

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Foreign Exchange Risk

Although CP conducts business primarily in Canada, a significant portion of its revenues, expenses, assets and liabilities including debt are denominated in U.S. dollars. The value of the Canadian dollar is affected by a number of domestic and international factors, including, without limitation, economic performance, and Canadian, U.S. and international monetary policies. Consequently, the Company's results are affected by fluctuations in the exchange rate between these currencies. In 2021, CP expects that every \$0.01 weakening (or strengthening) of the Canadian dollar relative to the U.S. dollar, positively (or negatively) impacts Total revenues by approximately \$27 million (2019 – approximately \$30 million), negatively (or positively) impacts Operating expenses by approximately \$14 million (2019 – approximately \$15 million), and negatively (or positively) impacts Net interest expense by approximately \$3 million (2019 – approximately \$3 million) on an annualized basis.

CP uses U.S. dollar-denominated debt to hedge its net investment in U.S. operations. As at December 31, 2020, the net investment in U.S. operations is less than the total U.S. denominated debt. Consequently, FX translation on the Company's undesignated debt and lease liabilities causes additional impacts on earnings in Other income.

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

Share Price Impact on Stock-Based Compensation

Based on information available at December 31, 2020 and expectations for 2021 grants, for every \$1.00 change in share price, stock-based compensation expense has a corresponding change of approximately \$0.4 million to \$0.6 million (2019 – approximately \$0.4 million to \$0.6 million). This excludes the impact of changes in share price relative to the S&P/TSX 60 Index, the S&P/TSX Capped Industrial Index, the S&P 1500 Road and Rail Index, and to Class I railways, which may trigger different performance share unit payouts. Stock-based compensation may also be impacted by non-market performance conditions.

Additional information concerning stock-based compensation is included in Item 8. Financial Statements and Supplementary Data, Note 23 Stock-based compensation.

Interest Rate Risk

Debt financing forms part of the Company's capital structure. The debt agreements entered into expose CP to increased interest costs on future fixed debt instruments and existing variable rate debt instruments, should market rates increase. In addition, the present value of the Company's assets and liabilities will also vary with interest rate changes. To manage interest rate exposure, CP may enter into forward rate agreements such as treasury rate locks or bond forwards that lock in rates for a future date, thereby protecting against interest rate increases. CP may also enter into swap agreements whereby one party agrees to pay a fixed rate of interest while the other party pays a floating rate. Contingent on the direction of interest rates, the Company may incur higher costs depending on the contracted rate.

As at December 31, 2020, CP did not have any floating rate debt obligations outstanding, and therefore fluctuations in interest rates would not have an impact on the Company's financial condition, results of operations, or liquidity.

The fair value of the Company's fixed rate debt may fluctuate with changes in market interest rates. A hypothetical one percent decrease in interest rates as of December 31, 2020 would result in an increase of approximately \$1.5 billion to the fair value of our debt as at December 31, 2020 (December 31, 2019 – approximately \$1.2 billion). Fair values of CP's fixed rate debt are estimated by considering the impact of the hypothetical interest rates on quoted market prices and current borrowing rates, but do not consider other factors that could impact actual results.

Information concerning market risks is supplemented in Item 8. Financial Statements and Supplementary Data, Note 17 Financial instruments.