2002 Annual Report

The long haul

2002 Annual Report

Another year of challenge put our company to the test. It was a test of our model and our mettle, a test we believe we passed. In 2002, CN delivered strong results in the face of a severe drought affecting one of our markets, and economic uncertainty.

We remain confident as the challenge continues. CN is on a long haul, with a solid trip plan, a powerful engine and a worthy destination: delivering performance that endures.

Contents

Except where otherwise indicated, all financial information reflected in this document is expressed in Canadian dollars and determined on the basis of United States generally accepted accounting principles (U.S. GAAP).

Performance that endures At CN, our destination is an objective in an always-challenging economic and competitive landscape: growth. Long-term, sustainable, profitable top-line growth.

Delivering profitable top-line growth is firmly connected to the ability to create real value for customers. Customer value is determined by each one's individual requirements, but at its core is a meaningful contribution to efficiency, productivity and competitiveness. At CN, we know that when we contribute in a significant way to a customer's business success, we have formed a strong platform for expanding the relationship.

Profitable top-line growth. This is what shareholders want, along with something equally important: financial durability. At CN, this is a critical element of shareholder value. We have worked to build an enterprise that is capable of generating revenue growth, steadily increasing profitability, strong cash flow and return on investment.

Performance that endures. It is a destination at which one never truly arrives – there are always new challenges – but in 2002, CN demonstrated that it is well on its way to achieving its objectives.

The destination

The trip plan

Pursuing growth one carload at a time Railroads have historically done a very good job of providing reliable transportation solutions to bulk shippers – primarily grain and coal and other products that move on unit trains. CN is a well-established bulk carrier, with a number of strong, long-term customer relationships. But in bulk commodities shipping, there is little to differentiate between railroads, leaving less room for market share gains.

CN has a unique franchise, less dependent upon bulk commodities than other major North American railroads. Our strengths align well with service-sensitive businesses like merchandise – automotive, metals and minerals, petroleum and chemicals, and forest products – as well as intermodal. Merchandise businesses, sometimes called carload shippers, are where we have the clearest competitive advantage, both against trucks and other rail carriers.

With its precision, velocity and reliability, the CN service plan is perfectly suited to the merchandise shipper. Our strategy – our trip plan – is to pursue carload business by emphasizing transportation solutions rather than transactions. The level of service reliability we provide gives us a greater opportunity to help customers reduce their transportation costs, enabling us to help them succeed.

What drives CN Two things drive this company: our unique service plan and the talented, dedicated people who make it work.

With the CN service plan, we have succeeded in creating a uniquely efficient, reliable transportation solution that's more economical than trucks and capable of delivering more value than traditional rail carriers. We are continually working to perfect the service plan's industry-leading performance – striving to improve upon 90 per cent-plus reliability while at the same time increasing speed. CN is always concentrating on further enhancing service quality in ways that go beyond speed or reliability, such as providing better quality equipment and simplifying customer processes.

On-time performance is of little use if the shipment arrives damaged. So CN is accelerating the process of renewing and upgrading its fleet, purchasing equipment like state-of-the-art refrigerated rail cars for grocery shippers, new boxcars for paper shippers and an increased number of centerbeam flatcars for our forest product customers.

Ease of doing business is another important service quality issue. CN is investing to make it simpler to get service schedules and rates, simpler to order equipment and manage shipments, and simpler to manage and pay invoices.

The engine




Creating a culture of difference-makers Every CN employee has an opportunity to have a positive impact on improved service quality for customers. Across the entire organization, CN has launched employee development and training programs aimed at improving skills and enhancing individual performance.

Sales has been a particular emphasis. Over the past several years, CN has been systematically transforming and expanding its sales force, adding more highly qualified professionals to drive a fundamental shift away from the traditional "order-taker" approach to rail transportation sales and marketing. An intensified focus on training is designed to improve CN sales professionals' ability to identify, develop and present proactive, value-adding solutions that support CN's growth strategy.

CN changed its sales compensation structure in 1999 to support the right behaviors – with a commission-like bonus formula that rewards high achievers and creates incentives to grow, not just maintain, revenues each year. Meanwhile, CN is pursuing an aggressive, ongoing sales strategy aimed at uncovering ways to reach new customers who can benefit from rail – going beyond traditional rail channels that focus only on large nationwide accounts to expand coverage and increase the number of opportunities to grow revenue.

A groundbreaking new partnership with labor CN is a different kind of railroad, always looking for new and innovative ways to lead and excel. Nowhere is this more in evidence than at CN's U.S. operations. This is where we worked together with the Brotherhood of Locomotive Engineers (BLE) and with the United Transportation Union (UTU) at the former Wisconsin Central division and with the BLE in the former Illinois Central territory to forge truly game-changing labor agreements in 2002. The new contracts are better for CN, better for employees and, by strengthening our ability to improve service quality, ultimately are better for shippers.

In contrast with other major Class 1 railroad mileage- and rule-based wage systems, these agreements are based on an hourly wage. CN benefits from enhanced productivity and unprecedented flexibility with the elimination of outdated work rules and mileage caps. In addition to excellent compensation, employees benefit from better work and home-life balance as well as job security provisions.

Dear shareholders:

CN delivered growth and generated record free cash flow and solid earnings in spite of external factors that negatively affected revenues and increased costs. CN performed well this year – more important, we have a great team and a good, solid franchise that put us in an excellent position for the long haul.

A year of continued challenge The year 2002 proved to be challenging, with an increasingly tough market environment characterized by a severe drought that decimated the Canadian wheat harvest, the ongoing decline of Canada's CN-served metallurgical coal mines and continued uncertainty in the North American economy.

All in all, 2002 was a test of CN's character, resiliency and strength, a test I feel we passed. In fact, I believe we can be proud of what we accomplished.

Rising to the challenge Our 2002 financial performance was solid in the face of adversity. We grew revenues, driven mainly by the Wisconsin Central acquisition, but also by the strength of our merchandise franchise, which offset significantly weaker grain revenues. At the same time, through aggressive cost control measures, we mitigated major cost pressures. We were able to deliver an adjusted operating ratio of 69.4 per cent in 2002 compared to the 68.5 per cent adjusted figure in 2001. A key achievement was CN's record free cash flow of $513 million, building on the $443 million generated in 2001.

Tough measures In the fourth quarter of 2002, we recorded charges for workforce reductions and for U.S. personal injury and other claims. We made the difficult decision to make a permanent workforce reduction of 1,146 employees. This move reflects a hard reality: we must aggressively control our costs in order to remain competitive, especially in today's economic environment.

We have a responsibility to operate as efficiently as we possibly can without compromising safety. But it doesn't make a decision like this any easier. My hope is to get this company to the point where these kinds of cuts aren't necessary – to grow the business to the point where we're adding people, rather than subtracting them. This is our goal.

Delivering value for CN investors We are determined to continue to create shareholder value in every way we can. With our strong balance sheet and free cash flow, we are fortunate to be able to do this in a number of ways. While we always seek avenues to build the strength of the business, there are times when the best means to deliver value is through share repurchases.

We decided that 2002 was just such a time. In the fourth quarter, the CN Board authorized a share repurchase program of up to 13.0 million shares over the course of one year beginning on October 25, 2002. The buyback potentially represents 6.5 per cent of shares outstanding.

We have proven our ability to make and successfully integrate acquisitions that bring real benefit to this company and its investors. The Illinois Central integration proceeded so smoothly that the STB discontinued its formal oversight process of the merger after two years, three years ahead of schedule. The Wisconsin Central integration is nearly complete, following the same step-by-step approach designed to maintain safety at the highest level and avoid any disruption or compromise of customer service.

A solid model that is working The most encouraging aspect of our 2002 performance was our ability to deliver good overall performance in spite of an enormous revenue hit in our grain business unit. While the revenues gained in our Wisconsin Central acquisition helped offset the impact, a major factor in CN's 2002 performance was the success of our growth strategy in merchandise businesses focused on selling the benefits of premium-quality rail service.

Our merchandise businesses are steadily gaining market share, growing much faster than the industry. We're achieving these share gains across many segments: automotive, fuel oil, aluminum, liquified petroleum gas, lumber and newsprint. And the sales strategy we created in 1999 to pursue smaller customers is clearly working.

Railroading is a tough business, but not necessarily a complicated one. Success is all about staying focused on the basics: one, providing good service – doing what you say you'll do, every time. Two, managing your costs. Three, focusing on asset utilization. Four, doing the first three things without getting anyone hurt. And five, developing your people. The first three things we're now doing at a high level, and the fourth is something we're always working on. My biggest focus is on the fifth: people.

Financial summary

($ in millions, except per share data, or unless otherwise indicated)	**2002** (1)	2001 (1)	2000 (1)
Financial results			
Revenues	**$ 6,110**	$ 5,652	$ 5,428
Operating income	**1,469**	1,682	1,648
Net income	**800**	1,040	937
Diluted earnings per share	**3.97**	5.23	4.67
Dividend per share	**0.86**	0.78	0.70
Net capital expenditures	**938**	941	958
Financial position			
Total assets	**21,738**	21,223	17,314
Long-term debt, including current portion and convertible preferred securities	**5,577**	6,293	4,665
Shareholders' equity	**8,369**	7,488	6,598
Financial ratios *(%)*			
Operating ratio	**76.0**	70.2	69.6
Debt to total capitalization	**40.0**	45.7	41.4

(1) 2001 includes Wisconsin Central Transportation Corporation from October 9, 2001. In addition, the Company's financial results for 2002, 2001 and 2000 include items impacting their comparability as discussed in the Company's Management's Discussion and Analysis on pages 31 and 35.

Employees *(average for the year)*

2000	22,457
2001 (1)	22,668
2002	23,190

Adjusted earnings per share *(dollars)* (2)

2000	4.39
2001 (1)	4.92
2002	5.22

Adjusted operating ratio *(percentage)* (3)

2000	69.6
2001 (1)	68.5
2002	69.4

(1) The 2001 figures include Wisconsin Central Transportation Corporation from October 9, 2001.
(2) Based on 2002, 2001 and 2000 adjusted net income, as discussed in the Company's Management's Discussion and Analysis on pages 31 and 35.
(3) Excludes a 2002 charge of $281 million to increase the Company's provision for U.S. personal injury and other claims, and workforce reduction charges of $120 million and $98 million in 2002 and 2001, respectively, as discussed in the Company's Management's Discussion and Analysis on pages 31 and 35.

All across this organization, CN people are realizing that they each can play a significant role in the success of this company. I'm particularly proud of the labor agreements we reached in 2002 with the Brotherhood of Locomotive Engineers (BLE) and the United Transportation Union (UTU) at our former Wisconsin Central division and with the BLE in our former IC territories. These ground-breaking contracts free CN from outdated work rules and compensation structures while giving engineers, conductors and brakemen excellent wages, job security and more time with their families.

We're slowly transforming the culture of this great company. Are we there yet? No. Will we ever completely get there? Probably not, because it's a continuous process of improvement. We can always get better. That's what a passion for performance is all about.

A strong team This company's management team is one of the most outstanding groups of individuals I've ever seen assembled in my 38 years of railroading. James Foote and Claude Mongeau are two of our standouts. James is one of the top marketing people in the business. He's been in this industry his whole career and has been involved in nearly every aspect of running a railroad, holding positions in law, finance, operations and now marketing, his current position. He's done a great job leading the growth in our merchandise businesses. Claude Mongeau is among the best and brightest business minds in Canada. At only 41, Claude is a pillar of our financial discipline and a key architect of our strategic agenda. James and Claude are just two of many – too many to list here – who have played an integral role in our success. This is a solid team, and I'm proud to have this opportunity to lead them.

As you know, Paul Tellier announced in December 2002 his decision to accept the position of President and Chief Executive Officer of Bombardier Inc. I don't have to tell you what Paul has meant to this organization. I congratulate him and thank him for his dedication, leadership and vision. We worked very closely together during the time I have been with the company to set CN's current strategic direction. That direction won't change under my leadership.

It's a long haul As one of the leaders of this company and throughout my management career, I've always been struck by the pressure we get to produce short-term results. Don't misunderstand me; this isn't a bad thing – it imposes discipline on management and supports full accountability. But if you get too caught up in short-term performance, it can make it tougher to pursue strategies critical to long-term success. Under my leadership, the CN management team will continue to balance the need to protect and build your long-term investment with the desire for strong year-over-year results.

As bulk commodities continue to struggle in 2003, we will aggressively continue to build our service-sensitive businesses to maintain revenue growth while we closely watch expenses. We are on a long haul, making steady progress up the steep grade of a tough economy. When the track levels off, as we know it will, we'll be poised to accelerate to new levels of performance. Thank you for coming along.

Yours sincerely,

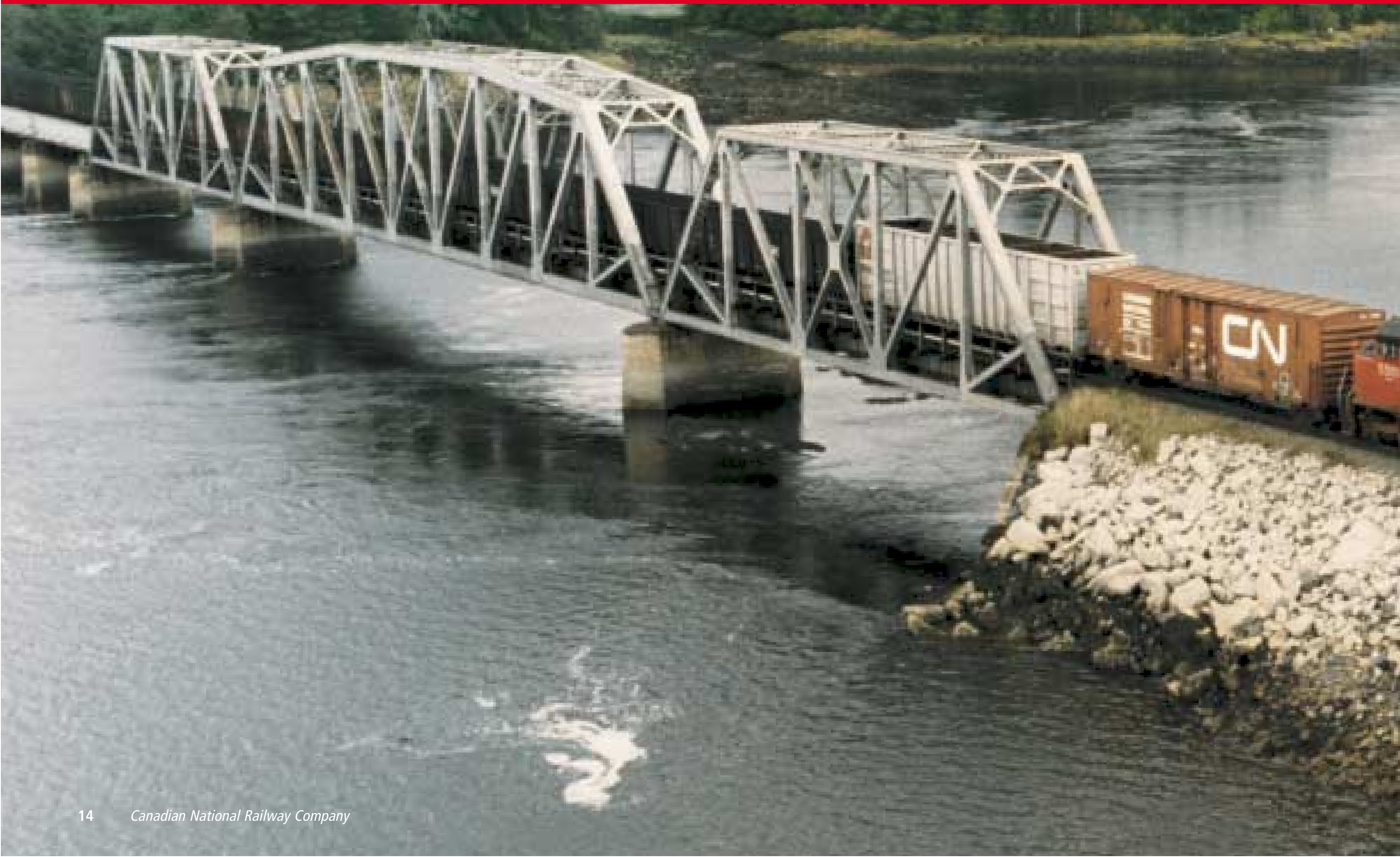
(signed)
E. Hunter Harrison
President and Chief Executive Officer

Creating win-win relationships CN has delivered growth in difficult times by meeting the needs of shippers with a superior rail product, the scheduled railroad.

Our growth strategy centers upon continuing to leverage this superior product to deliver value for service-sensitive carload customers, many of whom use trucks for a large proportion of their transportation needs. The carload market is much bigger than the unit train market, concentrated mostly in the merchandise business sector. CN has a significantly higher proportion of merchandise freight in its portfolio than other major railroads, with experience and an operating approach that translate to a strong competitive position.

The degree of precision and reliability of our service plan provides an opportunity to help certain customers reduce spending on transportation while capturing a higher percentage of it for CN. Our sales strategy is focused on helping customers see that we can reduce total logistics costs without sacrificing performance. There are three principal ways CN's superior rail service enables us to deliver cost savings for customers without having to reduce our rates:

The road to delivering value



Reducing customer-owned inventory Better service reliability means lower inventory requirements – less capital in goods-in-transit; reduced need for safety stock or express trucking costs to ensure uninterrupted processes; lower warehousing and storage costs.

Reducing customer-owned fleets We know from our own experience that better service reliability means smaller rail car fleet requirements – which reduces depreciation and interest expense; lowers leasing costs; reduces maintenance costs; and decreases overall ownership risk. We can deliver the same benefits to customers who own significant rail car fleets.

Moving traffic from truck to rail It's a fact that most rail rates are lower than truck, but many companies pay the higher freight costs to gain the high degree of reliability trucks traditionally offer. Once rail reliability and trust are established, many shippers discover that rail meets their needs at significantly lower cost.

Considerable potential exists for truly win-win business relationships. Shippers realize reduced transportation, inventory, equipment and back office costs, while CN gains higher-yield business, more volume and closer customer collaboration that forms a strong base for further growth.

Reducing inventory is increasingly critical in most manufacturing processes, and a well-managed transportation chain is the principal success factor. Led by automotive producers, more and more manufacturers are moving to just-in-time management of inputs, which demands precision not typically found in rail transportation. Those who do use rail often maintain substantial backup inventory on-site to ensure that an adequate supply of products is available for their customers.

Already a major transportation supplier to automotive manufacturers, CN is supporting customers in other industries using scheduled rail service to bring value through smoother logistics.

Paper manufacturers and printers are highly focused on inventory reduction, representing a significant opportunity for CN and shippers of paper products. Our approach here is to provide a highly reliable transportation product that renders the need for a large safety stock obsolete. If necessary, we offer integrated services that include the use of warehousing to hold some buffer stock or serve non-rail served facilities. As we demonstrate reliability, we're well positioned to take on more traffic.

Performance and productivity, just in time

With its velocity, precision and reliability, CN's scheduled rail service affords magazine and newspaper printers the ability to run just-in-time operations more cost effectively – eliminating or reducing the need to maintain "safety stock," a backup inventory of paper supply to ensure uninterrupted production.


DECOR
wallpaper*
LUXURY LIVING
BAZAAR
Canadian
REAL SIMPLE
ELLE
COTÉ SUD
surface
HOUSE & HOME
trends
THE TOP LOOKS FOR 2003
the hottest paint colours
dwell
Spectacular Settings
10 Houses with a Point of View
Gourmet
FRENCH COUNTRY COOKING
WINE ENTHUSIAST
GASTRO
STEP
DESIGN REVOLUTION
AZURE
DESIGN BUZZ FROM
AMERICA'S BEST BIG COMPANIES
Forbes
PC Format
Québec
Grand
WIRED
FASTCOMPANY
23
MATCH
SHARON STONE

Fewer cars, smoother pipeline, lower costs

Reducing private rail car fleets is an attractive way to improve productivity of the supply chain while significantly reducing costs for industries that depend on their own equipment to transport materials and products to and from their plants.

The enhanced speed and dependability of CN's scheduled network can have an immediate impact on helping customers reduce their fleets. We've proven it for ourselves – from 1998 to 2002, CN reduced its active rail car fleet by almost 25,000 cars, or more than 28 per cent, as a direct result of the precision and control afforded by the service plan.

Chemical manufacturers maintain extremely complex transportation pipelines, typically with multiple inputs flowing directly from rail cars into the plants. Their cars serve literally as warehouses on wheels. Most manufacturers in this industry make a huge investment in rail cars in order to maintain large fleets partly to offset variables in rail transportation. With 90 per cent-plus reliability that removes the variables, CN can help reduce that investment.

Manufacturers of consumer goods such as these plastic milk containers typically maintain large private rail car fleets in order to manage extremely complex transportation pipelines for raw materials. CN's service plan enables dramatic fleet reduction – we've proven it in our own operations. Now we're proving it in our customers' operations.

Moving shipments from truck to rail has an immediate impact on transportation costs. Trucking normally commands a premium based on reliability, speed and simplicity. Traditionally, the complexity of the carload business has been a major barrier to rail penetration.

CN is working to change that. In recent years, we have captured a significant amount of traffic from trucks in key intercontinental corridors through continuous transit time reduction and ongoing investment in new equipment.

Our strategy in merchandise is to identify areas currently handled by trucks that are natural for railroads. Rail transportation isn't as well suited for shippers with 24–48-hour transit windows, but there are vast numbers of small- to medium-sized shippers who use trucks exclusively because they are simply not accustomed to utilizing rail. For instance, shippers of rolled steel and aluminum ingots supplying the automotive industry are increasingly discovering the benefits – fewer weight restrictions and greater load efficiency at two to three truckloads per car – of precision scheduled rail service. Increasingly, they are becoming CN customers.

From between the white lines to the main line

Many suppliers of aluminum ingots used in the automotive industry have traditionally relied upon truck transportation to ship product. CN's high-quality service is encouraging suppliers to take advantage of the greater load efficiency and fewer weight restrictions of rail.


MonteCarlo SS

CN at a glance

CN derives revenue from seven business units – a balanced mix of goods moving over a network of approximately 18,000 route miles of track spanning North America. CN is the only rail network on the continent to connect three coasts – the Pacific, the Atlantic and the Gulf of Mexico.

Statistical summary

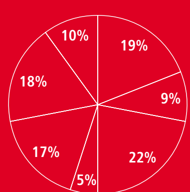
	2002	2001*	2000
Route miles *(includes Canada and the U.S.)*	**17,821**	17,986	15,532
Carloads *(thousands)*	**4,164**	3,821	3,796
Gross ton miles *(millions)*	**309,295**	293,857	288,150
Revenue ton miles *(millions)*	**159,876**	153,095	149,557
Rail employees *(average for the year)*	**23,190**	22,668	22,457
Diesel fuel consumed *(liters in millions)*	**1,420**	1,328	1,292
Diesel fuel consumed *(U.S. gallons in millions)*	**375**	351	341
Average fuel price per liter *(dollars)*	**$ 0.32**	$ 0.36	$ 0.33
Average fuel price per U.S. gallon *(dollars)*	**$ 1.20**	$ 1.35	$ 1.24

** Includes Wisconsin Central Transportation Corporation from October 9, 2001.*

2002 data

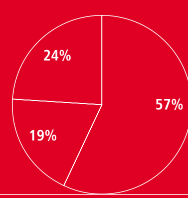
Freight revenues	*(millions)*	**Revenue ton miles**	*(millions)*	**Freight revenue per revenue ton mile**	*(cents)*
Petroleum and chemicals	$1,102	Petroleum and chemicals	30,006	Petroleum and chemicals	3.67
Metals and minerals	521	Metals and minerals	13,505	Metals and minerals	3.86
Forest products	1,323	Forest products	33,551	Forest products	3.94
Coal	326	Coal	14,503	Coal	2.25
Grain and fertilizers	986	Grain and fertilizers	35,773	Grain and fertilizers	2.76
Intermodal	1,052	Intermodal	29,257	Intermodal	3.60
Automotive	591	Automotive	3,281	Automotive	18.01

Freight revenues
2002 percentage data



19% Petroleum and chemicals
9% Metals and minerals
22% Forest products
5% Coal
17% Grain and fertilizers
18% Intermodal
10% Automotive

Revenue – traffic mix
Per cent



57% U.S. domestic and transborder
19% Overseas
24% Canadian domestic

We believe the balance of our business mix positions us well to weather economic downturns and maximizes our potential to grow revenue by competing with trucks.

Petroleum and chemicals

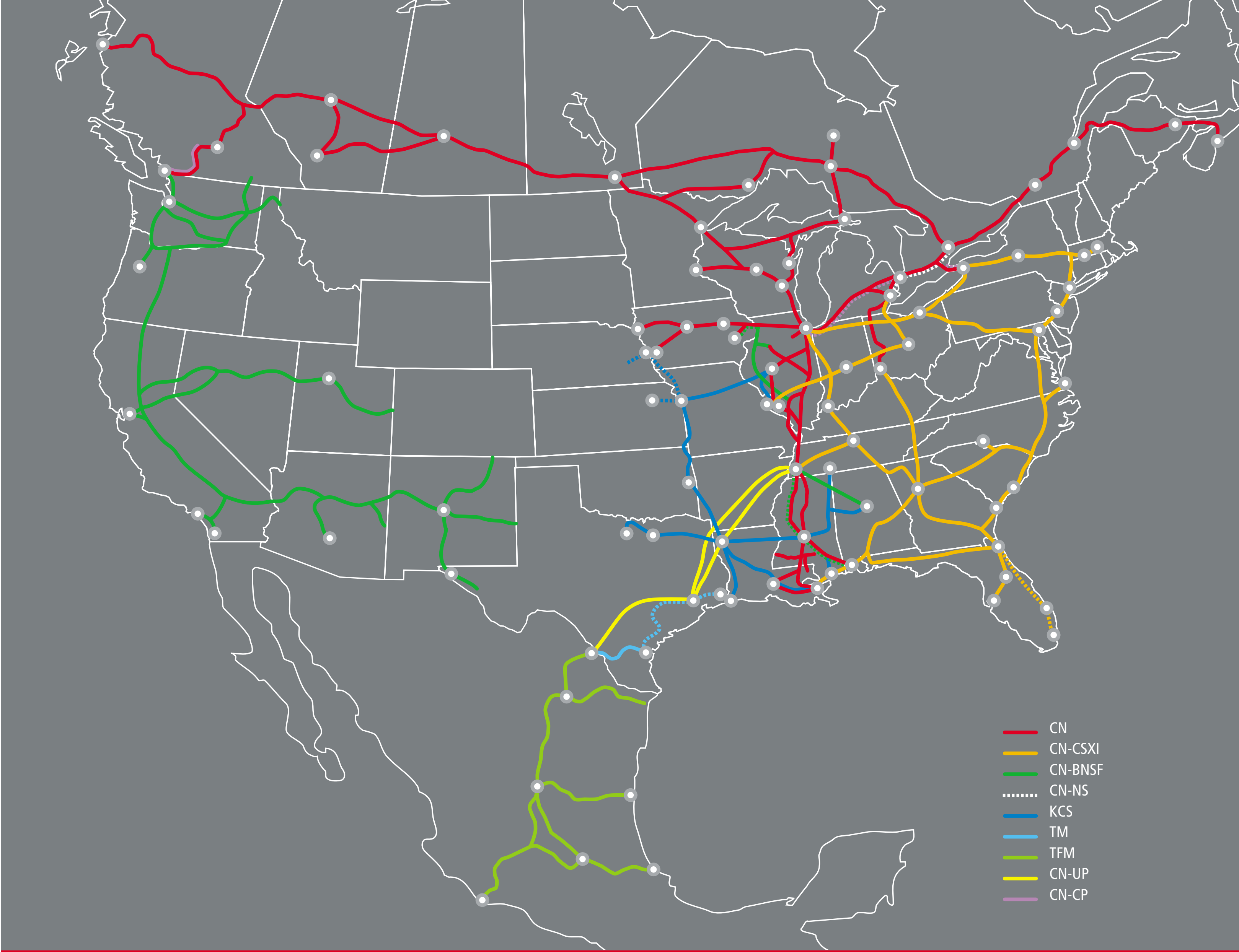
Petroleum and chemicals comprise a wide range of commodities, including chemicals, sulfur, plastics, petroleum and gas products. Most of CN's petroleum and chemicals shipments originate in the Gulf of Mexico, in Alberta and in eastern Canada, and are destined for customers in Canada, the United States and overseas export.

Metals and minerals

CN's metals and minerals business consists primarily of nonferrous base metals, steel, equipment and parts. Exclusive access to major mines and smelters throughout North America makes CN a leader in the transportation of copper, lead, zinc concentrates, refined metals and aluminum.

Forest products

CN is the largest carrier of forest products in North America. The product lines for this business unit include various types of lumber, panels, wood chips, woodpulp, printing paper, linerboard and newsprint. In Canada, CN enjoys superior access to the major fiber-producing regions. In the United States, CN is strategically located to serve both the northern and southern U.S. corridors with interline capabilities to other Class 1 railroads.



Coal

CN moves both Canadian and U.S. thermal coal. Canadian thermal coal is delivered to power utilities primarily in eastern Canada. U.S. thermal coal is transported from mines in southern Illinois or from western U.S. mines via interchange with other railroads to utilities in the U.S. Midwest.

Grain and fertilizers

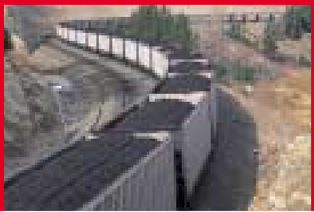
CN's grain and fertilizer business transports commodities grown in western Canada and the U.S. Midwest. The majority of grain and grain products carried by CN are for export. In the United States, CN handles grain grown in Illinois and Iowa for export, as well as to domestic processing facilities and feed markets. CN also serves producers of potash, ammonium nitrate, urea and other fertilizers.

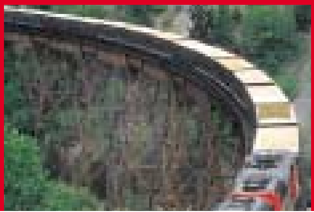
Intermodal

CN's intermodal business consists of two product segments. The first segment, domestic, is responsible for consumer products and manufactured goods, operating through both retail and wholesale channels. The second, the international segment, handles import and export container traffic, serving the ports of Vancouver, Montreal, Halifax, Mobile and New Orleans.

Automotive

CN is a leading carrier of automotive products originating in southwestern Ontario and Michigan. This business unit moves both finished vehicles and parts within the United States, Canada and Mexico. CN also serves shippers of import vehicles via the ports of Halifax and Vancouver, and through interchange with other railroads.





Dear Fellow Shareholders:

The past year has been one of challenge and change at CN. Economic challenges and drought in the grain producing areas served by CN caused our management to work even harder to produce good results. The departure of Paul Tellier in December confirmed our resilience and our succession planning. We welcome Hunter Harrison as our new President and Chief Executive Officer with great enthusiasm.

The challenges of corporate governance issues throughout corporate America highlighted our good governance practices, which have been a priority for our company since our Initial Public Offering.

CN has always been a leader in good corporate governance. We have from our inception had a separate non-executive chair as well as independent and financially literate members forming our audit committee. Our Board meets regularly without management, which illustrates the strength and independence of our Board. *Investor Relations* magazine awarded CN its top corporate governance award. CN has also received the Korn/Ferry-*Revue Commerce* award for the best corporate governance practices in Quebec.

We will always strive to maintain these high standards – it is part of our proud tradition, ensuring we will always be accountable to those who invest in our company.

CN directors have made substantial personal investments in our company, clearly an illustration of the close alignment of the interests of the Board of Directors with those of our shareholders.

After 10 years as President and Chief Executive Officer of CN, Paul Tellier has chosen to pursue new challenges at Bombardier Inc. We are grateful to Paul for his inspired leadership and especially for leaving the company ready for his successor with a strong balance sheet and a clear sense of direction.

We are all committed to continue the path of excellence Paul established, and our new President and Chief Executive Officer, Hunter Harrison, *North America's Railroader of the Year* in 2001, is well equipped to take CN to the next level.

The Board is very optimistic that with the depth of leadership at CN, we can and intend to maintain our position as North America's most efficient and profitable railroad.

To our dedicated employees at CN, we are grateful for your continued commitment to excellence; to my fellow Board members, I am very appreciative of your conscientious attention to maintaining the high standards you have set; and finally to our shareholders, we will always appreciate and respect your investment by our commitment to delivering solid shareholder value.

Sincerely,

(signed)
David McLean, O.B.C. LL.D.
Chairman of the Board

Pulling together…

for a brighter future

Safety above all; lifelong learning; community support; and commitment to action. These are the values that form the bedrock of CN's community investment philosophy. Our goal is simple: we seek, through our resources, our talents and our time, to help make our communities better places to live and work.

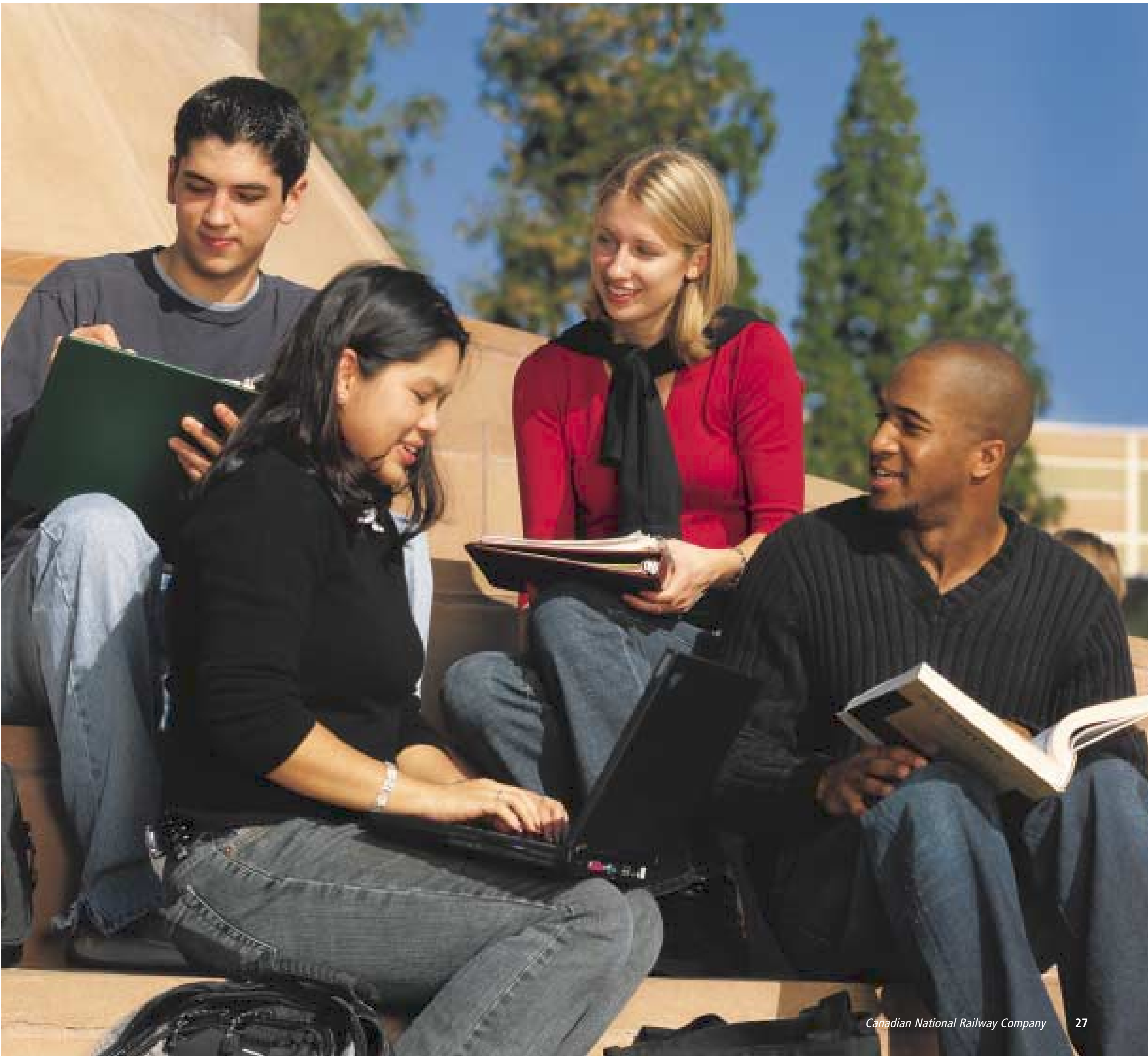
CN's corporate citizenship philosophy, called "Pulling Together," is focused on four areas: community safety, transportation education, community response and United Way/Centraide – areas carefully chosen so our efforts have the best chance to make a difference.

Because we know North America's prosperity is closely linked to its transportation infrastructure, we support study and research in transportation, encouraging young people to get involved in the field and help shape the future. We focus our support on creating and helping to sustain centers of excellence in transportation education and policy by providing funds for university chairs, scholarships and postgraduate fellowships. A few notable examples of our support in 2002:

Sustainable Transport, Logistics and Supply Chain Management Chair, University of Manitoba – A major donation from CN helped to create this chair, to be held at the university's I.H. Asper School of Business starting in 2003. The chair is part of a new program in logistics, transportation and supply chain management at one of Canada's premier centers of study in the transportation field.

The CN Transportation and Logistics Management Fund, University of Wisconsin-Superior – In 2002, CN made a significant contribution to help develop programs and fund scholarships at the school in the transportation management field of study. The fund will provide income to support research projects, scholarships for students majoring in transportation management who maintain high academic standards and program development such as the purchase of specialized simulation software.

The CN Intermodal Transportation Chair, Université de Montréal – The CN chair, created in 2002, continues a long relationship between CN and one of Canada's most prestigious institutions of higher learning. The chair will devote itself primarily to research on intermodal transportation, addressing a range of topics, from the transport of goods to government transportation policies.



Glossary of Terms

Average length of haul – The average distance in miles one ton is carried. Computed by dividing total ton-miles by tons of freight.

Carload – A one-car shipment of freight from one consignor to one consignee.

Car velocity – Car velocity is an average speed calculation, expressed in miles per day, of the car movements from time of release at one location to arrival at the destination.

Class 1 railroad – As determined by the U.S. Surface Transportation Board, a railroad with annual operating revenues that exceed the threshold indexed to a base of U.S.$250 million in 1991 dollars.

Gross ton miles – The weight of railway cars and contents behind the locomotives expressed in tons multiplied by the distance in miles from the originating location to the destination on the railroad.

Intermodal service – In railroad transportation, the movement of trailers or containers on railroad freight cars.

Linehaul – The movement of trains between terminals and stations on the main or branch lines of the road, exclusive of switching movements.

Main track – A track extending through and between stations upon which trains are operated.

Operating ratio – The ratio of operating expenses to operating revenues.

Regional railroad – As defined by the Association of American Railroads, a regional railroad is one that operates at least 350 miles of track and/or has annual revenues of at least U.S.$40 million but less than the Class 1 threshold indexed to a base of U.S.$250 million in 1991 dollars.

Revenue ton mile – The movement of a ton of freight over one mile for revenue.

Right-of-way – A strip of land of various widths upon which a rail track is built.

Rolling stock – Transportation equipment on wheels, especially locomotives and freight cars.

Route miles – The miles of right-of-way operated by a railroad. In multiple track territories only one track counts as route miles.

Scheduled railroad – Running a scheduled railroad is a disciplined process that handles individual car movements according to a specific plan where possible and that manages expectations to meet agreed upon customer commitments.

Siding – A track auxiliary to the main track for meeting or passing trains, or a track for industrial purposes.

Through train – A train operated between two or more major concentration or distribution points.

Trip plan – A trip plan is a detailed chain of train handling events describing how a car(s) can be handled from the shipper's door to the consignee's door. Trip plans are expressed in hours and are tailored for each specific customer location.

Unit train – A train with a fixed, coupled consist of cars operated continuously in shuttle service under load from origin and delivered intact at destination and returning usually for reloading at the same origin.

Waybill – The document covering a shipment and showing the forwarding and receiving stations, the name of consignor and consignee, the car initials and number, the routing, the description and weight of the commodity, instructions for special services, the rate, total charges, advances and waybill reference for previous services, and the amount prepaid.

Yard – A system of tracks within defined limits, designed for switching services.

Yard dwell – Yard dwell is the average duration, expressed in hours, that cars spend in a specific operating terminal.

Financial Section (U.S. GAAP)

Contents

Canadian National Railway Company

Notes to Consolidated Financial Statements

Selected Railroad Statistics

Year ended December 31,	**2002**	2001[1]	2000
Rail operations			
Freight revenues *($ millions)*	**5,901**	5,457	5,236
Gross ton miles *(millions)*	**309,295**	293,857	288,150
Revenue ton miles (RTM) *(millions)*	**159,876**	153,095	149,557
Route miles *(includes Canada and the U.S.)*	**17,821**	17,986	15,532
Operating expenses per RTM *(cents)*	**2.90**	2.59	2.53
Adjusted operating expenses per RTM *(cents)*[2]	**2.65**	2.53	2.53
Freight revenue per RTM *(cents)*	**3.69**	3.56	3.50
Carloads *(thousands)*	**4,164**	3,821	3,796
Freight revenue per carload *($)*	**1,417**	1,428	1,379
Diesel fuel consumed *(liters in millions)*	**1,420**	1,328	1,292
Average fuel price *($/liter)*	**0.32**	0.36	0.33
Revenue ton miles per liter of fuel consumed	**113**	115	116
Gross ton miles per liter of fuel consumed	**218**	221	223
Diesel fuel consumed *(U.S. gallons in millions)*	**375**	351	341
Average fuel price *($/U.S. gallon)*	**1.20**	1.35	1.24
Revenue ton miles per U.S. gallon of fuel consumed	**426**	436	439
Gross ton miles per U.S. gallon of fuel consumed	**825**	837	845
Locomotive bad order ratio *(%)*[3]	**7.0**	7.1	7.0
Freight car bad order ratio *(%)*	**6.0**	5.7	5.1
Productivity			
Adjusted operating ratio *(%)*[2]	**69.4**	68.5	69.6
Freight revenue per route mile *($ thousands)*	**331**	303	337
Revenue ton miles per route mile *(thousands)*	**8,971**	8,512	9,629
Freight revenue per average number of employees *($ thousands)*	**254**	241	233
Revenue ton miles per average number of employees *(thousands)*	**6,894**	6,754	6,660
Employees			
Number at end of period	**22,114**	22,868	21,378
Average number during period	**23,190**	22,668	22,457
Labor and fringe benefits expense per RTM *(cents)*	**1.15**	1.06	0.98
Adjusted labor and fringe benefits expense per RTM *(cents)*[4]	**1.07**	1.00	0.98
Injury frequency rate per 200,000 person hours	**3.0**	4.4	5.5
Accident rate per million train miles	**2.0**	2.0	2.1

(1) Includes Wisconsin Central Transportation Corporation from October 9, 2001.

(2) Excludes a 2002 charge of $281 million to increase the Company's provision for U.S. personal injury and other claims, and workforce reduction charges of $120 million and $98 million in 2002 and 2001, respectively, as discussed in the Company's Management's Discussion and Analysis on pages 31 and 35.

(3) In 2002, the Company expanded its measure of bad order locomotives to include all those not available for service, including on-line failures. The comparative figures have been restated accordingly.

(4) Excludes workforce reduction charges recorded in 2002 and 2001.

Management's discussion and analysis (MD&A) relates to the financial condition and results of operations of Canadian National Railway Company (CN) together with its wholly owned subsidiaries, including Grand Trunk Corporation (GTC), Illinois Central Corporation (IC) and Wisconsin Central Transportation Corporation (WC), the latter from October 9, 2001. 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). This MD&A should be read in conjunction with the Company's Consolidated Financial Statements and notes thereto.

Financial results

2002 compared to 2001

On October 9, 2001, the Company completed its acquisition of WC and began a phased integration of the companies' operations. Accordingly, in the following discussion, the Company's results include the results of operations of WC, which were fully integrated into those of the Company in 2002.

The Company recorded consolidated net income of $800 million ($4.07 per basic share) for the year ended December 31, 2002 compared to $1,040 million ($5.41 per basic share) for the year ended December 31, 2001. Diluted earnings per share were $3.97 for the current year compared to $5.23 in 2001. Operating income was $1,469 million for 2002 compared to $1,682 million in 2001.

The years ended December 31, 2002 and 2001 included items impacting the comparability of the results of operations. Included in 2002 is a fourth quarter charge of $281 million, or $173 million after tax, to increase the Company's provision for U.S. personal injury and other claims, and a charge for workforce reductions of $120 million, or $79 million after tax. In 2001, the Company recorded a deferred income tax recovery of $122 million resulting from the enactment of lower corporate tax rates in Canada, a charge for workforce reductions of $98 million, or $62 million after tax, a charge to write down the Company's net investment in 360networks Inc. of $99 million, or $71 million after tax and a gain of $101 million, or $73 million after tax related to the sale of the Company's 50 percent interest in the Detroit River Tunnel Company (DRT).

Excluding the effects of the items discussed in the preceding paragraph, adjusted consolidated net income(1) was $1,052 million ($5.35 per basic share or $5.22 per diluted share) in 2002 compared to $978 million ($5.09 per basic share or $4.92 per diluted share) in 2001, an increase of $74 million, or 8%. Adjusted operating income,(1) which excludes the 2002 charge to increase the Company's provision for U.S. personal injury and other claims and the 2002 and 2001 workforce reduction charges, increased by $90 million, or 5%, to $1,870 million. The adjusted operating ratio was 69.4% in 2002 compared to 68.5% in 2001, a 0.9-point increase.

(1) The Company's results of operations include items affecting the comparability of results. Management believes adjusted consolidated net income and the resulting adjusted performance measures for such items as operating income, operating ratio, per share data and other statistical measures are useful measures of performance that facilitate period-to-period comparisons. These adjusted measures do not have any standardized meaning prescribed by GAAP and are not necessarily comparable to similar measures presented by other companies, and therefore, should not be considered in isolation.

Revenues

Revenues for the year ended December 31, 2002 totaled $6,110 million compared to $5,652 million in 2001. The increase of $458 million, or 8%, was mainly due to the inclusion of a full year of revenues attributable to the operations of WC in 2002. In addition, revenue gains were made in petroleum and chemicals, automotive, intermodal and forest products. These overall increases in revenues were partly offset by continued weakness in Canadian grain, coal, and metals and minerals. Revenue ton miles increased by 4% relative to 2001 and freight revenue per revenue ton mile increased by 4%.

Year ended December 31,	**2002**	2001	**2002**	2001	**2002**	2001
	Revenues		Revenue ton miles		Freight revenue per revenue ton mile	
	In millions				*In cents*	
Petroleum and chemicals	**$1,102**	$ 923	**30,006**	25,243	**3.67**	3.66
Metals and minerals	**521**	458	**13,505**	10,777	**3.86**	4.25
Forest products	**1,323**	1,088	**33,551**	29,639	**3.94**	3.67
Coal	**326**	338	**14,503**	15,566	**2.25**	2.17
Grain and fertilizers	**986**	1,161	**35,773**	42,728	**2.76**	2.72
Intermodal	**1,052**	969	**29,257**	26,257	**3.60**	3.69
Automotive	**591**	520	**3,281**	2,885	**18.01**	18.02
Other items*	**209**	195	**–**	–	**–**	–
Total	**$6,110**	$5,652	**159,876**	153,095	**3.69**	3.56

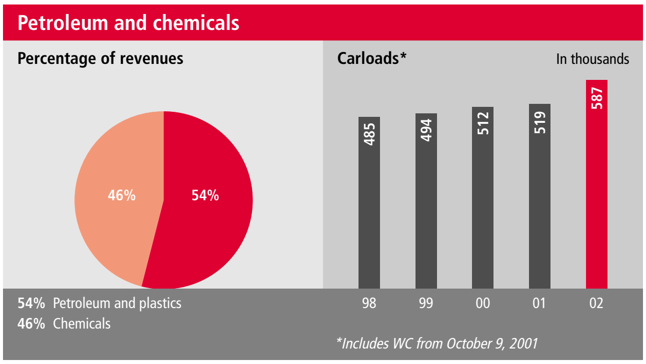
** Principally non-freight revenues derived from third parties.*

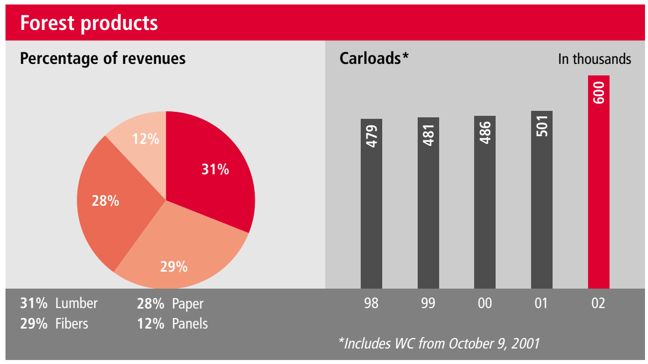
Petroleum and chemicals

Revenues for the year ended December 31, 2002 increased by $179 million, or 19%, over 2001. Growth was mainly due to the inclusion of a full year of revenues attributable to the operations of WC in 2002, strong sulfur traffic to the United States and offshore markets and market share gains in various sectors. The revenue per revenue ton mile remained relatively unchanged for the year as the effect of the weaker Canadian dollar was offset by an increase in the average length of haul for non-WC traffic.

Forest products

Revenues for the year ended December 31, 2002 increased by $235 million, or 22%, over 2001. Growth was mainly due to the inclusion of a full year of revenues attributable to the operations of WC in 2002, a strong North American housing market and improving pulp and paper markets. Also contributing to growth in the second half of the year were strong lumber shipments from CN's western lumber producers. The increase in revenue per revenue ton mile of 7% was mainly due to the effect of the weaker Canadian dollar and the inclusion of shorter haul WC traffic.



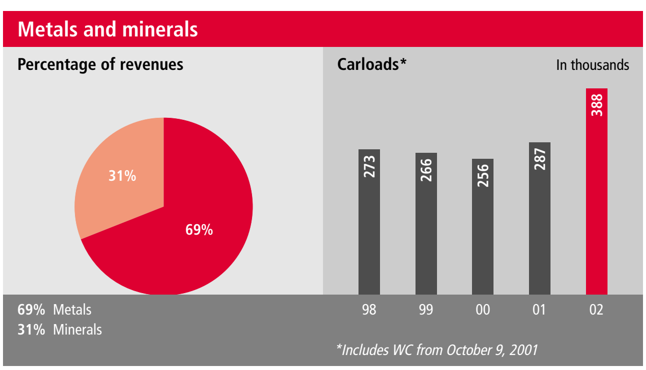


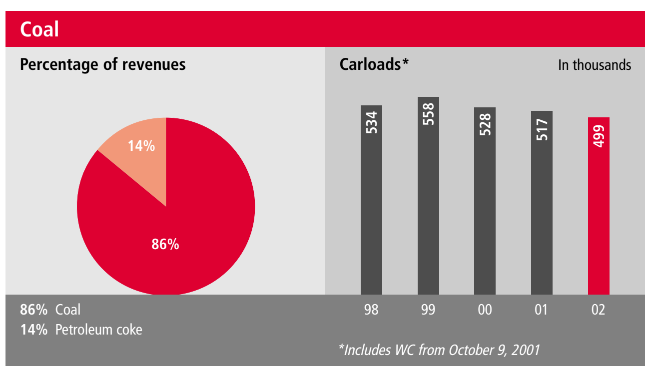
Metals and minerals

Revenues for the year ended December 31, 2002 increased by $63 million, or 14%, over 2001. The increase was mainly due to the inclusion of a full year of revenues attributable to the operations of WC in 2002, market share gains in the non-ferrous segment, particularly aluminum, and strong construction materials traffic. Partly offsetting these gains were the effects of weak steel markets in the first half of the year, one-time gains in 2001 and reduced traffic in specific segments due to ongoing customer strikes. Revenue per revenue ton mile decreased by 9% over 2001 mainly due to an increase in longer haul traffic and the inclusion of certain lower rated WC traffic.

Coal

Revenues for the year ended December 31, 2002 decreased by $12 million, or 4%, from 2001. The decrease was mainly attributable to weak Canadian coal exports to offshore markets and reduced demand from power utilities in the first half of the year. The revenue per revenue ton mile increase of 4% was mainly due to a decrease in longer haul traffic.



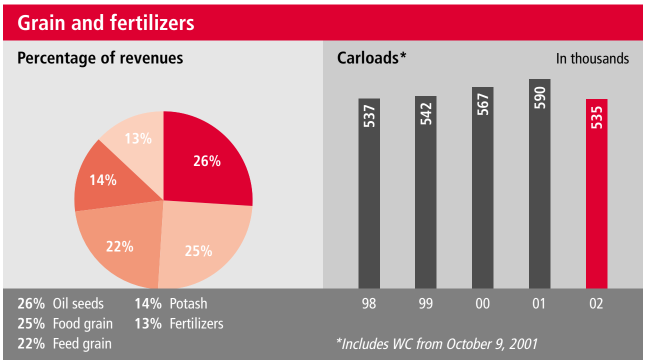


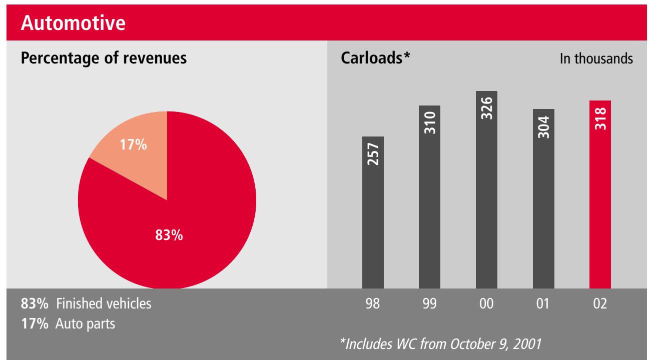
Grain and fertilizers

Revenues for the year ended December 31, 2002 decreased by $175 million, or 15%, from 2001. The decrease reflects a significant deterioration in the Canadian grain crop, a decline in U.S. originated traffic and the loss of a potash move. Revenue per revenue ton mile increased by 1% mainly as a result of an increase in regulated grain rates.

Automotive

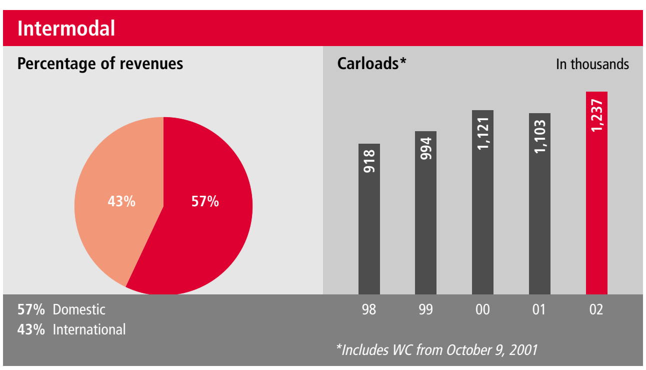
Revenues for the year ended December 31, 2002 increased by $71 million, or 14%, over 2001. The increase reflects strong motor vehicle production in both Canada and the United States. Revenue per revenue ton mile remained relatively unchanged for the year as the effect of the weaker Canadian dollar was offset by an increase in the average length of haul.





Intermodal

Revenues for the year ended December 31, 2002 increased by $83 million, or 9%, over 2001. Growth in the international segment was driven by market share gains by steamship lines served by CN. The domestic segment benefited from growing North American markets, particularly in Canada. Revenue per revenue ton mile decreased by 2%, mainly due to a higher average fuel surcharge in 2001 and an increase in the average length of haul.



Operating expenses

Operating expenses amounted to $4,641 million in 2002 compared to $3,970 million in 2001. The increase was mainly due to the inclusion of a full year of expenses attributable to the operations of WC in 2002, higher Casualty and other expenses resulting primarily from the 2002 charge to increase the Company's provision for U.S. personal injury and other claims, and increased expenses for labor and fringe benefits that included a higher workforce reduction charge in 2002 compared to 2001. These increases were partly offset by lower fuel costs. Operating expenses, excluding the 2002 charge for U.S. personal injury and other claims and the 2002 and 2001 workforce reduction charges, amounted to $4,240 million, an increase of $368 million, or 10%, from 2001.[1]

Dollars in millions *Year ended December 31,*	2002		2001	
	Amount	**% of revenue**	Amount	% of revenue
Labor and fringe benefits	**$1,837**	**30.1%**	$1,624	28.7%
Purchased services and material	**778**	**12.7%**	692	12.2%
Depreciation and amortization	**584**	**9.6%**	532	9.4%
Fuel	**459**	**7.5%**	484	8.6%
Equipment rents	**346**	**5.7%**	309	5.5%
Casualty and other	**637**	**10.4%**	329	5.8%
Total	**$4,641**		$3,970	

Labor and fringe benefits: Labor and fringe benefit expenses in 2002 increased by $213 million, or 13%, as compared to 2001. The increase was mainly due to the inclusion of a full year of expenses attributable to the operations of WC in 2002, a higher workforce reduction charge in 2002, wage increases, and higher benefit expenses, including health and welfare, particularly in the U.S. These increases were partly offset by the effects of a reduced workforce in 2002.

In 2002, the Company announced 1,146 job reductions across all corporate and operating functions in a renewed drive to improve productivity and recorded a workforce reduction charge of $120 million. Reductions relating to this and the 2001 workforce reduction charge were 388 in 2001, 433 in 2002, with the remainder to be completed by the end of 2003. The charges included payments for severance, early retirement incentives and bridging to early retirement, to be made to affected employees.

Purchased services and material: These costs increased by $86 million, or 12%, in 2002 as compared to 2001. The increase was mainly due to the inclusion of a full year of expenses attributable to the operations of WC in 2002 and higher expenses for professional services and joint facilities. These increases were partly offset by reduced expenses for crew transportation and lodging in 2002.

Depreciation and amortization: Depreciation and amortization expense in 2002 increased by $52 million, or 10%, as compared to 2001. The increase was mainly due to the inclusion of a full year of expenses attributable to the operations of WC in 2002 and the impact of net capital additions in the current year.

Fuel: Fuel expense in 2002 decreased by $25 million, or 5%, as compared to 2001. The decrease was primarily due to a lower average price of fuel, partially offset by the inclusion of a full year of expenses attributable to the operations of WC in 2002.

Equipment rents: These expenses increased by $37 million, or 12%, in 2002 as compared to 2001. The increase was mainly due to the inclusion of a full year of expenses attributable to the operations of WC in 2002 and lower car hire income, partly offset by reduced expenses for long-term operating leases.

Casualty and other: These expenses increased by $308 million, or 94%, in 2002 as compared to 2001. The increase was mainly due to higher expenses for personal injury and other claims which included a fourth quarter 2002 charge of $281 million to increase the provision for U.S. personal injury and other claims, and higher derailment related expenses. Partly offsetting these increases were lower expenses related to environmental matters and bad debts.

Other

Interest expense: Interest expense increased by $34 million to $361 million for the year ended December 31, 2002 as compared to 2001. The increase was mainly due to the financing related to the acquisition of WC and the inclusion of a full year of WC expenses in 2002. Partly offsetting these increases was lower interest expense as a result of the conversion of the convertible preferred securities in July 2002 and the maturity of certain notes in 2001.

Other income: In 2002, the Company recorded other income of $76 million compared to $65 million in 2001. The increase was mainly due to the inclusion of a full year of equity in earnings of English Welsh and Scottish Railway (EWS) in 2002 partly offset by lower gains on disposal of properties. Included in 2001 was a charge of $99 million to write down the Company's net investment in 360networks Inc. and a gain of $101 million related to the sale of the Company's 50 percent interest in DRT.

Income tax expense: The Company recorded income tax expense of $384 million for the year ended December 31, 2002 compared to $380 million in 2001. The effective tax rate for the year ended December 31, 2002 was 32.4% compared to 35.4% in 2001, excluding the 2001 deferred income tax recovery of $122 million resulting from the enactment of lower corporate tax rates in Canada. The decrease in 2002 was primarily due to lower income tax rates in Canada.

2001 compared to 2000

The Company recorded consolidated net income of $1,040 million ($5.41 per basic share) for the year ended December 31, 2001 compared to $937 million ($4.81 per basic share) for the year ended December 31, 2000. Diluted earnings per share were $5.23 for 2001 compared to $4.67 in 2000. The results for 2001 include net income of $17 million related to the acquisition of WC. Operating income was $1,682 million for 2001 compared to $1,648 million in 2000. This represents an increase of $34 million, or 2%.

The years ended December 31, 2001 and 2000 included items impacting the comparability of the results of operations. Included in 2001 is a deferred income tax recovery of $122 million resulting from the enactment of lower corporate tax rates in Canada, a charge for workforce reductions of $98 million, or $62 million after tax, a charge to write down the Company's net investment in 360networks Inc. of $99 million, or $71 million after tax and a gain of $101 million, or $73 million after tax related to the sale of the Company's 50 percent interest in DRT. In 2000, the Company recorded a gain of $84 million, or $58 million after tax related to the exchange of its minority equity investments in certain joint venture companies for 11.4 million shares of 360networks Inc.

Excluding the effects of the items discussed in the preceding paragraph, adjusted consolidated net income[1] was $978 million ($5.09 per basic share or $4.92 per diluted share) in 2001 compared to $879 million ($4.51 per basic share or $4.39 per diluted share) in 2000. Adjusted operating income,[1] which excludes the 2001 charge for workforce reductions, increased by $132 million, or 8%, to $1,780 million. The adjusted operating ratio, which excludes the 2001 charge for workforce reductions, improved to 68.5% in 2001 from 69.6% in 2000, a 1.1-point betterment.

Revenues

Revenues for the year ended December 31, 2001 totaled $5,652 million compared to $5,428 million in 2000. The increase of $224 million, or 4%, was mainly attributable to the inclusion of $129 million of WC revenues and to gains in metals and minerals, intermodal, forest products and grain and fertilizers. This was partially offset by lower automotive revenues. Revenue ton miles and freight revenue per revenue ton mile each increased by 2% as compared to 2000.

Year ended December 31,	2001	2000	2001	2000	2001	2000
	Revenues		Revenue ton miles		Freight revenue per revenue ton mile	
	In millions				*In cents*	
Petroleum and chemicals	$ 923	$ 894	25,243	24,858	3.66	3.60
Metals and minerals	458	392	10,777	9,207	4.25	4.26
Forest products	1,088	1,008	29,639	28,741	3.67	3.51
Coal	338	328	15,566	15,734	2.17	2.08
Grain and fertilizers	1,161	1,136	42,728	42,396	2.72	2.68
Intermodal	969	919	26,257	25,456	3.69	3.61
Automotive	520	559	2,885	3,165	18.02	17.66
Other items*	195	192	–	–	–	–
Total	$5,652	$5,428	153,095	149,557	3.56	3.50

** Principally non-freight revenues derived from third parties.*

Petroleum and chemicals

Revenues for the year ended December 31, 2001 increased by $29 million, or 3%, over 2000 of which $22 million resulted from the inclusion of WC revenues. Excluding WC, growth in 2001 was driven by market share gains and plant expansions in the petroleum products sector, increased salt traffic, mainly in the early part of the year, and the weaker Canadian dollar. Significant weakness in sulfur demand partially offset these increases. The revenue per revenue ton mile increase of 2% for 2001 was mainly attributable to the effect of the weaker Canadian dollar.

Metals and minerals

Revenues for the year ended December 31, 2001 increased by $66 million, or 17%, over 2000 of which $22 million resulted from the inclusion of WC revenues. Excluding WC, growth in 2001 was driven by strong Canadian aluminum exports to the United States in line with weaker U.S. production, increased levels of equipment traffic, market share gains in steel, ores and concentrates, and increased stone and rock shipments to the United States. Significant weakness in the steel markets partially offset overall growth. Revenue per revenue ton mile was essentially flat year over year.

Forest products

Revenues for the year ended December 31, 2001 increased by $80 million, or 8%, over 2000 of which $55 million resulted from the inclusion of WC revenues. Excluding WC, growth was driven by market share gains in the panels segment and the effect of the weaker Canadian dollar. These gains were partially offset by weakness in the pulp and paper markets due, in part, to a significant reduction in U.S. paper consumption. The increase in revenue per revenue ton mile of 5% was mainly due to the effect of the weaker Canadian dollar and the inclusion of shorter haul WC traffic.

Coal

Revenues for the year ended December 31, 2001 increased by $10 million, or 3%, over 2000 of which $7 million resulted from the inclusion of WC revenues. Excluding WC, strong demand for thermal coal in 2001 was partially offset by reduced shipments of metallurgical coal due to the closure of some Canadian mines in 2000. The revenue per revenue ton mile increase of 4% was mainly due to an increase in rates tied to commodity prices and the effect of the weaker Canadian dollar.

Grain and fertilizers

Revenues for the year ended December 31, 2001 increased by $25 million, or 2%, over 2000 of which $15 million resulted from the inclusion of WC revenues. Excluding WC, growth was mainly driven by higher wheat shipments to the United States, increased market share of U.S. corn and soybean traffic and higher exports of canola through Vancouver. The 1% increase in revenue per revenue ton mile was mainly due to a shift to shorter haul traffic and the effect of the weaker Canadian dollar, partially offset by the introduction of the Canadian grain revenue cap in August 2000.

Intermodal

Revenues for the year ended December 31, 2001 increased by $50 million, or 5%, over 2000 of which $7 million resulted from the inclusion of WC revenues. Excluding WC, growth was driven by market share gains in the international segment and from new service offerings in the domestic segment. Weaker economic conditions in the second half of 2001 led to slower growth. Revenue per revenue ton mile increased by 2% due to rate increases and the effect of the weaker Canadian dollar, partially offset by a shift to longer haul traffic.

Automotive

Revenues for the year ended December 31, 2001 decreased by $39 million, or 7%, from 2000. The revenue decline resulted from weakness in North American vehicle production in 2001 and from one-time gains obtained in 2000 due, in part, to competitors' service problems. The decline was partially offset by the effect of the weaker Canadian dollar. The increase in revenue per revenue ton mile of 2% was mainly due to the weaker Canadian dollar partially offset by an increase in the average length of haul.

Operating expenses

Operating expenses amounted to $3,970 million in 2001 compared to $3,780 million in 2000. The increase in 2001 was mainly due to the inclusion of $86 million of WC expenses, higher labor and fringe benefit expenses that included a charge for workforce reductions of $98 million, higher fuel costs, and increased expenses for equipment rents. Partially offsetting these increases were lower expenses for purchased services and material. Operating expenses, excluding the workforce reduction charge, amounted to $3,872 million, an increase of $92 million, or 2%, from 2000.[1]

Dollars in millions *Year ended December 31,*	2001		2000	
	Amount	% of revenue	Amount	% of revenue
Labor and fringe benefits	$1,624	28.7%	$1,472	27.1%
Purchased services and material	692	12.2%	746	13.8%
Depreciation and amortization	532	9.4%	525	9.7%
Fuel	484	8.6%	446	8.2%
Equipment rents	309	5.5%	285	5.2%
Casualty and other	329	5.8%	306	5.6%
Total	$3,970		$3,780	

Labor and fringe benefits: Labor and fringe benefit expenses in 2001 increased by $152 million, or 10%, as compared to 2000. The increase was mainly attributable to the workforce reduction charge, the inclusion of WC labor expense of $40 million, wage increases and the impact of the weaker Canadian dollar on U.S. denominated expenses. This was partially offset by lower pension and other benefit related expenses.

The Company recorded a workforce reduction charge of $98 million in the second quarter of 2001 for the reduction of 690 positions (388 occurred in 2001 and the remainder was completed by the end of 2002). The charge included payments for severance, early retirement incentives and bridging to early retirement, to be made to affected employees.

Purchased services and material: These expenses decreased by $54 million, or 7%, in 2001 as compared to 2000. The decrease was mainly due to one-time consulting and professional fees related to a proposed combination in 2000, lower contracted services and higher recoveries in 2001 from work performed for third parties. This was partially offset by higher equipment repair and maintenance expenses and $12 million resulting from the inclusion of WC expenses.

Depreciation and amortization: Depreciation and amortization expense in 2001 increased by $7 million, or 1%, as compared to 2000. The effect of revised depreciation rates for certain assets mostly offset the increases related to net capital additions and the inclusion of WC depreciation of $10 million.

Fuel: Fuel expense in 2001 increased by $38 million, or 9%, as compared to 2000, primarily due to an increase in the average cost of fuel and the inclusion of $10 million of WC fuel expense.

Equipment rents: These expenses increased by $24 million, or 8%, in 2001 as compared to 2000. The increase was mainly attributable to lower lease and offline car hire income and the inclusion of $6 million of WC equipment rents. This was partially offset by lower private car mileage payments.

Casualty and other: These expenses increased by $23 million, or 8%, in 2001 as compared to 2000. The increase resulted from higher expenses for occupational disease claims and environmental matters, higher provincial capital taxes and the inclusion of $8 million of WC expenses. This was partially offset by lower expenses for damaged equipment and merchandise claims and provincial sales tax recoveries in 2001.

Other

Interest expense: Interest expense increased by $16 million to $327 million for the year ended December 31, 2001 as compared to 2000. The increase was mainly due to the financing related to the acquisition of WC, the inclusion of $4 million of WC interest expense, and the impact of the weaker Canadian dollar on U.S. denominated interest costs. This was, in part, offset by the refinancing of a portion of matured debt at lower rates.

Other income: In 2001, the Company recorded other income of $65 million compared to $136 million in 2000. Included in 2001 is a charge of $99 million to write down the Company's net investment in 360networks Inc., a gain of $101 million related to the sale of the Company's 50 percent interest in DRT and $11 million of WC other income. The comparative 2000 period included an $84 million gain related to the 360networks Inc. transaction.

Income tax expense: The Company recorded an income tax expense of $380 million for the year ended December 31, 2001 compared to $536 million in 2000. The decrease in income tax expense was mainly due to a $122 million deferred income tax recovery recorded in 2001 resulting from the enactment of lower corporate tax rates in Canada. Excluding this item, the effective tax rate for the year ended December 31, 2001 decreased to 35.4% from 36.4% in 2000 due mainly to lower tax rates in 2001.

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 its Accounts receivable 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 $1,612 million for the year ended December 31, 2002 compared to $1,621 million for 2001. Cash generated in 2002 was partially consumed by payments for interest, workforce reductions and personal injury and other claims of $398 million, $177 million and $156 million, respectively, compared to $322 million, $169 million and $149 million, respectively in 2001. Pension contributions and payments for income taxes were $92 million and $65 million, respectively, compared to $69 million and $63 million, respectively in 2001. The Company increased the level of accounts receivable sold under its Accounts receivable securitization program by $5 million in 2002 and $133 million in 2001. Payments in 2003 for workforce reductions are expected to be $168 million while pension contributions are expected to be approximately $92 million.

Investing activities: Cash used by investing activities in 2002 amounted to $924 million compared to $2,173 million in 2001. The Company's investing activities in 2002 included aggregate net proceeds of $69 million from the sale of its investments in Tranz Rail Holdings Limited and Australian Transport Network Limited, and $28 million from the sale of IC Terminal Holdings Company. Investing activities in 2001 included $1,278 million related to the acquisition of WC as at October 9, 2001 and net proceeds of $112 million from the sale of DRT. Net capital expenditures for the year ended December 31, 2002 amounted to $938 million, including $76 million related to WC, a decrease of $3 million over 2001. Net capital expenditures included expenditures for roadway renewal, rolling stock, and other capacity and productivity improvements.

The Company anticipates that capital expenditures for 2003 will remain at approximately the same level as 2002. This will include funds required for ongoing renewal of the basic plant and other acquisitions and investments required to improve the Company's operating efficiency and customer service.

As at December 31, 2002, the Company had commitments to acquire railroad ties, rail, freight cars and locomotives at an aggregate cost of $183 million.

Dividends: During 2002, the Company paid dividends totaling $170 million to its shareholders at the quarterly rate of $0.215 per share.

Free cash flow

The Company generated $513 million of free cash flow for the year ended December 31, 2002, compared to $443 million for the same 2001 period, excluding $1,278 million related to the 2001 acquisition of WC. The Company defines free cash flow as cash provided from operating activities, excluding increases in the level of accounts receivable sold under the securitization program ($5 million in 2002, $133 million in 2001), less capital expenditures, other investing activities and dividends paid.

Financing activities: Cash used by financing activities totaled $546 million for the year ended December 31, 2002 compared to cash generated of $740 million in 2001. In 2002, issuances and repayments of long-term debt related principally to the Company's commercial paper and revolving credit facilities. In 2001, the Company issued debt securities in two series, U.S.$400 million (Cdn$629 million) 6.375% Notes due 2011 and U.S.$200 million (Cdn$314 million) 7.375% Debentures due 2031, related to the acquisition of WC.

In 2002, $203 million was used to repurchase common shares under the share repurchase program. In 2001, the Company also had a share repurchase program, under which it did not repurchase any common shares.

During 2002, the Company recorded $114 million in capital lease obligations ($91 million in 2001) related to new equipment and the exercise of purchase options on existing equipment.

The Company has access to various financing arrangements:

Revolving credit facilities

In December 2002, the Company entered into a U.S.$1,000 million three-year revolving credit facility and concurrently terminated its previous revolving credit facilities before their scheduled maturity in March 2003. The credit facility provides for borrowings at various interest rates, plus applicable margins, and contains customary financial covenants. Throughout the year, the Company was in compliance with all financial covenants contained in its outstanding revolving credit agreements. The Company's borrowings of U.S.$172 million (Cdn$273 million) outstanding at December 31, 2001 were entirely repaid in the first quarter of 2002. At December 31, 2002, the Company had borrowings under its revolving credit facility of U.S.$90 million (Cdn$142 million) at an average interest rate of 1.77%. Outstanding letters of credit under the previous facilities were transferred into the current facility. As at December 31, 2002, letters of credit under the revolving credit facility amounted to $295 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 $600 million, or the U.S. dollar equivalent. Commercial paper debt is due within one year but has been classified as long-term debt, reflecting the Company's intent and contractual ability to refinance the short-term borrowing through subsequent issuances of commercial paper or drawing down on the long-term revolving credit facility. As at December 31, 2002, the Company had outstanding commercial paper of U.S.$136 million (Cdn$214 million) compared to U.S.$213 million (Cdn$339 million) as at December 31, 2001.

Shelf registration statement

At December 31, 2002, the Company had U.S.$400 million remaining for issuance under its shelf registration statement, which expires in August 2003.

Accounts receivable securitization program

The sale of a portion of the Company's accounts receivable is conducted under a securitization program, which has a $350 million maximum limit and will expire in June 2003. The program is subject to customary credit rating and reporting requirements. In the event the program is terminated before its scheduled maturity, the Company expects to have sufficient liquidity remaining in its revolving credit facility to meet its payment obligations. The Company intends to renew or replace the program upon expiration. At December 31, 2002, pursuant to the agreement, $173 million and U.S.$113 million (Cdn$177 million) had been sold on a limited recourse basis, an increase of $5 million from the level of accounts receivable sold at December 31, 2001.

The Receivables Purchase Agreement provides for customary indemnification provisions, which survive for a period of two years following the final purchase of any receivable, three years from the final collection date or until statute barred, in the case of taxes. As at December 31, 2002, the Company has not recorded a liability associated with these indemnifications, for which there is no monetary limitation, as the Company does not expect to make any payments pertaining to the indemnifications of this program. Although there is no monetary limitation with respect to these indemnifications, the Company would not expect the amount to exceed the maximum limit under the program.

Contractual obligations and commercial commitments

In the normal course of business, the Company incurs contractual obligations and commercial commitments. The following tables set forth material obligations and commitments as of December 31, 2002:

Contractual obligations

In millions	**Total**	2003	2004	2005	2006	2007	2008 and thereafter
Debentures and notes	**$4,167**	$394	$419	$158	$394	$ 79	$2,723
Capital leases and other[a]	**1,424**	180	141	444	46	90	523
Long-term debt	**5,591**	574	560	602	440	169	3,246
Operating leases	**1,154**	212	188	167	139	120	328
Total obligations	**$6,745**	**$786**	**$748**	**$769**	**$579**	**$289**	**$3,574**

Commercial commitments

In millions	**Total**	2003	2004	2005	2006	2007	2008 and thereafter
Standby letters of credit	**$403**	$401	$ 1	$–	$1	$–	$–
Other commercial commitments[b]	**183**	112	71	–	–	–	–
Total commitments	**$586**	**$513**	**$72**	**$–**	**$1**	**$–**	**$–**

(a) Excludes $498 million of imputed interest on capital leases at rates ranging from approximately 3.0% to 14.6%.

(b) Includes commitments for railroad ties, rail, freight cars and locomotives.

For 2003 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.

Guarantees

Guarantee of residual values of operating leases
The Company has guaranteed a portion of the residual values of certain of its assets under operating leases with expiry dates between 2004 and 2012, for the benefit of the lessor. If the fair value of the assets, at the end of their respective lease term, is less than the fair value, as estimated at the inception of the lease, then the Company must, under certain conditions, compensate the lessor for the shortfall. The maximum exposure in respect of these guarantees is $63 million. As at December 31, 2002, the Company has not recorded a liability associated with these guarantees, as the Company does not expect to make any payments pertaining to the guarantees of these leases.

Standby letters of credit
The Company, including certain of its subsidiaries, has granted irrevocable standby letters of credit, issued by highly rated banks, to third parties to indemnify them in the event the Company does not perform its contractual obligations. As at December 31, 2002, the maximum potential liability under these letters of credit was $403 million of which $334 million was for workers' compensation and other employee benefits and $69 million was for equipment under leases and other.

As at December 31, 2002, the Company has not recorded a liability with respect to these guarantees, as the Company does not expect to make any payments in excess of what is recorded on the Company's financial statements for the aforementioned items. The standby letters of credit mature at various dates between 2003 and 2007.

Indemnifications

CN Pension Plan and CN 1935 Pension Plan
The Company has indemnified and held harmless the current trustee and the former trustee of the Canadian National Railways Pension Trust Funds, and the respective officers, directors, employees and agents of such trustees, from any and all taxes, claims, liabilities, damages, costs and expenses arising out of the performance of their obligations under the relevant trust agreements and trust deeds, including in respect of their reliance on authorized instructions of the Company or for failing to act in the absence of authorized instructions. These indemnifications survive the termination of such agreements or trust deeds. As at December 31, 2002, the Company has not recorded a liability associated with these indemnifications, as the Company does not expect to make any payments pertaining to these indemnifications.

Share repurchase program

On October 22, 2002, the Board of Directors of the Company approved a share repurchase program which allows for the repurchase of up to 13.0 million common shares between October 25, 2002 and October 24, 2003 pursuant to a normal course issuer bid, at prevailing market prices. As at December 31, 2002, $203 million was used to repurchase 3.0 million common shares at an average price of $67.68 per share.

Termination of conversion rights of 5.25% convertible preferred securities ("Securities")

On May 6, 2002, the Company met the conditions required to terminate the Securities holders' right to convert their Securities into common shares of the Company, and set the conversion termination date as July 3, 2002. The conditions were met when the Company's common share price exceeded 120% of the conversion price of U.S.$38.48 per share for a specified period, and all accrued interest on the Securities had been paid. On July 3, 2002, Securities that had not been previously surrendered for conversion were deemed converted, resulting in the issuance of 6.0 million common shares of the Company.

Acquisition of Wisconsin Central Transportation Corporation

On October 9, 2001, the Company completed its acquisition of WC for an acquisition cost of $1,301 million (U.S.$833 million) and began a phased integration of the companies' operations.

The Company accounted for the merger using the purchase method of accounting as required by the Financial Accounting Standards Board's (FASB) Statement of Financial Accounting Standards (SFAS) No. 141 "Business Combinations." As such, the Company's consolidated financial statements include the assets, liabilities and results of operations of WC as of October 9, 2001, the date of acquisition. The Company had estimated, on a preliminary basis, the fair values of the assets and liabilities acquired based on currently available information. In 2002, the Company finalized the allocation of the purchase price and adjusted the preliminary fair values of the assets and liabilities acquired as follows: Current assets decreased by $10 million, Properties increased by $141 million, Other assets and deferred charges decreased by $98 million, Current liabilities increased by $10 million, Deferred income taxes increased by $16 million and Other liabilities and deferred credits increased by $3 million. The increase in Properties and decrease in Other assets and deferred charges was mainly due to the final valuation of the Company's foreign equity investment. The remaining adjustments resulted from additional information obtained for conditions and circumstances that existed at the time of acquisition.

The following table outlines the final fair values of WC's assets and liabilities acquired:

In millions	
Current assets	$ 165
Properties	2,576
Other assets and deferred charges	335
Total assets acquired	3,076
Current liabilities	363
Deferred income taxes	759
Other liabilities and deferred credits	181
Long-term debt	472
Total liabilities assumed	1,775
Net assets acquired	$1,301

Recent accounting pronouncements

In January 2003, the FASB issued FASB Interpretation (FIN) No. 46, "Consolidation of Variable Interest Entities." FIN No. 46 requires that an enterprise holding other than a voting interest in a Variable Interest Entity (VIE) could, subject to certain conditions, be required to consolidate the VIE if the enterprise will absorb a majority of the VIE's expected losses and/or receive a majority of its expected residual returns. This interpretation is effective for newly created entities after January 31, 2003. For pre-existing VIEs, the provisions of the interpretation are effective for periods beginning after June 15, 2003. The Company does not expect FIN No. 46 to have a material impact on its financial statements.

In November 2002, the FASB issued FIN No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others," which requires that a guarantor disclose and recognize in its financial statements its obligations relating to guarantees that it has issued. Liability recognition is required at the inception of the guarantee, whether or not payment is probable. The disclosure requirements are effective for periods ending after December 15, 2002, and have been reflected in the notes to the Company's 2002 consolidated financial statements. The recognition and measurement provisions are effective for guarantees issued or modified after December 31, 2002. The Company will apply the recognition and measurement provisions of FIN No. 45 on a prospective basis and, as such, does not expect it to have an initial material impact on its financial statements upon adoption.

In July 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities," which requires that a liability for costs associated with an exit or disposal activity be recognized when the liability is incurred. SFAS No. 146 also establishes that the liability should be initially measured at fair value and subsequently adjusted for changes in estimated cash flows. SFAS No. 146 is to be applied to exit or disposal activities initiated after December 31, 2002. The Company will apply SFAS No. 146 on a prospective basis and, as such, does not expect it to have an initial material impact on its financial statements upon adoption.

In August 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations," which requires an entity to record the fair value of an asset retirement obligation as a liability in the period in which it incurs a legal obligation associated with the retirement of tangible long-lived assets. As a result of the issuance of SFAS No. 143, the Company is reviewing the accounting policy of its asset replacement program. A change in this policy will be treated as a change in accounting principle with a cumulative effect adjustment being recorded in the first quarter of 2003. This statement is effective for the Company's fiscal year beginning January 1, 2003. The Company is currently evaluating the impact of this statement on its financial statements.

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 matters, depreciation lives, 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 Consolidated Financial Statements and notes thereto.

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

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.

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 changed certain of these assumptions, which have not had a material effect on its results of operations. 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) and represent a major expense for the railroad industry. The FELA system, which requires either the finding of fault through the U.S. jury system or individual settlements, has contributed to the significant increase in the Company's personal injury expense in recent years. In view of the Company's growing presence in the United States and the increase in the number of occupational disease claims over the past few years, an actuarial study was conducted in 2002, and in the fourth quarter of 2002 the Company changed its methodology for estimating its liability for U.S. personal injury and other claims, including occupational disease claims and claims for property damage, from a case-by-case approach to an actuarial-based approach. Consequently, and as discussed in Note 2 to the Consolidated Financial Statements, the Company recorded a charge of $281 million ($173 million after tax) to increase its provision for these claims.

Under the actuarial-based approach, the Company accrues the cost for the expected personal injury and property damage claims and existing occupational disease claims, based on actuarial estimates of their ultimate cost. The Company is unable to estimate the total cost for unasserted occupational disease claims. However, a liability for unasserted occupational disease claims is accrued to the extent they are probable and can be reasonably estimated.

Under the case-by-case approach, the Company was accruing the cost for claims as incidents were reported based on currently available information. In addition, the Company did not record a liability for unasserted claims, as such amounts could not be reasonably estimated under the case-by-case approach.

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 $25 million and the annual expense by approximately $5 million.

The Company's expenses for personal injury and other claims, net of recoveries, and including the above-mentioned charge, were $393 million in 2002 ($78 million in 2001 and $60 million in 2000) and payments for such items were $156 million in 2002 ($149 million in 2001 and $111 million in 2000). As at December 31, 2002, the Company had aggregate reserves for personal injury and other claims of $664 million ($430 million at December 31, 2001).

Environmental matters

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 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 technique, 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 environmental assessment conducted on a site-by-site basis. A liability is initially recorded at the completion of the second phase and adjusted, if necessary, upon completion of the third and/or fourth phase depending on the facts, as they become known.

The initial phase entails an overview of the pertinent site and includes obtaining and reviewing historical data. At the end of the second phase, the presence or absence of contamination is confirmed for those sites identified as a concern in the initial phase. Upon completion of phase three, the extent of the contamination is determined and if necessary, options are developed to monitor, contain or remediate the contamination. In the final phase, the remediation or containment program is put in operation.

Cost scenarios are established by external consultants based on extent of contamination and expected costs for remedial efforts. The Company uses these scenarios to estimate the costs related to a particular site. At December 31, 2002, most of the Company's properties not acquired through recent acquisitions are approaching phase four and therefore costs related to such sites may change based on information as it becomes available. For properties acquired through recent acquisitions, the Company obtained assessments from both external and internal consultants and a liability has been accrued based on such assessments. These estimates may change based on information as it becomes available.

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 year they become known.

Future occurrences

In the operation of a railroad, 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.

The Company's expenses relating to environmental matters, net of recoveries, have not been significant in the past three years. Payments for such items were $16 million in 2002 ($14 million in 2001 and $11 million in 2000). As at December 31, 2002, the Company had aggregate accruals for environmental costs of $106 million ($112 million at December 31, 2001). The Company anticipates that the majority of the liability will be paid out over the next five years.

Depreciation lives

Railroad properties are carried at cost less accumulated depreciation including asset impairment write-downs. The Company follows the group method of depreciation 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 $12 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 2001, the Company conducted a comprehensive study for its Canadian properties, which revealed that estimated depreciable lives for certain asset types had increased, and therefore those asset lives were extended prospectively. As a result, depreciation expense was reduced by $44 million for the year ended December 31, 2001. The study conducted in 2000 for the Company's U.S. properties did not have an impact on depreciation expense.

In 2002, the Company recorded total depreciation and amortization expense of $591 million ($538 million in 2001 and $533 million in 2000). At December 31, 2002, the Company had Properties of $19,681 million, net of accumulated depreciation of $9,159 million ($19,145 million in 2001, net of accumulated depreciation of $9,006 million).

Pensions and other post-retirement benefits

The Company accounts for pension 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 plan performance over the expected average remaining service life of the employee group covered by the plans. The following description pertaining to pensions relate generally to the Company's main pension plan, the CN Pension Plan. The Company's other pension plans are not significant.

For pensions, an actuarial valuation is required at least on a triennial basis. However, for the last 15 years, the Company has conducted an annual actuarial valuation to account for pensions, which uses management assumptions for the discount rate, the expected long-term rate of return on plan assets and the rate of compensation increase. The Canadian plans have a measurement date of December 31 whereas the U.S. plans have a measurement date of September 30. 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 or 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 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 economic conditions, employee demographics, mortality rates and investment performance.

The Company sets its discount rate assumption annually to reflect the rates available on high-quality, fixed-income debt instruments with a duration of approximately 11 years, which is expected to match the timing and amount of expected benefit payments. High quality debt instruments are corporate bonds with a rating of AA or better. A discount rate of 6.5%, based on bond yields prevailing at December 31, 2002, was considered appropriate by the Company and is supported by reports issued by third party advisors. A one-percentage-point change in the discount rate would not cause a material change in the Company's net periodic benefit cost.

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 and the expected composition of the plans' assets. The Company has elected to use a market-related value of assets, whereby realized and unrealized capital gains and losses are recognized over a period of five years, while investment and dividend income are recognized immediately. The Company follows a disciplined investment strategy, which limits investments in international companies and prohibits investments in speculative type assets and as such, the Company does not anticipate the expected average rate of return on plan assets to fluctuate materially when compared to major capital market indices. During the last ten years ended December 31, 2002, the CN Pension Plan earned an annual average rate of return of 9.6%. The actual and market-related value rates of return on plan assets for the last five years were as follows:

Rates of return	**2002**	2001	2000	1999	1998
Actual	**(0.3)%**	(1.4)%	10.5%	15.0%	12.6%
Market-related value	**7.4 %**	10.2 %	13.7%	13.8%	10.4%

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. However, given the recent performance of its plan assets and the equity markets in North America, the Company will, effective for 2003, reduce the expected long-term rate of return on plan assets from 9% to 8% to reflect management's current view of long-term investment returns. The effect of this change in management's assumption will be to increase net periodic benefit cost in 2003 by approximately $50 million.

Based on the fair value of the assets held as at December 31, 2002, the plan assets are comprised of 1% in cash and short-term investments, 40% in bonds and mortgages, 50% in Canadian and foreign equities and 9% in real estate and oil and gas assets. The long-term asset allocation percentages are not expected to differ materially from the current composition.

The rate of compensation increase of 4% 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 was 18% in the current year, and it is assumed that the rate will decrease gradually to 8% in 2012 and remain at that level thereafter. 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.

The latest actuarial valuation of the CN Pension Plan was conducted as at December 31, 2001 and indicated a funding excess. Based on the Pension Plan's current position, the Company's contributions are expected to be approximately $75 million in each of 2003, 2004 and 2005. The assumptions discussed above are not expected to have a significant impact on the cash funding requirements of the pension plan in 2003.

For pensions, the Company recorded consolidated net periodic benefit income of $20 million and $13 million in 2002 and 2001, respectively, and net periodic benefit cost of $6 million in 2000. Consolidated net periodic benefit cost for other post-retirement benefits was $45 million, $35 million, and $25 million in 2002, 2001, and 2000, respectively. At December 31, 2002, the Company's accrued benefit cost for post-retirement benefits other than pensions was $284 million ($258 million at December 31, 2001). In addition, at December 31, 2002, the Company's consolidated pension benefit obligation and accumulated post-retirement benefit obligation were $11,243 million and $444 million, respectively ($11,156 million and $309 million at December 31, 2001).

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, 2002, 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 asset is 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 liability is mainly composed of temporary differences related to properties, including purchase accounting adjustments. Estimating the ultimate settlement period, given that depreciation rates in effect are based on information as it develops, requires judgment and management's best estimates. The reversal of timing 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 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 $12 million in 2002. In 2001, the Company recorded a reduction of $90 million to its net deferred income tax liability resulting from the enactment of lower corporate tax rates in Canada. As a result, for the year ended December 31, 2001, a deferred income tax recovery of $122 million was recorded in the Consolidated statement of income and a deferred income tax expense of $32 million was recorded in Other comprehensive income.

For the year ended December 31, 2002, the Company recorded total income tax expense of $384 million ($380 million in 2001 and $536 million in 2000) of which $272 million was for deferred income taxes ($295 million in 2001 and $312 million in 2000). The Company's net deferred income tax liability at December 31, 2002 was $4,704 million ($4,438 million at December 31, 2001).

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. 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 factors 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 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 certain 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.

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.

In recent years, there has been significant consolidation of rail systems in the United States. The resulting larger rail systems are able to offer seamless services in larger market areas and effectively compete with the Company in certain markets. 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 federal, provincial, state, municipal and local regulations under environmental laws and regulations 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 the operation of a railroad, 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.

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 technique, 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, 2002, 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 January 2003, the Company has labor agreements with bargaining groups representing substantially its entire Canadian unionized workforce. These agreements are generally effective until December 31, 2003.

U.S. workforce

The general approach to labor negotiations by U.S. Class 1 railroads is to bargain on a collective national basis. Grand Trunk Western (GTW), Duluth, Winnipeg and Pacific (DWP), ICRR, CCP Holdings, Inc. (CCP) and just recently WC, have bargained on a local basis rather than holding national, industry wide negotiations because 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.

As of January 2003, the Company has in place agreements with bargaining units representing the entire unionized workforce at ICRR, GTW, DWP, and CCP, and 65% of the unionized workforce at WC. These agreements have various moratorium provisions, ranging from the end of 2001 to the end of 2005, which preserve the status quo in respect of given areas during the terms of such moratoriums. Several of these agreements are currently under renegotiation and several will open for negotiation in 2003.

Negotiations are ongoing with the bargaining units with which the Company does not have agreements or settlements. Until new agreements are reached or until settlements are ratified, the terms and conditions of previous 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 their resolution 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 (Canada) (the CTA), and (ii) safety by the federal Minister of Transport under the Railway Safety Act (Canada) and certain other statutes. The Company's U.S. rail operations are subject to regulation by the Surface Transportation Board (STB) (the successor to the Interstate Commerce Commission) and the Federal Railroad Administration. In addition, the Company is subject to a variety of health, safety, security, labor, environmental and other regulations, all of which can affect its competitive position and profitability.

The CTA Review Panel, which was appointed by the federal government to carry out a comprehensive review of the Canadian transportation legislation, issued its report to the Minister of Transport at the end of June 2001. The report was released to the public on July 18, 2001 and contains numerous recommendations for legislative changes, which, if adopted, would affect all modes of transportation, including rail. Concurrently, the Minister of Transport launched a transportation blueprint consultation process, which could eventually lead to new legislation affecting rail and other transportation industries. No assurance can be given that any decisions by the federal government pursuant to the report's recommendations or in connection with the blueprint consultation process will not materially adversely affect the Company's financial position or results of operations.

Financial instruments

Although the Company conducts its business and receives revenues primarily in Canadian dollars, a growing portion of its revenues, expenses, assets and debt are denominated in U.S. dollars. Thus, the Company's results are affected by fluctuations in the exchange rate between these currencies. 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 affect the Company's revenues and expenses.

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. However, the credit standing of counterparties or their guarantors is regularly monitored, and losses due to counterparty non-performance are not anticipated.

To mitigate the effects of fuel price changes on its operating margins and overall profitability, the Company has a systematic hedging program which calls for regularly entering into swap positions on crude and heating oil to cover a target percentage of future fuel consumption up to two years in advance. At December 31, 2002, the Company has hedged approximately 47% of the estimated 2003 fuel consumption and 25% of the estimated 2004 fuel consumption. This represents approximately 263 million U.S. gallons at an average price of U.S.$0.5865 per U.S. gallon.

Realized gains and losses from the Company's fuel hedging activities were a $3 million gain, a $6 million loss and a $49 million gain for the years ended December 31, 2002, 2001 and 2000, respectively.

At December 31, 2002, Accumulated other comprehensive income included an unrealized gain of $30 million, $20 million after tax ($38 million unrealized loss, $25 million after tax at December 31, 2001), of which $29 million relates to derivative instruments that will mature within the next year.

General indemnifications

In the normal course of business, the Company has provided indemnifications, customary for the type of transaction or for the railway business, in various agreements with third parties, including indemnification provisions where the Company would be required to indemnify third parties and others. Indemnifications are found in various types of contracts with third parties which include, but are not limited to, (a) contracts granting the Company the right to use or enter upon property owned by third parties such as leases, easements, trackage rights and sidetrack agreements; (b) contracts granting rights to others to use the Company's property, such as leases, licenses and easements; (c) contracts for the sale of assets; (d) contracts for the acquisition of services; (e) financing agreements; (f) trust indentures or fiscal agency agreements or similar agreements relating to debt or equity securities of the Company and engagement agreements with financial advisors; (g) transfer agent and registrar agreements in respect of the Company's securities; and (h) trust agreements establishing trust funds to secure the payment to certain officers and senior employees of special retirement compensation arrangements or plans. To the extent of any actual claims under these agreements, the Company maintains provisions for such items, which it considers to be adequate. Due to the nature of the indemnification clauses, the maximum exposure for future payments may be material, however cannot be determined with certainty.

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 cyclicality in the demand for them. However, many of the bulk commodities the Company transports move offshore and are impacted more by global economic conditions than North American economic cycles. The Company's results of operations can be expected to reflect this cyclicality because of the significant fixed costs inherent in railroad operations.

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

Potential terrorist actions can have a direct or indirect impact on the U.S. transportation infrastructure, including railway infrastructure, and interfere with the free flow of trade across the two countries. International conflicts can also have an impact on the Company's markets.

The Company's revenues in 2001 were affected by widespread recessionary conditions. Although growth rebounded strongly in early 2002, there continues to be ongoing concern about the sustainability of the recovery due to uncertain consumer and business confidence. While economic growth is expected to continue in 2003, the Company remains cautious about business prospects.

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 affected.

In addition to the inherent risks of the business cycle, the Company is occasionally susceptible to severe weather conditions. For example, in the first quarter of 1998, a severe ice storm hit eastern Canada, which disrupted operations and service for the railroad as well as for CN customers. More recently, severe drought conditions in western Canada significantly reduced bulk commodity revenues, principally grain. There continues to be widespread concerns about the impact of crop conditions on grain supplies in the near term.

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.

Selected quarterly financial data

Selected quarterly financial data for the eight most recently completed quarters ending December 31, 2002 is disclosed in Note 23 to the Company's 2002 Consolidated Financial Statements.

Disclosure 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-14(c) and 15-d-14(c)) as of January 21, 2003 (the "Evaluation Date") within the 90-day period leading to and ending on the filing date of this annual report, have concluded that the Company's disclosure controls and procedures were adequate and effective and designed to ensure that material information relating to the Company and its consolidated subsidiaries would have been made known to them. Subsequent to the Evaluation Date, there were no significant changes in the Company's internal controls or, to their knowledge, in other factors that could significantly affect the Company's disclosure controls and procedures.

Management Report

The accompanying consolidated financial statements of Canadian National Railway Company and all information in this annual report are the responsibility of management and have been approved by the Board of Directors.

The financial statements have been prepared by management in conformity with generally accepted accounting principles in the United States. These statements include some amounts that are based on best estimates and judgments. Financial information used elsewhere in the annual report is consistent with that in the financial statements.

Management of the Company, in furtherance of the integrity and objectivity of data in the financial statements, has developed and maintains a system of internal accounting controls and supports an extensive program of internal audits. Management believes that this system of internal accounting controls provides reasonable assurance that financial records are reliable and form a proper basis for preparation of financial statements, and that assets are properly accounted for and safeguarded.

The Board of Directors carries out its responsibility for the financial statements in this report principally through its Audit, Finance and Risk Committee, consisting solely of outside directors. The Audit, Finance and Risk Committee reviews the Company's consolidated financial statements and annual report and recommends their approval by the Board of Directors. Also, the Audit, Finance and Risk Committee meets regularly with the Chief, Internal Audit, and with the shareholders' auditors.

These consolidated financial statements have been audited by KPMG LLP, who have been appointed as the sole auditors of the Company by the shareholders.

(signed)
Claude Mongeau
Executive Vice-President and Chief Financial Officer

January 21, 2003

(signed)
Serge Pharand
Vice-President and Corporate Comptroller

January 21, 2003

Auditors' Report

To the Board of Directors of Canadian National Railway Company

We have audited the consolidated balance sheets of Canadian National Railway Company as at December 31, 2002 and 2001 and the consolidated statements of income, comprehensive income, changes in shareholders' equity and cash flows for each of the years in the three-year period ended December 31, 2002. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian and United States generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2002 and 2001, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2002, in accordance with generally accepted accounting principles in the United States.

On January 20, 2003, we reported separately to the shareholders of the Company on consolidated financial statements for the same period, prepared in accordance with Canadian generally accepted accounting principles.

(signed)
KPMG LLP
Chartered Accountants

Montreal, Canada
January 20, 2003

Consolidated Statement of Income

In millions, except per share data	*Year ended December 31,* **2002**	2001	2000
Revenues			
Petroleum and chemicals	**$ 1,102**	$ 923	$ 894
Metals and minerals	**521**	458	392
Forest products	**1,323**	1,088	1,008
Coal	**326**	338	328
Grain and fertilizers	**986**	1,161	1,136
Intermodal	**1,052**	969	919
Automotive	**591**	520	559
Other items	**209**	195	192
Total revenues	**6,110**	5,652	5,428
Operating expenses			
Labor and fringe benefits *(Note 14)*	**1,837**	1,624	1,472
Purchased services and material	**778**	692	746
Depreciation and amortization *(Note 2)*	**584**	532	525
Fuel	**459**	484	446
Equipment rents	**346**	309	285
Casualty and other *(Note 2)*	**637**	329	306
Total operating expenses	**4,641**	3,970	3,780
Operating income	**1,469**	1,682	1,648
Interest expense *(Note 15)*	**(361)**	(327)	(311)
Other income *(Note 16)*	**76**	65	136
Income before income taxes	**1,184**	1,420	1,473
Income tax expense *(Note 17)*	**(384)**	(380)	(536)
Net income	**$ 800**	$1,040	$ 937
Basic earnings per share (Note 19)	**$ 4.07**	$ 5.41	$ 4.81
Diluted earnings per share (Note 19)	**$ 3.97**	$ 5.23	$ 4.67

See accompanying notes to consolidated financial statements.

Consolidated Statement of Comprehensive Income

In millions *Year ended December 31,*	**2002**	2001	2000
Net income	**$800**	$1,040	$ 937
Other comprehensive income (loss) *(Note 22)*:			
Unrealized foreign exchange gain (loss) on translation of U.S. dollar denominated long-term debt designated as a hedge of the net investment in U.S. subsidiaries	**51**	(202)	(91)
Unrealized foreign exchange gain (loss) on translation of the net investment in foreign operations	**(40)**	308	191
Unrealized holding gain (loss) on investment in 360networks Inc. *(Note 6)*	**–**	(129)	129
Unrealized holding gain (loss) on fuel derivative instruments *(Note 21)*	**68**	(38)	–
Minimum pension liability adjustment *(Note 13)*	**(20)**	(17)	–
Other comprehensive income (loss) before income taxes	**59**	(78)	229
Income tax expense on other comprehensive income (loss)	**(20)**	(15)	(72)
Other comprehensive income (loss)	**39**	(93)	157
Comprehensive income	**$839**	$ 947	$1,094

See accompanying notes to consolidated financial statements.

Consolidated Balance Sheet

In millions *December 31,*	**2002**	2001
Assets		
Current assets:		
Cash and cash equivalents	**$ 25**	$ 53
Accounts receivable *(Note 4)*	**722**	645
Material and supplies	**127**	133
Deferred income taxes *(Note 17)*	**122**	153
Other	**196**	180
	1,192	1,164
Properties *(Note 5)*	**19,681**	19,145
Other assets and deferred charges *(Note 6)*	**865**	914
Total assets	**$21,738**	$21,223
Liabilities and shareholders' equity		
Current liabilities:		
Accounts payable and accrued charges *(Note 8)*	**$ 1,487**	$ 1,374
Current portion of long-term debt *(Note 10)*	**574**	163
Other	**73**	132
	2,134	1,669
Deferred income taxes *(Note 17)*	**4,826**	4,591
Other liabilities and deferred credits *(Note 9)*	**1,406**	1,345
Long-term debt *(Note 10)*	**5,003**	5,764
Convertible preferred securities *(Note 11)*	**–**	366
Shareholders' equity:		
Common shares *(Note 11)*	**4,785**	4,442
Accumulated other comprehensive income *(Note 22)*	**97**	58
Retained earnings	**3,487**	2,988
	8,369	7,488
Total liabilities and shareholders' equity	**$21,738**	$21,223

On behalf of the Board:

David G.A. McLean
Director

E. Hunter Harrison
Director

See accompanying notes to consolidated financial statements.

Consolidated Statement of Changes in Shareholders' Equity

In millions	Issued and outstanding common shares	Common shares	Accumulated other comprehensive income (loss)	Retained earnings	Total shareholders' equity
Balances December 31, 1999	202.4	$ 4,597	$ (6)	$ 1,531	$ 6,122
Net income	–	–	–	937	937
Stock options exercised and employee share plans *(Note 11, 12)*	1.2	47	–	–	47
Share repurchase program *(Note 11)*	(13.0)	(295)	–	(234)	(529)
Other comprehensive income *(Note 22)*	–	–	157	–	157
Dividends ($0.70 per share)	–	–	–	(136)	(136)
Balances December 31, 2000	190.6	4,349	151	2,098	6,598
Net income	–	–	–	1,040	1,040
Stock options exercised *(Note 11, 12)*	2.1	93	–	–	93
Other comprehensive loss *(Note 22)*	–	–	(93)	–	(93)
Dividends ($0.78 per share)	–	–	–	(150)	(150)
Balances December 31, 2001	192.7	4,442	58	2,988	7,488
Net income	–	–	–	800	800
Stock options exercised *(Note 11, 12)*	1.8	75	–	–	75
Conversion of convertible preferred securities *(Note 11)*	6.0	340	–	–	340
Share repurchase program *(Note 11)*	(3.0)	(72)	–	(131)	(203)
Other comprehensive income *(Note 22)*	–	–	39	–	39
Dividends ($0.86 per share)	–	–	–	(170)	(170)
Balances December 31, 2002	**197.5**	**$4,785**	**$ 97**	**$3,487**	**$8,369**

See accompanying notes to consolidated financial statements.

Consolidated Statement of Cash Flows

In millions *Year ended December 31,*	**2002**	2001	2000
Operating activities			
Net income	**$ 800**	$ 1,040	$ 937
Adjustments to reconcile net income to net cash provided from operating activities:			
Depreciation and amortization *(Note 18)*	**591**	538	533
Deferred income taxes *(Note 17)*	**272**	295	312
Charge to increase U.S. personal injury and other claims liability *(Note 2)*	**281**	–	–
Workforce reduction charges *(Note 14)*	**120**	98	–
Equity in earnings of English Welsh and Scottish Railway *(Note 16)*	**(33)**	(8)	–
Gain on sale of investments *(Note 16)*	**–**	(101)	(84)
Write-down of investment *(Note 16)*	**–**	99	–
Other changes in:			
Accounts receivable	**(80)**	199	80
Material and supplies	**–**	11	6
Accounts payable and accrued charges	**(154)**	(385)	(157)
Other net current assets and liabilities	**(18)**	(27)	(36)
Other	**(167)**	(138)	(85)
Cash provided from operating activities	**1,612**	1,621	1,506
Investing activities			
Net additions to properties *(Note 18)*	**(938)**	(941)	(958)
Acquisition of Wisconsin Central Transportation Corporation *(Note 3)*	**–**	(1,278)	–
Other, net	**14**	46	(23)
Cash used by investing activities	**(924)**	(2,173)	(981)
Dividends paid	**(170)**	(150)	(136)
Financing activities			
Issuance of long-term debt	**3,146**	4,015	860
Reduction of long-term debt	**(3,558)**	(3,336)	(1,038)
Issuance of common shares *(Note 11)*	**69**	61	28
Repurchase of common shares *(Note 11)*	**(203)**	–	(529)
Cash provided from (used by) financing activities	**(546)**	740	(679)
Net increase (decrease) in cash and cash equivalents	**(28)**	38	(290)
Cash and cash equivalents, beginning of year	**53**	15	305
Cash and cash equivalents, end of year	**$ 25**	$ 53	$ 15
Supplemental cash flow information			
Payments for:			
Interest *(Note 15)*	**$ 398**	$ 322	$ 315
Workforce reductions *(Note 9)*	**177**	169	189
Personal injury and other claims *(Note 20)*	**156**	149	111
Pensions *(Note 13)*	**92**	69	59
Income taxes *(Note 17)*	**65**	63	101

See accompanying notes to consolidated financial statements.

Canadian National Railway Company (CN or the Company), directly and through its subsidiaries, is engaged in the rail transportation business. CN spans Canada and mid-America, from the Atlantic and Pacific oceans to the Gulf of Mexico, serving the ports of Vancouver, Prince Rupert, B.C., Montreal, Halifax, New Orleans and Mobile, Alabama, and the key cities of Toronto, Buffalo, Chicago, Detroit, Duluth, Minnesota/Superior, Wisconsin, Green Bay, Wisconsin, Minneapolis/St. Paul, Memphis, St. Louis and Jackson, Mississippi, with connections to all points in North America. CN's revenues are derived from the movement of a diversified and balanced portfolio of goods, including petroleum and chemicals, grain and fertilizers, coal, metals and minerals, forest products, intermodal and automotive.

1 Summary of significant accounting policies

These consolidated financial statements are expressed in Canadian dollars, except where otherwise indicated, and have been prepared in accordance with accounting principles generally accepted in the United States (U.S. GAAP). 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 matters, depreciation lives, pensions and other post-retirement benefits, and income taxes, based upon currently available information. Actual results could differ from these estimates.

A. Principles of consolidation

These consolidated financial statements include the accounts of all subsidiaries, including Wisconsin Central Transportation Corporation (WC) for which the Company acquired control and consolidated effective October 9, 2001. The Company's investments in which it has significant influence are accounted for using the equity method and all other investments are accounted for using the cost method.

B. Revenues

Freight revenues are recognized on services performed by the Company, based on the percentage of completed service method. Costs associated with movements are recognized as the service is performed.

C. Foreign exchange

All of the Company's United States (U.S.) operations are self-sustaining foreign entities with the U.S. dollar as their functional currency. The Company also has an equity investment in an international affiliate based in the United Kingdom with the British pound as its functional currency. Accordingly, the U.S. operations' assets and liabilities and the Company's foreign equity investment are translated into Canadian dollars at the rate in effect at the balance sheet date and the revenues and expenses are translated at average exchange rates during the year. All adjustments resulting from the translation of the foreign operations are recorded in Other comprehensive income (Note 22).

The Company has designated all U.S. dollar denominated long-term debt of the parent company as a foreign exchange hedge of its net investment in U.S. subsidiaries. Accordingly, unrealized foreign exchange gains and losses, from the dates of designation, on the translation of the U.S. dollar denominated long-term debt are also included in Other comprehensive income.

D. Cash and cash equivalents

Cash and cash equivalents include highly liquid investments purchased three months or less from maturity and are stated at cost, which approximates market value.

E. Accounts receivable

Accounts receivable are recorded at cost net of the provision for doubtful accounts that is based on expected collectibility. Any gains or losses on the sale of accounts receivable are calculated by comparing the carrying amount of the accounts receivable sold to the total of the cash proceeds on sale and the fair value of the retained interest in such receivables on the date of transfer. Fair values are determined on a discounted cash flow basis. Costs related to the sale of accounts receivable are recognized in earnings in the period incurred.

F. Material and supplies

Inventory is valued at weighted-average cost for ties, rails, fuel and new materials in stores, and at estimated utility or sales value for usable secondhand, obsolete and scrap materials.

G. Properties

Railroad properties are carried at cost less accumulated depreciation including asset impairment write-downs. Labor, materials and other costs associated with the installation of rail, ties, ballast and other track improvements are capitalized to the extent they meet the Company's minimum threshold for capitalization. Included in property additions are the costs of developing computer software for internal use. Maintenance costs are expensed as incurred.

1 Summary of significant accounting policies *(continued)*

The cost of railroad properties, less net salvage value, retired or disposed of in the normal course of business is charged to accumulated depreciation, in accordance with the group method of depreciation. The Company reviews the carrying amounts of properties held and used whenever events or changes in circumstances indicate that such carrying amounts may not be recoverable based on future undiscounted cash flows. Assets that are deemed impaired as a result of such review are recorded at the lower of carrying amount or fair value. Assets held for sale are measured at the lower of their carrying amount or fair value, less cost to sell. Losses resulting from significant line sales are recognized when the asset meets the criteria for classification as held for sale whereas losses resulting from abandonment are recognized when the asset ceases to be used. Gains are recognized when they are realized.

H. Depreciation

The cost of properties, net of asset impairment write-downs, is depreciated on a straight-line basis over their estimated useful lives as follows:

Asset class	Annual rate
Track and roadway	2%
Rolling stock	3%
Buildings	6%
Other	4%

The Company follows the group method of depreciation and as such conducts comprehensive depreciation studies on a periodic basis to assess the reasonableness of the lives of properties based upon current information and historical activities. Changes in estimated useful lives are accounted for prospectively.

I. Pensions

Pension costs are determined using actuarial methods. Net periodic benefit cost is charged to operations and includes:

(i) the cost of pension benefits provided in exchange for employees' services rendered during the year,

(ii) the interest cost of pension obligations,

(iii) the amortization of the initial net transition obligation on a straight-line basis over the expected average remaining service life of the employee group covered by the plans,

(iv) the amortization of prior service costs and amendments over the expected average remaining service life of the employee group covered by the plans,

(v) the expected long-term return on pension fund assets, and

(vi) the amortization of cumulative unrecognized net actuarial gains and losses in excess of 10% of the greater of the beginning of year balances of the projected benefit obligation or market-related value of plan assets over the expected average remaining service life of the employee group covered by the plans.

The pension plans are funded through contributions determined in accordance with the projected unit credit actuarial cost method.

J. Post-retirement benefits other than pensions

The Company accrues the cost of post-retirement benefits other than pensions using actuarial methods. These benefits, which are funded by the Company as they become due, include life insurance programs, medical benefits, supplemental pension allowances and free rail travel benefits.

The Company amortizes the cumulative unrecognized net actuarial gains and losses in excess of 10% of the projected benefit obligation at the beginning of the year, over the expected average remaining service life of the employee group covered by the plans.

K. Derivative financial instruments

The Company uses derivative financial instruments in the management of its fuel exposure, and may use them from time to time, in the management of its interest rate and foreign currency exposures. Derivative instruments are recorded on the balance sheet at fair value and the changes in fair value are recorded in earnings or Other comprehensive income depending on the nature and effectiveness of the hedge transaction. Income and expense related to hedged derivative financial instruments are recorded in the same category as that generated by the underlying asset or liability.

L. Personal injury claims

In Canada, 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.

In the U.S., the Company accrues the cost for the expected personal injury claims and existing occupational disease claims, based on actuarial estimates of their ultimate cost. A liability for unasserted occupational disease claims is also accrued to the extent they are probable and can be reasonably estimated.

M. Environmental expenditures

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. Liabilities are recorded when environmental assessments and/or remedial efforts are likely, and when the costs, based on a specific plan of action in terms of the technology to be used and the extent of the corrective action required, can be reasonably estimated.

N. 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 tax asset or liability is included in the computation of net income. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which temporary differences are expected to be recovered or settled.

O. Stock-based compensation

The Company accounts for stock-based compensation in accordance with Accounting Principles Board Opinion (APB) 25, "Accounting for Stock Issued to Employees," and related interpretations. Accordingly, compensation cost is recorded for the Company's performance-based stock option awards and no compensation cost is recorded for the Company's conventional stock option awards. If compensation cost had been determined based upon fair values at the date of grant for awards under all plans, consistent with the methods of Statement of Financial Accounting Standards (SFAS) No. 123, "Accounting for Stock-Based Compensation," the Company's pro forma net income and earnings per share would have been as follows:

Year ended December 31,	**2002**	2001	2000
Net income, as reported *(in millions)*	**$ 800**	$1,040	$ 937
Add (deduct) compensation cost, net of applicable taxes, determined under:			
Intrinsic value method for performance-based awards (APB 25)	**9**	19	3
Fair value method for all awards (SFAS No. 123)	**(45)**	(28)	(23)
Pro forma net income *(in millions)*	**$ 764**	$1,031	$ 917
Basic earnings per share, as reported	**$4.07**	$ 5.41	$4.81
Basic earnings per share, pro forma	**$3.88**	$ 5.37	$4.70
Diluted earnings per share, as reported	**$3.97**	$ 5.23	$4.67
Diluted earnings per share, pro forma	**$3.80**	$ 5.19	$4.58

These pro forma amounts include compensation cost as calculated using the Black-Scholes option-pricing model with the following assumptions:

Year ended December 31,	**2002**	2001	2000
Expected option life *(years)*	**7.0**	7.0	7.0
Risk-free interest rate	**5.79%**	5.36%	5.38%
Expected stock price volatility	**30%**	30%	30%
Average dividend per share	**$0.86**	$0.78	$0.70

Year ended December 31,	**2002**	2001	2000
Weighted average fair value of options granted	**$30.98**	$13.79	$12.54

P. Recent accounting pronouncements

In January 2003, the Financial Accounting Standards Board (FASB) issued FASB Interpretation (FIN) No. 46, "Consolidation of Variable Interest Entities." FIN No. 46 requires that an enterprise holding other than a voting interest in a Variable Interest Entity (VIE) could, subject to certain conditions, be required to consolidate the VIE if the enterprise will absorb a majority of the VIE's expected losses and/or receive a majority of its expected residual returns. This interpretation is effective for newly created entities after January 31, 2003. For pre-existing VIEs, the provisions of the interpretation are effective for periods beginning after June 15, 2003. The Company does not expect FIN No. 46 to have a material impact on its financial statements.

In November 2002, the FASB issued FIN No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others," which requires that a guarantor disclose and recognize in its financial statements its obligations relating to guarantees that it has issued. Liability recognition is required at the inception of the guarantee, whether or not payment is probable. The disclosure requirements are effective for periods ending after December 15, 2002, and have been reflected in the Notes to Consolidated Financial Statements. The recognition and measurement provisions are effective for guarantees issued or modified after December 31, 2002. The Company will apply the recognition and measurement provisions of FIN No. 45 on a prospective basis and, as such, does not expect it to have an initial material impact on its financial statements upon adoption.

In July 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities," which requires that a liability for costs associated with an exit or disposal activity be recognized when the liability is incurred. SFAS No. 146 also establishes that the liability should be initially measured at fair value and subsequently adjusted for changes in estimated cash flows. SFAS No. 146 is to be applied to exit or disposal activities initiated after December 31, 2002. The Company will apply SFAS No. 146 on a prospective basis and, as such, does not expect it to have an initial material impact on its financial statements upon adoption.

In August 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations," which requires an entity to record the fair value of an asset retirement obligation as a liability in the period in which it incurs a legal obligation associated with the retirement of tangible long-lived assets. As a result of the issuance of SFAS No. 143, the Company is reviewing the accounting policy of its asset replacement program. A change in this policy will be treated as a change in accounting principle with a cumulative effect adjustment being recorded in the first quarter of 2003. The statement is effective for the Company's fiscal year beginning January 1, 2003. The Company is currently evaluating the impact of this statement on its financial statements.

2 Accounting changes

2002

U.S. personal injury and other claims

In the fourth quarter of 2002, the Company changed its methodology for estimating its liability for U.S. personal injury and other claims, including occupational disease claims and claims for property damage, from a case-by-case approach to an actuarial-based approach. Consequently, the Company recorded a charge of $281 million ($173 million after tax) to increase its provision for these claims.

Under the actuarial-based approach, the Company accrues the cost for the expected personal injury and property damage claims and existing occupational disease claims, based on actuarial estimates of their ultimate cost. The Company is unable to estimate the total cost for unasserted occupational disease claims. However, a liability for unasserted occupational disease claims is accrued to the extent they are probable and can be reasonably estimated.

Under the case-by-case approach, a liability was recorded only when the expected loss was both probable and reasonably estimable based on currently available information. In addition, the Company did not record a liability for unasserted claims, as such amounts could not be reasonably estimated under the case-by-case approach.

The Company's U.S. personal injury and other claims expense, including the above-mentioned charge, was $362 million in 2002. Had the Company continued to apply the case-by-case approach to its U.S. personal injury and other claims liability, recognizing the effects of the actual claims experience for existing and new claims in the fourth quarter, these expenses would have been approximately $135 million in 2002.

2001

Depreciation

In 2001, the Company conducted a comprehensive depreciation study for its Canadian properties to assess the reasonableness of the depreciable lives of properties based on current and historical information. The study revealed that estimated depreciable lives for certain asset types had increased, and therefore, those asset lives were extended prospectively. As a result, depreciation and amortization expense was reduced by $44 million ($28 million after tax) in 2001.

Derivative financial instruments

On January 1, 2001, the Company adopted SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended by SFAS No. 138 "Accounting for Certain Derivative Instruments and Certain Hedging Activities." These statements require that all derivative instruments be recorded on the balance sheet at their fair value. Changes in fair value of derivatives are recorded each period in current earnings or Other comprehensive income, depending on whether or not a derivative is designated as part of a hedge transaction and, if so, the type of hedge transaction. The initial adoption of these statements on January 1, 2001 resulted in the recognition of an unrealized loss of $17 million ($11 million after tax) in Other comprehensive income. Of that amount, $8 million ($5 million after tax) was recognized in earnings during 2001. The adoption of these statements did not have a material impact on net income for 2001 since prior to its adoption, the Company had already deferred and amortized gains and losses in its results of operations. Income and expense related to the hedged derivative financial instruments were recorded in the same category as that generated by the underlying asset or liability.

3 Acquisition of Wisconsin Central Transportation Corporation

On January 29, 2001, the Company, through an indirect wholly owned subsidiary, and WC entered into a merger agreement (the Merger) providing for the acquisition of all of the shares of WC by the Company for an acquisition cost of $1,301 million (U.S.$833 million). The Merger was approved by the shareholders of WC at a special meeting held on April 4, 2001. On September 7, 2001, the U.S. Surface Transportation Board rendered a decision, unanimously approving the Company's acquisition of WC. On October 9, 2001, the Company completed its acquisition of WC and began a phased integration of the companies' operations. The acquisition was financed by debt and cash on hand.

The Company accounted for the Merger using the purchase method of accounting as required by SFAS No. 141 "Business Combinations." As such, the Company's consolidated financial statements include the assets, liabilities and results of operations of WC as of October 9, 2001, the date of acquisition. The Company had estimated, on a preliminary basis, the fair values of the assets and liabilities acquired based on currently available information. In 2002, the Company finalized the allocation of the purchase price and adjusted the preliminary fair values of the assets and liabilities acquired as follows: Current assets decreased by $10 million, Properties increased by $141 million, Other assets and deferred charges decreased by $98 million, Current liabilities increased by $10 million, Deferred income taxes increased by $16 million and Other liabilities and deferred credits increased by $3 million. The increase in Properties and decrease in Other assets and deferred charges was mainly due to the final valuation of the Company's foreign equity investment. The remaining adjustments resulted from additional information obtained for conditions and circumstances that existed at the time of acquisition.

The following table outlines the final fair values of WC's assets and liabilities acquired:

In millions	
Current assets	$ 165
Properties	2,576
Other assets and deferred charges	335
Total assets acquired	3,076
Current liabilities	363
Deferred income taxes	759
Other liabilities and deferred credits	181
Long-term debt	472
Total liabilities assumed	1,775
Net assets acquired	$1,301

If the Company had acquired WC on January 1, 2000, based on the historical amounts reported by WC, net of the difference between the Company's cost to acquire WC and its net assets, revenues, net income, basic and diluted earnings per share would have been $6,090 million, $1,090 million, $5.67 per basic share and $5.48 per diluted share, respectively for the year ended December 31, 2001 and $5,961 million, $971 million, $4.98 per basic share and $4.84 per diluted share, respectively for 2000. These pro forma figures do not reflect synergies, and accordingly, do not account for any potential increases in operating income, any estimated cost savings or facilities consolidation.

4 Accounts receivable

In millions *December 31,*	**2002**	2001
Freight		
Trade	**$321**	$309
Accrued	**150**	119
Non-freight	**310**	298
	781	726
Provision for doubtful accounts	**(59)**	(81)
	$722	$645

The Company has a five-year revolving agreement, expiring in June 2003, to sell eligible freight trade receivables up to a maximum of $350 million of receivables outstanding at any point in time. The Company intends to renew or replace the program upon expiration. At December 31, 2002, pursuant to the agreement, $173 million and U.S.$113 million (Cdn$177 million) had been sold on a limited recourse basis compared to $168 million and U.S.$113 million (Cdn$179 million) at December 31, 2001. Recourse is limited to 10% of receivables sold and consists of additional freight trade receivables that have been recorded in Other current assets. The Company has retained the responsibility for servicing, administering and collecting freight trade receivables sold. Other income included $9 million in 2002 and $10 million in each of 2001 and 2000 for costs related to the agreement, which fluctuate with changes in prevailing interest rates.

No servicing asset or liability has been recorded since the costs of servicing are compensated by the benefits of the agreement.

The Receivables Purchase Agreement provides for customary indemnification provisions, which survive for a period of two years following the final purchase of any receivable, three years from the final collection date or until statute barred, in the case of taxes. As at December 31, 2002, the Company has not recorded a liability associated with these indemnifications, for which there is no monetary limitation, as the Company does not expect to make any payments pertaining to the indemnifications of this program.

5 Properties

In millions	***December 31, 2002***			*December 31, 2001*		
	Cost	**Accumulated depreciation**	**Net**	Cost	Accumulated depreciation	Net
Track, roadway and land	**$22,048**	**$6,265**	**$15,783**	$21,582	$6,230	$15,352
Rolling stock	**4,057**	**1,506**	**2,551**	3,913	1,456	2,457
Buildings	**1,819**	**880**	**939**	1,715	826	889
Other	**916**	**508**	**408**	941	494	447
	$28,840	**$9,159**	**$19,681**	$28,151	$9,006	$19,145
Capital leases included in rolling stock	**$ 1,351**	**$ 233**	**$ 1,118**	$ 1,249	$ 209	$ 1,040

6 Other assets and deferred charges

In millions *December 31,*	**2002**	2001
Investments	**$380**	$496
Prepaid benefit cost *(Note 13)*	**353**	251
Deferred receivables	**88**	108
Unamortized debt issue costs	**41**	54
Other	**3**	5
	$865	$914

Investments

As at December 31, 2002, the Company had $368 million ($478 million at December 31, 2001) of investments accounted for under the equity method and $12 million ($18 million at December 31, 2001) of investments accounted for under the cost method.

Investment in Tranz Rail Holdings Limited (Tranz Rail) and Australian Transport Network Limited (ATN)

In 2002, the Company sold its interests in Tranz Rail and ATN for aggregate net proceeds of $69 million, which approximated the carrying value of the investments. Prior to the sale, the Company had accounted for these investments as "available for sale" in accordance with the FASB's Emerging Issues Task Force (EITF) 87-11, "Allocation of Purchase Price to Assets to be Sold."

Investment in English Welsh and Scottish Railway (EWS)

Through its acquisition of WC in 2001, the Company acquired 40.9% of EWS, a company which provides most of the rail freight services in Great Britain, operates freight trains through the English Channel tunnel and carries mail for the Royal Mail. The final fair value of the investment at the date of acquisition was determined based on the discounted cash flow method and a multiple of EWS earnings. The Company accounts for its investment in EWS using the equity method. At December 31, 2002, the excess of the Company's share of the book value of EWS' net assets over the carrying value of the investment is being depreciated over the life of its assets and is not significant.

Investment in 360networks Inc.

In June 2001, the Company recorded a charge of $99 million, $71 million after tax, to write down 100% of its net investment in 360networks Inc. and subsequently sold all of its shares. In 2000, the Company had recorded a gain of $84 million, $58 million after tax, related to the exchange of its minority equity investments in certain joint venture companies for 11.4 million shares of 360networks Inc. Prior to the write-down, the Company accounted for its investment in 360networks Inc. in accordance with SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities." The shares held were classified as "available-for-sale securities" whereby the investment was carried at market value on the balance sheet and the change in the value of the investment was recorded in Other comprehensive income as an unrealized holding gain. As a result of the write-down, the Company eliminated all marked-to-market adjustments related to its investment in 360networks Inc., previously recorded in Other comprehensive income.

7 Credit facilities

In December 2002, the Company entered into a U.S.$1,000 million three-year revolving credit facility and concurrently terminated its previous revolving credit facilities before their scheduled maturity in March 2003. The credit facility 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 credit facility agreement contains customary financial covenants, based on U.S. GAAP, including limitations on debt as a percentage of total capitalization and maintenance of tangible net worth above pre-defined levels. Throughout the year, the Company was in compliance with all financial covenants contained in its outstanding revolving credit agreements. The Company's commercial paper program is backed by a portion of its revolving credit facility. As at December 31, 2002, the Company had outstanding commercial paper of U.S.$136 million (Cdn$214 million) compared to U.S.$213 million (Cdn$339 million) as at December 31, 2001. The Company's borrowings of U.S.$172 million (Cdn$273 million) outstanding at December 31, 2001 were entirely repaid in the first quarter of 2002. At December 31, 2002, the Company had borrowings under its revolving credit facility of U.S.$90 million (Cdn$142 million) at an average interest rate of 1.77%. Outstanding letters of credit under the previous facilities were transferred into the current facility. As at December 31, 2002, letters of credit under the revolving credit facility amounted to $295 million.

8 Accounts payable and accrued charges

In millions *December 31,*	**2002**	2001
Trade payables	**$ 436**	$ 385
Income and other taxes	**251**	236
Payroll-related accruals	**235**	218
Workforce reduction provisions	**168**	151
Personal injury and other claims *(Note 20)*	**136**	51
Accrued charges	**113**	131
Accrued interest	**104**	141
Accrued operating leases	**18**	19
Other	**26**	42
	$1,487	$1,374

9 Other liabilities and deferred credits

In millions *December 31,*	**2002**	2001
Personal injury and other claims, net of current portion *(Note 20)*	**$ 528**	$ 379
Workforce reduction provisions, net of current portion *(A)*	**253**	340
Accrual for post-retirement benefits other than pensions *(B)*	**284**	258
Environmental reserve, net of current portion	**81**	73
Deferred credits and other	**260**	295
	$1,406	$1,345

A. Workforce reduction provisions *(Note 14)*

The workforce reduction provisions, which cover employees in both Canada and the United States, are mainly comprised of payments related to severance, early retirement incentives and bridging to early retirement, the majority of which will be disbursed within the next three years. Payments have reduced the provisions by $177 million for the year ended December 31, 2002 ($169 million for the year ended December 31, 2001). As at December 31, 2002, the aggregate provisions, including the current portion, amounted to $421 million ($491 million as at December 31, 2001).

B. Post-retirement benefits other than pensions

(i) Change in benefit obligation

In millions *Year ended December 31,*	**2002**	2001
Benefit obligation at beginning of year	**$309**	$242
Amendments	**18**	25
Actuarial loss	**101**	20
Interest cost	**23**	19
Service cost	**13**	11
Foreign currency changes	**(1)**	6
Transfer from other plans	**–**	5
Benefits paid	**(19)**	(19)
Benefit obligation at end of year	**$444**	$309

(ii) Funded status

In millions *December 31,*	**2002**	2001
Unfunded benefit obligation at end of year	**$444**	$309
Unrecognized net actuarial loss	**(122)**	(26)
Unrecognized prior service cost	**(38)**	(25)
Accrued benefit cost for post-retirement benefits other than pensions	**$284**	$258

(iii) Components of net periodic benefit cost

In millions *Year ended December 31,*	**2002**	2001	2000
Interest cost	**$23**	$19	$15
Service cost	**13**	11	8
Amortization of prior service cost	**5**	3	1
Recognized net actuarial loss	**4**	2	1
Net periodic benefit cost	**$45**	$35	$25

(iv) Weighted-average assumptions

December 31,	**2002**	2001	2000
Discount rate	**6.65%**	6.97%	6.95%
Rate of compensation increase	**4.00%**	4.00%	4.25%

For measurement purposes, increases in the per capita cost of covered health care benefits were assumed to be 17% for 2003 and 18% for 2002. It is assumed that the rate will decrease gradually to 8% in 2012 and remain at that level thereafter.

A one-percentage-point change in the health care cost trend rate would not cause a material change in the Company's net periodic benefit cost nor the post-retirement benefit obligation.

10 Long-term debt

In millions	Maturity	Currency in which payable	*December 31,* **2002**	2001
Debentures and notes: (A)				
Canadian National series:				
6.63% 10-year notes	May 15, 2003	U.S.$	**$ 236**	$ 239
7.00% 10-year notes	Mar. 15, 2004	U.S.$	**419**	422
6.45% Puttable Reset Securities (PURS) *(B)*	July 15, 2006	U.S.$	**394**	398
6.38% 10-year notes *(C)*	Oct. 15, 2011	U.S.$	**631**	636
6.80% 20-year notes *(C)*	July 15, 2018	U.S.$	**315**	318
7.63% 30-year debentures	May 15, 2023	U.S.$	**236**	239
6.90% 30-year notes *(C)*	July 15, 2028	U.S.$	**749**	755
7.38% 30-year debentures *(C)*	Oct. 15, 2031	U.S.$	**315**	318
Illinois Central series:				
6.75% 10-year notes	May 15, 2003	U.S.$	**158**	159
7.75% 10-year notes	May 1, 2005	U.S.$	**158**	159
6.98% 12-year notes	July 12, 2007	U.S.$	**79**	80
6.63% 10-year notes	June 9, 2008	U.S.$	**32**	32
5.00% 99-year income debentures	Dec. 1, 2056	U.S.$	**12**	12
7.70% 100-year debentures	Sep. 15, 2096	U.S.$	**197**	199
Wisconsin Central series:				
6.63% 10-year notes	April 15, 2008	U.S.$	**236**	239
Total debentures and notes			**4,167**	4,205
Other:				
Revolving credit facilities *(Note 7)*		U.S.$	**142**	273
Commercial paper *(D) (Note 7)*		U.S.$	**214**	339
Capital lease obligations, amounts owing under equipment agreements and other *(E)*		Various	**1,068**	1,125
Total other			**1,424**	1,737
Subtotal			**5,591**	5,942
Less:				
Current portion of long-term debt			**574**	163
Net unamortized discount			**14**	15
			588	178
			$5,003	$5,764

A. The Company's debentures and notes are unsecured.

B. The PURS contain imbedded simultaneous put and call options at par. At the time of issuance, the Company sold the option to call the securities on July 15, 2006 (the reset date). If the call option is exercised, the imbedded put option is automatically triggered, resulting in the redemption of the original PURS. The call option holder will then have the right to remarket the securities at a new coupon rate for an additional 30-year term ending July 15, 2036. The new coupon rate will be determined according to a pre-set mechanism based on market conditions then prevailing. If the call option is not exercised, the put option is deemed to have been exercised, resulting in the redemption of the PURS on July 15, 2006.

C. These debt securities are redeemable, in whole or in part, at the option of the Company, at any time, at the greater of par and a formula price based on interest rates prevailing at the time of redemption.

D. 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 $600 million, or the U.S. dollar equivalent. Commercial paper debt is due within one year but has been classified as long-term debt, reflecting the Company's intent and contractual ability to refinance the short-term borrowing through subsequent issuances of commercial paper or drawing down on the revolving credit facility. Interest rates on commercial paper at December 31, 2002 range from approximately 1.4% to 1.7%.

E. Interest rates for the capital leases range from approximately 3.0% to 14.6% with maturity dates in the years 2003 through 2025. The imputed interest on these leases amounted to $498 million as at December 31, 2002, and $545 million as at December 31, 2001.

The equipment agreements are payable by monthly or semi-annual installments over various periods to 2007 at interest rates ranging from 6.0% to 6.7%. As at December 31, 2002, the principal amount repayable was $14 million ($19 million as at December 31, 2001). The capital leases, equipment agreements, and other obligations are secured by properties with a net carrying amount of $1,136 million as at December 31, 2002 and $1,108 million as at December 31, 2001.

During 2002, the Company recorded $114 million in assets it acquired through the exercise of purchase options on existing leases and leases for new equipment ($91 million in 2001). An equivalent amount was recorded in debt.

F. Long-term debt maturities, including repurchase arrangements and capital lease repayments on debt outstanding as at December 31, 2002 but excluding repayments of commercial paper and revolving credit facility of $214 million and $142 million, respectively, for the next five years and thereafter, are as follows:

Year	*In millions*
2003	$ 574
2004	560
2005	246
2006	438
2007	164
2008 and thereafter	3,239

G. The aggregate amount of debt payable in U.S. currency as at December 31, 2002 is U.S.$3,164 million (Cdn$4,987 million) and U.S.$3,334 million (Cdn$5,302 million) as at December 31, 2001.

11 Capital stock and convertible preferred securities

A. Authorized capital stock

The authorized capital stock of the Company is as follows:

- Unlimited number of Common Shares, without par value
- Unlimited number of Class A Preferred Shares, without par value issuable in series
- Unlimited number of Class B Preferred Shares, without par value issuable in series

B. Issued and outstanding common shares

During 2002, the Company issued 7.8 million shares of which 1.8 million shares (2.1 million shares in 2001 and 1.2 million shares in 2000) was related to stock options exercised and 6.0 million shares was related to the conversion of the Company's convertible preferred securities. The total number of common shares issued and outstanding was 197.5 million as at December 31, 2002.

C. Convertible preferred securities ("Securities")

On May 6, 2002, the Company met the conditions required to terminate the Securities holders' right to convert their Securities into common shares of the Company, and set the conversion termination date as July 3, 2002. The conditions were met when the Company's common share price exceeded 120% of the conversion price of U.S.$38.48 per share for a specified period, and all accrued interest on the Securities had been paid. On July 3, 2002, Securities that had not been previously surrendered for conversion were deemed converted, resulting in the issuance of 6.0 million common shares of the Company.

In 1999, the Company had issued 4.6 million 5.25% Securities due on June 30, 2029, at U.S.$50 per Security. These Securities were subordinated securities convertible into common shares of CN at the option of the holder at an original conversion price of U.S.$38.48 per common share, representing an original conversion rate of 1.2995 common shares for each Security.

D. Share repurchase programs

On October 22, 2002, the Board of Directors of the Company approved a share repurchase program which allows for the repurchase of up to 13.0 million common shares between October 25, 2002 and October 24, 2003 pursuant to a normal course issuer bid, at prevailing market prices. As at December 31, 2002, $203 million was used to repurchase 3.0 million common shares at an average price of $67.68 per share.

In 2001, the Board of Directors of the Company approved a share repurchase program under which the Company did not repurchase any common shares.

In 2000, $529 million was used to repurchase 13.0 million common shares, the maximum allowed under the program, pursuant to a normal course issuer bid at an average price of $40.70 per share.

12 Stock plans

The Company has various stock-based incentive plans for eligible employees. A description of the Company's major plans is provided below:

A. Employee share plan

The Company has an Employee Share Investment Plan (ESIP) giving eligible employees the opportunity to subscribe for up to 6% of their gross salaries to purchase shares of the Company's common stock on the open market and to have the Company invest, on the employees' behalf, a further 35% of the amount invested by the employees. Participation at December 31, 2002 was 8,911 employees (9,432 at December 31, 2001). The total number of ESIP shares purchased on behalf of employees, including the Company's contributions, was 497,459 in 2002, 516,726 in 2001 and 637,531 in 2000, resulting in a pre-tax charge to income of $9 million, $8 million and $6 million for the years ended December 31, 2002, 2001 and 2000, respectively.

12 Stock plans *(continued)*

B. Mid-term incentive share unit plan

The Company has a share unit plan, which was approved by the Board of Directors in 2001, for designated senior management employees entitling them to receive payout on June 30, 2004 of a combination of common stock of the Company, as to fifty percent, and cash value, as to the remaining fifty percent.

The share units vest conditionally upon the attainment of targets relating to the Company's share price during the six-month period ending June 30, 2004. At December 31, 2002, the total number of share units outstanding was 419,900, representing a potential maximum compensation cost of $42 million. Due to the nature of the vesting conditions, no compensation cost was recorded for 2002 and 2001. At December 31, 2002, an additional 45,100 share units remained authorized for future issuances under this plan.

C. Stock options

The Company has stock option plans for eligible employees to acquire common shares of the Company upon vesting at a price equal to the market value of the common shares at the date of granting. The options are exercisable during a period not exceeding 10 years. The right to exercise options generally accrues over a period of four years of continuous employment. Options are not generally exercisable during the first 12 months after the date of grant. At December 31, 2002, an additional 2.6 million common shares remained authorized for future issuances under these plans.

Options issued by the Company include conventional options, which vest over a period of time, and performance options, which vest upon the attainment of Company targets relating to the operating ratio and unlevered return on investment. The total conventional and performance options outstanding at December 31, 2002 were 9.1 million and 2.0 million, respectively.

Changes in the Company's stock options are as follows:

	Number of options	Weighted-average exercise price
	In millions	
Outstanding at December 31, 1999 [(1)]	8.3	$ 34.88
Granted	2.2	$ 35.33
Canceled	(0.4)	$ 36.23
Exercised	(1.2)	$ 22.19
Outstanding at December 31, 2000 [(1)]	8.9	$ 34.95
Conversion of WC options	1.0	$ 58.63
Granted	2.4	$ 50.65
Canceled	(0.3)	$ 46.01
Exercised	(2.1)	$ 30.43
Outstanding at December 31, 2001 [(1) (2)]	9.9	$ 43.62
Granted	3.2	$ 76.78
Canceled	(0.2)	$ 56.98
Exercised	(1.8)	$ 39.16
Outstanding at December 31, 2002 [(1) (2)]	**11.1**	**$53.50**

(1) Includes IC converted stock options translated to Canadian dollars using the foreign exchange rate in effect at the balance sheet date.

(2) Includes WC converted stock options translated to Canadian dollars using the foreign exchange rate in effect at the balance sheet date.

Stock options outstanding and exercisable as at December 31, 2002 were as follows:

	Options outstanding			Options exercisable	
Range of exercise prices	Number of options	Weighted-average years to expiration	Weighted-average exercise price	Number of options	Weighted-average exercise price
	In millions			*In millions*	
$13.50–$23.72	0.1	3	$ 17.23	0.1	$ 17.23
$25.18–$35.01	2.1	6	$ 33.59	1.2	$ 32.48
$35.70–$49.45	3.2	6	$ 44.69	2.7	$ 44.56
$50.02–$69.77	2.5	8	$ 51.43	0.8	$ 52.93
$70.04 and above	3.2	9	$ 77.59	0.1	$ 97.09
Balance at December 31, 2002 [(1)]	**11.1**	**7**	**$53.50**	**4.9**	**$44.01**

(1) Includes IC and WC converted stock options translated to Canadian dollars using the foreign exchange rate in effect at the balance sheet date.

D. Stock-based compensation cost

Compensation cost for performance-based stock option awards under these plans is determined by the options' intrinsic value in accordance with APB 25, "Accounting for Stock Issued to Employees," and related interpretations. Compensation cost recognized for stock-based awards was $9 million, $19 million and $3 million in 2002, 2001 and 2000, respectively. Disclosures required under the fair value measurement and recognition method prescribed by SFAS No. 123, "Accounting for Stock-Based Compensation," are presented in Note 1 – Summary of significant accounting policies.

13 Pensions

The Company has retirement benefit plans under which substantially all of its employees are entitled to benefits at retirement age, generally based on compensation and length of service and/or contributions. The tables that follow pertain to all such plans. However, the following descriptions relate solely to the Company's main pension plan, the CN Pension Plan (the Pension Plan). The Company's other pension plans are not significant.

Description of plan

The Pension Plan is a contributory defined benefit pension plan that covers the majority of CN employees. It provides for pensions based mainly on years of service and final average pensionable earnings and is generally applicable from the first day of employment. Indexation of pensions is provided after retirement through a gain (loss) sharing mechanism, subject to guaranteed minimum increases. An independent trust company is the Trustee of the Canadian National Railways Pension Trust Funds (CN Pension Trust Funds). As Trustee, the trust company performs certain duties, which include holding legal title to the assets of the CN Pension Trust Funds and ensuring that the Company, as Administrator, complies with the provisions of the Pension Plan and the related legislation.

Funding policy

Employee contributions to the Pension Plan are determined by the plan rules. Company contributions are in accordance with the requirements of the Government of Canada legislation, The Pension Benefits Standards Act, 1985, and are determined by actuarial valuations conducted at least on a triennial basis. These valuations are made in accordance with legislative requirements and with the recommendations of the Canadian Institute of Actuaries for the valuation of pension plans. The latest actuarial valuation of the Pension Plan was conducted as at December 31, 2001 and indicated a funding excess. Based on the Pension Plan's current position, the Company's contributions are expected to be approximately $75 million in each of 2003, 2004 and 2005.

Description of fund assets

The assets of the Pension Plan are accounted for separately in the CN Pension Trust Funds and consist of cash and short-term investments, bonds, mortgages, Canadian and foreign equities, real estate, and oil and gas assets. Based on the fair value of the assets held at December 31, 2002, the plan assets are comprised of 1% in cash and short-term investments, 40% in bonds and mortgages, 50% in Canadian and foreign equities and 9% in real estate and oil and gas assets.

(a) Change in benefit obligation

In millions Year ended December 31,	2002	2001
Benefit obligation at beginning of year	**$11,156**	$10,855
Interest cost	**714**	701
Actuarial (gain) loss	**(92)**	94
Service cost	**99**	92
Plan participants' contributions	**61**	73
Foreign currency changes	**(1)**	6
Benefit payments and transfers	**(694)**	(665)
Benefit obligation at end of year	**$11,243**	$11,156

(b) Change in plan assets

In millions Year ended December 31,	2002	2001
Fair value of plan assets at beginning of year	**$11,763**	$12,455
Employer contributions	**92**	69
Plan participants' contributions	**61**	73
Foreign currency changes	**(1)**	6
Actual return on plan assets	**(39)**	(175)
Benefit payments and transfers	**(694)**	(665)
Fair value of plan assets at end of year	**$11,182**	$11,763

(c) Funded status

In millions December 31,	2002	2001
Excess (deficiency) of fair value of plan assets over benefit obligation at end of year [(1)]	**$ (61)**	$ 607
Unrecognized net actuarial (gain) loss [(1)]	**282**	(537)
Unrecognized net transition obligation	**19**	39
Unrecognized prior service cost	**113**	133
Net amount recognized	**$353**	$ 242

(1) Subject to future reduction for gain sharing under the terms of the plan.

(d) Amount recognized in the Consolidated Balance Sheet

In millions December 31,	2002	2001
Prepaid benefit cost *(Note 6)*	**$353**	$251
Accrued benefit cost	**–**	(9)
Additional minimum pension liability	**(38)**	(18)
Intangible asset	**1**	1
Accumulated other comprehensive income *(Note 22)*	**37**	17
Net amount recognized	**$353**	$242

13 Pensions *(continued)*

(e) Components of net periodic benefit cost

In millions *Year ended December 31,*	**2002**	2001	2000
Interest cost	**$ 714**	$ 701	$ 690
Service cost	**99**	92	70
Amortization of net transition obligation	**20**	20	19
Amortization of prior service cost	**20**	20	19
Expected return on plan assets	**(874)**	(846)	(792)
Recognized net actuarial loss	**1**	–	–
Net periodic benefit cost (income)	**$ (20)**	$ (13)	$ 6

(f) Weighted-average assumptions

December 31,	**2002**	2001	2000
Discount rate	**6.50%**	6.50%	6.50%
Rate of compensation increase	**4.00%**	4.00%	4.25%
Expected return on plan assets for year ending December 31	**9.00%**	9.00%	9.00%

Effective January 1, 2003, the Company will reduce the expected long-term rate of return on plan assets from 9% to 8% to reflect management's current view of long-term investment returns. The effect of this change in management's assumption will be to increase net periodic benefit cost in 2003 by approximately $50 million.

As at December 31, 2002, one of the Company's pension plans had an accumulated benefit obligation of $112 million ($106 million at December 31, 2001) in excess of the fair value of the plan assets of $77 million ($79 million at December 31, 2001) which gave rise to an additional minimum pension liability. The projected benefit obligation was $116 million at December 31, 2002 ($110 million at December 31, 2001).

The Company has indemnified and held harmless the current trustee and the former trustee of the Canadian National Railways Pension Trust Funds, and the respective officers, directors, employees and agents of such trustees, from any and all taxes, claims, liabilities, damages, costs and expenses arising out of the performance of their obligations under the relevant trust agreements and trust deeds, including in respect of their reliance on authorized instructions of the Company or for failing to act in the absence of authorized instructions. These indemnifications survive the termination of such agreements or trust deeds. As at December 31, 2002, the Company has not recorded a liability associated with these indemnifications, as the Company does not expect to make any payments pertaining to these indemnifications.

14 Workforce reduction charges

In 2002, the Company announced 1,146 job reductions, in a renewed drive to improve productivity in all its corporate and operating functions, and recorded a charge of $120 million, $79 million after tax. In 2001, a charge of $98 million, $62 million after tax, was recorded for the reduction of 690 positions. Reductions relating to these charges were 388 in 2001, 433 in 2002, with the remainder to be completed by the end of 2003. The charges included payments for severance, early retirement incentives and bridging to early retirement, to be made to affected employees.

15 Interest expense

In millions *Year ended December 31,*	**2002**	2001	2000
Interest on long-term debt	**$361**	$329	$322
Interest income	**–**	(2)	(11)
	$361	$327	$311
Cash interest payments	**$398**	$322	$315

16 Other income

In millions *Year ended December 31,*	**2002**	2001	2000
Gain on disposal of properties	**$ 41**	$ 53	$ 57
Equity in earnings of English Welsh and Scottish Railway *(Note 6)*	**33**	8	–
Investment income	**18**	22	10
Foreign exchange gain	**12**	7	10
Gain on sale of interest in Detroit River Tunnel Company *(A)*	**–**	101	–
Write-down of investment in 360networks Inc. *(Note 6)*	**–**	(99)	–
Gain on exchange of investment *(Note 6)*	**–**	–	84
Net real estate costs	**(15)**	(20)	(22)
Other	**(13)**	(7)	(3)
	$ 76	$ 65	$136

A. In March 2001, the Company completed the sale of its 50 percent interest in the Detroit River Tunnel Company (DRT) for proceeds of $112 million and recorded a gain of $101 million, $73 million after tax. The DRT is a 1.6 mile rail-only tunnel crossing the Canada-U.S. border between Detroit and Windsor, Ontario.

17 Income taxes

The Company's consolidated effective income tax rate differs from the statutory Federal tax rate. The reconciliation of income tax expense is as follows:

In millions *Year ended December 31,*	2002	2001	2000
Federal tax rate	**26.1%**	28.1%	29.1%
Income tax expense at the statutory Federal tax rate	**$ (309)**	$ (399)	$ (429)
Income tax (expense) recovery resulting from:			
Provincial and other taxes	**(140)**	(178)	(180)
Deferred income tax adjustment due to rate reductions	**–**	122	–
U.S. tax rate differential	**(1)**	3	9
Gain on disposals and dividends	**6**	18	18
Other	**60**	54	46
Income tax expense	**$ (384)**	$ (380)	$ (536)
Income before income taxes			
Canada	**$1,101**	$1,153	$1,172
U.S.	**83**	267	301
	$1,184	$1,420	$1,473
Current income taxes			
Canada	**$ (130)**	$ (99)	$ (153)
U.S.	**18**	14	(71)
	$ (112)	$ (85)	$ (224)
Deferred income taxes			
Canada	**$ (221)**	$ (173)	$ (290)
U.S.	**(51)**	(122)	(22)
	$ (272)	$ (295)	$ (312)
Cash payments for income taxes	**$ 65**	$ 63	$ 101

Significant components of deferred income tax assets and liabilities are as follows:

In millions *December 31,*	2002	2001
Deferred income tax assets		
Workforce reduction provisions	**$ 144**	$ 178
Accruals and other reserves	**276**	182
Post-retirement benefits	**99**	85
Losses and tax credit carryforwards	**69**	53
	588	498
Deferred income tax liabilities		
Properties and other	**5,292**	4,936
Total net deferred income tax liability	**4,704**	4,438
Net current deferred income tax asset	**122**	153
Net long-term deferred income tax liability	**$4,826**	$4,591
Net deferred income tax liability		
Canada	**$1,285**	$1,050
U.S.	**3,419**	3,388
	$4,704	$4,438

The Company expects to realize its deferred income tax assets from the generation of future taxable income, as the related payments are made and losses and tax credit carryforwards are utilized.

The Company recognized tax credits of $9 million in 2002 for research and development expenditures ($35 million in 2001 for investment tax credits) not previously recognized, which reduced the cost of properties.

18 Segmented information

The Company operates in one business segment with operations and assets in Canada and the United States.

Information on geographic areas

In millions *Year ended December 31,*	2002	2001	2000
Revenues:			
Canadian rail	**$3,726**	$3,675	$3,650
U.S. rail	**2,384**	1,977	1,778
	$6,110	$5,652	$5,428
Operating income:			
Canadian rail	**$1,163**	$1,181	$1,199
U.S. rail	**306**	501	449
	$1,469	$1,682	$1,648
Net income:			
Canadian rail	**$ 719**	$ 844	$ 695
U.S. rail	**81**	196	242
	$ 800	$1,040	$ 937
Depreciation and amortization:			
Canadian rail *(A)*	**$ 343**	$ 309	$ 336
U.S. rail	**248**	229	197
	$ 591	$ 538	$ 533
Capital expenditures: (B)			
Canadian rail *(C)*	**$ 717**	$ 723	$ 802
U.S. rail	**335**	274	310
	$1,052	$ 997	$1,112

In millions *December 31,*	2002	2001
Identifiable assets:		
Canadian rail	**$ 9,688**	$ 9,036
U.S. rail *(D)*	**12,050**	12,187
	$21,738	$21,223

(A) Includes $7 million (2001: $6 million, 2000: $8 million) of depreciation and amortization of properties related to other business activities.

(B) Represents additions to properties that include non-cash capital expenditures financed through capital lease arrangements.

(C) Includes $4 million (2001: $5 million, 2000: $9 million) of additions to properties related to other business activities.

(D) Includes equity holdings in foreign investments held by the Company's U.S. subsidiaries.

19 Earnings per share

Year ended December 31,	**2002**	2001	2000
Basic earnings per share	**$4.07**	$5.41	$4.81
Diluted earnings per share	**$3.97**	$5.23	$4.67

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

In millions *Year ended December 31,*	**2002**	2001	2000
Net income	**$800**	$1,040	$937
Income impact on assumed conversion of preferred securities *(Note 11)*	**6**	12	11
	$806	$1,052	$948
Weighted-average shares outstanding	**196.7**	192.1	195.0
Effect of dilutive securities and stock options	**6.1**	8.9	7.8
Weighted-average diluted shares outstanding	**202.8**	201.0	202.8

At December 31, 2002, 3.2 million stock options at a weighted-average exercise price of $77.56 were not included in the calculation of diluted earnings per share since their inclusion would have had an anti-dilutive impact.

20 Major commitments and contingencies

A. Leases

The Company has lease commitments for locomotives, freight cars and intermodal equipment, many of which provide the option to purchase the leased items at fixed values during or at the end of the lease term. As at December 31, 2002, the Company's commitments under operating and capital leases are $1,154 million and $1,407 million, respectively. Annual net minimum payments in each of the next five years and thereafter, are as follows:

Year *In millions*	Operating	Capital
2003	$ 212	$ 168
2004	188	153
2005	167	111
2006	139	68
2007	120	123
2008 and thereafter	328	784
	$1,154	1,407
Less: imputed interest on capital leases at rates ranging from approximately 3.0% to 14.6%		498
Present value of minimum lease payments at current rate included in debt		$ 909

Rent expense for operating leases was $269 million, $258 million and $219 million for the years ended December 31, 2002, 2001 and 2000, respectively. Contingent rentals and sublease rentals were not significant.

The Company has guaranteed a portion of the residual values of certain of its assets under operating leases with expiry dates between 2004 and 2012, for the benefit of the lessor. If the fair value of the assets, at the end of their respective lease term, is less than the fair value, as estimated at the inception of the lease, then the Company must, under certain conditions, compensate the lessor for the shortfall. The maximum exposure in respect of these guarantees is $63 million. As at December 31, 2002, the Company has not recorded a liability associated with these guarantees, as the Company does not expect to make any payments pertaining to the guarantees of these leases.

B. Other commitments

As at December 31, 2002, the Company had commitments to acquire railroad ties, rail, freight cars and locomotives at an aggregate cost of $183 million. Furthermore, as at December 31, 2002, the Company had entered into agreements with fuel suppliers to purchase approximately 38% of its anticipated 2003 volume and 8% of its anticipated 2004 volume at market prices prevailing on the date of the purchase.

C. Contingencies

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.

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) and represent a major expense for the railroad industry. The FELA system, which requires either the finding of fault through the U.S. jury system or individual settlements, has contributed to the significant increase in the Company's personal injury expense in recent years. In view of the Company's growing presence in the United States and the increase in the number of occupational disease claims over the past few years, an actuarial study was conducted in 2002, and in the fourth quarter of 2002 the Company changed its methodology for estimating its liability for U.S. personal injury and other claims, including occupational disease claims and claims for property damage, from a case-by-case approach to an actuarial-based approach. Consequently, and as discussed in Note 2, the Company recorded a charge of $281 million ($173 million after tax) to increase its provision for these claims.

Under the actuarial-based approach, the Company accrues the cost for the expected personal injury and property damage claims and existing occupational disease claims, based on actuarial estimates of their ultimate cost. The Company is unable to estimate the total cost for unasserted occupational disease claims. However, a liability for unasserted occupational disease claims is accrued to the extent they are probable and can be reasonably estimated.

Under the case-by-case approach, the Company was accruing the cost for claims as incidents were reported based on currently available information. In addition, the Company did not record a liability for unasserted claims, as such amounts could not be reasonably estimated under the case-by-case approach.

The Company's expenses for personal injury and other claims, net of recoveries, and including the above-mentioned charge, were $393 million in 2002, ($78 million in 2001 and $60 million in 2000) and payments for such items were $156 million in 2002 ($149 million in 2001 and $111 million in 2000). As at December 31, 2002, the Company had aggregate reserves for personal injury and other claims of $664 million ($430 million at December 31, 2001).

Although the Company considers such provisions to be adequate for all its outstanding and pending claims, the final outcome with respect to actions outstanding or pending at December 31, 2002, 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.

D. Environmental matters

The Company's operations are subject to federal, provincial, state, municipal and local regulations under environmental laws and regulations 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. The magnitude of such additional liabilities and the costs of complying with environmental laws and containing or remediating contamination 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

therefore, the likelihood of any such costs being incurred or whether such costs would be material to the Company cannot be determined at this time. There can thus be no assurance that 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. Although the effect on operating results and liquidity cannot be reasonably estimated, management believes, based on current information, that environmental matters will not have a material adverse effect on the Company's financial condition or competitive position. Costs related to any future remediation will be accrued in the year in which they become known.

As at December 31, 2002, the Company had aggregate accruals for environmental costs of $106 million ($112 million as at December 31, 2001). During 2002, payments of $16 million were applied to the provision for environmental costs compared to $14 million in 2001 and $11 million in 2000. The Company anticipates that the majority of the liability at December 31, 2002 will be paid out over the next five years.

In addition, related environmental capital expenditures were $19 million in both 2002 and 2001 and $20 million in 2000. The Company expects to incur capital expenditures relating to environmental matters of approximately $20 million in each of 2003 and 2004 and $17 million in 2005.

E. Standby letters of credit

The Company, including certain of its subsidiaries, has granted irrevocable standby letters of credit, issued by highly rated banks, to third parties to indemnify them in the event the Company does not perform its contractual obligations. As at December 31, 2002, the maximum potential liability under these letters of credit was $403 million of which $334 million was for workers' compensation and other employee benefits and $69 million was for equipment under leases and other.

20 Major commitments and contingencies *(continued)*

As at December 31, 2002, the Company has not recorded a liability with respect to these guarantees, as the Company does not expect to make any payments in excess of what is recorded on the Company's financial statements for the aforementioned items. The standby letters of credit mature at various dates between 2003 and 2007.

F. General indemnifications

In the normal course of business, the Company has provided indemnifications, customary for the type of transaction or for the railway business, in various agreements with third parties, including indemnification provisions where the Company would be required to indemnify third parties and others. Indemnifications are found in various types of contracts with third parties which include, but are not limited to, (a) contracts granting the Company the right to use or enter upon property owned by third parties such as leases, easements, trackage rights and sidetrack agreements; (b) contracts granting rights to others to use the Company's property, such as leases, licenses and easements; (c) contracts for the sale of assets; (d) contracts for the acquisition of services; (e) financing agreements; (f) trust indentures or fiscal agency agreements or similar agreements relating to debt or equity securities of the Company and engagement agreements with financial advisors; (g) transfer agent and registrar agreements in respect of the Company's securities; and (h) trust agreements establishing trust funds to secure the payment to certain officers and senior employees of special retirement compensation arrangements or plans. To the extent of any actual claims under these agreements, the Company maintains provisions for such items, which it considers to be adequate. Due to the nature of the indemnification clauses, the maximum exposure for future payment cannot be determined with certainty, however, may be material.

21 Financial instruments

A. Risk management

The Company has limited involvement with derivative financial instruments in the management of its fuel, foreign currency and interest rate exposures, and does not use them for trading purposes.

(i) Credit risk

In the normal course of business, the Company monitors the financial condition of its customers and reviews the credit history of each new customer.

The Company is exposed to credit risk in the event of non-performance by counterparties to its derivative financial instruments. Although collateral or other security to support financial instruments subject to credit risk is usually not obtained, counterparties are of high credit quality and their credit standing or that of their guarantor is regularly monitored. As a result, losses due to counterparty non-performance are not anticipated. The total risk associated with the Company's counterparties was immaterial at December 31, 2002. The Company believes there are no significant concentrations of credit risk.

(ii) Fuel

To mitigate the effects of fuel price changes on its operating margins and overall profitability, the Company has a systematic hedging program which calls for regularly entering into swap positions on crude and heating oil to cover a target percentage of future fuel consumption up to two years in advance. The changes in the fair value of the swap positions are highly correlated to changes in the price of fuel and therefore, these fuel hedges are being accounted for as cash flow hedges, whereby the effective portion of the cumulative change in the market value of the derivative instruments has been recorded in Accumulated other comprehensive income. The amounts in Accumulated other comprehensive income will be reclassified into income upon the ultimate consumption of the hedged fuel. To the extent that the cumulative change in the fair value of the swap positions does not offset the cumulative change in the price of fuel, the ineffective portion of the hedge will be recognized into income immediately. In the event that the fuel hedge is discontinued and the forecasted purchase of fuel is not expected to occur, the amount in Accumulated other comprehensive income would be reclassified into income immediately.

Realized gains and losses from the Company's fuel hedging activities were a $3 million gain, a $6 million loss and a $49 million gain for the years ended December 31, 2002, 2001 and 2000, respectively. At December 31, 2002, the Company has hedged approximately 47% of the estimated 2003 fuel consumption and 25% of the estimated 2004 fuel consumption. This represents approximately 263 million U.S. gallons at an average price of U.S.$0.5865 per U.S. gallon.

At December 31, 2002, Accumulated other comprehensive income included an unrealized gain of $30 million, $20 million after tax ($38 million unrealized loss, $25 million after tax at December 31, 2001), of which $29 million relates to derivative instruments that will mature within the next year. The Company did not recognize any material gains or losses in 2002 and 2001 due to hedge ineffectiveness as the Company's derivative instruments have been highly effective in hedging the changes in cash flows associated with forecasted purchases of diesel fuel.

(iii) Foreign currency

Although the Company conducts its business and receives revenues primarily in Canadian dollars, a growing portion of its revenues, expenses, assets and debt are denominated in U.S. dollars. Thus, the Company's results are affected by fluctuations in the exchange rate between these currencies. 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 affect the Company's revenues and expenses.

For the purpose of minimizing volatility of earnings resulting from the conversion of U.S. dollar denominated long-term debt into the Canadian dollar, the Company has designated all U.S. dollar denominated long-term debt of the parent company as a foreign exchange hedge of its net investment in U.S. subsidiaries. As a result, from the dates of designation, unrealized foreign exchange gains and losses on the translation of the Company's U.S. dollar denominated long-term debt are recorded in Accumulated other comprehensive income.

(iv) Interest rates
From time to time, the Company enters into interest rate swap transactions for the purpose of minimizing the volatility in the fair value of certain fixed-interest long-term debt. In 2002 and 2001, the Company did not enter into any interest rate swap transactions.

(v) Other
The Company does not currently have any derivative instruments not designated as hedging instruments.

B. Fair value of financial instruments
Generally accepted accounting principles define the fair value of a financial instrument as the amount at which the instrument could be exchanged in a current transaction between willing parties. The Company uses the following methods and assumptions to estimate the fair value of each class of financial instruments for which the carrying amounts are included in the Consolidated Balance Sheet under the following captions:

(i) Cash and cash equivalents, Accounts receivable, Accounts payable and accrued charges, and Other current liabilities:
The carrying amounts approximate fair value because of the short maturity of these instruments.

(ii) Other assets and deferred charges:
Investments: The Company has various debt and equity investments for which the carrying value approximates the fair value, with the exception of a cost investment for which the fair value was estimated based on the Company's proportionate share of its net assets.

(iii) Long-term debt:
The fair value of the Company's long-term debt is estimated based on the quoted market prices for the same or similar debt instruments, as well as discounted cash flows using current interest rates for debt with similar terms, company rating, and remaining maturity.

(iv) Convertible preferred securities:
In 2001, the fair value of the Company's convertible preferred securities was estimated based on the quoted market price.

The following table presents the carrying amounts and estimated fair values of the Company's financial instruments as at December 31, 2002 and 2001 for which the carrying values on the Consolidated Balance Sheet are different from their fair values:

In millions	***December 31, 2002***		*December 31, 2001*	
	Carrying amount	**Fair value**	Carrying amount	Fair value
Financial assets				
Investments	**$ 380**	**$ 440**	$ 496	$ 551
Financial liabilities				
Long-term debt (including current portion)	**$5,577**	**$5,738**	$5,927	$5,986
Convertible preferred securities	**$ –**	**$ –**	$ 366	$ 479

22 Other comprehensive income (loss)

A. Components of Other comprehensive income (loss) and the related tax effects are as follows:

In millions	***Year ended December 31, 2002***		
	Before tax amount	**Income tax (expense) recovery**	**Net of tax amount**
Unrealized foreign exchange gain on translation of U.S. dollar denominated long-term debt designated as a hedge of the net investment in U.S. subsidiaries	**$ 51**	**$(17)**	**$ 34**
Unrealized foreign exchange loss on translation of the net investment in foreign operations	**(40)**	**13**	**(27)**
Unrealized holding gain on fuel derivative instruments *(Note 21)*	**68**	**(23)**	**45**
Minimum pension liability adjustment *(Note 13)*	**(20)**	**7**	**(13)**
Other comprehensive income	**$ 59**	**$(20)**	**$ 39**

In millions	*Year ended December 31, 2001*		
	Before tax amount	Income tax (expense) recovery	Net of tax amount
Unrealized foreign exchange loss on translation of U.S. dollar denominated long-term debt designated as a hedge of the net investment in U.S. subsidiaries	$(202)	$ 71	$(131)
Unrealized foreign exchange gain on translation of the net investment in foreign operations	308	(108)	200
Unrealized holding loss on investment in 360networks Inc. *(Note 6)*	(129)	35	(94)
Unrealized holding loss on fuel derivative instruments *(Note 21)*	(38)	13	(25)
Minimum pension liability adjustment *(Note 13)*	(17)	6	(11)
Deferred income tax (DIT) rate enactment	–	(32)	(32)
Other comprehensive loss	$ (78)	$ (15)	$ (93)

22 Other comprehensive income (loss) *(continued)*

In millions	*Year ended December 31, 2000*		
	Before tax amount	Income tax (expense) recovery	Net of tax amount
Unrealized foreign exchange loss on translation of U.S. dollar denominated long-term debt designated as a hedge of the net investment in U.S. subsidiaries	$ (91)	$ 34	$ (57)
Unrealized foreign exchange gain on translation of the net investment in U.S. subsidiaries	191	(71)	120
Unrealized holding gain on investment in 360networks Inc. *(Note 6)*	129	(35)	94
Other comprehensive income	$229	$ (72)	$ 157

B. Changes in the balances of each classification within Accumulated other comprehensive income (loss) are as follows:

In millions

	Foreign exchange – U.S. $ debt	Foreign exchange – Net investment in foreign operations	Holding gain (loss) on 360networks Inc. investment	Holding gain (loss) on fuel derivative instruments	Minimum pension liability adjustment	DIT rate enactment	Accumulated other comprehensive income (loss)
Balance at January 1, 2000	$ (33)	$ 27	$ –	$ –	$ –	$ –	$ (6)
Period change	(57)	120	94	–	–	–	157
Balance at December 31, 2000	(90)	147	94	–	–	–	151
Period change	(131)	200	(94)	(25)	(11)	(32)	(93)
Balance at December 31, 2001	(221)	347	–	(25)	(11)	(32)	58
Period change	34	(27)	–	45	(13)	–	39
Balance at December 31, 2002	**$(187)**	**$320**	**$ –**	**$ 20**	**$(24)**	**$(32)**	**$ 97**

23 Quarterly financial data – unaudited

In millions, except per share data

	2002				2001			
	First	**Second**	**Third**	**Fourth [1]**	First	Second	Third	Fourth
Revenues	**$1,509**	**$1,551**	**$1,503**	**$1,547**	$1,398	$1,392	$1,325	$1,537
Operating income	**$ 406**	**$ 490**	**$ 484**	**$ 89**	$ 385	$ 346	$ 430	$ 521
Net income	**$ 230**	**$ 280**	**$ 268**	**$ 22**	$ 275	$ 217	$ 252	$ 296
Basic earnings per share	**$ 1.19**	**$ 1.44**	**$ 1.34**	**$ 0.11**	$ 1.44	$ 1.13	$ 1.31	$ 1.54
Diluted earnings per share	**$ 1.15**	**$ 1.39**	**$ 1.32**	**$ 0.11**	$ 1.39	$ 1.10	$ 1.27	$ 1.48
Dividend declared per share	**$0.215**	**$0.215**	**$0.215**	**$0.215**	$0.195	$0.195	$0.195	$0.195

(1) In the fourth quarter of 2002, the Company recorded a charge of $281 million ($173 million after tax) to increase its liability for U.S. personal injury and other claims and a charge for workforce reductions of $120 million ($79 million after tax).

24 Comparative figures

Certain figures, previously reported for 2001 and 2000, have been reclassified to conform with the basis of presentation adopted in the current year.

Financial Section (Canadian GAAP)

Contents

Canadian National Railway Company

The CN Pension Plan and the CN 1935 Pension Plan

Notes to Consolidated Financial Statements

Management's discussion and analysis (MD&A) relates to the financial condition and results of operations of Canadian National Railway Company (CN) together with its wholly owned subsidiaries, including Grand Trunk Corporation (GTC), Illinois Central Corporation (IC) and Wisconsin Central Transportation Corporation (WC), the latter from October 9, 2001. 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 Canadian generally accepted accounting principles (Canadian GAAP). This MD&A should be read in conjunction with the Company's Consolidated Financial Statements and notes thereto.

Financial results

2002 compared to 2001

On October 9, 2001, the Company completed its acquisition of WC and began a phased integration of the companies' operations. Accordingly, in the following discussion, the Company's results include the results of operations of WC, which were fully integrated into those of the Company in 2002.

The Company recorded consolidated net income of $571 million ($2.87 per basic share) for the year ended December 31, 2002 compared to $727 million ($3.72 per basic share) for the year ended December 31, 2001. Diluted earnings per share were $2.82 for the current year compared to $3.62 in 2001. Operating income was $1,116 million for 2002 compared to $1,366 million in 2001.

The years ended December 31, 2002 and 2001 included items impacting the comparability of the results of operations. Included in 2002 is a fourth quarter charge of $281 million, or $173 million after tax, to increase the Company's provision for U.S. personal injury and other claims, and a charge for workforce reductions of $120 million, or $79 million after tax. In 2001, the Company recorded a charge for workforce reductions of $98 million, or $62 million after tax, a charge to write down the Company's net investment in 360networks Inc. of $99 million, or $77 million after tax and a gain of $101 million, or $82 million after tax related to the sale of the Company's 50 percent interest in the Detroit River Tunnel Company (DRT).

Excluding the effects of the items discussed in the preceding paragraph, adjusted consolidated net income[1] was $823 million ($4.15 per basic share or $4.07 per diluted share) in 2002 compared to $784 million ($4.02 per basic share or $3.90 per diluted share) in 2001, an increase of $39 million, or 5%. Adjusted operating income,[1] which excludes the 2002 charge to increase the Company's provision for U.S. personal injury and other claims and the 2002 and 2001 workforce reduction charges, increased by $53 million, or 4%, to $1,517 million. The adjusted operating ratio was 75.2% in 2002 compared to 74.1% in 2001, a 1.1-point increase.

(1) The Company's results of operations include items affecting the comparability of results. Management believes adjusted consolidated net income and the resulting adjusted performance measures for such items as operating income, operating ratio, per share data and other statistical measures are useful measures of performance that facilitate period-to-period comparisons. These adjusted measures do not have any standardized meaning prescribed by GAAP and are not necessarily comparable to similar measures presented by other companies, and therefore, should not be considered in isolation.

Revenues

Revenues for the year ended December 31, 2002 totaled $6,110 million compared to $5,652 million in 2001. The increase of $458 million, or 8%, was mainly due to the inclusion of a full year of revenues attributable to the operations of WC in 2002. In addition, revenue gains were made in petroleum and chemicals, automotive, intermodal and forest products. These overall increases in revenues were partly offset by continued weakness in Canadian grain, coal, and metals and minerals. Revenue ton miles increased by 4% relative to 2001 and freight revenue per revenue ton mile increased by 4%.

Year ended December 31,	**2002**	2001	**2002**	2001	**2002**	2001
	Revenues		Revenue ton miles		Freight revenue per revenue ton mile	
	In millions				*In cents*	
Petroleum and chemicals	**$1,102**	$ 923	**30,006**	25,243	**3.67**	3.66
Metals and minerals	**521**	458	**13,505**	10,777	**3.86**	4.25
Forest products	**1,323**	1,088	**33,551**	29,639	**3.94**	3.67
Coal	**326**	338	**14,503**	15,566	**2.25**	2.17
Grain and fertilizers	**986**	1,161	**35,773**	42,728	**2.76**	2.72
Intermodal	**1,052**	969	**29,257**	26,257	**3.60**	3.69
Automotive	**591**	520	**3,281**	2,885	**18.01**	18.02
Other items*	**209**	195	**–**	–	**–**	–
Total	**$6,110**	$5,652	**159,876**	153,095	**3.69**	3.56

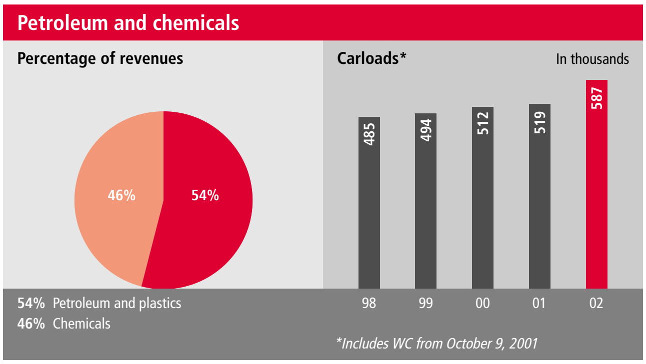
** Principally non-freight revenues derived from third parties.*

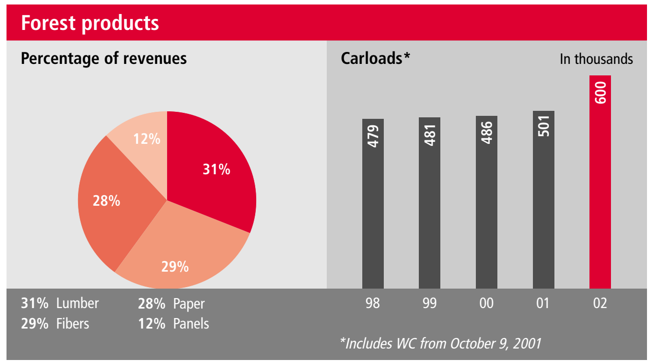
Petroleum and chemicals

Revenues for the year ended December 31, 2002 increased by $179 million, or 19%, over 2001. Growth was mainly due to the inclusion of a full year of revenues attributable to the operations of WC in 2002, strong sulfur traffic to the United States and offshore markets and market share gains in various sectors. The revenue per revenue ton mile remained relatively unchanged for the year as the effect of the weaker Canadian dollar was offset by an increase in the average length of haul for non-WC traffic.

Forest products

Revenues for the year ended December 31, 2002 increased by $235 million, or 22%, over 2001. Growth was mainly due to the inclusion of a full year of revenues attributable to the operations of WC in 2002, a strong North American housing market and improving pulp and paper markets. Also contributing to growth in the second half of the year were strong lumber shipments from CN's western lumber producers. The increase in revenue per revenue ton mile of 7% was mainly due to the effect of the weaker Canadian dollar and the inclusion of shorter haul WC traffic.



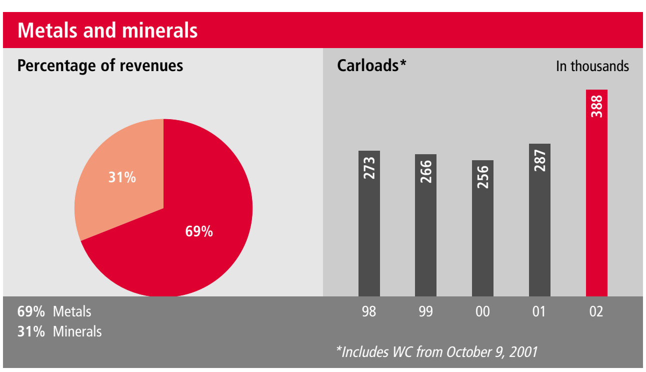


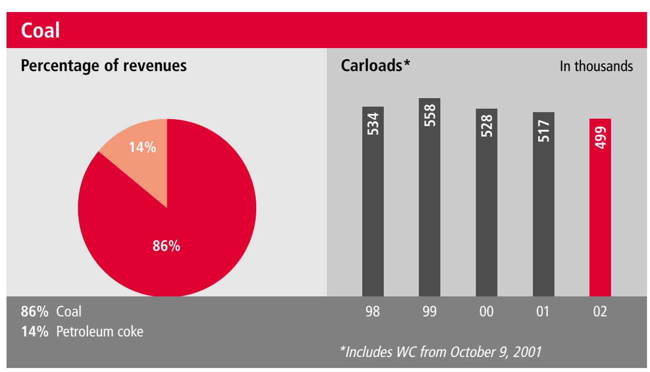
Metals and minerals

Revenues for the year ended December 31, 2002 increased by $63 million, or 14%, over 2001. The increase was mainly due to the inclusion of a full year of revenues attributable to the operations of WC in 2002, market share gains in the non-ferrous segment, particularly aluminum, and strong construction materials traffic. Partly offsetting these gains were the effects of weak steel markets in the first half of the year, one-time gains in 2001 and reduced traffic in specific segments due to ongoing customer strikes. Revenue per revenue ton mile decreased by 9% over 2001 mainly due to an increase in longer haul traffic and the inclusion of certain lower rated WC traffic.

Coal

Revenues for the year ended December 31, 2002 decreased by $12 million, or 4%, from 2001. The decrease was mainly attributable to weak Canadian coal exports to offshore markets and reduced demand from power utilities in the first half of the year. The revenue per revenue ton mile increase of 4% was mainly due to a decrease in longer haul traffic.



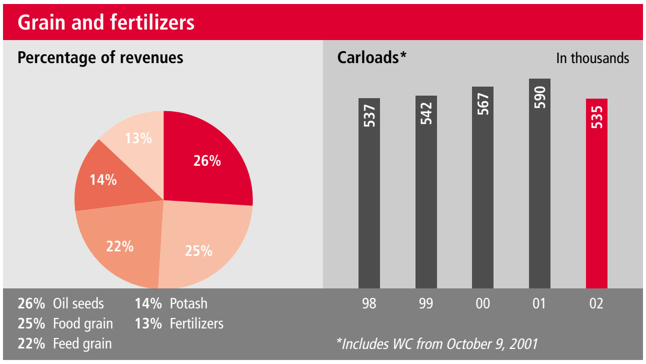


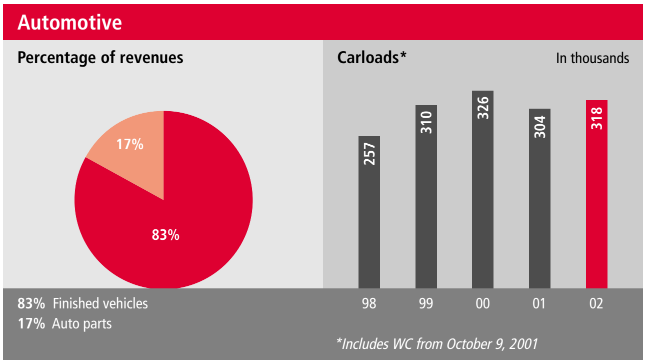
Grain and fertilizers

Revenues for the year ended December 31, 2002 decreased by $175 million, or 15%, from 2001. The decrease reflects a significant deterioration in the Canadian grain crop, a decline in U.S. originated traffic and the loss of a potash move. Revenue per revenue ton mile increased by 1% mainly as a result of an increase in regulated grain rates.

Automotive

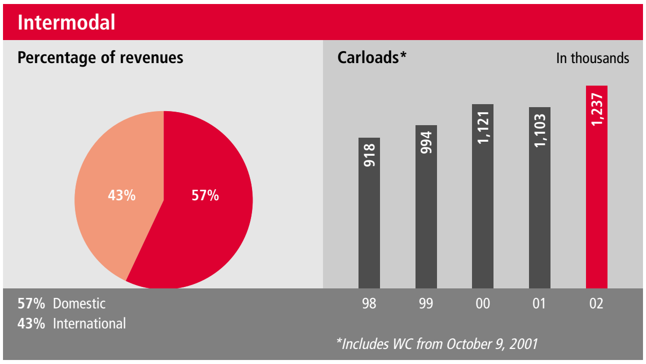
Revenues for the year ended December 31, 2002 increased by $71 million, or 14%, over 2001. The increase reflects strong motor vehicle production in both Canada and the United States. Revenue per revenue ton mile remained relatively unchanged for the year as the effect of the weaker Canadian dollar was offset by an increase in the average length of haul.





Intermodal

Revenues for the year ended December 31, 2002 increased by $83 million, or 9%, over 2001. Growth in the international segment was driven by market share gains by steamship lines served by CN. The domestic segment benefited from growing North American markets, particularly in Canada. Revenue per revenue ton mile decreased by 2%, mainly due to a higher average fuel surcharge in 2001 and an increase in the average length of haul.



Operating expenses

Operating expenses amounted to $4,994 million in 2002 compared to $4,286 million in 2001. The increase was mainly due to the inclusion of a full year of expenses attributable to the operations of WC in 2002, higher Casualty and other expenses resulting primarily from the 2002 charge to increase the Company's provision for U.S. personal injury and other claims, and increased expenses for labor and fringe benefits that included a higher workforce reduction charge in 2002 compared to 2001. These increases were partly offset by lower fuel costs. Operating expenses, excluding the 2002 charge for U.S. personal injury and other claims and the 2002 and 2001 workforce reduction charges, amounted to $4,593 million, an increase of $405 million, or 10%, from 2001.[1]

Dollars in millions *Year ended December 31,*	**2002**		2001	
	Amount	**% of revenue**	Amount	% of revenue
Labor and fringe benefits	**$2,051**	**33.6%**	$1,810	32.0%
Purchased services and material	**908**	**14.9%**	811	14.4%
Depreciation and amortization	**499**	**8.1%**	463	8.2%
Fuel	**459**	**7.5%**	485	8.6%
Equipment rents	**353**	**5.8%**	314	5.5%
Casualty and other	**724**	**11.8%**	403	7.1%
Total	**$4,994**		$4,286	

Labor and fringe benefits: Labor and fringe benefit expenses in 2002 increased by $241 million, or 13%, as compared to 2001. The increase was mainly due to the inclusion of a full year of expenses attributable to the operations of WC in 2002, a higher workforce reduction charge in 2002, wage increases, and higher benefit expenses, including health and welfare, particularly in the U.S. These increases were partly offset by the effects of a reduced workforce in 2002.

In 2002, the Company announced 1,146 job reductions across all corporate and operating functions in a renewed drive to improve productivity and recorded a workforce reduction charge of $120 million. Reductions relating to this and the 2001 workforce reduction charge were 388 in 2001, 433 in 2002, with the remainder to be completed by the end of 2003. The charges included payments for severance, early retirement incentives and bridging to early retirement, to be made to affected employees.

Purchased services and material: These costs increased by $97 million, or 12%, in 2002 as compared to 2001. The increase was mainly due to the inclusion of a full year of expenses attributable to the operations of WC in 2002 and higher expenses for professional services and joint facilities. These increases were partly offset by reduced expenses for crew transportation and lodging in 2002.

Depreciation and amortization: Depreciation and amortization expense in 2002 increased by $36 million, or 8%, as compared to 2001. The increase was mainly due to the inclusion of a full year of expenses attributable to the operations of WC in 2002 and the impact of net capital additions in the current year.

Fuel: Fuel expense in 2002 decreased by $26 million, or 5%, as compared to 2001. The decrease was primarily due to a lower average price of fuel, partially offset by the inclusion of a full year of expenses attributable to the operations of WC in 2002.

Equipment rents: These expenses increased by $39 million, or 12%, in 2002 as compared to 2001. The increase was mainly due to the inclusion of a full year of expenses attributable to the operations of WC in 2002 and lower car hire income, partly offset by reduced expenses for long-term operating leases.

Casualty and other: These expenses increased by $321 million, or 80%, in 2002 as compared to 2001. The increase was mainly due to higher expenses for personal injury and other claims which included a fourth quarter 2002 charge of $281 million to increase the provision for U.S. personal injury and other claims, and higher derailment related expenses. Partly offsetting these increases were lower expenses related to environmental matters and bad debts.

Other

Interest expense: Interest expense increased by $41 million to $353 million for the year ended December 31, 2002 as compared to 2001. The increase was mainly due to the financing related to the acquisition of WC and the inclusion of a full year of WC expenses in 2002. Partly offsetting these increases was the maturity of certain notes in 2001.

Other income: In 2002, the Company recorded other income of $76 million compared to $65 million in 2001. The increase was mainly due to the inclusion of a full year of equity in earnings of English Welsh and Scottish Railway (EWS) in 2002 partly offset by lower gains on disposal of properties. Included in 2001 was a charge of $99 million to write down the Company's net investment in 360networks Inc. and a gain of $101 million related to the sale of the Company's 50 percent interest in DRT.

Income tax expense: The Company recorded income tax expense of $268 million for the year ended December 31, 2002 compared to $392 million in 2001. The effective tax rate for the year ended December 31, 2002 decreased to 31.9% from 35.0% in 2001, due mainly to lower income tax rates in Canada.

2001 compared to 2000

The Company recorded consolidated net income of $727 million ($3.72 per basic share) for the year ended December 31, 2001 compared to $774 million ($3.91 per basic share) for the year ended December 31, 2000. Diluted earnings per share were $3.62 for 2001 compared to $3.82 in 2000. The results for 2001 include net income of $11 million related to the acquisition of WC. Operating income was $1,366 million for 2001 compared to $1,385 million in 2000. This represents a decrease of $19 million, or 1%.

The years ended December 31, 2001 and 2000 included items impacting the comparability of the results of operations. Included in 2001 is a charge for workforce reductions of $98 million, or $62 million after tax, a charge to write down the Company's net investment in 360networks Inc. of $99 million, or $77 million after tax and a gain of $101 million, or $82 million after tax related to the sale of the Company's 50 percent interest in DRT. In 2000, the Company recorded a gain of $84 million, or $58 million after tax related to the exchange of its minority equity investments in certain joint venture companies for 11.4 million shares of 360networks Inc.

Excluding the effects of the items discussed in the preceding paragraph, adjusted consolidated net income[(1)] was $784 million ($4.02 per basic share or $3.90 per diluted share) in 2001 compared to $716 million ($3.61 per basic share or $3.54 per diluted share) in 2000. Adjusted operating income,[(1)] which excludes the 2001 charge for workforce reductions, increased by $79 million, or 6%, to $1,464 million. The adjusted operating ratio, which excludes the 2001 charge for workforce reductions, improved to 74.1% in 2001 from 74.6% in 2000, a half-point betterment.

Revenues

Revenues for the year ended December 31, 2001 totaled $5,652 million compared to $5,446 million in 2000. The increase of $206 million, or 4%, was mainly attributable to the inclusion of $129 million of WC revenues and to gains in metals and minerals, intermodal, forest products and grain and fertilizers. This was partially offset by lower automotive revenues. Revenue ton miles and freight revenue per revenue ton mile each increased by 2% as compared to 2000.

Year ended December 31,	2001	2000	2001	2000	2001	2000
	Revenues		Revenue ton miles		Freight revenue per revenue ton mile	
	In millions				*In cents*	
Petroleum and chemicals	$ 923	$ 894	25,243	24,858	3.66	3.60
Metals and minerals	458	392	10,777	9,207	4.25	4.26
Forest products	1,088	1,008	29,639	28,741	3.67	3.51
Coal	338	328	15,566	15,734	2.17	2.08
Grain and fertilizers	1,161	1,136	42,728	42,396	2.72	2.68
Intermodal	969	919	26,257	25,456	3.69	3.61
Automotive	520	559	2,885	3,165	18.02	17.66
Other items*	195	210	–	–	–	–
Total	$5,652	$5,446	153,095	149,557	3.56	3.50

** Principally non-freight revenues derived from third parties.*

Petroleum and chemicals

Revenues for the year ended December 31, 2001 increased by $29 million, or 3%, over 2000 of which $22 million resulted from the inclusion of WC revenues. Excluding WC, growth in 2001 was driven by market share gains and plant expansions in the petroleum products sector, increased salt traffic, mainly in the early part of the year, and the weaker Canadian dollar. Significant weakness in sulfur demand partially offset these increases. The revenue per revenue ton mile increase of 2% for 2001 was mainly attributable to the effect of the weaker Canadian dollar.

Metals and minerals

Revenues for the year ended December 31, 2001 increased by $66 million, or 17%, over 2000 of which $22 million resulted from the inclusion of WC revenues. Excluding WC, growth in 2001 was driven by strong Canadian aluminum exports to the United States in line with weaker U.S. production, increased levels of equipment traffic, market share gains in steel, ores and concentrates, and increased stone and rock shipments to the United States. Significant weakness in the steel markets partially offset overall growth. Revenue per revenue ton mile was essentially flat year over year.

Forest products

Revenues for the year ended December 31, 2001 increased by $80 million, or 8%, over 2000 of which $55 million resulted from the inclusion of WC revenues. Excluding WC, growth was driven by market share gains in the panels segment and the effect of the weaker Canadian dollar. These gains were partially offset by weakness in the pulp and paper markets due, in part, to a significant reduction in U.S. paper consumption. The increase in revenue per revenue ton mile of 5% was mainly due to the effect of the weaker Canadian dollar and the inclusion of shorter haul WC traffic.

Coal

Revenues for the year ended December 31, 2001 increased by $10 million, or 3%, over 2000 of which $7 million resulted from the inclusion of WC revenues. Excluding WC, strong demand for thermal coal in 2001 was partially offset by reduced shipments of metallurgical coal due to the closure of some Canadian mines in 2000. The revenue per revenue ton mile increase of 4% was mainly due to an increase in rates tied to commodity prices and the effect of the weaker Canadian dollar.

Grain and fertilizers

Revenues for the year ended December 31, 2001 increased by $25 million, or 2%, over 2000 of which $15 million resulted from the inclusion of WC revenues. Excluding WC, growth was mainly driven by higher wheat shipments to the United States, increased market share of U.S. corn and soybean traffic and higher exports of canola through Vancouver. The 1% increase in revenue per revenue ton mile was mainly due to a shift to shorter haul traffic and the effect of the weaker Canadian dollar, partially offset by the introduction of the Canadian grain revenue cap in August 2000.

Intermodal

Revenues for the year ended December 31, 2001 increased by $50 million, or 5%, over 2000 of which $7 million resulted from the inclusion of WC revenues. Excluding WC, growth was driven by market share gains in the international segment and from new service offerings in the domestic segment. Weaker economic conditions in the second half of 2001 led to slower growth. Revenue per revenue ton mile increased by 2% due to rate increases and the effect of the weaker Canadian dollar, partially offset by a shift to longer haul traffic.

Automotive

Revenues for the year ended December 31, 2001 decreased by $39 million, or 7%, from 2000. The revenue decline resulted from weakness in North American vehicle production in 2001 and from one-time gains obtained in 2000 due, in part, to competitors' service problems. The decline was partially offset by the effect of the weaker Canadian dollar. The increase in revenue per revenue ton mile of 2% was mainly due to the weaker Canadian dollar partially offset by an increase in the average length of haul.

Operating expenses

Operating expenses amounted to $4,286 million in 2001 compared to $4,061 million in 2000. The increase in 2001 was mainly due to the inclusion of $95 million of WC expenses, higher labor and fringe benefit expenses that included a charge for workforce reductions of $98 million, increased depreciation and amortization expense, higher fuel costs, and increased expenses for equipment rents and casualty and other. Partially offsetting these increases were lower expenses for purchased services and material. Operating expenses, excluding the workforce reduction charge, amounted to $4,188 million, an increase of $127 million, or 3%, from 2000.[1]

Dollars in millions *Year ended December 31,*	2001		2000	
	Amount	% of revenue	Amount	% of revenue
Labor and fringe benefits	$1,810	32.0%	$1,674	30.7%
Purchased services and material	811	14.4%	858	15.8%
Depreciation and amortization	463	8.2%	412	7.6%
Fuel	485	8.6%	450	8.3%
Equipment rents	314	5.5%	291	5.3%
Casualty and other	403	7.1%	376	6.9%
Total	$4,286		$4,061	

Labor and fringe benefits: Labor and fringe benefit expenses in 2001 increased by $136 million, or 8%, as compared to 2000. The increase was mainly attributable to the workforce reduction charge, the inclusion of WC labor expense of $46 million, wage increases and the impact of the weaker Canadian dollar on U.S. denominated expenses. This was partially offset by lower pension and other benefit related expenses.

The Company recorded a workforce reduction charge of $98 million in the second quarter of 2001 for the reduction of 690 positions (388 occurred in 2001 and the remainder was completed by the end of 2002). The charge included payments for severance, early retirement incentives and bridging to early retirement, to be made to affected employees.

Purchased services and material: These expenses decreased by $47 million, or 5%, in 2001 as compared to 2000. The decrease was mainly due to one-time consulting and professional fees related to a proposed combination in 2000, lower contracted services and higher recoveries in 2001 from work performed for third parties. This was partially offset by higher equipment repair and maintenance expenses and $15 million resulting from the inclusion of WC expenses.

Depreciation and amortization: Depreciation and amortization expense in 2001 increased by $51 million, or 12%, as compared to 2000. The increase was mainly due to net capital additions and the inclusion of WC depreciation of $10 million.

Fuel: Fuel expense in 2001 increased by $35 million, or 8%, as compared to 2000, primarily due to an increase in the average cost of fuel and the inclusion of $10 million of WC fuel expense.

Equipment rents: These expenses increased by $23 million, or 8%, in 2001 as compared to 2000. The increase was mainly attributable to lower lease and offline car hire income and the inclusion of $6 million of WC equipment rents. This was partially offset by lower private car mileage payments.

Casualty and other: These expenses increased by $27 million, or 7%, in 2001 as compared to 2000. The increase resulted from higher expenses for occupational disease claims and environmental matters, higher provincial capital taxes and the inclusion of $8 million of WC expenses. This was partially offset by lower expenses for damaged equipment and merchandise claims and provincial sales tax recoveries in 2001.

Other

Interest expense: Interest expense increased by $17 million to $312 million for the year ended December 31, 2001 as compared to 2000. The increase was mainly due to the financing related to the acquisition of WC, the inclusion of $4 million of WC interest expense, and the impact of the weaker Canadian dollar on U.S. denominated interest costs. This was, in part, offset by the refinancing of a portion of matured debt at lower rates.

Other income: In 2001, the Company recorded other income of $65 million compared to $126 million in 2000. Included in 2001 is a charge of $99 million to write down the Company's net investment in 360networks Inc., a gain of $101 million related to the sale of the Company's 50 percent interest in DRT and $11 million of WC other income. The comparative 2000 period included an $84 million gain related to the 360networks Inc. transaction.

Income tax expense: The Company recorded an income tax expense of $392 million for the year ended December 31, 2001 compared to $442 million in 2000. The effective tax rate for the year ended December 31, 2001 decreased to 35.0% from 36.3% in 2000 due mainly to lower tax rates in 2001.

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 its Accounts receivable 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 $1,173 million for the year ended December 31, 2002 compared to $1,232 million for 2001. Cash generated in 2002 was partially consumed by payments for interest, workforce reductions and personal injury and other claims of $390 million, $177 million and $156 million, respectively, compared to $307 million, $169 million and $149 million, respectively in 2001. Pension contributions and payments for income taxes were $92 million and $65 million, respectively, compared to $69 million and $63 million, respectively in 2001. The Company increased the level of accounts receivable sold under its Accounts receivable securitization program by $5 million in 2002 and $133 million in 2001. Payments in 2003 for workforce reductions are expected to be $168 million while pension contributions are expected to be approximately $92 million.

Investing activities: Cash used by investing activities in 2002 amounted to $476 million compared to $1,764 million in 2001. The Company's investing activities in 2002 included aggregate net proceeds of $69 million from the sale of its investments in Tranz Rail Holdings Limited and Australian Transport Network Limited, and $28 million from the sale of IC Terminal Holdings Company. Investing activities in 2001 included $1,278 million related to the acquisition of WC as at October 9, 2001 and net proceeds of $112 million from the sale of DRT. Net capital expenditures for the year ended December 31, 2002 amounted to $571 million, including $27 million related to WC, a decrease of $34 million over 2001. Net capital expenditures included expenditures for roadway renewal, rolling stock, and other capacity and productivity improvements.

The Company anticipates that capital expenditures for 2003 will remain at approximately the same level as 2002. This will include funds required for ongoing renewal of the basic plant and other acquisitions and investments required to improve the Company's operating efficiency and customer service.

As at December 31, 2002, the Company had commitments to acquire railroad ties, rail, freight cars and locomotives at an aggregate cost of $183 million.

Dividends: During 2002, the Company paid dividends totaling $179 million to its shareholders at the quarterly rate of $0.215 per share on the common shares and 5.25% per year on the convertible preferred securities.

Free cash flow

The Company generated $513 million of free cash flow for the year ended December 31, 2002, compared to $439 million for the same 2001 period, excluding $1,278 million related to the 2001 acquisition of WC. The Company defines free cash flow as cash provided from operating activities, excluding increases in the level of accounts receivable sold under the securitization program ($5 million in 2002, $133 million in 2001), less capital expenditures, other investing activities and dividends paid.

Financing activities: Cash used by financing activities totaled $546 million for the year ended December 31, 2002 compared to cash generated of $740 million in 2001. In 2002, issuances and repayments of long-term debt related principally to the Company's commercial paper and revolving credit facilities. In 2001, the Company issued debt securities in two series, U.S.$400 million (Cdn$629 million) 6.375% Notes due 2011 and U.S.$200 million (Cdn$314 million) 7.375% Debentures due 2031, related to the acquisition of WC.

In 2002, $203 million was used to repurchase common shares under the share repurchase program. In 2001, the Company also had a share repurchase program, under which it did not repurchase any common shares.

During 2002, the Company recorded $114 million in capital lease obligations ($91 million in 2001) related to new equipment and the exercise of purchase options on existing equipment.

The Company has access to various financing arrangements:

Revolving credit facilities

In December 2002, the Company entered into a U.S.$1,000 million three-year revolving credit facility and concurrently terminated its previous revolving credit facilities before their scheduled maturity in March 2003. The credit facility provides for borrowings at various interest rates, plus applicable margins, and contains customary financial covenants. Throughout the year, the Company was in compliance with all financial covenants contained in its outstanding revolving credit agreements. The Company's borrowings of U.S.$172 million (Cdn$273 million) outstanding at December 31, 2001 were entirely repaid in the first quarter of 2002. At December 31, 2002, the Company had borrowings under its revolving credit facility of U.S.$90 million (Cdn$142 million) at an average interest rate of 1.77%. Outstanding letters of credit under the previous facilities were transferred into the current facility. As at December 31, 2002, letters of credit under the revolving credit facility amounted to $295 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 $600 million, or the U.S. dollar equivalent. Commercial paper debt is due within one year but has been classified as long-term debt, reflecting the Company's intent and contractual ability to refinance the short-term borrowing through subsequent issuances of commercial paper or drawing down on the long-term revolving credit facility. As at December 31, 2002, the Company had outstanding commercial paper of U.S.$136 million (Cdn$214 million) compared to U.S.$213 million (Cdn$339 million) as at December 31, 2001.

Shelf registration statement

At December 31, 2002, the Company had U.S.$400 million remaining for issuance under its shelf registration statement, which expires in August 2003.

Accounts receivable securitization program

The sale of a portion of the Company's accounts receivable is conducted under a securitization program, which has a $350 million maximum limit and will expire in June 2003. The program is subject to customary credit rating and reporting requirements. In the event the program is terminated before its scheduled maturity, the Company expects to have sufficient liquidity remaining in its revolving credit facility to meet its payment obligations. The Company intends to renew or replace the program upon expiration. At December 31, 2002, pursuant to the agreement, $173 million and U.S.$113 million (Cdn$177 million) had been sold on a limited recourse basis, an increase of $5 million from the level of accounts receivable sold at December 31, 2001.

The Receivables Purchase Agreement provides for customary indemnification provisions, which survive for a period of two years following the final purchase of any receivable, three years from the final collection date or until statute barred, in the case of taxes. As at December 31, 2002, the Company has not recorded a liability associated with these indemnifications, for which there is no monetary limitation, as the Company does not expect to make any payments pertaining to the indemnifications of this program. Although there is no monetary limitation with respect to these indemnifications, the Company would not expect the amount to exceed the maximum limit under the program.

Contractual obligations and commercial commitments

In the normal course of business, the Company incurs contractual obligations and commercial commitments. The following tables set forth material obligations and commitments as of December 31, 2002:

Contractual obligations

In millions	**Total**	2003	2004	2005	2006	2007	2008 and thereafter
Debentures and notes	**$4,167**	$394	$419	$158	$394	$ 79	$2,723
Capital leases and other[a]	**1,424**	180	141	444	46	90	523
Long-term debt	**5,591**	574	560	602	440	169	3,246
Operating leases	**1,154**	212	188	167	139	120	328
Total obligations	**$6,745**	**$786**	**$748**	**$769**	**$579**	**$289**	**$3,574**

Commercial commitments

In millions	**Total**	2003	2004	2005	2006	2007	2008 and thereafter
Standby letters of credit	**$403**	$401	$ 1	$–	$1	$–	$–
Other commercial commitments[b]	**183**	112	71	–	–	–	–
Total commitments	**$586**	**$513**	**$72**	**$–**	**$1**	**$–**	**$–**

(a) Excludes $498 million of imputed interest on capital leases at rates ranging from approximately 3.0% to 14.6%.
(b) Includes commitments for railroad ties, rail, freight cars and locomotives.

For 2003 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.

Guarantees

Guarantee of residual values of operating leases

The Company has guaranteed a portion of the residual values of certain of its assets under operating leases with expiry dates between 2004 and 2012, for the benefit of the lessor. If the fair value of the assets, at the end of their respective lease term, is less than the fair value, as estimated at the inception of the lease, then the Company must, under certain conditions, compensate the lessor for the shortfall. The maximum exposure in respect of these guarantees is $63 million. As at December 31, 2002, the Company has not recorded a liability associated with these guarantees, as the Company does not expect to make any payments pertaining to the guarantees of these leases.

Standby letters of credit

The Company, including certain of its subsidiaries, has granted irrevocable standby letters of credit, issued by highly rated banks, to third parties to indemnify them in the event the Company does not perform its contractual obligations. As at December 31, 2002, the maximum potential liability under these letters of credit was $403 million of which $334 million was for workers' compensation and other employee benefits and $69 million was for equipment under leases and other.

As at December 31, 2002, the Company has not recorded a liability with respect to these guarantees, as the Company does not expect to make any payments in excess of what is recorded on the Company's financial statements for the aforementioned items. The standby letters of credit mature at various dates between 2003 and 2007.

Indemnifications

CN Pension Plan and CN 1935 Pension Plan

The Company has indemnified and held harmless the current trustee and the former trustee of the Canadian National Railways Pension Trust Funds, and the respective officers, directors, employees and agents of such trustees, from any and all taxes, claims, liabilities, damages, costs and expenses arising out of the performance of their obligations under the relevant trust agreements and trust deeds, including in respect of their reliance on authorized instructions of the Company or for failing to act in the absence of authorized instructions. These indemnifications survive the termination of such agreements or trust deeds. As at December 31, 2002, the Company has not recorded a liability associated with these indemnifications, as the Company does not expect to make any payments pertaining to these indemnifications.

Share repurchase program

On October 22, 2002, the Board of Directors of the Company approved a share repurchase program which allows for the repurchase of up to 13.0 million common shares between October 25, 2002 and October 24, 2003 pursuant to a normal course issuer bid, at prevailing market prices. As at December 31, 2002, $203 million was used to repurchase 3.0 million common shares at an average price of $67.68 per share.

Termination of conversion rights of 5.25% convertible preferred securities ("Securities")

On May 6, 2002, the Company met the conditions required to terminate the Securities holders' right to convert their Securities into common shares of the Company, and set the conversion termination date as July 3, 2002. The conditions were met when the Company's common share price exceeded 120% of the conversion price of U.S.$38.48 per share for a specified period, and all accrued interest on the Securities had been paid. On July 3, 2002, Securities that had not been previously surrendered for conversion were deemed converted, resulting in the issuance of 6.0 million common shares of the Company.

Acquisition of Wisconsin Central Transportation Corporation

On October 9, 2001, the Company completed its acquisition of WC for an acquisition cost of $1,301 million (U.S.$833 million) and began a phased integration of the companies' operations.

The Company accounted for the merger using the purchase method of accounting as required by the Canadian Institute of Chartered Accountants (CICA) Handbook Section 1581 "Business Combinations." As such, the Company's consolidated financial statements include the assets, liabilities and results of operations of WC as of October 9, 2001, the date of acquisition. The Company had estimated, on a preliminary basis, the fair values of the assets and liabilities acquired based on currently available information. In 2002, the Company finalized the allocation of the purchase price and adjusted the preliminary fair values of the assets and liabilities acquired as follows: Current assets decreased by $10 million, Properties increased by $141 million, Other assets and deferred charges decreased by $98 million, Current liabilities increased by $10 million, Deferred income taxes increased by $16 million and Other liabilities and deferred credits increased by $3 million. The increase in Properties and decrease in Other assets and deferred charges was mainly due to the final valuation of the Company's foreign equity investment. The remaining adjustments resulted from additional information obtained for conditions and circumstances that existed at the time of acquisition.

The following table outlines the final fair values of WC's assets and liabilities acquired:

In millions	
Current assets	$ 165
Properties	2,576
Other assets and deferred charges	335
Total assets acquired	3,076
Current liabilities	363
Deferred income taxes	759
Other liabilities and deferred credits	181
Long-term debt	472
Total liabilities assumed	1,775
Net assets acquired	$1,301

Recent accounting pronouncements

In December 2002, the CICA issued Handbook Section 3063 "Impairment of Long-Lived Assets." Section 3063 provides accounting guidance for the determination of a long-lived asset impairment as well as recognition, measurement and disclosure of the impairment. This section is effective for the Company's fiscal year beginning January 1, 2004. The Company does not expect Section 3063 to have an initial material impact on its financial statements upon adoption.

Also in December 2002, the CICA issued Handbook Section 3475 "Disposal of Long-Lived Assets and Discontinued Operations." Section 3475 provides accounting guidance for long-lived assets to be disposed of other than by sale, long-lived assets to be disposed of by sale and presentation and disclosure for discontinued operations. This section is effective for disposal activities initiated by the Company on or after May 1, 2003. The Company does not expect Section 3475 to have an initial material impact on its financial statements upon adoption.

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 matters, depreciation lives, 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 Consolidated Financial Statements and notes thereto.

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

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.

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 changed certain of these assumptions, which have not had a material effect on its results of operations. 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) and represent a major expense for the railroad industry. The FELA system, which requires either the finding of fault through the U.S. jury system or individual settlements, has contributed to the significant increase in the Company's personal injury expense in recent years. In view of the Company's growing presence in the United States and the increase in the number of occupational disease claims over the past few years, an actuarial study was conducted in 2002, and in the fourth quarter of 2002 the Company changed its methodology for estimating its liability for U.S. personal injury and other claims, including occupational disease claims and claims for property damage, from a case-by-case approach to an actuarial-based approach. Consequently, and as discussed in Note 2 to the Consolidated Financial Statements, the Company recorded a charge of $281 million ($173 million after tax) to increase its provision for these claims.

Under the actuarial-based approach, the Company accrues the cost for the expected personal injury and property damage claims and existing occupational disease claims, based on actuarial estimates of their ultimate cost. The Company is unable to estimate the total cost for unasserted occupational disease claims. However, a liability for unasserted occupational disease claims is accrued to the extent they are probable and can be reasonably estimated.

Under the case-by-case approach, the Company was accruing the cost for claims as incidents were reported based on currently available information. In addition, the Company did not record a liability for unasserted claims, as such amounts could not be reasonably estimated under the case-by-case approach.

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 $25 million and the annual expense by approximately $5 million.

The Company's expenses for personal injury and other claims, net of recoveries, and including the above-mentioned charge, were $393 million in 2002 ($78 million in 2001 and $60 million in 2000) and payments for such items were $156 million in 2002 ($149 million in 2001 and $111 million in 2000). As at December 31, 2002, the Company had aggregate reserves for personal injury and other claims of $664 million ($430 million at December 31, 2001).

Environmental matters

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 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 technique, 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 environmental assessment conducted on a site-by-site basis. A liability is initially recorded at the completion of the second phase and adjusted, if necessary, upon completion of the third and/or fourth phase depending on the facts, as they become known.

The initial phase entails an overview of the pertinent site and includes obtaining and reviewing historical data. At the end of the second phase, the presence or absence of contamination is confirmed for those sites identified as a concern in the initial phase. Upon completion of phase three, the extent of the contamination is determined and if necessary, options are developed to monitor, contain or remediate the contamination. In the final phase, the remediation or containment program is put in operation.

Cost scenarios are established by external consultants based on extent of contamination and expected costs for remedial efforts. The Company uses these scenarios to estimate the costs related to a particular site. At December 31, 2002, most of the Company's properties not acquired through recent acquisitions are approaching phase four and therefore costs related to such sites may change based on information as it becomes available. For properties acquired through recent acquisitions, the Company obtained assessments from both external and internal consultants and a liability has been accrued based on such assessments. These estimates may change based on information as it becomes available.

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 year they become known.

Future occurrences

In the operation of a railroad, 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.

The Company's expenses relating to environmental matters, net of recoveries, have not been significant in the past three years. Payments for such items were $16 million in 2002 ($14 million in 2001 and $11 million in 2000). As at December 31, 2002, the Company had aggregate accruals for environmental costs of $106 million ($112 million at December 31, 2001). The Company anticipates that the majority of the liability will be paid out over the next five years.

Depreciation lives

Railroad properties are carried at cost less accumulated depreciation including asset impairment write-downs. The Company follows the group method of depreciation 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 $12 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 2001, the Company conducted a comprehensive study for its Canadian properties, which did not have an impact on depreciation expense as the benefit of increased lives was offset by deficiencies in certain accumulated depreciation balances. The study conducted in 2000 for the Company's U.S. properties did not have an impact on depreciation expense.

In 2002, the Company recorded total depreciation and amortization expense of $506 million ($469 million in 2001 and $421 million in 2000). At December 31, 2002, the Company had Properties of $16,898 million, net of accumulated depreciation of $6,285 million ($16,723 million in 2001, net of accumulated depreciation of $6,070 million).

Pensions and other post-retirement benefits

The Company accounts for pension and other post-retirement benefits as required by CICA Handbook Section 3461 "Employee Future Benefits." Under this accounting standard, 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 plan performance over the expected average remaining service life of the employee group covered by the plans. The following description pertaining to pensions relate generally to the Company's main pension plan, the CN Pension Plan. The Company's other pension plans are not significant.

For pensions, an actuarial valuation is required at least on a triennial basis. However, for the last 15 years, the Company has conducted an annual actuarial valuation to account for pensions, which uses management assumptions for the discount rate, the expected long-term rate of return on plan assets and the rate of compensation increase. The Canadian plans have a measurement date of December 31 whereas the U.S. plans have a measurement date of September 30. 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 or disability. Changes in these assumptions result in actuarial gains or losses which in accordance with Section 3461, 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 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 economic conditions, employee demographics, mortality rates and investment performance.

The Company sets its discount rate assumption annually to reflect the rates available on high-quality, fixed-income debt instruments with a duration of approximately 11 years, which is expected to match the timing and amount of expected benefit payments. High quality debt instruments are corporate bonds with a rating of AA or better. A discount rate of 6.5%, based on bond yields prevailing at December 31, 2002, was considered appropriate by the Company and is supported by reports issued by third party advisors. A one-percentage-point change in the discount rate would not cause a material change in the Company's net periodic benefit cost.

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 and the expected composition of the plans' assets. The Company has elected to use a market-related value of assets, whereby realized and unrealized capital gains and losses are recognized over a period of five years, while investment and dividend income are recognized immediately. The Company follows a disciplined investment strategy, which limits investments in international companies and prohibits investments in speculative type assets and as such, the Company does not anticipate the expected average rate of return on plan assets to fluctuate materially when compared to major capital market indices. During the last ten years ended December 31, 2002, the CN Pension Plan earned an annual average rate of return of 9.6%. The actual and market-related value rates of return on plan assets for the last five years were as follows:

Rates of return	**2002**	2001	2000	1999	1998
Actual	**(0.3)%**	(1.4)%	10.5%	15.0%	12.6%
Market-related value	**7.4 %**	10.2 %	13.7%	13.8%	10.4%

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. However, given the recent performance of its plan assets and the equity markets in North America, the Company will, effective for 2003, reduce the expected long-term rate of return on plan assets from 9% to 8% to reflect management's current view of long-term investment returns. The effect of this change in management's assumption will be to increase net periodic benefit cost in 2003 by approximately $50 million.

Based on the fair value of the assets held as at December 31, 2002, the plan assets are comprised of 1% in cash and short-term investments, 40% in bonds and mortgages, 50% in Canadian and foreign equities and 9% in real estate and oil and gas assets. The long-term asset allocation percentages are not expected to differ materially from the current composition.

The rate of compensation increase of 4% 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 was 18% in the current year, and it is assumed that the rate will decrease gradually to 8% in 2012 and remain at that level thereafter. 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.

The latest actuarial valuation of the CN Pension Plan was conducted as at December 31, 2001 and indicated a funding excess. Based on the Pension Plan's current position, the Company's contributions are expected to be approximately $75 million in each of 2003, 2004 and 2005. The assumptions discussed above are not expected to have a significant impact on the cash funding requirements of the pension plan in 2003.

For pensions, the Company recorded consolidated net periodic benefit income of $20 million and $13 million in 2002 and 2001, respectively, and net periodic benefit cost of $6 million in 2000. Consolidated net periodic benefit cost for other post-retirement benefits was $45 million, $35 million, and $25 million in 2002, 2001, and 2000, respectively. At December 31, 2002, the Company's accrued benefit cost for post-retirement benefits other than pensions was $284 million ($258 million at December 31, 2001). In addition, at December 31, 2002, the Company's consolidated pension benefit obligation and accumulated post-retirement benefit obligation were $11,243 million and $444 million, respectively ($11,156 million and $309 million at December 31, 2001).

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 substantively 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, 2002, 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 asset is 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 liability is mainly composed of temporary differences related to properties, including purchase accounting adjustments. Estimating the ultimate settlement period, given that depreciation rates in effect are based on information as it develops, requires judgment and management's best estimates. The reversal of timing differences is expected at future substantively 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 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 $8 million in 2002. For the year ended December 31, 2002, the Company recorded total income tax expense of $268 million ($392 million in 2001 and $442 million in 2000) of which $156 million was for deferred income taxes ($307 million in 2001 and $218 million in 2000). The Company's net deferred income tax liability at December 31, 2002 was $3,703 million ($3,576 million at December 31, 2001).

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. 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 factors 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 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 certain 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.

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.

In recent years, there has been significant consolidation of rail systems in the United States. The resulting larger rail systems are able to offer seamless services in larger market areas and effectively compete with the Company in certain markets. 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 federal, provincial, state, municipal and local regulations under environmental laws and regulations 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 the operation of a railroad, 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.

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 technique, 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, 2002, 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 January 2003, the Company has labor agreements with bargaining groups representing substantially its entire Canadian unionized workforce. These agreements are generally effective until December 31, 2003.

U.S. workforce

The general approach to labor negotiations by U.S. Class 1 railroads is to bargain on a collective national basis. Grand Trunk Western (GTW), Duluth, Winnipeg and Pacific (DWP), ICRR, CCP Holdings, Inc. (CCP) and just recently WC, have bargained on a local basis rather than holding national, industry wide negotiations because 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.

As of January 2003, the Company has in place agreements with bargaining units representing the entire unionized workforce at ICRR, GTW, DWP, and CCP, and 65% of the unionized workforce at WC. These agreements have various moratorium provisions, ranging from the end of 2001 to the end of 2005, which preserve the status quo in respect of given areas during the terms of such moratoriums. Several of these agreements are currently under renegotiation and several will open for negotiation in 2003.

Negotiations are ongoing with the bargaining units with which the Company does not have agreements or settlements. Until new agreements are reached or until settlements are ratified, the terms and conditions of previous 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 their resolution 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 (Canada) (the CTA), and (ii) safety by the federal Minister of Transport under the Railway Safety Act (Canada) and certain other statutes. The Company's U.S. rail operations are subject to regulation by the Surface Transportation Board (STB) (the successor to the Interstate Commerce Commission) and the Federal Railroad Administration. In addition, the Company is subject to a variety of health, safety, security, labor, environmental and other regulations, all of which can affect its competitive position and profitability.

The CTA Review Panel, which was appointed by the federal government to carry out a comprehensive review of the Canadian transportation legislation, issued its report to the Minister of Transport at the end of June 2001. The report was released to the public on July 18, 2001 and contains numerous recommendations for legislative changes, which, if adopted, would affect all modes of transportation, including rail. Concurrently, the Minister of Transport launched a transportation blueprint consultation process, which could eventually lead to new legislation affecting rail and other transportation industries. No assurance can be given that any decisions by the federal government pursuant to the report's recommendations or in connection with the blueprint consultation process will not materially adversely affect the Company's financial position or results of operations.

Financial instruments

Although the Company conducts its business and receives revenues primarily in Canadian dollars, a growing portion of its revenues, expenses, assets and debt are denominated in U.S. dollars. Thus, the Company's results are affected by fluctuations in the exchange rate between these currencies. 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 affect the Company's revenues and expenses.

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. However, the credit standing of counterparties or their guarantors is regularly monitored, and losses due to counterparty non-performance are not anticipated.

To mitigate the effects of fuel price changes on its operating margins and overall profitability, the Company has a systematic hedging program which calls for regularly entering into swap positions on crude and heating oil to cover a target percentage of future fuel consumption up to two years in advance. At December 31, 2002, the Company has hedged approximately 47% of the estimated 2003 fuel consumption and 25% of the estimated 2004 fuel consumption. This represents approximately 263 million U.S. gallons at an average price of U.S.$0.5865 per U.S. gallon.

Realized gains and losses from the Company's fuel hedging activities were a $3 million gain, a $6 million loss and a $49 million gain for the years ended December 31, 2002, 2001 and 2000, respectively.

As a result of fuel hedging activities, the Company had an unrealized gain of $30 million at December 31, 2002 compared to an unrealized loss of $38 million at December 31, 2001.

General indemnifications

In the normal course of business, the Company has provided indemnifications, customary for the type of transaction or for the railway business, in various agreements with third parties, including indemnification provisions where the Company would be required to indemnify third parties and others. Indemnifications are found in various types of contracts with third parties which include, but are not limited to, (a) contracts granting the Company the right to use or enter upon property owned by third parties such as leases, easements, trackage rights and sidetrack agreements; (b) contracts granting rights to others to use the Company's property, such as leases, licenses and easements; (c) contracts for the sale of assets; (d) contracts for the acquisition of services; (e) financing agreements; (f) trust indentures or fiscal agency agreements or similar agreements relating to debt or equity securities of the Company and engagement agreements with financial advisors; (g) transfer agent and registrar agreements in respect of the Company's securities; and (h) trust agreements establishing trust funds to secure the payment to certain officers and senior employees of special retirement compensation arrangements or plans. To the extent of any actual claims under these agreements, the Company maintains provisions for such items, which it considers to be adequate. Due to the nature of the indemnification clauses, the maximum exposure for future payments may be material, however cannot be determined with certainty.

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 cyclicality in the demand for them. However, many of the bulk commodities the Company transports move offshore and are impacted more by global economic conditions than North American economic cycles. The Company's results of operations can be expected to reflect this cyclicality because of the significant fixed costs inherent in railroad operations.

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

Potential terrorist actions can have a direct or indirect impact on the U.S. transportation infrastructure, including railway infrastructure, and interfere with the free flow of trade across the two countries. International conflicts can also have an impact on the Company's markets.

The Company's revenues in 2001 were affected by widespread recessionary conditions. Although growth rebounded strongly in early 2002, there continues to be ongoing concern about the sustainability of the recovery due to uncertain consumer and business confidence. While economic growth is expected to continue in 2003, the Company remains cautious about business prospects.

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 affected.

In addition to the inherent risks of the business cycle, the Company is occasionally susceptible to severe weather conditions. For example, in the first quarter of 1998, a severe ice storm hit eastern Canada, which disrupted operations and service for the railroad as well as for CN customers. More recently, severe drought conditions in western Canada significantly reduced bulk commodity revenues, principally grain. There continues to be widespread concerns about the impact of crop conditions on grain supplies in the near term.

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.

Selected quarterly financial data

Selected quarterly financial data for the eight most recently completed quarters ending December 31, 2002 is disclosed in Note 23 to the Company's 2002 Consolidated Financial Statements.

Disclosure 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-14(c) and 15-d-14(c)) as of January 21, 2003 (the "Evaluation Date") within the 90-day period leading to and ending on the filing date of this annual report, have concluded that the Company's disclosure controls and procedures were adequate and effective and designed to ensure that material information relating to the Company and its consolidated subsidiaries would have been made known to them. Subsequent to the Evaluation Date, there were no significant changes in the Company's internal controls or, to their knowledge, in other factors that could significantly affect the Company's disclosure controls and procedures.

Management Report

The accompanying consolidated financial statements of Canadian National Railway Company and all information in this annual report are the responsibility of management and have been approved by the Board of Directors.

The financial statements have been prepared by management in conformity with generally accepted accounting principles in Canada. These statements include some amounts that are based on best estimates and judgments. Financial information used elsewhere in the annual report is consistent with that in the financial statements.

Management of the Company, in furtherance of the integrity and objectivity of data in the financial statements, has developed and maintains a system of internal accounting controls and supports an extensive program of internal audits. Management believes that this system of internal accounting controls provides reasonable assurance that financial records are reliable and form a proper basis for preparation of financial statements, and that assets are properly accounted for and safeguarded.

The Board of Directors carries out its responsibility for the financial statements in this report principally through its Audit, Finance and Risk Committee, consisting solely of outside directors. The Audit, Finance and Risk Committee reviews the Company's consolidated financial statements and annual report and recommends their approval by the Board of Directors. Also, the Audit, Finance and Risk Committee meets regularly with the Chief, Internal Audit, and with the shareholders' auditors.

These consolidated financial statements have been audited by KPMG LLP, who have been appointed as the sole auditors of the Company by the shareholders.

(signed)
Claude Mongeau
Executive Vice-President and Chief Financial Officer

January 21, 2003

(signed)
Serge Pharand
Vice-President and Corporate Comptroller

January 21, 2003

Auditors' Report

To the shareholders of Canadian National Railway Company

We have audited the consolidated balance sheets of Canadian National Railway Company as at December 31, 2002 and 2001 and the consolidated statements of income, changes in shareholders' equity and cash flows for each of the years in the three-year period ended December 31, 2002. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian and United States generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2002 and 2001, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2002, in accordance with Canadian generally accepted accounting principles.

On January 20, 2003, we reported separately to the Board of Directors of the Company on consolidated financial statements for the same period, prepared in accordance with United States generally accepted accounting principles.

(signed)
KPMG LLP
Chartered Accountants

Montreal, Canada
January 20, 2003

Consolidated Statement of Income

In millions, except per share data *Year ended December 31,*	**2002**	2001	2000
Revenues			
Petroleum and chemicals	**$1,102**	$ 923	$ 894
Metals and minerals	**521**	458	392
Forest products	**1,323**	1,088	1,008
Coal	**326**	338	328
Grain and fertilizers	**986**	1,161	1,136
Intermodal	**1,052**	969	919
Automotive	**591**	520	559
Other items	**209**	195	210
Total revenues	**6,110**	5,652	5,446
Operating expenses			
Labor and fringe benefits *(Note 14)*	**2,051**	1,810	1,674
Purchased services and material	**908**	811	858
Depreciation and amortization	**499**	463	412
Fuel	**459**	485	450
Equipment rents	**353**	314	291
Casualty and other *(Note 2)*	**724**	403	376
Total operating expenses	**4,994**	4,286	4,061
Operating income	**1,116**	1,366	1,385
Interest expense *(Note 15)*	**(353)**	(312)	(295)
Other income *(Note 16)*	**76**	65	126
Income before income taxes	**839**	1,119	1,216
Income tax expense *(Note 17)*	**(268)**	(392)	(442)
Net income	**$ 571**	$ 727	$ 774
Basic earnings per share (Note 19)	**$ 2.87**	$ 3.72	$ 3.91
Diluted earnings per share (Note 19)	**$ 2.82**	$ 3.62	$ 3.82

See accompanying notes to consolidated financial statements.

Consolidated Balance Sheet

In millions December 31,	2002	2001
Assets		
Current assets:		
Cash and cash equivalents	**$ 25**	$ 53
Accounts receivable *(Note 4)*	**722**	645
Material and supplies	**127**	133
Deferred income taxes *(Note 17)*	**122**	153
Other	**167**	180
	1,163	1,164
Properties *(Note 5)*	**16,898**	16,723
Other assets and deferred charges *(Note 6)*	**863**	901
Total assets	**$18,924**	$18,788
Liabilities and shareholders' equity		
Current liabilities:		
Accounts payable and accrued charges *(Note 8)*	**$ 1,487**	$ 1,374
Current portion of long-term debt *(Note 10)*	**574**	163
Other	**73**	101
	2,134	1,638
Deferred income taxes *(Note 17)*	**3,825**	3,729
Other liabilities and deferred credits *(Note 9)*	**1,335**	1,296
Long-term debt *(Note 10)*	**5,003**	5,764
Shareholders' equity:		
Common shares *(Note 11)*	**3,558**	3,209
Convertible preferred securities *(Note 11)*	**–**	327
Contributed surplus	**175**	178
Currency translation	**132**	133
Retained earnings	**2,762**	2,514
	6,627	6,361
Total liabilities and shareholders' equity	**$18,924**	$18,788

On behalf of the Board:

David G.A. McLean
Director

E. Hunter Harrison
Director

See accompanying notes to consolidated financial statements.

Consolidated Statement of Changes in Shareholders' Equity

In millions	Issued and outstanding common shares	Issued and outstanding convertible preferred securities	Common shares	Convertible preferred securities	Contributed surplus	Currency translation	Retained earnings	Total shareholders' equity
Balances December 31, 1999	202.4	4.6	$ 3,311	$ 327	$ 190	$ (9)	$ 1,626	$ 5,445
Net income	–	–	–	–	–	–	774	774
Stock options exercised *(Note 11, 12)*	1.2	–	26	–	–	–	–	26
Share repurchase program *(Note 11)*	(13.0)	–	(213)	–	(12)	–	(304)	(529)
Currency translation	–	–	–	–	–	70	–	70
Dividends ($0.70 per share)	–	–	–	–	–	–	(136)	(136)
Dividends on convertible preferred securities	–	–	–	–	–	–	(11)	(11)
Balances December 31, 2000	190.6	4.6	3,124	327	178	61	1,949	5,639
Net income	–	–	–	–	–	–	727	727
Stock options exercised *(Note 11, 12)*	2.1	–	85	–	–	–	–	85
Currency translation	–	–	–	–	–	72	–	72
Dividends ($0.78 per share)	–	–	–	–	–	–	(150)	(150)
Dividends on convertible preferred securities	–	–	–	–	–	–	(12)	(12)
Balances December 31, 2001	192.7	4.6	3,209	327	178	133	2,514	6,361
Net income	–	–	–	–	–	–	571	571
Stock options exercised *(Note 11, 12)*	1.8	–	75	–	–	–	–	75
Conversion of convertible preferred securities *(Note 11)*	6.0	(4.6)	327	(327)	–	–	–	–
Share repurchase program *(Note 11)*	(3.0)	–	(53)	–	(3)	–	(147)	(203)
Currency translation	–	–	–	–	–	(1)	–	(1)
Dividends ($0.86 per share)	–	–	–	–	–	–	(170)	(170)
Dividends on convertible preferred securities	–	–	–	–	–	–	(6)	(6)
Balances December 31, 2002	**197.5**	**–**	**$3,558**	**$ –**	**$175**	**$132**	**$2,762**	**$6,627**

See accompanying notes to consolidated financial statements.

Consolidated Statement of Cash Flows

In millions *Year ended December 31,*	**2002**	2001	2000
Operating activities			
Net income	**$ 571**	$ 727	$ 774
Adjustments to reconcile net income to net cash provided from operating activities:			
Depreciation and amortization *(Note 18)*	**506**	469	421
Deferred income taxes *(Note 17)*	**156**	307	218
Charge to increase U.S. personal injury and other claims liability *(Note 2)*	**281**	–	–
Workforce reduction charges *(Note 14)*	**120**	98	–
Equity in earnings of English Welsh and Scottish Railway *(Note 16)*	**(33)**	(8)	–
Gain on sale of investments *(Note 16)*	**–**	(101)	(84)
Write-down of investment *(Note 16)*	**–**	99	–
Other changes in:			
Accounts receivable	**(80)**	197	71
Material and supplies	**–**	11	7
Accounts payable and accrued charges	**(154)**	(378)	(168)
Other net current assets and liabilities	**(18)**	(26)	(39)
Other	**(176)**	(163)	(72)
Cash provided from operating activities	**1,173**	1,232	1,128
Investing activities			
Net additions to properties *(Note 18)*	**(571)**	(605)	(607)
Acquisition of Wisconsin Central Transportation Corporation *(Note 3)*	**–**	(1,278)	–
Other, net	**95**	119	21
Cash used by investing activities	**(476)**	(1,764)	(586)
Dividends paid	**(179)**	(174)	(149)
Financing activities			
Issuance of long-term debt	**3,146**	4,015	860
Reduction of long-term debt	**(3,558)**	(3,336)	(1,038)
Issuance of common shares *(Note 11)*	**69**	61	26
Repurchase of common shares *(Note 11)*	**(203)**	–	(529)
Cash provided from (used by) financing activities	**(546)**	740	(681)
Net increase (decrease) in cash and cash equivalents	**(28)**	34	(288)
Cash and cash equivalents, beginning of year	**53**	19	307
Cash and cash equivalents, end of year	**$ 25**	$ 53	$ 19
Supplemental cash flow information			
Payments for:			
Interest *(Note 15)*	**$ 390**	$ 307	$ 299
Workforce reductions *(Note 9)*	**177**	169	189
Personal injury and other claims *(Note 20)*	**156**	149	111
Pensions *(Note 13)*	**92**	69	59
Income taxes *(Note 17)*	**65**	63	101

See accompanying notes to consolidated financial statements.

Canadian National Railway Company (CN or the Company), directly and through its subsidiaries, is engaged in the rail transportation business. CN spans Canada and mid-America, from the Atlantic and Pacific oceans to the Gulf of Mexico, serving the ports of Vancouver, Prince Rupert, B.C., Montreal, Halifax, New Orleans and Mobile, Alabama, and the key cities of Toronto, Buffalo, Chicago, Detroit, Duluth, Minnesota/Superior, Wisconsin, Green Bay, Wisconsin, Minneapolis/St. Paul, Memphis, St. Louis and Jackson, Mississippi, with connections to all points in North America. CN's revenues are derived from the movement of a diversified and balanced portfolio of goods, including petroleum and chemicals, grain and fertilizers, coal, metals and minerals, forest products, intermodal and automotive.

1 Summary of significant accounting policies

These consolidated financial statements are expressed in Canadian dollars, except where otherwise indicated, and have been prepared in accordance with accounting principles generally accepted in Canada (Canadian GAAP). Significant differences between the accounting principles applied in the accompanying financial statements and those under United States generally accepted accounting principles (U.S. GAAP) are quantified and explained in Note 22 to the financial statements. 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 matters, depreciation lives, pensions and other post-retirement benefits, and income taxes, based upon currently available information. Actual results could differ from these estimates.

A. Principles of consolidation

These consolidated financial statements include the accounts of all subsidiaries, including Wisconsin Central Transportation Corporation (WC) for which the Company acquired control and consolidated effective October 9, 2001. The Company's investments in which it has significant influence are accounted for using the equity method and all other investments are accounted for using the cost method.

B. Revenues

Freight revenues are recognized on services performed by the Company, based on the percentage of completed service method. Costs associated with movements are recognized as the service is performed.

C. Foreign exchange

All of the Company's United States (U.S.) operations are self-sustaining foreign entities with the U.S. dollar as their functional currency. The Company also has an equity investment in an international affiliate based in the United Kingdom with the British pound as its functional currency. Accordingly, the U.S. operations' assets and liabilities and the Company's foreign equity investment are translated into Canadian dollars at the rate in effect at the balance sheet date and the revenues and expenses are translated at average exchange rates during the year. All adjustments resulting from the translation of the foreign operations are recorded in Currency translation, which forms part of Shareholders' equity.

The Company has designated all U.S. dollar denominated long-term debt of the parent company as a foreign exchange hedge of its net investment in U.S. subsidiaries. Accordingly, unrealized foreign exchange gains and losses, from the dates of designation, on the translation of the U.S. dollar denominated long-term debt are also included in Currency translation.

D. Cash and cash equivalents

Cash and cash equivalents include highly liquid investments purchased three months or less from maturity and are stated at cost, which approximates market value.

E. Accounts receivable

Accounts receivable are recorded at cost net of the provision for doubtful accounts that is based on expected collectibility. Any gains or losses on the sale of accounts receivable are calculated by comparing the carrying amount of the accounts receivable sold to the total of the cash proceeds on sale and the fair value of the retained interest in such receivables on the date of transfer. Fair values are determined on a discounted cash flow basis. Costs related to the sale of accounts receivable are recognized in earnings in the period incurred.

F. Material and supplies

Inventory is valued at weighted-average cost for ties, rails, fuel and new materials in stores, and at estimated utility or sales value for usable secondhand, obsolete and scrap materials.

G. Properties

Railroad properties are carried at cost less accumulated depreciation including asset impairment write-downs. All costs of materials associated with the installation of rail, ties, ballast and other track improvements are capitalized to the extent they meet the Company's minimum threshold for capitalization. The related labor and overhead costs are also capitalized for the installation of new, non-replacement track. All other labor and overhead costs and maintenance costs are expensed as incurred. Related interest costs are charged to expense. Included in property additions are the costs of developing computer software for internal use.

The cost of railroad properties, less net salvage value, retired or disposed of in the normal course of business is charged to accumulated depreciation, in accordance with the group method of depreciation. The Company reviews the carrying amounts of properties whenever events or changes in circumstances indicate that such carrying amounts may not be recoverable based on future undiscounted cash flows or estimated net realizable value. Assets that are deemed impaired as a result of such review are recorded at the lower of carrying amount or net recoverable amount.

H. Depreciation

The cost of properties, net of asset impairment write-downs, is depreciated on a straight-line basis over their estimated useful lives as follows:

Asset class	Annual rate
Track and roadway	2%
Rolling stock	3%
Buildings	6%
Other	4%

The Company follows the group method of depreciation and as such conducts comprehensive depreciation studies on a periodic basis to assess the reasonableness of the lives of properties based upon current information and historical activities. Such a study was conducted in 2001 for the Company's Canadian properties. The study did not have a significant effect on depreciation expense as the benefit of increased asset lives was offset by deficiencies in certain accumulated depreciation balances. Changes in estimated useful lives are accounted for prospectively.

I. Pensions

Pension costs are determined using actuarial methods. Net periodic benefit cost is charged to operations and includes:

(i) the cost of pension benefits provided in exchange for employees' services rendered during the year,

(ii) the interest cost of pension obligations,

(iii) the amortization of the initial net transition obligation on a straight-line basis over the expected average remaining service life of the employee group covered by the plans,

(iv) the amortization of prior service costs and amendments over the expected average remaining service life of the employee group covered by the plans,

(v) the expected long-term return on pension fund assets, and

(vi) the amortization of cumulative unrecognized net actuarial gains and losses in excess of 10% of the greater of the beginning of year balances of the projected benefit obligation or market-related value of plan assets over the expected average remaining service life of the employee group covered by the plans.

The pension plans are funded through contributions determined in accordance with the projected unit credit actuarial cost method.

J. Post-retirement benefits other than pensions

The Company accrues the cost of post-retirement benefits other than pensions using actuarial methods. These benefits, which are funded by the Company as they become due, include life insurance programs, medical benefits, supplemental pension allowances and free rail travel benefits.

The Company amortizes the cumulative unrecognized net actuarial gains and losses in excess of 10% of the projected benefit obligation at the beginning of the year, over the expected average remaining service life of the employee group covered by the plans.

K. Derivative financial instruments

The Company uses derivative financial instruments in the management of its fuel exposure, and may use them from time to time, in the management of its interest rate and foreign currency exposures. Gains or losses on such instruments entered into for the purpose of hedging financial risk exposures are deferred and amortized in the results of operations over the life of the hedged asset or liability or over the term of the derivative financial instrument. Income and expense related to hedged derivative financial instruments are recorded in the same category as that generated by the underlying asset or liability.

L. Personal injury claims

In Canada, 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.

In the U.S., the Company accrues the cost for the expected personal injury claims and existing occupational disease claims, based on actuarial estimates of their ultimate cost. A liability for unasserted occupational disease claims is also accrued to the extent they are probable and can be reasonably estimated.

1 Summary of significant accounting policies *(continued)*

M. Environmental expenditures

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. Liabilities are recorded when environmental assessments and/or remedial efforts are likely, and when the costs, based on a specific plan of action in terms of the technology to be used and the extent of the corrective action required, can be reasonably estimated.

N. 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 tax asset or liability is included in the computation of net income. Deferred tax assets and liabilities are measured using substantively enacted tax rates expected to apply to taxable income in the years in which temporary differences are expected to be recovered or settled.

O. Stock-based compensation

The Company accounts for stock-based compensation in accordance with the Canadian Institute of Chartered Accountants (CICA) Handbook Section 3870 "Stock-Based Compensation and Other Stock-Based Payments," as explained in Note 2 – Accounting changes. Accordingly, compensation cost is recorded for the Company's performance-based stock option awards under the intrinsic value method and recognized over the vesting period. No compensation cost is recorded for the Company's conventional stock option awards.

P. Recent accounting pronouncements

In December 2002, the CICA issued Handbook Section 3063 "Impairment of Long-Lived Assets." Section 3063 provides accounting guidance for the determination of a long-lived asset impairment as well as recognition, measurement and disclosure of the impairment. This section is effective for the Company's fiscal year beginning January 1, 2004. The Company does not expect Section 3063 to have an initial material impact on its financial statements upon adoption.

Also in December 2002, the CICA issued Handbook Section 3475 "Disposal of Long-Lived Assets and Discontinued Operations." Section 3475 provides accounting guidance for long-lived assets to be disposed of other than by sale, long-lived assets to be disposed of by sale and presentation and disclosure for discontinued operations. This section is effective for disposal activities initiated by the Company on or after May 1, 2003. The Company does not expect Section 3475 to have an initial material impact on its financial statements upon adoption.

2 Accounting changes

2002

U.S. personal injury and other claims

In the fourth quarter of 2002, the Company changed its methodology for estimating its liability for U.S. personal injury and other claims, including occupational disease claims and claims for property damage, from a case-by-case approach to an actuarial-based approach. Consequently, the Company recorded a charge of $281 million ($173 million after tax) to increase its provision for these claims.

Under the actuarial-based approach, the Company accrues the cost for the expected personal injury and property damage claims and existing occupational disease claims, based on actuarial estimates of their ultimate cost. The Company is unable to estimate the total cost for unasserted occupational disease claims. However, a liability for unasserted occupational disease claims is accrued to the extent they are probable and can be reasonably estimated.

Under the case-by-case approach, a liability was recorded only when the expected loss was both probable and reasonably estimable based on currently available information. In addition, the Company did not record a liability for unasserted claims, as such amounts could not be reasonably estimated under the case-by-case approach.

The Company's U.S. personal injury and other claims expense, including the above-mentioned charge, was $362 million in 2002. Had the Company continued to apply the case-by-case approach to its U.S. personal injury and other claims liability, recognizing the effects of the actual claims experience for existing and new claims in the fourth quarter, these expenses would have been approximately $135 million in 2002.

Stock-based compensation

Effective January 1, 2002, the Company adopted the CICA Handbook Section 3870 "Stock-Based Compensation and Other Stock-Based Payments." The new recommendations require the use of a fair value based approach of accounting for all non-employee and certain employee stock-based awards, such as direct awards of stock, awards that call for settlement in cash or other assets, or stock appreciation rights that call for settlement through the issuance of equity instruments. For all other employee stock-based awards, such as stock option awards, the recommendations encourage but do not require that the fair value based approach be used, though require additional disclosure including net income and earnings per share, as if the fair value based accounting method had been used to account for these awards.

The Company has elected to prospectively apply the intrinsic value based method of accounting to its awards of conventional and performance-based employee stock options granted on or after January 1, 2002. These options are granted at an exercise price equal to the market value of the common shares at the date of granting and, as such, compensation cost is not recognized for conventional-based options since both the number of shares to which an individual is entitled and the exercise price are known at the date of granting. Compensation cost attributable to performance-based employee stock option awards, granted on or after January 1, 2002, is measured at intrinsic value and recognized over the vesting period. Changes in intrinsic value between the grant date and the measurement date result in a change in the measure of compensation cost. For the year ended December 31, 2002, no compensation cost was recognized as no performance-based employee stock option awards were granted. In prior periods, the Company did not record compensation cost related to employee stock option grants and, any consideration paid by employees on the exercise of stock options was recorded as share capital.

In accordance with the new recommendations, the Company accounts for its direct awards of stock to employees, which are issued through the mid-term incentive share unit plan, using the fair value based approach to awards granted on or after January 1, 2002. The mid-term incentive share unit plan entitles employees to receive payout of a combination of common stock of the Company (equity settled portion), as to 50 percent, and cash value (cash settled portion), as to the remaining 50 percent.

The new recommendations will not be applied to the equity settled portion of this award granted prior to January 1, 2002 since the new recommendations require prospective application for such awards.

Compensation cost for the cash settled portion of this award is measured at fair value, which in all respects is equivalent to intrinsic value since the compensation cost stemming from the award must be finally measured at intrinsic value, and is recognized over the vesting period. Changes in intrinsic value between the grant date and the measurement date result in a change in the measure of compensation cost. The new recommendations require retroactive application, without restatement, of the Company's grants outstanding at January 1, 2002 that call for settlement in cash. Had the new recommendations been retroactively applied to the cash settled portion, there would have been no impact on prior periods' financial statements, since no compensation cost was, or would have been recognized for prior periods, due to the nature of the vesting conditions.

For the year ended December 31, 2002, the Company granted 3.2 million conventional options. For the year ended December 31, 2002, 1.8 million of previously issued stock options were exercised.

If compensation cost had been determined as if the fair value based accounting approach had been used for all awards granted for the year ended December 31, 2002, the Company's net income and earnings per share would have been as follows:

Year ended December 31,	2002
Net income *(in millions)*	$ 553
Basic earnings per share	$2.78
Diluted earnings per share	$2.73

As permitted by the new recommendations, these amounts exclude the effect of awards granted prior to January 1, 2002 and include the calculation of compensation cost using the Black-Scholes option-pricing model with the following assumptions:

Year ended December 31,	2002
Expected option life *(years)*	7.0
Risk-free interest rate	5.79%
Expected stock price volatility	30%
Average dividend per share	$ 0.86

Year ended December 31,	2002
Weighted average fair value of options granted	$30.98

2001

Foreign currency translation

In 2001, the Company early adopted the CICA amended recommendations of Section 1650 "Foreign Currency Translation." The amended section eliminates the deferral and amortization of unrealized translation gains or losses on foreign currency denominated monetary items that have a fixed or ascertainable life extending beyond the end of a fiscal year. Translation gains or losses on the above items are now recognized in net income immediately. As required by the amended section, the Company retroactively restated all prior period financial statements presented. The cumulative effect of the adoption of the amended section of $93 million ($62 million after tax) has been reflected as a charge to opening retained earnings of 1999. The effect on net income for 2001 and 2000 was an increase of $1 million and $2 million, respectively.

2000

Earnings per share

In 2000, the Company early adopted the CICA recommendations related to the presentation of earnings per share. The standard essentially harmonizes Canadian and U.S. standards, specifically in the areas of presenting earnings per share information, computing diluted earnings per share and disclosure requirements. The new standard requires restatement of prior year comparative information.

3 Acquisition of Wisconsin Central Transportation Corporation

On January 29, 2001, the Company, through an indirect wholly owned subsidiary, and WC entered into a merger agreement (the Merger) providing for the acquisition of all of the shares of WC by the Company for an acquisition cost of $1,301 million (U.S.$833 million). The Merger was approved by the shareholders of WC at a special meeting held on April 4, 2001. On September 7, 2001, the U.S. Surface Transportation Board rendered a decision, unanimously approving the Company's acquisition of WC. On October 9, 2001, the Company completed its acquisition of WC and began a phased integration of the companies' operations. The acquisition was financed by debt and cash on hand.

The Company accounted for the Merger using the purchase method of accounting as required by CICA Handbook Section 1581 "Business Combinations." As such, the Company's consolidated financial statements include the assets, liabilities and results of operations of WC as of October 9, 2001, the date of acquisition. The Company had estimated, on a preliminary basis, the fair values of the assets and liabilities acquired based on currently available information. In 2002, the Company finalized the allocation of the purchase price and adjusted the preliminary fair values of the assets and liabilities acquired as follows: Current assets decreased by $10 million, Properties increased by $141 million, Other assets and deferred charges decreased by $98 million, Current liabilities increased by $10 million, Deferred income taxes increased by $16 million and Other liabilities and deferred credits increased by $3 million. The increase in Properties and decrease in Other assets and deferred charges was mainly due to the final valuation of the Company's foreign equity investment. The remaining adjustments resulted from additional information obtained for conditions and circumstances that existed at the time of acquisition.

The following table outlines the final fair values of WC's assets and liabilities acquired:

In millions	
Current assets	$ 165
Properties	2,576
Other assets and deferred charges	335
Total assets acquired	3,076
Current liabilities	363
Deferred income taxes	759
Other liabilities and deferred credits	181
Long-term debt	472
Total liabilities assumed	1,775
Net assets acquired	$1,301

4 Accounts receivable

In millions *December 31,*	**2002**	2001
Freight		
Trade	**$321**	$309
Accrued	**150**	119
Non-freight	**310**	298
	781	726
Provision for doubtful accounts	**(59)**	(81)
	$722	$645

The Company has a five-year revolving agreement, expiring in June 2003, to sell eligible freight trade receivables up to a maximum of $350 million of receivables outstanding at any point in time. The Company intends to renew or replace the program upon expiration. At December 31, 2002, pursuant to the agreement, $173 million and U.S.$113 million (Cdn$177 million) had been sold on a limited recourse basis compared to $168 million and U.S.$113 million (Cdn$179 million) at December 31, 2001. Recourse is limited to 10% of receivables sold and consists of additional freight trade receivables that have been recorded in Other current assets. The Company has retained the responsibility for servicing, administering and collecting freight trade receivables sold. Other income included $9 million in 2002 and $10 million in each of 2001 and 2000 for costs related to the agreement, which fluctuate with changes in prevailing interest rates.

No servicing asset or liability has been recorded since the costs of servicing are compensated by the benefits of the agreement.

The Receivables Purchase Agreement provides for customary indemnification provisions, which survive for a period of two years following the final purchase of any receivable, three years from the final collection date or until statute barred, in the case of taxes. As at December 31, 2002, the Company has not recorded a liability associated with these indemnifications, for which there is no monetary limitation, as the Company does not expect to make any payments pertaining to the indemnifications of this program.

5 Properties

In millions	*December 31, 2002*			*December 31, 2001*		
	Cost	**Accumulated depreciation**	**Net**	Cost	Accumulated depreciation	Net
Track, roadway and land	**$16,727**	**$3,604**	**$13,123**	$16,549	$3,510	$13,039
Rolling stock	**3,841**	**1,392**	**2,449**	3,703	1,336	2,367
Buildings	**1,723**	**778**	**945**	1,622	721	901
Other	**892**	**511**	**381**	919	503	416
	$23,183	**$6,285**	**$16,898**	$22,793	$6,070	$16,723
Capital leases included in rolling stock	**$ 1,348**	**$ 244**	**$ 1,104**	$ 1,246	$ 218	$ 1,028

6 Other assets and deferred charges

In millions *December 31,*	**2002**	2001
Investments	**$380**	$496
Prepaid benefit cost *(Note 13)*	**353**	251
Deferred receivables	**88**	108
Unamortized debt issue costs	**41**	42
Other	**1**	4
	$863	$901

Investments

As at December 31, 2002, the Company had $368 million ($478 million at December 31, 2001) of investments accounted for under the equity method and $12 million ($18 million at December 31, 2001) of investments accounted for under the cost method.

Investment in Tranz Rail Holdings Limited (Tranz Rail) and Australian Transport Network Limited (ATN)

In 2002, the Company sold its interests in Tranz Rail and ATN for aggregate net proceeds of $69 million, which approximated the carrying value of the investments. Prior to the sale, the Company had accounted for these investments as "available for sale."

Investment in English Welsh and Scottish Railway (EWS)

Through its acquisition of WC in 2001, the Company acquired 40.9% of EWS, a company which provides most of the rail freight services in Great Britain, operates freight trains through the English Channel tunnel and carries mail for the Royal Mail. The final fair value of the investment at the date of acquisition was determined based on the discounted cash flow method and a multiple of EWS earnings. The Company accounts for its investment in EWS using the equity method. At December 31, 2002, the excess of the Company's share of the book value of EWS' net assets over the carrying value of the investment is being depreciated over the life of its assets and is not significant.

Investment in 360networks Inc.

In June 2001, the Company recorded a charge of $99 million, $77 million after tax, to write down 100% of its net investment in 360networks Inc. and subsequently sold all of its shares. In 2000, the Company had recorded a gain of $84 million, $58 million after tax, related to the exchange of its minority equity investments in certain joint venture companies for 11.4 million shares of 360networks Inc.

7 Credit facilities

In December 2002, the Company entered into a U.S.$1,000 million three-year revolving credit facility and concurrently terminated its previous revolving credit facilities before their scheduled maturity in March 2003. The credit facility 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 credit facility agreement contains customary financial covenants, based on U.S. GAAP, including limitations on debt as a percentage of total capitalization and maintenance of tangible net worth above pre-defined levels. Throughout the year, the Company was in compliance with all financial covenants contained in its outstanding revolving credit agreements. The Company's commercial paper program is backed by a portion of its revolving credit facility. As at December 31, 2002, the Company had outstanding commercial paper of U.S.$136 million (Cdn$214 million) compared to U.S.$213 million (Cdn$339 million) as at December 31, 2001. The Company's borrowings of U.S.$172 million (Cdn$273 million) outstanding at December 31, 2001 were entirely repaid in the first quarter of 2002. At December 31, 2002, the Company had borrowings under its revolving credit facility of U.S.$90 million (Cdn$142 million) at an average interest rate of 1.77%. Outstanding letters of credit under the previous facilities were transferred into the current facility. As at December 31, 2002, letters of credit under the revolving credit facility amounted to $295 million.

8 Accounts payable and accrued charges

In millions *December 31,*	2002	2001
Trade payables	$ 436	$385
Income and other taxes	251	236
Payroll-related accruals	235	218
Workforce reduction provisions	168	151
Personal injury and other claims *(Note 20)*	136	51
Accrued charges	113	131
Accrued interest	104	141
Accrued operating leases	18	19
Other	26	42
	$1,487	$1,374

9 Other liabilities and deferred credits

In millions *December 31,*	2002	2001
Personal injury and other claims, net of current portion *(Note 20)*	$528	$379
Workforce reduction provisions, net of current portion *(A)*	253	340
Accrual for post-retirement benefits other than pensions *(B)*	284	258
Environmental reserve, net of current portion	81	73
Deferred credits and other	189	246
	$1,335	$1,296

A. Workforce reduction provisions *(Note 14)*

The workforce reduction provisions, which cover employees in both Canada and the United States, are mainly comprised of payments related to severance, early retirement incentives and bridging to early retirement, the majority of which will be disbursed within the next three years. Payments have reduced the provisions by $177 million for the year ended December 31, 2002 ($169 million for the year ended December 31, 2001). As at December 31, 2002, the aggregate provisions, including the current portion, amounted to $421 million ($491 million as at December 31, 2001).

B. Post-retirement benefits other than pensions

(i) Change in benefit obligation

In millions *Year ended December 31,*	2002	2001
Benefit obligation at beginning of year	$309	$242
Amendments	18	25
Actuarial loss	101	20
Interest cost	23	19
Service cost	13	11
Foreign currency changes	(1)	6
Transfer from other plans	–	5
Benefits paid	(19)	(19)
Benefit obligation at end of year	$444	$309

(ii) Funded status

In millions *December 31,*	2002	2001
Unfunded benefit obligation at end of year	$444	$309
Unrecognized net actuarial loss	(122)	(26)
Unrecognized prior service cost	(38)	(25)
Accrued benefit cost for post-retirement benefits other than pensions	$284	$258

(iii) Components of net periodic benefit cost

In millions *Year ended December 31,*	2002	2001	2000
Interest cost	$23	$19	$15
Service cost	13	11	8
Amortization of prior service cost	5	3	1
Recognized net actuarial loss	4	2	1
Net periodic benefit cost	$45	$35	$25

(iv) Weighted-average assumptions

December 31,	2002	2001	2000
Discount rate	6.65%	6.97%	6.95%
Rate of compensation increase	4.00%	4.00%	4.25%

For measurement purposes, increases in the per capita cost of covered health care benefits were assumed to be 17% for 2003 and 18% for 2002. It is assumed that the rate will decrease gradually to 8% in 2012 and remain at that level thereafter.

A one-percentage-point change in the health care cost trend rate would not cause a material change in the Company's net periodic benefit cost nor the post-retirement benefit obligation.

10 Long-term debt

In millions	Maturity	Currency in which payable	*December 31,* 2002	2001
Debentures and notes: (A)				
Canadian National series:				
6.63% 10-year notes	May 15, 2003	U.S.$	**$ 236**	$ 239
7.00% 10-year notes	Mar. 15, 2004	U.S.$	**419**	422
6.45% Puttable Reset Securities (PURS) *(B)*	July 15, 2006	U.S.$	**394**	398
6.38% 10-year notes *(C)*	Oct. 15, 2011	U.S.$	**631**	636
6.80% 20-year notes *(C)*	July 15, 2018	U.S.$	**315**	318
7.63% 30-year debentures	May 15, 2023	U.S.$	**236**	239
6.90% 30-year notes *(C)*	July 15, 2028	U.S.$	**749**	755
7.38% 30-year debentures *(C)*	Oct. 15, 2031	U.S.$	**315**	318
Illinois Central series:				
6.75% 10-year notes	May 15, 2003	U.S.$	**158**	159
7.75% 10-year notes	May 1, 2005	U.S.$	**158**	159
6.98% 12-year notes	July 12, 2007	U.S.$	**79**	80
6.63% 10-year notes	June 9, 2008	U.S.$	**32**	32
5.00% 99-year income debentures	Dec. 1, 2056	U.S.$	**12**	12
7.70% 100-year debentures	Sep. 15, 2096	U.S.$	**197**	199
Wisconsin Central series:				
6.63% 10-year notes	April 15, 2008	U.S.$	**236**	239
Total debentures and notes			**4,167**	4,205
Other:				
Revolving credit facilities *(Note 7)*		U.S.$	**142**	273
Commercial paper *(D) (Note 7)*		U.S.$	**214**	339
Capital lease obligations, amounts owing under equipment agreements and other *(E)*		Various	**1,068**	1,125
Total other			**1,424**	1,737
Subtotal			**5,591**	5,942
Less:				
Current portion of long-term debt			**574**	163
Net unamortized discount			**14**	15
			588	178
			$5,003	$5,764

A. The Company's debentures and notes are unsecured.

B. The PURS contain imbedded simultaneous put and call options at par. At the time of issuance, the Company sold the option to call the securities on July 15, 2006 (the reset date). If the call option is exercised, the imbedded put option is automatically triggered, resulting in the redemption of the original PURS. The call option holder will then have the right to remarket the securities at a new coupon rate for an additional 30-year term ending July 15, 2036. The new coupon rate will be determined according to a pre-set mechanism based on market conditions then prevailing. If the call option is not exercised, the put option is deemed to have been exercised, resulting in the redemption of the PURS on July 15, 2006.

C. These debt securities are redeemable, in whole or in part, at the option of the Company, at any time, at the greater of par and a formula price based on interest rates prevailing at the time of redemption.

D. 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 $600 million, or the U.S. dollar equivalent. Commercial paper debt is due within one year but has been classified as long-term debt, reflecting the Company's intent and contractual ability to refinance the short-term borrowing through subsequent issuances of commercial paper or drawing down on the revolving credit facility. Interest rates on commercial paper at December 31, 2002 range from approximately 1.4% to 1.7%.

10 Long-term debt *(continued)*

E. Interest rates for the capital leases range from approximately 3.0% to 14.6% with maturity dates in the years 2003 through 2025. The imputed interest on these leases amounted to $498 million as at December 31, 2002, and $545 million as at December 31, 2001.

The equipment agreements are payable by monthly or semi-annual installments over various periods to 2007 at interest rates ranging from 6.0% to 6.7%. As at December 31, 2002, the principal amount repayable was $14 million ($19 million as at December 31, 2001). The capital leases, equipment agreements, and other obligations are secured by properties with a net carrying amount of $1,122 million as at December 31, 2002 and $1,096 million as at December 31, 2001.

During 2002, the Company recorded $114 million in assets it acquired through the exercise of purchase options on existing leases and leases for new equipment ($91 million in 2001). An equivalent amount was recorded in debt.

F. Long-term debt maturities, including repurchase arrangements and capital lease repayments on debt outstanding as at December 31, 2002 but excluding repayments of commercial paper and revolving credit facility of $214 million and $142 million, respectively, for the next five years and thereafter, are as follows:

Year	*In millions*
2003	$ 574
2004	560
2005	246
2006	438
2007	164
2008 and thereafter	3,239

G. The aggregate amount of debt payable in U.S. currency as at December 31, 2002 is U.S.$3,164 million (Cdn$4,987 million) and U.S.$3,334 million (Cdn$5,302 million) as at December 31, 2001.

11 Capital stock and convertible preferred securities

A. Authorized capital stock

The authorized capital stock of the Company is as follows:

- Unlimited number of Common Shares, without par value
- Unlimited number of Class A Preferred Shares, without par value issuable in series
- Unlimited number of Class B Preferred Shares, without par value issuable in series

B. Issued and outstanding common shares

During 2002, the Company issued 7.8 million shares of which 1.8 million shares (2.1 million shares in 2001 and 1.2 million shares in 2000) was related to stock options exercised and 6.0 million shares was related to the conversion of the Company's convertible preferred securities. The total number of common shares issued and outstanding was 197.5 million as at December 31, 2002.

C. Convertible preferred securities ("Securities")

On May 6, 2002, the Company met the conditions required to terminate the Securities holders' right to convert their Securities into common shares of the Company, and set the conversion termination date as July 3, 2002. The conditions were met when the Company's common share price exceeded 120% of the conversion price of U.S.$38.48 per share for a specified period, and all accrued interest on the Securities had been paid. On July 3, 2002, Securities that had not been previously surrendered for conversion were deemed converted, resulting in the issuance of 6.0 million common shares of the Company.

In 1999, the Company had issued 4.6 million 5.25% Securities due on June 30, 2029, at U.S.$50 per Security. These Securities were subordinated securities convertible into common shares of CN at the option of the holder at an original conversion price of U.S.$38.48 per common share, representing an original conversion rate of 1.2995 common shares for each Security.

D. Share repurchase programs

On October 22, 2002, the Board of Directors of the Company approved a share repurchase program which allows for the repurchase of up to 13.0 million common shares between October 25, 2002 and October 24, 2003 pursuant to a normal course issuer bid, at prevailing market prices. As at December 31, 2002, $203 million was used to repurchase 3.0 million common shares at an average price of $67.68 per share.

In 2001, the Board of Directors of the Company approved a share repurchase program under which the Company did not repurchase any common shares.

In 2000, $529 million was used to repurchase 13.0 million common shares, the maximum allowed under the program, pursuant to a normal course issuer bid at an average price of $40.70 per share.

12 Stock plans

The Company has various stock-based incentive plans for eligible employees. A description of the Company's major plans is provided below:

A. Employee share plan

The Company has an Employee Share Investment Plan (ESIP) giving eligible employees the opportunity to subscribe for up to 6% of their gross salaries to purchase shares of the Company's common stock on the open market and to have the Company invest, on the employees' behalf, a further 35% of the amount invested by the employees. Participation at December 31, 2002 was 8,911 employees (9,432 at December 31, 2001). The total number of ESIP shares purchased on behalf of employees, including the Company's contributions, was 497,459 in 2002, 516,726 in 2001 and 637,531 in 2000, resulting in a pre-tax charge to income of $9 million, $8 million and $6 million for the years ended December 31, 2002, 2001 and 2000, respectively.

B. Mid-term incentive share unit plan

The Company has a share unit plan, which was approved by the Board of Directors in 2001, for designated senior management employees entitling them to receive payout on June 30, 2004 of a combination of common stock of the Company, as to fifty percent, and cash value, as to the remaining fifty percent.

The share units vest conditionally upon the attainment of targets relating to the Company's share price during the six-month period ending June 30, 2004. At December 31, 2002, the total number of share units outstanding was 419,900, representing a potential maximum compensation cost of $21 million. Due to the nature of the vesting conditions, no compensation cost was recorded for 2002 and 2001. At December 31, 2002, an additional 45,100 share units remained authorized for future issuances under this plan.

C. Stock options

The Company has stock option plans for eligible employees to acquire common shares of the Company upon vesting at a price equal to the market value of the common shares at the date of granting. The options are exercisable during a period not exceeding 10 years. The right to exercise options generally accrues over a period of four years of continuous employment. Options are not generally exercisable during the first 12 months after the date of grant. At December 31, 2002, an additional 2.6 million common shares remained authorized for future issuances under these plans.

Options issued by the Company include conventional options, which vest over a period of time, and performance options, which vest upon the attainment of Company targets relating to the operating ratio and unlevered return on investment. The total conventional and performance options outstanding at December 31, 2002 were 9.1 million and 2.0 million, respectively.

Changes in the Company's stock options are as follows:

	Number of options	Weighted-average exercise price
	In millions	
Outstanding at December 31, 1999 [1]	8.3	$ 34.88
Granted	2.2	$ 35.33
Canceled	(0.4)	$ 36.23
Exercised	(1.2)	$ 22.19
Outstanding at December 31, 2000 [1]	8.9	$ 34.95
Conversion of WC options	1.0	$ 58.63
Granted	2.4	$ 50.65
Canceled	(0.3)	$ 46.01
Exercised	(2.1)	$ 30.43
Outstanding at December 31, 2001 [1] [2]	9.9	$ 43.62
Granted	3.2	$ 76.78
Canceled	(0.2)	$ 56.98
Exercised	(1.8)	$ 39.16
Outstanding at December 31, 2002 [1] [2]	**11.1**	**$53.50**

(1) Includes IC converted stock options translated to Canadian dollars using the foreign exchange rate in effect at the balance sheet date.

(2) Includes WC converted stock options translated to Canadian dollars using the foreign exchange rate in effect at the balance sheet date.

Stock options outstanding and exercisable as at December 31, 2002 were as follows:

	Options outstanding			Options exercisable	
Range of exercise prices	Number of options	Weighted-average years to expiration	Weighted-average exercise price	Number of options	Weighted-average exercise price
	In millions			*In millions*	
$13.50–$23.72	0.1	3	$ 17.23	0.1	$ 17.23
$25.18–$35.01	2.1	6	$ 33.59	1.2	$ 32.48
$35.70–$49.45	3.2	6	$ 44.69	2.7	$ 44.56
$50.02–$69.77	2.5	8	$ 51.43	0.8	$ 52.93
$70.04 and above	3.2	9	$ 77.59	0.1	$ 97.09
Balance at December 31, 2002 [1]	**11.1**	**7**	**$53.50**	**4.9**	**$44.01**

(1) Includes IC and WC converted stock options translated to Canadian dollars using the foreign exchange rate in effect at the balance sheet date.

D. Stock-based compensation cost

Compensation cost for performance-based stock option awards under these plans is determined by the options' intrinsic value in accordance with the CICA Handbook Section 3870 "Stock-Based Compensation and Other Stock-Based Payments." No compensation cost was recognized for stock-based awards in 2002. Disclosures required under the fair value based accounting approach are presented in Note 2 – Accounting changes.

13 Pensions

The Company has retirement benefit plans under which substantially all of its employees are entitled to benefits at retirement age, generally based on compensation and length of service and/or contributions. The tables that follow pertain to all such plans. However, the following descriptions relate solely to the Company's main pension plan, the CN Pension Plan (the Pension Plan). The Company's other pension plans are not significant.

Description of plan

The Pension Plan is a contributory defined benefit pension plan that covers the majority of CN employees. It provides for pensions based mainly on years of service and final average pensionable earnings and is generally applicable from the first day of employment. Indexation of pensions is provided after retirement through a gain (loss) sharing mechanism, subject to guaranteed minimum increases. An independent trust company is the Trustee of the Canadian National Railways Pension Trust Funds (CN Pension Trust Funds). As Trustee, the trust company performs certain duties, which include holding legal title to the assets of the CN Pension Trust Funds and ensuring that the Company, as Administrator, complies with the provisions of the Pension Plan and the related legislation.

Funding policy

Employee contributions to the Pension Plan are determined by the plan rules. Company contributions are in accordance with the requirements of the Government of Canada legislation, The Pension Benefits Standards Act, 1985, and are determined by actuarial valuations conducted at least on a triennial basis. These valuations are made in accordance with legislative requirements and with the recommendations of the Canadian Institute of Actuaries for the valuation of pension plans. The latest actuarial valuation of the Pension Plan was conducted as at December 31, 2001 and indicated a funding excess. Based on the Pension Plan's current position, the Company's contributions are expected to be approximately $75 million in each of 2003, 2004 and 2005.

Description of fund assets

The assets of the Pension Plan are accounted for separately in the CN Pension Trust Funds and consist of cash and short-term investments, bonds, mortgages, Canadian and foreign equities, real estate, and oil and gas assets. Based on the fair value of the assets held at December 31, 2002, the plan assets are comprised of 1% in cash and short-term investments, 40% in bonds and mortgages, 50% in Canadian and foreign equities and 9% in real estate and oil and gas assets.

(a) Change in benefit obligation

In millions *Year ended December 31,*	**2002**	2001
Benefit obligation at beginning of year	**$11,156**	$10,855
Interest cost	**714**	701
Actuarial (gain) loss	**(92)**	94
Service cost	**99**	92
Plan participants' contributions	**61**	73
Foreign currency changes	**(1)**	6
Benefit payments and transfers	**(694)**	(665)
Benefit obligation at end of year	**$11,243**	$11,156

(b) Change in plan assets

In millions *Year ended December 31,*	**2002**	2001
Fair value of plan assets at beginning of year	**$11,763**	$12,455
Employer contributions	**92**	69
Plan participants' contributions	**61**	73
Foreign currency changes	**(1)**	6
Actual return on plan assets	**(39)**	(175)
Benefit payments and transfers	**(694)**	(665)
Fair value of plan assets at end of year	**$11,182**	$11,763

(c) Funded status

In millions *December 31,*	**2002**	2001
Excess (deficiency) of fair value of plan assets over benefit obligation at end of year (1)	**$ (61)**	$ 607
Unrecognized net actuarial (gain) loss (1)	**282**	(537)
Unrecognized net transition obligation	**19**	39
Unrecognized prior service cost	**113**	133
Net amount recognized	**$353**	$ 242

(1) Subject to future reduction for gain sharing under the terms of the plan.

(d) Amount recognized in the Consolidated Balance Sheet

In millions *December 31,*	**2002**	2001
Prepaid benefit cost *(Note 6)*	**$353**	$251
Accrued benefit cost	**–**	(9)
Net amount recognized	**$353**	$242

(e) Components of net periodic benefit cost

In millions *Year ended December 31,*	**2002**	2001	2000
Interest cost	**$ 714**	$ 701	$ 690
Service cost	**99**	92	70
Amortization of net transition obligation	**20**	20	19
Amortization of prior service cost	**20**	20	19
Expected return on plan assets	**(874)**	(846)	(792)
Recognized net actuarial loss	**1**	–	–
Net periodic benefit cost (income)	**$ (20)**	$ (13)	$ 6

(f) Weighted-average assumptions

December 31,	**2002**	2001	2000
Discount rate	**6.50%**	6.50%	6.50%
Rate of compensation increase	**4.00%**	4.00%	4.25%
Expected return on plan assets for year ending December 31	**9.00%**	9.00%	9.00%

Effective January 1, 2003, the Company will reduce the expected long-term rate of return on plan assets from 9% to 8% to reflect management's current view of long-term investment returns. The effect of this change in management's assumption will be to increase net periodic benefit cost in 2003 by approximately $50 million.

The Company has indemnified and held harmless the current trustee and the former trustee of the Canadian National Railways Pension Trust Funds, and the respective officers, directors, employees and agents of such trustees, from any and all taxes, claims, liabilities, damages, costs and expenses arising out of the performance of their obligations under the relevant trust agreements and trust deeds, including in respect of their reliance on authorized instructions of the Company or for failing to act in the absence of authorized instructions. These indemnifications survive the termination of such agreements or trust deeds. As at December 31, 2002, the Company has not recorded a liability associated with these indemnifications, as the Company does not expect to make any payments pertaining to these indemnifications.

14 Workforce reduction charges

In 2002, the Company announced 1,146 job reductions, in a renewed drive to improve productivity in all its corporate and operating functions, and recorded a charge of $120 million, $79 million after tax. In 2001, a charge of $98 million, $62 million after tax, was recorded for the reduction of 690 positions. Reductions relating to these charges were 388 in 2001, 433 in 2002, with the remainder to be completed by the end of 2003. The charges included payments for severance, early retirement incentives and bridging to early retirement, to be made to affected employees.

15 Interest expense

In millions *Year ended December 31,*	**2002**	2001	2000
Interest on long-term debt	**$353**	$314	$306
Interest income	**–**	(2)	(11)
	$353	$312	$295
Cash interest payments	**$390**	$307	$299

16 Other income

In millions *Year ended December 31,*	**2002**	2001	2000
Gain on disposal of properties	**$ 41**	$ 53	$ 57
Equity in earnings of English Welsh and Scottish Railway *(Note 6)*	**33**	8	–
Investment income	**18**	22	–
Foreign exchange gain	**12**	7	10
Gain on sale of interest in Detroit River Tunnel Company *(A)*	**–**	101	–
Write-down of investment in 360networks Inc. *(Note 6)*	**–**	(99)	–
Gain on exchange of investment *(Note 6)*	**–**	–	84
Net real estate costs	**(15)**	(20)	(22)
Other	**(13)**	(7)	(3)
	$ 76	$ 65	$126

A. In March 2001, the Company completed the sale of its 50 percent interest in the Detroit River Tunnel Company (DRT) for proceeds of $112 million and recorded a gain of $101 million, $82 million after tax. The DRT is a 1.6 mile rail-only tunnel crossing the Canada-U.S. border between Detroit and Windsor, Ontario.

17 Income taxes

The Company's consolidated effective income tax rate differs from the statutory Federal tax rate. The reconciliation of income tax expense is as follows:

In millions *Year ended December 31,*	**2002**	2001	2000
Federal tax rate	**26.1%**	28.1%	29.1%
Income tax expense at the statutory Federal tax rate	**$(219)**	$ (314)	$ (353)
Income tax (expense) recovery resulting from:			
Provincial and other taxes	**(97)**	(134)	(148)
Deferred income tax adjustment due to rate reductions	**–**	–	(4)
U.S. tax rate differential	**1**	1	7
Gain on disposals and dividends	**6**	27	20
Other	**41**	28	36
Income tax expense	**$(268)**	$ (392)	$ (442)
Income before income taxes			
Canada	**$ 900**	$ 955	$ 999
U.S.	**(61)**	164	217
	$ 839	$1,119	$1,216
Current income taxes			
Canada	**$(130)**	$ (99)	$ (153)
U.S.	**18**	14	(71)
	$(112)	$ (85)	$ (224)
Deferred income taxes			
Canada	**$(161)**	$ (226)	$ (228)
U.S.	**5**	(81)	10
	$(156)	$ (307)	$ (218)
Cash payments for income taxes	**$ 65**	$ 63	$ 101

17 Income taxes *(continued)*

Significant components of deferred income tax assets and liabilities are as follows:

In millions *December 31,*	**2002**	2001
Deferred income tax assets		
Workforce reduction provisions	**$ 144**	$ 178
Accruals and other reserves	**263**	182
Post-retirement benefits	**99**	85
Losses and tax credit carryforwards	**69**	53
	575	498
Deferred income tax liabilities		
Properties and other	**4,278**	4,074
Total net deferred income tax liability	**3,703**	3,576
Net current deferred income tax asset	**122**	153
Net long-term deferred income tax liability	**$3,825**	$3,729
Net deferred income tax liability		
Canada	**$ 436**	$ 291
U.S.	**3,267**	3,285
	$3,703	$3,576

The Company expects to realize its deferred income tax assets from the generation of future taxable income, as the related payments are made and losses and tax credits carryforwards are utilized.

The Company recognized tax credits of $9 million in 2002 for research and development expenditures ($35 million in 2001 for investment tax credits) not previously recognized, which reduced the cost of properties.

18 Segmented information

The Company operates in one business segment with operations and assets in Canada and the United States.

Information on geographic areas

In millions *Year ended December 31,*	**2002**	2001	2000
Revenues:			
Canadian rail	**$3,726**	$3,675	$3,668
U.S. rail	**2,384**	1,977	1,778
	$6,110	$5,652	$5,446
Operating income:			
Canadian rail	**$ 954**	$ 966	$1,025
U.S. rail	**162**	400	360
	$1,116	$1,366	$1,385
Net income:			
Canadian rail	**$ 577**	$ 591	$ 589
U.S. rail	**(6)**	136	185
	$ 571	$ 727	$ 774

In millions *Year ended December 31,*	**2002**	2001	2000
Depreciation and amortization:			
Canadian rail *(A)*	**$ 278**	$ 255	$ 232
U.S. rail	**228**	214	189
	$ 506	$ 469	$ 421
Capital expenditures: (B)			
Canadian rail *(C)*	**$ 491**	$ 484	$ 541
U.S. rail	**194**	177	215
	$ 685	$ 661	$ 756

In millions *December 31,*	**2002**	2001
Identifiable assets:		
Canadian rail	**$ 7,402**	$ 6,987
U.S. rail *(D)*	**11,522**	11,801
	$18,924	$18,788

(A) Includes $7 million (2001: $6 million, 2000: $9 million) of depreciation and amortization of properties related to other business activities.

(B) Represents additions to properties that include non-cash capital expenditures financed through capital lease arrangements.

(C) Includes $4 million (2001: $5 million, 2000: $9 million) of additions to properties related to other business activities.

(D) Includes equity holdings in foreign investments held by the Company's U.S. subsidiaries.

19 Earnings per share

The 2000 comparative figures have been restated to conform to the new accounting standard as explained in Note 2. The amended CICA Section 1650 "Foreign Currency Translation" requires restatement of prior years' income and, as such, earnings per basic and diluted share for 2000 have increased by $0.01, respectively.

Year ended December 31,	**2002**	2001	2000
Basic earnings per share	**$2.87**	$3.72	$3.91
Diluted earnings per share	**$2.82**	$3.62	$3.82

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

In millions *Year ended December 31,*	**2002**	2001	2000
Net income	**$571**	$727	$774
Dividends on convertible preferred securities *(Note 11)*	**6**	12	11
	$565	$715	$763
Weighted-average shares outstanding	**196.7**	192.1	195.0
Effect of dilutive securities and stock options	**6.1**	8.9	7.8
Weighted-average diluted shares outstanding	**202.8**	201.0	202.8

At December 31, 2002, 3.2 million stock options at a weighted-average exercise price of $77.56 were not included in the calculation of diluted earnings per share since their inclusion would have had an anti-dilutive impact.

20 Major commitments and contingencies

A. Leases

The Company has lease commitments for locomotives, freight cars and intermodal equipment, many of which provide the option to purchase the leased items at fixed values during or at the end of the lease term. As at December 31, 2002, the Company's commitments under operating and capital leases are $1,154 million and $1,407 million, respectively. Annual net minimum payments in each of the next five years and thereafter, are as follows:

Year	*In millions*	Operating	Capital
2003		$ 212	$ 168
2004		188	153
2005		167	111
2006		139	68
2007		120	123
2008 and thereafter		328	784
		$1,154	1,407
Less: imputed interest on capital leases at rates ranging from approximately 3.0% to 14.6%			498
Present value of minimum lease payments at current rate included in debt			$ 909

Rent expense for operating leases was $269 million, $258 million and $219 million for the years ended December 31, 2002, 2001 and 2000, respectively. Contingent rentals and sublease rentals were not significant.

The Company has guaranteed a portion of the residual values of certain of its assets under operating leases with expiry dates between 2004 and 2012, for the benefit of the lessor. If the fair value of the assets, at the end of their respective lease term, is less than the fair value, as estimated at the inception of the lease, then the Company must, under certain conditions, compensate the lessor for the shortfall. The maximum exposure in respect of these guarantees is $63 million. As at December 31, 2002, the Company has not recorded a liability associated with these guarantees, as the Company does not expect to make any payments pertaining to the guarantees of these leases.

B. Other commitments

As at December 31, 2002, the Company had commitments to acquire railroad ties, rail, freight cars and locomotives at an aggregate cost of $183 million. Furthermore, as at December 31, 2002, the Company had entered into agreements with fuel suppliers to purchase approximately 38% of its anticipated 2003 volume and 8% of its anticipated 2004 volume at market prices prevailing on the date of the purchase.

C. Contingencies

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.

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) and represent a major expense for the railroad industry. The FELA system, which requires either the finding of fault through the U.S. jury system or individual settlements, has contributed to the significant increase in the Company's personal injury expense in recent years. In view of the Company's growing presence in the United States and the increase in the number of occupational disease claims over the past few years, an actuarial study was conducted in 2002, and in the fourth quarter of 2002 the Company changed its methodology for estimating its liability for U.S. personal injury and other claims, including occupational disease claims and claims for property damage, from a case-by-case approach to an actuarial-based approach. Consequently, and as discussed in Note 2, the Company recorded a charge of $281 million ($173 million after tax) to increase its provision for these claims.

Under the actuarial-based approach, the Company accrues the cost for the expected personal injury and property damage claims and existing occupational disease claims, based on actuarial estimates of their ultimate cost. The Company is unable to estimate the total cost for unasserted occupational disease claims. However, a liability for unasserted occupational disease claims is accrued to the extent they are probable and can be reasonably estimated.

Under the case-by-case approach, the Company was accruing the cost for claims as incidents were reported based on currently available information. In addition, the Company did not record a liability for unasserted claims, as such amounts could not be reasonably estimated under the case-by-case approach.

The Company's expenses for personal injury and other claims, net of recoveries, and including the above-mentioned charge, were $393 million in 2002, ($78 million in 2001 and $60 million in 2000) and payments for such items were $156 million in 2002 ($149 million in 2001 and $111 million in 2000). As at December 31, 2002, the Company had aggregate reserves for personal injury and other claims of $664 million ($430 million at December 31, 2001).

Although the Company considers such provisions to be adequate for all its outstanding and pending claims, the final outcome with respect to actions outstanding or pending at December 31, 2002, 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.

20 Major commitments and contingencies *(continued)*

D. Environmental matters

The Company's operations are subject to federal, provincial, state, municipal and local regulations under environmental laws and regulations 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. The magnitude of such additional liabilities and the costs of complying with environmental laws and containing or remediating contamination 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

therefore, the likelihood of any such costs being incurred or whether such costs would be material to the Company cannot be determined at this time. There can thus be no assurance that 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. Although the effect on operating results and liquidity cannot be reasonably estimated, management believes, based on current information, that environmental matters will not have a material adverse effect on the Company's financial condition or competitive position. Costs related to any future remediation will be accrued in the year in which they become known.

As at December 31, 2002, the Company had aggregate accruals for environmental costs of $106 million ($112 million as at December 31, 2001). During 2002, payments of $16 million were applied to the provision for environmental costs compared to $14 million in 2001 and $11 million in 2000. The Company anticipates that the majority of the liability at December 31, 2002 will be paid out over the next five years.

In addition, related environmental capital expenditures were $19 million in both 2002 and 2001 and $20 million in 2000. The Company expects to incur capital expenditures relating to environmental matters of approximately $20 million in each of 2003 and 2004 and $17 million in 2005.

E. Standby letters of credit

The Company, including certain of its subsidiaries, has granted irrevocable standby letters of credit, issued by highly rated banks, to third parties to indemnify them in the event the Company does not perform its contractual obligations. As at December 31, 2002, the maximum potential liability under these letters of credit was $403 million of which $334 million was for workers' compensation and other employee benefits and $69 million was for equipment under leases and other.

As at December 31, 2002, the Company has not recorded a liability with respect to these guarantees, as the Company does not expect to make any payments in excess of what is recorded on the Company's financial statements for the aforementioned items. The standby letters of credit mature at various dates between 2003 and 2007.

F. General indemnifications

In the normal course of business, the Company has provided indemnifications, customary for the type of transaction or for the railway business, in various agreements with third parties, including indemnification provisions where the Company would be required to indemnify third parties and others. Indemnifications are found in various types of contracts with third parties which include, but are not limited to, (a) contracts granting the Company the right to use or enter upon property owned by third parties such as leases, easements, trackage rights and sidetrack agreements; (b) contracts granting rights to others to use the Company's property, such as leases, licenses and easements; (c) contracts for the sale of assets; (d) contracts for the acquisition of services; (e) financing agreements; (f) trust indentures or fiscal agency agreements or similar agreements relating to debt or equity securities of the Company and engagement agreements with financial advisors; (g) transfer agent and registrar agreements in respect of the Company's securities; and (h) trust agreements establishing trust funds to secure the payment to certain officers and senior employees of special retirement compensation arrangements or plans. To the extent of any actual claims under these agreements, the Company maintains provisions for such items, which it considers to be adequate. Due to the nature of the indemnification clauses, the maximum exposure for future payment cannot be determined with certainty, however, may be material.

21 Financial instruments

A. Risk management

The Company has limited involvement with derivative financial instruments in the management of its fuel, foreign currency and interest rate exposures, and does not use them for trading purposes.

(i) Credit risk

In the normal course of business, the Company monitors the financial condition of its customers and reviews the credit history of each new customer.

The Company is exposed to credit risk in the event of non-performance by counterparties to its derivative financial instruments. Although collateral or other security to support financial instruments subject to credit risk is usually not obtained, counterparties are of high credit quality and their credit standing or that of their guarantor is regularly monitored. As a result, losses due to counterparty non-performance are not anticipated. The total risk associated with the Company's counterparties was immaterial at December 31, 2002. The Company believes there are no significant concentrations of credit risk.

(ii) Fuel

To mitigate the effects of fuel price changes on its operating margins and overall profitability, the Company has a systematic hedging program which calls for regularly entering into swap positions on crude and heating oil to cover a target percentage of future fuel consumption up to two years in advance.

Realized gains and losses from the Company's fuel hedging activities were a $3 million gain, a $6 million loss and a $49 million gain for the years ended December 31, 2002, 2001 and 2000, respectively. At December 31, 2002, the Company has hedged approximately 47% of the estimated 2003 fuel consumption and 25% of the estimated 2004 fuel consumption. This represents approximately 263 million U.S. gallons at an average price of U.S.$0.5865 per U.S. gallon. Unrecognized gains and losses from the Company's fuel hedging activities were a $30 million gain, a $38 million loss and a $17 million loss as at December 31, 2002, 2001 and 2000, respectively.

(iii) Foreign currency

Although the Company conducts its business and receives revenues primarily in Canadian dollars, a growing portion of its revenues, expenses, assets and debt are denominated in U.S. dollars. Thus, the Company's results are affected by fluctuations in the exchange rate between these currencies. 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 affect the Company's revenues and expenses.

For the purpose of minimizing volatility of earnings resulting from the conversion of U.S. dollar denominated long-term debt into the Canadian dollar, the Company has designated all U.S. dollar denominated long-term debt of the parent company as a foreign exchange hedge of its net investment in U.S. subsidiaries. As a result, from the dates of designation, unrealized foreign exchange gains and losses on the translation of the Company's U.S. dollar denominated long-term debt are recorded in Currency translation, which forms part of Shareholders' equity.

(iv) Interest rates

From time to time, the Company enters into interest rate swap transactions for the purpose of minimizing the volatility in the fair value of certain fixed-interest long-term debt. In 2002 and 2001, the Company did not enter into any interest rate swap transactions.

(v) Other

The Company does not currently have any derivative instruments not designated as hedging instruments.

B. Fair value of financial instruments

Generally accepted accounting principles define the fair value of a financial instrument as the amount at which the instrument could be exchanged in a current transaction between willing parties. The Company uses the following methods and assumptions to estimate the fair value of each class of financial instruments for which the carrying amounts are included in the Consolidated Balance Sheet under the following captions:

(i) Cash and cash equivalents, Accounts receivable, Accounts payable and accrued charges, and Other current liabilities:

The carrying amounts approximate fair value because of the short maturity of these instruments.

(ii) Other assets and deferred charges:

Investments: The Company has various debt and equity investments for which the carrying value approximates the fair value, with the exception of a cost investment for which the fair value was estimated based on the Company's proportionate share of its net assets.

(iii) Long-term debt:

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

(iv) Convertible preferred securities:

In 2001, the fair value of the Company's convertible preferred securities was estimated based on the quoted market price.

21 Financial instruments *(continued)*

The following table presents the carrying amounts and estimated fair values of the Company's financial instruments as at December 31, 2002 and 2001 for which the carrying values on the Consolidated Balance Sheet are different from the fair values:

In millions	***December 31, 2002***		*December 31, 2001*	
	Carrying amount	**Fair value**	Carrying amount	Fair value
Financial assets				
Investments	**$ 380**	**$ 440**	$ 496	$ 551
Financial liabilities				
Long-term debt (including current portion)	**$5,577**	**$5,738**	$5,927	$5,986
Other				
Convertible preferred securities	**$ –**	**$ –**	$ 327	$ 479

22 Reconciliation of Canadian and United States generally accepted accounting principles

The consolidated financial statements of Canadian National Railway Company are expressed in Canadian dollars and are prepared in accordance with Canadian GAAP which conform, in all material respects, with U.S. GAAP except as described below:

A. Reconciliation of net income

The application of U.S. GAAP would have the following effects on the net income as reported:

In millions *Year ended December 31,*	**2002**	2001	2000
Net income – Canadian GAAP	**$ 571**	$727	$774
Adjustments in respect of:			
Property capitalization, net of depreciation	**363**	339	278
Interest on convertible preferred securities	**(9)**	(19)	(18)
Stock-based compensation cost	**(9)**	(19)	(3)
Income tax rate reductions	**–**	122	(4)
Income tax expense on current year U.S. GAAP adjustments	**(116)**	(110)	(90)
Net income – U.S. GAAP	**$ 800**	$1,040	$937

(i) Property capitalization

Under Canadian GAAP, the Company capitalizes only the material component of track replacement costs, to the extent it meets the Company's minimum threshold for capitalization, whereas under U.S. GAAP the labor, material and related overheads are capitalized. Furthermore, the Company capitalizes under U.S. GAAP all major expenditures for work that extends the useful life and/or improves the functionality of bridges and other structures and freight cars.

(ii) Stock-based compensation

As explained in Note 2, effective January 1, 2002, the Company adopted the CICA recommendations related to the accounting for stock-based compensation and other stock-based payments. The Company has elected to prospectively apply the recommendations to its awards of conventional and performance-based employee stock options granted on or after January 1, 2002. Compensation cost attributable to performance-based employee stock option awards granted before such date continues to be a reconciling difference.

(iii) Convertible preferred securities

As explained in Note 11, the Convertible preferred securities (Securities) were converted into common shares of the Company on July 3, 2002. Prior to such date, the Securities were treated as equity under Canadian GAAP, whereas under U.S. GAAP they were treated as debt. Consequently, the interest on the Securities until July 3, 2002 was treated as a dividend for Canadian GAAP but as interest expense for U.S. GAAP.

(iv) Foreign exchange

In 2001, the Company early adopted the CICA amended recommendations of Section 1650 "Foreign Currency Translation," which essentially harmonizes Canadian and U.S. accounting standards by eliminating the deferral and amortization of unrealized translation gains or losses on foreign currency denominated monetary items that have a fixed or ascertainable life extending beyond the end of a fiscal year and recognizing them into net income immediately. As required by the amended section, the Company has retroactively restated all prior period financial statements presented.

(v) Income tax expense

In 2001, under U.S. GAAP, the Company recorded a reduction to its net deferred income tax liability resulting from the enactment of lower corporate tax rates in Canada. As a result, a deferred income tax recovery of $122 million was recorded in the Consolidated statement of income and a deferred income tax expense of $32 million was recorded in Other comprehensive income. For Canadian GAAP purposes, there was no adjustment in 2001 as the impact resulting from lower corporate tax rates was accounted for in 2000 when the rates were substantively enacted. For the year ended December 31, 2000, the Canadian GAAP adjustment was a $4 million expense as the deferred tax position under Canadian GAAP was different.

B. Earnings per share

In 2000, the Company early adopted the CICA recommendations related to the presentation of earnings per share. Although the standard essentially harmonizes Canadian and U.S. standards, the earnings per share calculations continue to differ due to differences in the earnings figures.

(i) Basic earnings per share

Year ended December 31,	**2002**	2001	2000
Net income – U.S. GAAP	**$4.07**	$5.41	$4.81
Weighted-average number of common shares outstanding *(millions)* – U.S. GAAP	**196.7**	192.1	195.0

(ii) Diluted earnings per share

Year ended December 31,	**2002**	2001	2000
Net income – U.S. GAAP	**$3.97**	$5.23	$4.67
Weighted-average number of common shares outstanding *(millions)* – U.S. GAAP	**202.8**	201.0	202.8

C. Reconciliation of significant balance sheet items

(i) Shareholders' equity

As permitted under Canadian GAAP, the Company eliminated its accumulated deficit of $811 million as of June 30, 1995 through a reduction of the capital stock in the amount of $1,300 million, and created a contributed surplus of $489 million. Such a reorganization within Shareholders' equity is not permitted under U.S. GAAP.

Under Canadian GAAP, the dividend in kind declared in 1995 (with respect to land transfers) and other capital transactions were deducted from Contributed surplus. For U.S. GAAP purposes, these amounts would have been deducted from Retained earnings.

Under Canadian GAAP, costs related to the sale of shares have been deducted from Contributed surplus. For U.S. GAAP purposes, these amounts would have been deducted from Capital stock.

Under Canadian GAAP, the excess in cost over the stated value resulting from the repurchase of shares was allocated first to Capital stock, then to Contributed surplus and finally to Retained earnings. Under U.S. GAAP, the excess would have been allocated to Capital stock followed by Retained earnings.

For Canadian and U.S. GAAP purposes, the Company designated all U.S. dollar denominated long-term debt of the parent company as a foreign exchange hedge of its net investment in U.S. subsidiaries. Under Canadian GAAP, the resulting net unrealized foreign exchange gain, from the date of designation, has been included in Currency translation. For U.S. GAAP purposes, the resulting net unrealized foreign exchange gain has been included as part of Accumulated other comprehensive income, a separate component of Shareholders' equity, as required under Statement of Financial Accounting Standards (SFAS) No. 130, "Reporting Comprehensive Income."

(ii) Minimum pension liability adjustment

In 2002 and 2001, one of the Company's pension plans had an accumulated benefit obligation in excess of the fair value of the plan assets. Under U.S. GAAP, this gave rise to an additional minimum pension liability. An intangible asset was recognized up to the amount of the unrecognized prior service cost and the difference has been recorded in Accumulated other comprehensive income, a separate component of Shareholders' equity. There are no requirements under Canadian GAAP to record a minimum pension liability adjustment.

(iii) Derivative instruments

On January 1, 2001, under U.S. GAAP, the Company adopted SFAS No. 133 "Accounting for Derivative Instruments and Hedging Activities," as amended by SFAS No. 138 "Accounting for Certain Derivative Instruments and Certain Hedging Activities." In accordance with these statements, the Company has recorded in its balance sheet the fair value of derivative instruments used to hedge a portion of the Company's fuel requirements. Changes in the market value of these derivative instruments have been recorded in Accumulated other comprehensive income, a separate component of Shareholders' equity. There are no similar requirements under Canadian GAAP.

(iv) Convertible preferred securities

As explained in Note 11, the Convertible preferred securities (Securities) were converted into common shares of the Company on July 3, 2002. Prior to such date, the Securities were treated as equity under Canadian GAAP, whereas under U.S. GAAP they were treated as debt. Consequently, the initial costs related to the issuance of the Securities, net of amortization, which were previously deferred and amortized for U.S. GAAP, have since been reclassified to equity.

22 Reconciliation of Canadian and United States generally accepted accounting principles *(continued)*

(v) The application of U.S. GAAP would have a significant effect on the following balance sheet items as reported:

In millions *December 31,*	2002	2001
Current assets – Canadian GAAP	**$ 1,163**	$ 1,164
Fuel derivative instruments	**29**	–
Current assets – U.S. GAAP	**$ 1,192**	$ 1,164
Properties – Canadian GAAP	**$16,898**	$16,723
Property capitalization, net of depreciation	**2,783**	2,422
Properties – U.S. GAAP	**$19,681**	$19,145
Other assets and deferred charges – Canadian GAAP	**$ 863**	$ 901
Fuel derivative instruments	**1**	–
Intangible asset	**1**	1
Debt issue costs	**–**	12
Other assets and deferred charges – U.S. GAAP	**$ 865**	$ 914
Current liabilities – Canadian GAAP	**$ 2,134**	$ 1,638
Fuel derivative instruments	**–**	31
Current liabilities – U.S. GAAP	**$ 2,134**	$ 1,669
Deferred income tax liability – Canadian GAAP	**$ 3,825**	$ 3,729
Cumulative effect of prior years' adjustments to income	**955**	845
Income taxes on current year U.S. GAAP adjustments	**116**	110
Income taxes on translation of U.S. to Canadian GAAP adjustments	**16**	13
Income taxes on minimum pension liability adjustment	**(13)**	(6)
Income taxes on fuel derivative instruments	**10**	(13)
Income tax rate reductions	**(86)**	(86)
Other	**3**	(1)
Deferred income tax liability – U.S. GAAP	**$ 4,826**	$ 4,591
Other liabilities and deferred credits – Canadian GAAP	**$ 1,335**	$ 1,296
Stock-based compensation	**33**	24
Minimum pension liability adjustment	**38**	18
Fuel derivative instruments	**–**	7
Other liabilities and deferred credits – U.S. GAAP	**$ 1,406**	$ 1,345
Capital stock – Canadian GAAP	**$ 3,558**	$ 3,209
Capital reorganization	**1,300**	1,300
Stock-based compensation	**49**	48
Foreign exchange loss on convertible preferred securities	**12**	–
Costs related to the sale of shares	**(33)**	(33)
Share repurchase program	**(101)**	(82)
Capital stock – U.S. GAAP	**$ 4,785**	$ 4,442

In millions *December 31,*	2002	2001
Convertible preferred securities – Canadian GAAP	**$ –**	$ 327
Debt issue costs	**–**	12
Foreign exchange loss on convertible preferred securities	**–**	27
Convertible preferred securities (classified as debt) – U.S. GAAP	**$ –**	$ 366
Contributed surplus – Canadian GAAP	**$ 175**	$ 178
Dividend in kind with respect to land transfers	**248**	248
Costs related to the sale of shares	**33**	33
Other transactions and related income tax effect	**18**	18
Share repurchase program	**15**	12
Capital reorganization	**(489)**	(489)
Contributed surplus – U.S. GAAP	**$ –**	$ –
Currency translation – Canadian GAAP	**$ 132**	$ 133
Unrealized foreign exchange gain (loss) on U.S. to Canadian GAAP adjustments, net of applicable taxes	**1**	(7)
Fuel derivative instruments, net of applicable taxes	**20**	(25)
Income tax rate reductions	**(32)**	(32)
Minimum pension liability adjustment, net of applicable taxes	**(24)**	(11)
Accumulated other comprehensive income – U.S. GAAP	**$ 97**	$ 58
Retained earnings – Canadian GAAP	**$ 2,762**	$ 2,514
Cumulative effect of prior years' adjustments to income	**1,449**	1,136
Current year adjustments to net income	**229**	313
Share repurchase program	**86**	70
Cumulative dividend on convertible preferred securities	**38**	32
Capital reorganization	**(811)**	(811)
Dividend in kind with respect to land transfers	**(248)**	(248)
Other transactions and related income tax effect	**(18)**	(18)
Retained earnings – U.S. GAAP	**$ 3,487**	$ 2,988

23 Quarterly financial data – unaudited

In millions, except per share data

	2002				2001			
	First	**Second**	**Third**	**Fourth** (1)	First	Second	Third	Fourth
Revenues	**$1,509**	**$1,551**	**$1,503**	**$1,547**	$1,398	$1,392	$1,325	$1,537
Operating income	**$ 372**	**$ 385**	**$ 362**	**$ (3)**	$ 362	$ 245	$ 331	$ 428
Net income	**$ 211**	**$ 212**	**$ 187**	**$ (39)**	$ 271	$ 40	$ 178	$ 238
Basic earnings per share	**$ 1.08**	**$ 1.08**	**$ 0.93**	**$ (0.20)**	$ 1.40	$ 0.19	$ 0.91	$ 1.22
Diluted earnings per share	**$ 1.04**	**$ 1.04**	**$ 0.92**	**$ (0.19)**	$ 1.36	$ 0.19	$ 0.88	$ 1.18
Dividend declared per share	**$0.215**	**$0.215**	**$0.215**	**$0.215**	$0.195	$0.195	$0.195	$0.195

(1) In the fourth quarter of 2002, the Company recorded a charge of $281 million ($173 million after tax) to increase its liability for U.S. personal injury and other claims and a charge for workforce reductions of $120 million ($79 million after tax).

24 Comparative figures

Certain figures, previously reported for 2001 and 2000, have been reclassified to conform with the basis of presentation adopted in the current year.

General review

Trustee

Effective January 1, 2002, CIBC Mellon Trust Company (CIBC Mellon) was appointed as Trustee of the Canadian National Railways Pension Trust Funds (CN Pension Trust Funds, or Funds), replacing Montreal Trust Company of Canada. As Trustee, CIBC Mellon performs certain duties which include holding legal title to the assets of the Funds and providing a certificate confirming that Canadian National Railway Company (CN), as Administrator, complied with the provisions of the CN Pension Plan, the CN 1935 Pension Plan and the Pension Benefits Standards Act, 1985 and its regulations. The checks and direct deposit payments in respect of these plans were issued in the name of the CN Pension Trust Funds from bank accounts in the name of CIBC Mellon, Trustee of the CN Pension Trust Funds.

Administration of the pension plans

Overall accountability for the pension and benefit administration is the responsibility of CN. Mercer Human Resource Consulting, an employee benefits consulting firm, performs agreed-on pension and benefit administration services on behalf of CN.

Pension benefits

A. Pension improvements

The following pension improvements are effective January 1, 2002 and are based on recommendations made by the Pension Committee in 2001 and approved by CN's Board of Directors:

- The pension formula was increased from 1.6%/2.0% to 1.7%/2.0% for active members on January 1, 2002, for each year of pensionable service from January 1, 1966 for the CN Pension Plan only.
- The eligibility requirements to qualify for indexation were shortened from age 60 and at least five complete calendar years since retirement to age 59 and at least four complete calendar years since retirement.
- Pensions were indexed at 75% of inflation rather than 60% of inflation for the year 2002. Retirees and survivors who met the eligibility requirements saw their 2002 pension increase by 2.25% instead of 1.8% on the first $3,000 of basic monthly pension. This was a lifetime pension benefit increase.
- A special improvement to pensions was paid to eligible retirees and surviving spouses entitled to indexation on January 1, 2002, based on the number of years that such retirees were on pension and their pensionable service at the time of retirement. This was a lifetime pension benefit increase.

In addition to these improvements, the CN Pension Plan was amended to provide for a reduction in the basic employee contribution rates, subject to certain conditions, from 5.48%/6.98% to 4.3%/6.3%, effective January 1, 2002. This improvement reflected an agreement that CN reached with five of its six unions on the implementation of an employee-paid Long Term Disability (LTD) plan for unionized employees active on January 1, 2002 and thereafter. The remaining union had established an employee-paid LTD plan in 1999 and the members of such union also benefited from the contribution reductions, subject to the same conditions applicable to the other unionized members. Disability pensions under the CN Pension Plan will be reduced to reflect the benefit payable under such employee-paid LTD plans.

The non-unionized employees also benefited from the contribution reductions and the full cost of this reduction was charged to the Non-Unionized Employees' Improvement Account as they have been covered by a CN-paid LTD plan under the CN Flex Benefit Program for many years.

In 2002, CN's Board of Directors approved the recommendation made by the Pension Committee to index pensions at 75% of inflation rather than 60% of inflation for the year 2003. Therefore, retirees and survivors who meet the eligibility requirements will see their 2003 pension increase by 1.275% instead of 1.02% on the first $3,250 of basic monthly pension. This is a lifetime pension benefit increase.

B. Indexation agreement and escalation account

As a result of the indexation agreement negotiated with the railway unions in 1989 and improvements to such agreement negotiated in 1992 and 1998, approximately 41,500 retirees and surviving spouses received permanent pension increases in 2002. These increases amounted to 2.25% on the first $3,000 of basic CN monthly pension, with a guaranteed minimum monthly pension increase of $9.00 for eligible retirees and $4.50 for eligible surviving spouses.

Under this indexation agreement, effective January 1, 1989, 50% of the experience gains or losses related to pensioners are accounted for separately in the Escalation Account. Net experience gains are used to pay for indexation of pensions above the minimum up to the maximum annual amount. The maximum annual indexation for eligible retirees and survivors is 60% (75% for the 2002 and 2003 indexation) of the increase in the Consumer Price Index (CPI) to a maximum increase in CPI of 6%, with an annual limit on the amount of pension which can be indexed.

The Pension Committee may recommend additional benefits for pensioners, financed through the Escalation Account, if the balance in the account exceeds a certain threshold. These additional benefits are subject to approval by CN's Board of Directors. Such additional benefits were granted on January 1, 2002 as indicated under section *A. Pension improvements*. In 2002, CN's Board of Directors approved the Pension Committee's recommendation to increase maximum indexation for 2003 only, effective January 1, 2003 as indicated under section *A. Pension improvements*. The value of such improvements was charged to the Escalation Account in the current valuation.

C. Improvement accounts
Effective January 1, 1998, the unions and CN agreed to share the experience gains (losses) resulting from investment earnings related to active unionized members of the CN Pension Plan, based on the same concept as the indexation agreement. Under this agreement, annual calculations determine the amount of experience gains or losses to be credited (debited) to an account referred to as the Unionized Employees' Improvement Account. The balance of such account, if positive, may be used to improve benefits of unionized active members or reduce their contributions, as recommended by the Pension Committee and approved by CN's Board of Directors. The improvement account concept was also extended to non-unionized members and separate accounts were created for unionized and non-unionized members.

The increase in the pension formula on January 1, 2002 as described under section *A. Pension improvements* was financed through the Improvement Accounts as of January 1, 2002.

Annual pension statements
As required by the Pension Benefits Standards Act, 1985 and to keep employees who are members of the CN Pension Plan and the CN 1935 Pension Plan updated annually on their personal entitlement, personalized pension statements were prepared as at December 31, 2001 and distributed by June 2002.

Services to pensioners
A. Direct deposit:
The Direct Deposit System (DDS) is available to all retirees and survivors. Under this system, the monthly pension benefit is deposited directly into the individual's personal account. An itemized pension pay stub is sent to that individual initially, each January and whenever the gross or net amount changes. About 40,700 pensioners used this service in 2002.

B. Toll-free help lines:
Approximately 45,400 calls were handled in 2002 through the central toll-free help line (1-800-361-0739). Staff handling the toll-free telephone line have ready access to records and information required for quick, efficient and accurate responses to most callers' needs – in both of Canada's official languages.

Trustee's report

To the Administrator and the Members of the CN Pension Plan and the CN 1935 Pension Plan

We, CIBC Mellon Trust Company, are the Trustee of the Canadian National Railways Pension Trust Funds ("CN Pension Trust Funds").

As Trustee, we have appointed KPMG LLP to examine the systems, procedures and internal controls used in respect to the custody, investment and administration of the assets of the CN Pension Trust Funds, the administration of the CN Pension Plan and the CN 1935 Pension Plan ("1935 Plan"), and the performance of the Canadian National Railway Company ("CN") as Administrator of the CN Pension Plan and the 1935 Plan for the year ended December 31, 2002.

Our examination included such tests and procedures as were considered necessary in the circumstances taking into consideration the requirements of the Trust Deeds and our experience in the Canadian pension industry.

In our opinion, based on the reasonable, but not absolute, degree of assurance obtained from the examination performed, the aforementioned systems, procedures and internal controls used by CN as Administrator, operated effectively during the year ended December 31, 2002 and complied with the objectives of the Pension Benefits Standards Act, 1985 and its Regulations.

(signed)
CIBC Mellon Trust Company
Trustee of the Canadian National Railways
Pension Trust Funds

Toronto, January 20, 2003

Actuary's report

To the Board of Directors of
Canadian National Railway Company

We have conducted actuarial valuations for funding purposes as at December 31, 2001 for the CN Pension Plan and the CN 1935 Pension Plan.

As at December 31, 2001, these valuations revealed a consolidated actuarial liability of $10,486 million, a consolidated surplus of $482 million and a current service cost net of plan members' contributions of $87 million in 2002. The next actuarial valuations will be conducted as at December 31, 2004, at the latest.

In my opinion, for the purposes of the valuations,

- the data on which these valuations were based were sufficient and reliable,
- the assumptions are, in aggregate, appropriate, and
- the methods employed in the valuations are appropriate.

We have also conducted actuarial valuations for accounting purposes as at December 31, 2001 for the CN Pension Plan and the CN 1935 Pension Plan.

These valuations were made in accordance with the requirements of Section 3461 of the Handbook of the Canadian Institute of Chartered Accountants (CICA). They revealed a consolidated actuarial liability of $10,933 million.

The difference between the results of the actuarial valuations conducted for funding purposes and those conducted for accounting purposes is mainly due to the CICA Section 3461 requirement to use an interest rate inherent in the amount at which the actuarial liability could be settled at the date of valuation.

Both valuations have been prepared and, my opinions given, in accordance with accepted actuarial practice.

(signed)
Bernard Morency
Fellow of the Canadian Institute of Actuaries
Mercer Human Resource Consulting Limited

Montreal, January 21, 2003

Auditors' report

To the Board of Directors of
Canadian National Railway Company

We have audited the consolidated statement of net assets of the CN Pension Plan and the CN 1935 Pension Plan as at December 31, 2002 and the consolidated statement of changes in net assets for the year then ended. These financial statements are the responsibility of the Administrator. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the Administrator, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the net assets of the CN Pension Plan and the CN 1935 Pension Plan as at December 31, 2002 and the changes in their net assets for the year then ended in accordance with Canadian generally accepted accounting principles.

(signed)
KPMG LLP
Chartered Accountants

Montreal, Canada
January 20, 2003

Consolidated Statement of Net Assets at Market Value

In millions *As at December 31,*	**2002**	2001
Bonds	**$ 4,096**	$ 3,733
Mortgages	**319**	272
Real estate	**318**	271
Oil and gas	**657**	468
Equities	**5,565**	6,033
Cash and short-term investments	**143**	890
	11,098	11,667
Receivable from Canadian National Railway Company	**4**	5
Net other liabilities	**(9)**	(1)
	$11,093	$11,671

On behalf of the Board:

David G.A. McLean
Director

E. Hunter Harrison
Director

See accompanying notes to consolidated financial statements.

Consolidated Statement of Changes in Net Assets at Market Value

In millions *Year ended December 31,*	**2002**	2001
Net assets at market value, beginning of year	**$11,671**	$12,356
Investment income		
Bonds	**240**	238
Mortgages	**23**	18
Real estate	**10**	11
Oil and gas	**52**	48
Equities	**84**	88
Short-term investments	**14**	20
	423	423
Less administrative expenses	**(19)**	(18)
Investment income before net gain (loss) on sale of investments	**404**	405
Net gain (loss) on sale of investments	**(167)**	486
Total investment income	**237**	891
Unrealized depreciation in value of investments	**(268)**	(1,060)
Contributions		
Employees	**61**	73
Company	**74**	69
Total contributions	**135**	142
Disbursements for members		
Pension benefits paid	**(645)**	(618)
Refunds	**(37)**	(43)
Total disbursements for members	**(682)**	(661)
Transfers	**–**	3
Net decrease	**(578)**	(685)
Net assets at market value, end of year	**$11,093**	$11,671

See accompanying notes to consolidated financial statements.

1 Description of plans

These consolidated financial statements cover two pension plans, the CN Pension Plan and the CN 1935 Pension Plan (CN Plans), and include the accounts of the Canadian National Railways Pension Trust Funds and its wholly owned companies. All references in these financial statements to the "Company" refer to Canadian National Railway Company, which is the Administrator of the CN Plans. The CN 1935 Pension Plan is for a closed group of members and represents less than 1% of the pension obligation of the plans. Therefore, the following is a summarized description of the CN Pension Plan only. Please refer to the rules of the CN Pension Plan for additional information.

A. General

The CN Pension Plan (the Plan) is a contributory defined benefit pension plan generally applicable for employees from the first day of employment. Under this Plan, employees contribute between 4.3% and 4.7% (5.48% and 5.88% prior to January 1, 2002) of earnings up to the Year's Maximum Pensionable Earnings (YMPE) under the Canada or Quebec Pension Plan and between 6.3% and 6.7% (6.98% and 7.38% prior to January 1, 2002) of earnings in excess of the YMPE up to a maximum of $4,989 in 2002. Participants are not required to make contributions after 35 years of pensionable service. Company contributions are determined on the basis of actuarial valuations done at least on a triennial basis in accordance with the requirements of the Pension Benefits Standards Act, 1985 and Regulations thereunder.

B. Pensions

Pensions are based on the employee's average pensionable earnings for the best five consecutive calendar years or the last 60 months of employment at the rate of 2% for each year of pensionable service prior to January 1, 1966, 1.7% for each year of pensionable service thereafter up to the average YMPE over the last 60 months and 2% of the excess of such average pensionable earnings over the average YMPE. The maximum annual pension payable is $1,715 multiplied by the pensionable service of the member. Pensionable service is limited to 35 years.

C. Retirement age

The normal retirement age is 65. However, with the Company's consent, employees who are at least 55 years of age and have 85 points (age plus years of pensionable service) are entitled to an early retirement pension without reduction. Employees with less than 85 points can retire anytime from age 55 with a reduction in their pension of 0.5% for each month (6% per year) between their date of retirement and their 65th birthday.

D. Disability pensions

A member with 10 years of pensionable service who is declared either unfit to perform his/her usual employment with the Company due to a permanent disability which occurred prior to 1992, or totally and permanently disabled due to a disability which occurred after 1991, may, subject to certain conditions, apply for an immediate reduced or unreduced pension. Any declarations in respect of a member's disability are the responsibility of CN's Chief Medical Officer. The disability pension may be adjusted to take into account benefits payable under a long-term disability plan or under a Workers' Compensation Act of any province.

E. Pre-retirement survivors' pensions and death refunds

A survivor's pension is payable to the eligible spouse of a member who had a minimum of two years of plan membership upon his/her death. Otherwise, a death refund is payable to the spouse, or, if there is no spouse, to the estate of the member.

F. Post-retirement survivors' pensions and estate settlements

Upon the death of a retiree who had an eligible spouse at retirement, either 55% or 60% of the basic pension of the retiree is payable to that spouse during his/her lifetime depending on the option elected at retirement. The survivor's pension is guaranteed for the first 10 years after retirement. If the retiree and the surviving spouse, if any, die in the first 10 years after retirement, the survivor's pension will be payable to the estate of the retiree until the 10-year period is over.

G. Termination benefits

Upon termination of service, a member is entitled to either his/her contributions with interest or to the value of his/her benefits accrued under the Plan or to a deferred pension or a combination of the above, depending on his/her age, pensionable service and years of membership at termination.

H. Income taxes

The Plan is registered under the Income Tax Act and Regulations. Contributions to the Plan are tax deductible to the Company and investment income of the Canadian National Railways Pension Trust Funds is not taxable in Canada. Investment income from some foreign countries is subject to withholding taxes, which are either fully or partially recovered.

2 Summary of significant accounting policies

A. Basis of presentation

These consolidated financial statements are prepared on a market value basis, in accordance with generally accepted accounting principles in Canada for pension plans. Management is required to make estimates and assumptions that affect the reported amounts at the date of the financial statements. Actual results could differ from these estimates. These financial statements present the aggregate financial position of the CN Plans as a separate financial reporting entity independent of the sponsor and plan members, and are prepared to assist plan members and others in reviewing the activities of the CN Plans for the year and as such, do not portray the funding requirements of the CN Plans nor the benefit security of individual members.

B. Investments

Investment transactions are recorded at the point when the risks and rewards of ownership are transferred. Publicly traded securities are recorded on the trade date.

Investments are stated at market value which is determined using publicly quoted prices where available. When such prices are not available, market values are estimated on the basis of the present value of estimated future net cash flows, the market value of comparable assets, or the breakup value of underlying assets.

Market values of investments are determined as follows:

(i) Bonds are valued using the closing market price as at December 31.

(ii) Mortgages are valued using current market yields of financial instruments of similar maturity and at appropriate spreads from instruments of comparable quality.

(iii) Real estate consists of land and buildings. Land is valued using the market value of comparable assets, and buildings are valued using the present value of estimated future net cash flows and the market value of comparable assets. Independent valuations of land and buildings are performed triennially.

(iv) Oil and gas reserves are valued using the present value of estimated future net cash flows, which are based on projected production, prices, and costs. Land is valued using the market value of comparable assets. Trust units and equities are valued using the closing market price as at December 31.

(v) Equities are valued using the closing market price as at December 31.

(vi) Short-term investments and other assets are valued at cost, which approximates market value.

(vii) Listed derivative financial instruments are valued using the market settlement price as at December 31. Unlisted derivative financial instruments are valued using the present value of future net cash flows determined by using closing market levels and interest rates for instruments of similar maturity and credit risk.

The change in market value has been segregated in the Consolidated Statement of Changes in Net Assets at Market Value between net gain (loss) on sale of investments during the year and the unrealized appreciation (depreciation) in value of investments, which represents the balance of the change in market value of investments for the year.

C. Income recognition

Dividends are accrued on the ex-dividend date; income from other investments is accrued as earned. Gains or losses realized on the sale of investments are recognized on the dates of sales, are calculated based on the average cost of the assets and are included in the Consolidated Statement of Changes in Net Assets at Market Value as a net gain (loss) on sale of investments.

D. Foreign exchange

Assets and liabilities denominated in foreign currencies are translated using current rates as at December 31 or at the forward foreign exchange contract rates for investments that are hedged. Foreign dividends and interest income are translated at the rates prevailing when accrued.

Unrealized foreign exchange gains and losses on investments incurred during the year are included in unrealized appreciation (depreciation) in value of investments. The net gain (loss) on sale of investments denominated in foreign currencies includes the foreign exchange gain or loss realized on the transaction.

E. Contributions

Contributions from employees are recorded in the period in which the Company makes payroll deductions. The contributions from the Company, as determined by the latest actuarial valuations, are recorded using the accrual method.

F. Transfers

Transfers to/from other funds are accounted for in the period in which the value of the transfers can be reasonably estimated.

3 Investments

Investments consist of securities, assets or financial instruments where the CN Plans' original intention is to hold to maturity or until market conditions render alternative investments more attractive. Significant terms and conditions related to investments as at December 31 are as follows:

Market risk

Market risk is the risk that the value of an investment will fluctuate as a result of changes in market prices whether those changes are caused by factors specific to the individual investment or its issuer, or factors affecting all securities traded in the market. The CN Plans' policy is to invest in a diversified portfolio of investments, based on criteria established in the Statement of Investment Policies and Procedures, and may include the use of derivative financial instruments to mitigate the impact of market risk.

Equities are diversified by issuer and by industry. The most significant allocations to individual issuers or industry sectors are limited to 4.2% and 15.2%, (3.5% and 17.7% in 2001) respectively.

Foreign currency risk

Foreign currency exposure arises from investments denominated in currencies other than the Canadian dollar. Fluctuations in foreign currency rates can result in a positive or negative impact on the fair value of the CN Plans' investments. The CN Plans' exposure to currencies, as a proportion of total assets and after taking into account the effect of foreign currency derivatives positions, is as follows:

As at December 31,	**2002**	2001
Canada	**78%**	73%
United States of America	**11%**	18%
Euro zone	**3%**	4%
United Kingdom	**2%**	2%
Japan	**2%**	1%
Other	**4%**	2%
Total	**100%**	100%

Interest rate risk

Interest rate risk represents the risk that the market value of the CN Plans' investments will fluctuate due to changes in market interest rates. Sensitivity to interest rates is a function of the timing and amount of cash flows of the assets and liabilities of the CN Plans.

The term to maturity of interest rate sensitive investments, based on contractual repricing dates, is as follows:

In millions, except percentage data *As at December 31,*	**2002**					2001	
	Term to maturity						
	Within 1 year	**1 to 5 years**	**Over 5 years**	**Total**	**Average effective yield**	Total	Average effective yield
Short-term investments	**$132**	**$ –**	**$ –**	**$ 132**	**2.78%**	$ 881	2.51%
Bonds	**34**	**1,637**	**2,425**	**4,096**	**4.59%**	3,733	5.06%
Mortgages	**–**	**76**	**243**	**319**	**5.44%**	272	6.47%
Total	**$166**	**$1,713**	**$2,668**	**$4,547**	**4.60%**	$4,886	4.68%

Credit risk

Credit risk arises from the potential for an investee to fail or a counterparty to default on its contractual obligations to the CN Plans.

In accordance with formally established policies, the CN Plans manage credit risk by dealing with counterparties considered to be of high credit quality, utilizing an internal credit limit monitoring process as well as credit mitigation techniques such as master netting and collateral agreements.

Short-term investments consist primarily of securities issued by Canadian chartered banks. Seventy-eight percent (90% in 2001) of Bonds are issued or guaranteed by Canadian or U.S. governments and 18% (9% in 2001) by corporations. Mortgages are secured by real estate.

At year-end, the CN Plans' most significant exposures were with Canadian governments which issued or guaranteed $3,200 million ($3,181 million in 2001) of securities held by the CN Plans. Excluding the above, the remainder of assets are diversified with no other issuer accounting for more than 2.1% (3.3% in 2001) of total net assets. Credit risk resulting from the use by the CN Plans of derivative financial instruments is addressed in Note 4.

4 Derivative financial instruments

From time to time, the CN Plans use derivative financial instruments (derivatives) for asset mix management purposes or to hedge their exposures to foreign currency, interest rate or market risks of the portfolio or anticipated transactions. Derivatives are financial instruments whose value is derived from interest rates, foreign exchange rates, equity or commodity prices. When derivatives are used for hedging purposes, the gains or losses on the derivatives are offset by a corresponding change in the value of the hedged assets. Derivatives include forwards, futures, swaps and options. Types of contracts used by the CN Plans include:

- *Swaps,* which are contractual agreements between two parties to exchange fixed and/or floating rate payments based on a notional value.
- *Forwards and futures,* which are contractual agreements to either buy or sell a specified currency or financial instrument at a specific price and date in the future. Forwards are customized contracts transacted in the over-the-counter market. Futures are standardized contracts traded on regulated exchanges and are subject to daily cash margining.

The credit risk of derivative instruments is limited to the cost of replacing, at current fair value, all contracts which have a positive value. Credit risk on futures contracts is considered minimal as the counterparty to a futures contract is a public exchange, contracts are marked-to-market and margin receivables and payables are settled in cash daily.

The following table summarizes the derivatives portfolio of the CN Plans and the related credit exposure:

As at December 31,	**2002**			2001		
	Notional	**Fair value (2)**		Notional	Fair value (2)	
In millions	**value (1)**	**Assets**	**Liabilities**	value (1)	Assets	Liabilities
Interest rate:						
Swap contracts	**$ 50**	**$0.7**	**$ –**	$ 41	$ –	$ 0.2
Futures contracts	**765**	**–**	**–**	294	–	–
Foreign exchange:						
Forward contracts	**1,209**	**1.7**	**7.5**	867	15.1	7.2
Swap contracts	**–**	**–**	**–**	65	–	7.7
Equity and commodity:						
Futures contracts	**4**	**–**	**–**	9	–	–
Total	**$2,028**	**2.4**	**$7.5**	$1,276	15.1	$15.1
Effect of master netting and collateral agreements		**(0.2)**			(2.0)	
Net credit risk (replacement cost)		**$2.2**			$13.1	

(1) Notional value represents the amount to which a rate or price is applied in order to calculate the exchange of cash flows under a derivative contract.

(2) The fair values of all derivative contracts are included in the market value of the assets of the CN Plans.

5 Funding policy

In respect of the CN Plans, the contributions by the Company are determined in accordance with the requirements of the Pension Benefits Standards Act, 1985 and Regulations thereunder, and are based on the projected unit credit actuarial cost method, with projection of salaries where future salary changes affect the amount of the projected benefits. In the case of the CN 1935 Pension Plan, the Company makes money purchase contributions in accordance with the rules of the plan.

The latest actuarial valuations of the CN Plans were prepared by Mercer Human Resource Consulting Limited as at December 31, 2001 and were submitted to the Superintendent of Financial Institutions and to the Canada Customs and Revenue Agency. In these actuarial valuations, the principal assumptions adopted by the CN Plans' actuary are members' mortality, disability, retirement, termination of employment, merit and periodic increases in earnings, as well as a long-term rate of return of 7.0% (7.25% at the previous valuation) per annum on investments. Future increases in members' earnings have been projected using economic assumptions consistent with this long-term rate of return.

6 Transfers

In 2002, the accounts include a provision for the amounts to be remitted to/from other funds to cover transfers of members of CN Plans to other pension plans and transfers of members of other plans to the CN Plans.

7 Consolidated actuarial pension obligation and asset value

The actuarial valuations as at December 31, 2001 revealed a consolidated actuarial liability of $10,933 million and a consolidated actuarial asset value of $10,968 million. The results of these valuations were then used to estimate the corresponding figures as at December 31, 2002, which approximate $11,127 million and $11,212 million, respectively, as at that date. The principal components of the change in the pension obligations are the interest accrued on benefits ($706 million in 2002 and $693 million in 2001), benefit payments and transfers ($683 million in 2002 and $655 million in 2001), benefits accrued during the year ($157 million in 2002 and $163 million in 2001), and actuarial loss ($14 million in 2002 and $10 million in 2001). The consolidated actuarial liability was calculated in accordance with the Canadian Institute of Chartered Accountants (CICA) Handbook Section 3461 using a discount rate of 6.5% as at December 31, 2002 and December 31, 2001. The consolidated actuarial asset value is based on a market-related method, which recognizes the change in market value over a period of five years using the straight-line method.

2002 President's Awards for Excellence

Representing a diverse number of functions and locations, and demonstrating an unprecedented ability to work together at all levels, a record number of employees received CN's President's Awards for Excellence in 2002. From across the entire system in both Canada and the United States, they excelled in their efforts to come up with innovative solutions, focus on results, and make a difference at CN and in their communities.

Category: Safety

L.I.F.E. team – *Richard Dare, Benton – Illinois; Scott Lipe – Carbondale, Illinois; Brad Sanders – Centralia, Illinois; Arthur Rapp – Champaign, Illinois; Cathy Cortez, Charles Webster – Chicago, Illinois; Barry Kracht – Duquoin, Illinois; Charles Scholes – Effingham, Illinois; Terry Mason, Michael Mowen – Harvey, Illinois; Paul Adams, Erik Anderson, Larry Anderson, Carol Brinkman, Ronald Ester, David Hall, Bob Keane, Pat Post, Gordon Sharp, David Sprankle – Homewood, Illinois; Kenny Monke – Mattoon, Illinois; Doyle Cowles, Steven Craig, Brian Ott, Joseph Rubino – Waterloo, Iowa; Walter Carlton III, Gary Devall – Baton Rouge, Louisiana; Frank Elkins Jr. – New Orleans, Louisiana; Jeffrey Roberts – Detroit, Michigan; Terry Tindol – Battle Creek, Michigan; John Geary Jr., William Lustig, Ray Townley – Flat Rock, Michigan; Larry Bancroft, Jim McMahon, Ron Merrow – Pontiac, Michigan; David Hayslip, Robbie Harman – Troy, Michigan; William Chesteen – Grenada, Mississippi; Winky Freeman, Johney Grayson Jr., Randy Harris, Michael Strange – Jackson, Mississippi; Bennie Punchard – McComb, Mississippi; Joseph Baroni, Tarie Smith, Michael Wells – Memphis, Tennessee*

This 47-member union/management team takes its name – L.I.F.E. (for Live Injury-Free Everyday) – to heart, demonstrating an unwavering commitment to railroad safety, a top priority at CN. Representing all occupations, they revised the existing safety rule books from different organizations within CN's U.S. operations and developed an innovative safety initiative that moves away from more traditional approaches to implementing railroad safety processes and procedures. Their original solution uses a number of creative methods such as peer coaching.

Norman J. Witzell – Surrey, British Columbia

Constable Witzell is a man with a mission: spreading CN's message of rail safety to every corner of British Columbia. He goes above and beyond the normal call of duty and leaves nothing out in fulfilling his role as Community Services Officer, which he conducts based on a comprehensive action plan.

Category: New Business Opportunities

Air Canada Jet Fuel team – *Patrice Déry – Charny, Quebec; Mike A. Corr, Dave Howett – Concord, Ontario; Ron L. Borden – Mississauga, Ontario; Janet A. Drysdale, Carmino Russo – Montreal, Quebec*

These team members put their heads together to come up with a non-traditional and innovative approach to improving customer service. The result was a much quicker turnaround time for transporting jet fuel for Air Canada.

NSC Minerals – *Marc Arnaud, Tim Cowieson, Barry Pellerin – Saskatoon, Saskatchewan; Greg Kendall, Gary Parbery – Winnipeg, Manitoba*

A "cold call" from a Transportation officer was the initiative that got the ball rolling with NSC Minerals. With follow-up efforts from these team members, it led to bringing the company on board as an important new customer and transportation partner. The results: significant benefits to CN annually.

Category: Customer Focus

Judy Amato – Flat Rock, Michigan

Judy's passion for customer service is what prompted her client, Ford, to nominate her for the President's Award. In fact, Judy's contribution has helped both Ford and CN. One of her many client-focused initiatives helped Ford save on costs by using rail instead of trucking.

White Pine Team – *Douglas Webster – Chicago, Illinois; Jeff Brazeau, Joseph Dennis, Jim Firkus, James Waitanek – Ironwood, Michigan; Brad Koenig – Fond du Lac, Wisconsin; Jack Bratanich, Kenneth Feucht, Albert Hoecherl, Gerard Jiskra, Lyle Nelson, Randy Nichols, Brent Ogle, Wayne Phetteplace, Brian Tucci, Duane Webster – Ladysmith, Wisconsin; Dan Hampston, Ronald Lake, Fred Nafey, John Wickersham – Mellen, Wisconsin; William Lange, James Mabie Sr. – Prentice, Wisconsin; Gary Bright – South Range, Wisconsin; Frederick Bandt, Brad Dupee, Thomas Helton, Gary Hoffman, Richard Hoffman, James Peterson, Corey Quante, Brian Retzlaff – Stevens Point, Wisconsin*

This team jumped into action during an emergency last April. It was their quick thinking and combined efforts that prevented White Pine Copper Refinery from having to shut down when it was threatened by flooding. The consequences of the measures they took were impressive: White Pine avoided substantial losses in delayed deliveries and lost production.

Category: People Leadership

Denny Duncan – Mattoon, Illinois

Denny is a true role model for his staff. A dedicated manager who takes pride in his work, he is a good listener who is open to innovation, comments and suggestions. Even in extreme weather conditions, the teams he leads complete their work on schedule and under budget. And safety is always a priority in Denny's book; his bridge gangs have not had one reported injury since he took over in 1999.

Category: Cost Effectiveness

Research and Development team – *Helga Audet, Hani Bazerghi, Carla D'Alessandro, Deanna Derocher, Stephen Desabrais, John Edwards, Claude Essiembre, Linda Feudi, Greg Hickson, Stella Karnis, Farveh Momayezzadeh, Bob S. Moore, Susan Parker, Anshu Pathak, Dan Toy, Bob White, Walter Zanelli – Montreal, Quebec; Timothy Keegan – Edmonton, Alberta*

Using creativity, this cross-functional team contributed to improving CN's bottom line. They worked together to access Canadian federal and provincial R&D tax incentives arising from CN's investments in innovation in the areas of Systems, Transportation, Engineering, Environment and Safety. The new process they introduced is generating substantial benefits for CN now and into the future.

Category: Operational Breakthrough

B&S Gang no. 70 – *Doug Bainbridge, Jeff Beaudry, Mike Faubert, Rick Fortier, Don Hicks, Luc Labonté, Liduino Medeiros, Ken Payne, Todd Schell, Ernie Simard, Hank Vanstraten, Robert Zadow – Capreol, Ontario*

Working together, the members of this team – from field supervisor to the cook on the gang – proved that a revolutionary new procedure results in significant savings. They delivered exceptional performance in the execution of an innovative new method of bridge stringer replacement that completely transforms the traditionally labor-intensive, time-consuming task.

WC/BLE Labor Negotiating Team – *Jack Gibbins – Chicago, Illinois; Roger MacDougall – Rosemont, Illinois; Jeff Bochman – Fond du Lac, Wisconsin; John Reynolds – Green Bay, Wisconsin; Bill Grimstad, Allan Rothwell, Ed Terbell – Stevens Point, Wisconsin*

IC/BLE Labor Negotiating Team – *Myron Becker – Chicago, Illinois; Thomas J. Goodwine – Homewood, Illinois; John P. Kay – Jackson, Mississippi; John Koonce – Memphis, Tennessee*

These teams are responsible for a breakthrough in labor/management relations in the United States. The new agreements reached between Wisconsin Central and the Brotherhood of Locomotive Engineers (BLE) and between Illinois Central and the BLE simplify and modernize both the language of the contracts and the nature of the employment relationship between employees and the company, and improve the employees' quality of life.

Category: Bravery/Exceptional Community Service

James Jones – Detroit, Michigan (now retired and living in Myrtle Beach, South Carolina)

James was honored for an act of bravery that saved a woman's life. He came to the rescue of the elderly and handicapped senior who was trapped in a burning car in a gas station. It was thanks to his heroic act that the woman survived the life-threatening ordeal.

Operation Lifesaver – *Tom Bozyk, Sandra Hamm, Tom Hosfield, Rick Small, Ron B. Smith, Cynthia Stotz – Winnipeg, Manitoba; Don Marquis – Fort Frances, Ontario; Gerald Koopman – North Battleford, Saskatchewan; Hugh Beechy, Greg Smerchynski – Regina, Saskatchewan*

This team performs an important community service through Operation Lifesaver, a program to which they are totally dedicated. Their commitment to this rail industry initiative translates into increased awareness of the dangers of highway/railroad crossings and trespassing on railroad property. Team members work closely together using as many different and imaginative means as possible to get this important message out to their communities.

Category: Diversity

Brent Ballingall – Kamloops, British Columbia

Brent demonstrated his commitment to diversity by taking it upon himself to actively participate in several initiatives for Aboriginal peoples. He attended conferences and workshops, took part in the development of an Aboriginal/CN database on native sites, and was involved in CN's contribution to the construction of the Skeetchestn Pow-Wow arbor.

Judy MacKenzie – Edmonton, Alberta

Judy was singled out for championing diversity in recruiting for seasonal track opportunities. In addition to advertising through TMP Worldwide recruitment services, she directly contacted the employment offices of several local Aboriginal bands. Her actions resulted in the hiring of 55 people, a third of whom represent diverse groups.

Left to right: David G.A. McLean, E. Hunter Harrison, Gilbert H. Lamphere, V. Maureen Kempston Darkes, James K. Gray, Cedric E. Ritchie

Board of Directors (As of December 31, 2002)

David G.A. McLean, O.B.C., LL.D.
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Chairman and
Chief Executive Officer
The McLean Group
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Former Chairman of the Board
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Group Vice-President
General Motors Corporation
and President GM Latin America,
Africa and Middle East
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Former Chairman and
Chief Executive Officer
Canadian Hunter Exploration Ltd.
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Corporate Director and
Former Chairman and
Chief Executive Officer
The Bank of Nova Scotia
Committees: 1, 2, 5, 6, 7

Paul M. Tellier resigned from the Board of Directors on December 31, 2002.

Left to right: Robert Pace, Michael R. Armellino, Edward C. Lumley, Denis Losier, Gordon D. Giffin, Purdy Crawford, Edith E. Holiday, J.V. Raymond Cyr

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President and
Chief Executive Officer
The Pace Group
Committees: 1*, 2, 6, 7

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Committees: 1, 2, 4, 6, 7*

The Honorable
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Committees: 4, 5, 6*, 7

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Assumption Life
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Counsel
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PolyValor Inc.
Committees: 1, 4*, 5, 6, 7

Committees:
1 Audit, finance and risk 2 Corporate governance and nominating 3 Donations 4 Environment, safety and security 5 Human resources and compensation 6 Investment 7 Strategic planning
* denotes chairman of the committee

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Chairman of the Board

E. Hunter Harrison
President and
Chief Executive Officer

Tullio Cedraschi
President and
Chief Executive Officer
CN Investment Division

Les Dakens
Senior Vice-President
People

Sean Finn
Senior Vice-President
Public Affairs,
Chief Legal Officer and
Corporate Secretary

James M. Foote
Executive Vice-President
Sales and Marketing

Keith L. Heller
Senior Vice-President
Eastern Canada Division

Jack T. McBain
Senior Vice-President
Operations

Claude Mongeau
Executive Vice-President and
Chief Financial Officer

Robert E. Noorigian
Vice-President
Investor Relations

Shareholder and investor information

Annual meeting
The annual meeting of shareholders will be held at 10:30 am on Tuesday, April 15, 2003, at the Sheraton Center, Montreal, QC

Annual information form
The annual information form may be obtained by writing to:

The Corporate Secretary
Canadian National Railway Company
935 de La Gauchetière Street West
Montreal, Quebec H3B 2M9

Transfer agent and registrar
Computershare Trust Company of Canada

Offices in:
Montreal, QC; Toronto, ON; Calgary, AB; Vancouver, BC
Telephone: 1-800-332-0095
Fax: 1-888-453-0330
Web: www.computershare.com

Co-transfer agent and co-registrar
Computershare Trust Company of New York
88 Pine Street, 19th Floor
Wall Street Plaza, New York, NY 10005
Telephone: (212) 701-7600 or 1-800-245-7630

U.S. cash dividends
Shareholders wishing to receive dividends in U.S. dollars may obtain detailed information by communicating with:

Computershare Trust Company of Canada
Telephone: 1-800-332-0095

Stock exchanges
Canadian National common shares are listed on the Toronto and New York stock exchanges.

Ticker symbols:
CNR (Toronto Stock Exchange)
CNI (New York Stock Exchange)

Investor relations
Robert Noorigian
Vice-President, Investor Relations
Telephone: (514) 399-0052 or 1-800-319-9929

Shareholder services
Shareholders having inquiries concerning their shares or wishing to obtain information about CN should contact:

Computershare Trust Company of Canada
Shareholder Services
100 University Avenue, 9th Floor
Toronto, Ontario M5J 2Y1
Telephone: 1-800-332-0095
Fax: 1-888-453-0330
Email: caregistryinfo@computershare.com

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935 de La Gauchetière Street West
Montreal, Quebec H3B 2M9

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