. This new standard will impact the calculation of the pension plan

liabilities under a solvency or wind-up scenario when the Company conducts an actuarial valuation for purposes of determining the funding position of the Company's Canadian pension plans. The standard, which was effective February 2005, will apply to future actuarial valuations and may significantly impact future funding requirements.

The Company recorded consolidated net periodic benefit cost for pensions of \$17 million, \$22 million and \$49 million in 2005, 2004 and 2003, respectively. Consolidated net periodic benefit cost for other post-retirement benefits was \$24 million, \$29 million, and \$33 million in 2005, 2004, and 2003, respectively. At December 31, 2005, the Company's accrued benefit cost for post-retirement benefits other than pensions was \$313 million (\$309 million at December 31, 2004). In addition, at December 31, 2005, the Company's consolidated pension benefit obligation and accumulated post-retirement benefit obligation (APBO) were \$14,346 million and \$300 million, respectively (\$13,137 million and \$319 million at December 31, 2004).

The Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (the "Act"), signed into law in the United States in December 2003, provides for prescription drug benefits under Medicare, as well as a federal subsidy to sponsors of retiree health care benefit plans that provide prescription drug benefits that have been concluded to be actuarially equivalent to the Medicare benefit. Pursuant to FASB Staff Position 106-2, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement, and Modernization Act of 2003," adopted on July 1, 2004, the Company evaluated and determined the prescription drug benefits provided by its health care plans to be actuarially equivalent to the Medicare benefit under the Act. The Company measured the effects of the Act on the APBO as of January 1, 2004 and, as such, the APBO was reduced by \$49 million. Net periodic benefit cost for the year ended December 31, 2004 was reduced by \$7 million due to the effects of the Act.

In 2004, with the acquisitions of GLT and BC Rail, the Company assumed two additional defined benefit plans. The following table provides the Company's plan assets by category, benefit obligation at end of year, and Company and employee contributions by major pension plan:

<i>In millions</i>	<i>December 31, 2005</i>	CN Pension Plan	BC Rail Pension Plan	U.S. and Other Plans	Total
Plan assets by category					
Equity securities		\$ 7,814	\$ 300	\$ 131	\$ 8,245
Debt securities		4,514	194	62	4,770
Real estate		321	14	-	335
Other		1,420	88	16	1,524
Total		\$ 14,069	\$ 596	\$ 209	\$ 14,874
Benefit obligation at end of year		\$ 13,404	\$ 546	\$ 396	\$ 14,346
Company contributions in 2005		\$ 77	\$ 20	\$ 30	\$ 127
Employee contributions in 2005		\$ 55	\$ 3	\$ -	\$ 58

Income taxes

The Company follows the asset and liability method of accounting for income taxes. Under the asset and liability method, the change in the net deferred income tax asset or liability is included in the computation of net income. Deferred income tax assets and liabilities are measured using enacted income tax rates expected to apply to taxable income in the years in which temporary differences are expected to be recovered or settled. As a result, a projection of taxable income is required for those years, as well as an assumption of the ultimate recovery/settlement period for temporary differences. The projection of future taxable income is based on management's best estimate and may vary from actual taxable income. On an annual basis, the Company assesses its need to establish a valuation allowance for its deferred income tax assets and if it is deemed more likely than not that its deferred income tax assets will not be realized based on its taxable income projections, a valuation allowance is recorded. As at December 31, 2005, the Company expects that its deferred income tax assets will be recovered from future taxable income and therefore, has not set up a valuation allowance. In addition, Canadian and U.S. tax rules and regulations are subject to interpretation and require judgment by the Company that may be challenged by the taxation authorities. The Company believes that its provisions for income taxes are adequate pertaining to any assessments from the taxation authorities.

The Company's deferred income tax assets are mainly composed of temporary differences related to accruals for workforce reductions, personal injury and other claims, environmental and other post-retirement benefits, and losses and tax credit carryforwards. The majority of these accruals will be paid out over the next five years. The Company's deferred income tax liabilities are mainly composed of temporary differences related to properties and net prepaid benefit cost for pensions. The reversal of temporary differences is expected at future-enacted income tax rates which could change due to fiscal budget changes

and/or changes in income tax laws. As a result, a change in the timing and/or the income tax rate at which the components will reverse, could materially affect deferred income tax expense as recorded in the Company's results of operations. A one-percentage-point change in the Company's reported effective income tax rate would have the effect of changing the income tax expense by \$23 million in 2005.

In 2005, the Company recorded a deferred income tax expense of \$14 million and a corresponding increase to its net deferred income tax liability resulting from the net impact of higher enacted corporate tax rates in certain Canadian provinces. In the fourth quarter of 2003, the Company had recorded an increase of \$81 million to its net deferred income tax liability resulting from the enactment of higher corporate tax rates in the province of Ontario. As a result, for the year ended December 31, 2003, a deferred income tax expense of \$79 million was recorded in income and \$2 million was recorded in Other comprehensive loss.

For the year ended December 31, 2005, the Company recorded total income tax expense of \$781 million (\$596 million in 2004 and \$517 million in 2003) of which \$547 million was for deferred income taxes (\$366 million in 2004 and \$411 million in 2003). The Company's net deferred income tax liability at December 31, 2005 was \$4,752 million (\$4,359 million at December 31, 2004).

Business risks

Certain information included in this report may be "forward-looking statements" within the meaning of the United States Private Securities Litigation Reform Act of 1995 and under Canadian securities laws. Implicit in these statements, particularly in respect of growth opportunities, is the assumption that the positive economic trends in North America and Asia will continue.

This assumption, although considered reasonable by the Company at the time of preparation, may not materialize. Such forward-looking statements are not guarantees of future performance and involve known and unknown risks, uncertainties and other factors which may cause the outlook, the actual results or performance of the Company or the rail industry to be materially different from any future results or performance implied by such statements. Such factors include the specific risks set forth below as well as other risks detailed from time to time in reports filed by the Company with securities regulators in Canada and the United States.

Competition

The Company faces significant competition from a variety of carriers, including Canadian Pacific Railway Company (CP) which operates the other major rail system in Canada, serving most of the same industrial and population centers as the Company, long distance trucking companies and, in many markets, major U.S. railroads and other Canadian and U.S. railroads. Competition is generally based on the quality and reliability of services provided, price, and the condition and suitability of carriers' equipment. Competition is particularly intense in eastern Canada where an extensive highway network and population centers, located relatively close to one another, have encouraged significant competition from trucking companies. In addition, much of the freight carried by the Company consists of commodity goods that are available from other sources in competitive markets. Factors affecting the competitive position of suppliers of these commodities, including exchange rates, could materially adversely affect the demand for goods supplied by the sources served by the Company and, therefore, the Company's volumes, revenues and profit margins.

In addition to trucking competition, and to a greater degree than other rail carriers, the Company's subsidiary, Illinois Central Railroad Company (ICRR), is vulnerable to barge competition because its main routes are parallel to the Mississippi River system. The use of barges for some commodities, particularly coal and grain, often represents a lower cost mode of transportation. Barge competition and barge rates are affected by navigational interruptions from ice, floods and droughts, which can cause widely fluctuating barge rates. The ability of ICRR to maintain its market share of the available freight has traditionally been affected by the navigational conditions on the river.

The significant consolidation of rail systems in the United States has resulted in larger rail systems that are able to offer seamless services in larger market areas and accordingly, compete effectively with the Company in certain markets. This requires the Company to consider transactions that would similarly enhance its own service. There can be no assurance that the Company will be able to compete effectively against current and future competitors in

the railroad industry and that further consolidation within the railroad industry will not adversely affect the Company's competitive position. No assurance can be given that competitive pressures will not lead to reduced revenues, profit margins or both.

Environmental matters

The Company's operations are subject to numerous federal, provincial, state, municipal and local environmental laws and regulations in Canada and the United States 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. As a result, the Company incurs significant compliance and capital costs, on an ongoing basis, associated with environmental regulatory compliance and clean-up requirements in its railroad operations and relating to its past and present ownership, operation or control of real property.

While the Company believes that it has identified the costs likely to be incurred in the next several years, based on known information, for environmental matters, the Company's ongoing efforts to identify potential environmental concerns that may be associated with its properties may lead to future environmental investigations, which may result in the identification of additional environmental costs and liabilities.

In railroad and related transportation operations, it is possible that derailments, explosions or other accidents may occur that could cause harm to human health or to the environment. In addition, the Company is also exposed to liability risk, faced by the railroad industry generally, in connection with the transportation of toxic-by-inhalation hazardous materials such as chlorine and anhydrous ammonia, commodities that are essential to the public health and welfare and that, as a common carrier, the Company has a duty to transport. As a result, the Company may incur costs in the future, which may be material, to address any such harm, including costs relating to the performance of clean-ups, natural resource damages and compensatory or punitive damages relating to harm to individuals or property.

The ultimate cost of known contaminated sites cannot be definitely established, and the estimated environmental liability for any given site may vary depending on the nature and extent of the contamination, the available clean-up techniques, the Company's share of the costs and evolving regulatory standards governing environmental liability. Also, additional contaminated

sites yet unknown may be discovered or future operations may result in accidental releases. For these reasons, there can be no assurance that material 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 environmental liabilities or costs.

Personal injury and other claims

In the normal course of its operations, the Company becomes involved in various legal actions, including claims relating to personal injuries, occupational disease and damage to property. The Company maintains provisions for such items, which it considers to be adequate for all of its outstanding or pending claims. The final outcome with respect to actions outstanding or pending at December 31, 2005, or with respect to future claims, cannot be predicted with certainty, and therefore there can be no assurance that their resolution will not have a material adverse effect on the Company's financial position or results of operations in a particular quarter or fiscal year.

Labor negotiations

Canadian workforce

As of December 31, 2005, CN employed a total of 14,979 employees in Canada, of which 11,987 were unionized employees.

As of January 2006, the Company had in place labor agreements covering its entire Canadian unionized workforce. In 2006, CN will begin bargaining with two national unions whose agreements expire December 31, 2006. These agreements will remain in effect until bargaining and legal processes have been concluded.

Following the acquisition of BC Rail, the Company reached implementing agreements in December 2004 for BC Rail employees with the Council of Trade Unions and its members, representing all unions, regarding the integration of the various collective agreements. In March 2005, under Section 18 of the Canada Labour Code, the Company filed a request with the Canada Industrial Relations Board (CIRB) to amend the current bargaining agent certificates at BC Rail to correspond with those agents representing the same employee groups at CN. On October 13, 2005, the CIRB granted the Company's request but retained jurisdiction on any issues that might remain in contention.

There can be no assurance that the Company will be able to renew and have ratified its collective agreements without any strikes or lockouts.

U.S. workforce

As of December 31, 2005, CN employed a total of 6,561 employees in the United States, of which 5,676 were unionized employees.

As of January 2006, the Company had in place agreements with bargaining units representing the entire unionized workforce at Grand Trunk Western Railroad Incorporated (GTW); Duluth, Winnipeg and Pacific (DWP); ICRR; CCP Holdings, Inc. (CCP); Duluth, Missabe & Iron Railroad (DMIR), Bessemer & Lake Erie (BLE) and Pittsburgh & Conneaut Dock Company (PCD), and 93% of the unionized workforce at Wisconsin Central Transportation Corporation (WC). Agreements in place have various moratorium provisions, ranging from the end of 2004 to the end of 2009, which preserve the status quo in respect of given areas during the terms of such moratoriums. Several of these agreements are currently under renegotiation.

The general approach to labor negotiations by U.S. Class I railroads is to bargain on a collective national basis. GTW, DWP, ICRR, CCP, WC, DMIR, BLE and PCD have bargained on a local basis rather than holding national, industry-wide negotiations because they believe it results in agreements that better address both the employees' concerns and preferences, and the railways' actual operating environment. However, local negotiations may not generate federal intervention in a strike or lockout situation, since a dispute may be localized. The Company believes the potential mutual benefits of local bargaining outweigh the risks.

Negotiations are ongoing with the bargaining units with which the Company does not have agreements or settlements. Until new agreements are reached or the processes of the Railway Labor Act have been exhausted, the terms and conditions of existing agreements continue to apply. Although the Company does not anticipate work action related to these negotiations while they are ongoing, there can be no assurance that there will not be any such work action and that the resolution of these negotiations will not have a material adverse effect on the Company's financial position or results of operations.

Regulation

The Company's rail operations in Canada are subject to regulation as to (i) rate setting and network rationalization by the Canadian Transportation Agency (the Agency) under the Canada Transportation Act (the CTA), and (ii) safety by the federal Minister of Transport under the Railway Safety Act and certain other statutes. The Company's U.S. rail operations are subject to regulation as to (i) economic regulation by the STB and (ii) safety by the Federal Railroad Administration. As such, various Company business transactions must gain prior regulatory approval, with attendant risks and uncertainties. The Company is also subject to a variety of health, safety, security, labor,

environmental and other regulations, all of which can affect its competitive position and profitability.

With respect to safety, rail safety regulation in Canada is the responsibility of Transport Canada, which administers the Canadian Railway Safety Act, as well as the rail portions of other safety-related statutes. In the U.S., rail safety regulation is the responsibility of the Federal Railroad Administration, which administers the Federal Rail Safety Act, as well as the rail portions of other safety statutes. In addition, safety matters related to security are overseen by the Transportation Security Administration, which is part of the U.S. Department of Homeland Security.

The federal government carries out a review of Canadian transportation legislation periodically. The latest review resulted in a report to the Minister of Transport, released to the public on July 18, 2001, which contains numerous recommendations for legislative changes affecting all modes of transportation, including rail. On February 25, 2003, the Canadian Minister of Transport released its policy document *Straight Ahead - A Vision for Transportation in Canada*. On March 24, 2005, the Minister of Transport tabled Bill C-44 entitled *An Act to Amend the Canada Transportation Act and the Railway Safety Act, to enact the VIA Rail Canada Act and to make consequential amendments to other Acts*. Bill C-44 was terminated when Parliament was dissolved on November 29, 2005. No assurance can be given that any future legislative action by the federal government or other future government initiatives will not materially adversely affect the Company's financial position or results of operations.

The U.S. Congress has had under consideration for several years various pieces of legislation that would increase federal economic regulation of the railroad industry. In addition, the STB is authorized by statute to commence regulatory proceedings if it deems them to be appropriate. No assurance can be given that any future regulatory initiatives by the U.S. federal government will not materially adversely affect the Company's operations, or its competitive and financial position.

The Company is subject to statutory and regulatory directives in the United States addressing homeland security concerns. These include border security arrangements, pursuant to an agreement the Company and CP entered into with U.S. Customs and Border Protection (CBP) and the Canada Border Services Agency (CBSA). These requirements include advance electronic transmission of cargo information for U.S.-bound traffic and cargo screening (including gamma ray and radiation screening), as well as U.S. government-imposed restrictions on the transportation into the United States of certain commodities. In the fourth quarter of 2003, the CBP issued regulations to extend advance notification requirements to all modes of transportation and the U.S. Food and Drug Administration promulgated interim final rules requiring advance notification by all modes for certain food imports into the

United States. CBSA is also working on implementation of advance notification requirements for Canadian-bound traffic. The Company has also worked with the Association of American Railroads to develop and put in place an extensive industry-wide security plan to address terrorism and security-driven efforts by state and local governments seeking to restrict the routings of certain hazardous materials. If such state and local routing restrictions were to go into force, they would be likely to add to security concerns by foreclosing the Company's most optimal and secure transportation routes, leading to increased yard handling, longer hauls, and the transfer of traffic to lines less suitable for moving hazardous materials, while also infringing upon the exclusive and uniform federal oversight over railroad security matters. While the Company will continue to work closely with the CBSA, CBP, and other Canadian and U.S. agencies, as above, no assurance can be given that future decisions by the U.S., Canadian, provincial, state, or local governments on homeland security matters, or joint decisions by the industry in response to threats to the North American rail network, will not materially adversely affect the Company's operations, or its competitive and financial position.

In October 2002, the Company became the first North American railroad to gain membership in the U.S. Customs Trade Partnership Against Terrorism (C-TPAT). C-TPAT is a joint government-business initiative designed to build cooperative relationships that strengthen overall supply chain and border security on goods exported to the U.S. The Company is also designated as a low-risk carrier under the Customs Self-Assessment (CSA) program, a CBSA program designed to expedite the cross-border movement of goods of CSA-accredited importing companies for goods imported into Canada.

The Company's ownership of the former Great Lakes Transportation vessels is subject to regulation by the U.S. Coast Guard and the Department of Transportation, Maritime Administration, which regulate the ownership and operation of vessels operating on the Great Lakes and in U.S. coastal waters. On February 4, 2004, the Maritime Administration and the U.S. Coast Guard issued a Joint Notice of Proposed Rulemaking, proposing modifications to the regulations governing vessel documentation for lease financing for vessels engaged in the coastwise trade. In addition, the U.S. Congress has from time to time considered modifications to the legislation governing the United States coastwise trade. As a result of maritime legislation enacted in 2004, the regulations governing the Company's acquisition of these vessels should not be affected. Subsequent to the enactment of this legislation, on April 13, 2005, the Coast Guard and Maritime Administration withdrew their proposed rulemaking, and plan to publish a new notice of proposed rulemaking in the future to address the legislation's provisions. No assurance can be given that any future legislative or

regulatory initiatives by the U.S. federal government will not materially adversely affect the Company's operations, or its competitive and financial position.

Business prospects and other risks

In any given year, the Company, like other railroads, is susceptible to changes in the economic conditions of the industries and geographic areas that produce and consume the freight it transports or the supplies it requires to operate. In addition, many of the goods and commodities carried by the Company experience cyclical demand. Many of the bulk commodities the Company transports move offshore and are affected more by global rather than North American economic conditions. The Company's results of operations can be expected to reflect these conditions because of the significant fixed costs inherent in railroad operations.

Global as well as North American trade conditions, including trade barriers on certain commodities, may interfere with the free circulation of goods across Canada and the United States.

The Company, like other railroads, is susceptible to the volatility of fuel prices due to changes in the economy or supply disruptions. Rising fuel prices could materially adversely affect the Company's expenses. As such, CN has implemented a fuel surcharge program to help mitigate the impact of rising fuel prices. No assurance can be given that continued increases in fuel prices or supply disruptions will not materially adversely affect the Company's operations or its financial position.

Overall return in the capital market, and the level of interest rates, affect the funded status of the Company's pension plans as well as the Company's results of operations. Adverse changes with respect to pension plan returns and the level of interest rates from the date of the last actuarial valuation may increase future pension contributions and could have a material adverse effect on the Company's results of operations. The funding requirements as well as the impact on the results of operations will be determined following the completion of future actuarial valuations.

Potential terrorist actions can have a direct or indirect impact on the transportation infrastructure, including railway infrastructure in North America, and interfere with the free flow of goods. International conflicts can also have an impact on the Company's markets.

Although the Company conducts its business and receives revenues primarily in Canadian dollars, a growing portion of its revenues, expenses, assets and debt is denominated in U.S. dollars. Thus, the Company's results are affected by fluctuations in the exchange rate between these currencies. Based on the Company's current operations, the estimated annual impact on net income of a year-over-year one-cent change in the Canadian dollar relative to the U.S. dollar is approximately \$10 million. Changes in the exchange rate between the Canadian dollar and other currencies (including the U.S. dollar) make the goods transported by the

Company more or less competitive in the world marketplace and thereby further affect the Company's revenues and expenses.

Should a major economic slowdown or recession occur in North America or other key markets, or should major industrial restructuring take place, the volume of rail shipments carried by the Company is likely to be adversely affected.

In addition to the inherent risks of the business cycle, the Company's operations are occasionally susceptible to severe weather conditions, which can disrupt operations and service for the railroad as well as for the Company's customers. In recent years, severe drought conditions in western Canada, for instance, significantly reduced bulk commodity revenues, principally grain.

Generally accepted accounting principles require the use of historical cost as the basis of reporting in financial statements. As a result, the cumulative effect of inflation, which has significantly increased asset replacement costs for capital-intensive companies such as CN, is not reflected in operating expenses. Depreciation charges on an inflation-adjusted basis, assuming that all operating assets are replaced at current price levels, would be substantially greater than historically reported amounts.

Controls and procedures

The Company's Chief Executive Officer and its Chief Financial Officer, after evaluating the effectiveness of the Company's "disclosure controls and procedures" (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) as of December 31, 2005, have concluded that the Company's disclosure controls and procedures were adequate and effective to ensure that material information relating to the Company and its consolidated subsidiaries would have been made known to them.

During the fourth quarter ending December 31, 2005, there was no change in the Company's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

The Company is undergoing a comprehensive effort in preparation for compliance with Section 404 of the Sarbanes-Oxley Act for the year ending December 31, 2006. This effort includes, among other things, evaluating the adequacy of the Company's documentation of controls, assessing the effectiveness of control design, and testing the operation of the controls as designed.

In the course of its evaluation, management has identified certain deficiencies in its internal control over financial reporting. These deficiencies are being addressed through a detailed remediation program. The Company does not believe that any of the deficiencies identified to date, individually or in the aggregate, result in a material weakness to its internal control over financial reporting.

Additional information, including the Company's 2004 Annual Information Form (AIF) and Form 40-F, may be found on SEDAR at www.sedar.com and on EDGAR at www.sec.gov/edgar.shtml, respectively. The 2005 AIF and Form 40-F will become available on or prior to March 31, 2006.

Montreal, Canada
January 24, 2006