CANADIAN NATIONAL RAILWAY CO
Form 40-F
March 25, 2005

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 40-F

[ ] REGISTRATION STATEMENT PURSUANT TO SECTION 12 OF THE SECURITIES EXCHANGE ACT OF 1934
OR
[X] ANNUAL REPORT PURSUANT TO SECTION 13(a) OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended: **December 31, 2004** Commission File Number: **1-2413**

CANADIAN NATIONAL RAILWAY COMPANY

(Exact name of registrant as specified in its charter)

Canada	**4011**	**E.I. 980018609**
(Jurisdiction of incorporation or organization)	(Primary Standard Industrial Classification Code Number)	(I.R.S. Employer Identification No.)

935 de La Gauchetiere Street West
Montreal, Quebec
Canada H3B 2M9
(514) 399-7091
(Address, including zip code, and telephone number including area code, of Registrant's principal executive offices)

CT Corporation System
111 Eighth Avenue
New York, N.Y. 10011
(212) 894-8600
(Name, address, including zip code, and telephone number, including area code, of agent for service in the United States)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common shares	**New York Stock Exchange**
	Toronto Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: **None**

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act: **Debentures and Notes (Debt Securities) of Registrant**

For annual reports, indicate by check mark the information filed with this Form:

[X] Annual information form [ ] Audited annual financial statements

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report:

At December 31, 2004, 283,100,722 common shares were issued and outstanding.

Indicate by check mark whether the Registrant by filing the information contained in this Form is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934 (the "Exchange Act"). If "Yes" is marked, indicate the file number assigned to the Registrant in connection with such Rule.

Yes o No x

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

Yes x No o

CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

Canadian National Railway Company's President and Chief Executive Officer (the "CEO") and its Executive Vice-President and Chief Financial Officer (the "CFO"), after evaluating the effectiveness of Canadian National Railway Company's "disclosure controls and procedures" (as defined in Exchange Act Rules 13a-15(e) or 15d-15(e)) as of December 31, 2004 (the "Evaluation Date"), have concluded that as of the Evaluation Date, Canadian National Railway Company's disclosure controls and procedures were adequate and effective and designed to ensure that material information relating to Canadian National Railway Company and its consolidated subsidiaries would be made known to them by others within those entities.

Changes in Internal Control Over Financial Reporting

During the year ended December 31, 2004, there was no change in the Canadian National Railway Company's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, Canadian National Railway Company's internal control over financial reporting.

AUDIT COMMITTEE FINANCIAL EXPERT

The Registrant's board of directors has determined that it has several audit committee financial experts serving on its Audit, Finance and Risk Committee. Mr. Hugh Bolton has been determined to be an audit committee financial expert and is independent, as that term is defined by the New York Stock Exchange's listing standards applicable to U.S. Companies. The SEC has indicated that the designation or identification of Mr. Bolton as an audit committee financial expert does not deem him an "expert" for any purpose, impose any duties, obligations or liability on Mr. Bolton that are greater than those imposed on members of the audit committee and board of directors who do not carry this designation or identification, or affect the duties, obligations or liability of any other member of the audit committee or board of directors.

CODE OF ETHICS

The Registrant has adopted a code of ethics (the "Code of Business Conduct") that applies to all employees and officers, including its principal executive officer, principal financial officer and principal accounting officer. The Code of Conduct is available at the Registrant's Internet website www.cn.ca under the caption "Corporate Governance." Any amendments to the Code of Business Conduct will be posted at the Registrant's Internet website at the address listed above.

PRINCIPAL ACCOUNTANT FEES AND SERVICES

KPMG LLP has served as the Company's auditors since 1992. In 2004 and 2003, fees for audit, audit-related, tax and other services provided to the Company by KPMG LLP were the following:

Year ended December 31,	2004	2003
Audit fees	$2,883,805	$2,326,447
Audit-related fees	546,517	352,028
Tax fees	700,733	928,408
Total	$4,131,055	3,606,883

Pursuant to the terms of its charter, the Audit, Finance and Risk Committee of CN approves all audit services, audit engagement fees and terms and all non-audit engagements with the independent auditor. The Audit, Finance and Risk Committee pre-approved 100% of the services performed by our independent auditors for audit-related and tax fees for the year ended December 31, 2004 that were required to be pre-approved.

A discussion of the nature of the services provided under each category is provided below.

Audit fees

Consists of fees incurred for professional services rendered by the auditors in relation to the audit of the Company's consolidated annual financial statements, those of it's subsidiaries and the Company's pension plan financial statements.

Audit-related fees

Audit-related fees were incurred for attestation services in connection with reports required by statute or regulation and due diligence and other services, including comfort letters, in connection with the issuance of securities. In 2004 and in 2003, these amounts include $275,000 and $245,000 respectively, which were incurred for consultations with respect to Sarbanes-Oxley Act, Section 404 "Report on Internal Controls."

Tax fees

Consists of fees incurred for consultations on cross-border tax implications for employees and tax compliance. 2003 fees also include an amount of $250,000 incurred for research and development tax credit claim.

OFF BALANCE SHEET ARRANGEMENTS

Accounts receivable securitization program

The Company has an accounts receivable securitization program, expiring in June 2006, under which it may sell, on a revolving basis, a maximum of $450 million of eligible freight trade and other receivables outstanding at any point in time, to an unrelated trust. The Company has a contingent residual interest of approximately 10% of receivables sold, which is recorded in Other current assets.

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

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

At December 31, 2004, pursuant to the agreement, $445 million had been sold compared to $448 million at December 31, 2003.

Guarantees and indemnifications

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

Effective January 1, 2003, the Company is required to recognize a liability for the fair value of the obligation undertaken in issuing certain guarantees on the date the guarantee is issued or modified. In addition, where the Company expects to make a payment in respect of a guarantee, a liability will be recognized to the extent that one has not yet been recognized.

Guarantee of residual values of operating leases

The Company has guaranteed a portion of the residual values of certain of its assets under operating leases with expiry dates between 2005 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. At December 31, 2004, the maximum exposure in respect of these guarantees was $97 million, of which $8 million has been recorded. Of that amount, $6 million represents the expected cash outlay for such guarantees, while the remaining $2 million represents the Company's obligation to stand ready and honor the guarantees that were entered into subsequent to January 1, 2003. There are no recourse provisions to recover any amounts from third parties.

Other guarantees

The Company, including certain of its subsidiaries, has granted irrevocable standby letters of credit and surety bonds, issued by highly rated financial institutions, to third parties to indemnify them in the event the Company does not perform its contractual obligations. As at December 31, 2004, the maximum potential liability under these guarantees was $439 million of which $359 million was for workers' compensation and other employee benefits and $80 million was for equipment under leases and other. During 2004, the Company granted guarantees for which no liability has been recorded, as they relate to the Company's future performance.

As at December 31, 2004, the Company had not recorded any additional liability with respect to these guarantees, as the Company does not expect to make any additional payments associated with these guarantees. The guarantee instruments mature at various dates between 2005 and 2007.

CN Pension Plan, CN 1935 Pension Plan and BC Rail Ltd Pension Plan

The Company has indemnified and held harmless the current trustee and the former trustee of the Canadian National Railways Pension Trust Funds, the trustee of the BC Rail Ltd Pension Trust Fund, 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, 2004, the Company had not recorded a liability associated with these indemnifications, as the Company does not expect to make any payments pertaining to these indemnifications.

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 and securitization of accounts receivable; (d) contracts for the acquisition of services; (e) financing agreements; (f) trust indentures, fiscal agency agreements, underwriting agreements or similar agreements relating to debt or equity securities of the Company and engagement agreements with financial advisors; (g) transfer agent and registrar agreements in respect of the Company's securities; (h) trust agreements relating to pension plans and other plans, including those establishing trust funds to secure payment to certain officers and senior employees of special retirement compensation arrangements; (i) master agreements with financial institutions governing derivative transactions; and (j) settlement agreements with insurance companies or other third parties whereby such insurer or third party has been indemnified for any present or future claims relating to insurance policies, incidents or events covered by the settlement agreements. To the extent of any actual claims under these agreements, the Company maintains provisions for such items, which it considers to be adequate. Due to the nature of the indemnification clauses, the maximum exposure for future payments may be material. However, such exposure cannot be determined with certainty.

In 2004 and 2003, the Company entered into various indemnification contracts with third parties for which the maximum exposure for future payments cannot be determined with certainty. As a result, the Company was unable to determine the fair value of these guarantees and accordingly, no liability was recorded. As at December 31, 2004, the carrying value for guarantees for which the Company was able to determine the fair value, was $1 million. There are no recourse provisions to recover any amounts from third parties.

TABULAR DISCLOSURE OF CONTRACTUAL OBLIGATIONS

In the normal course of business, the Company incurs contractual obligations. The following table sets forth the Company's contractual obligations for the following items as at December 31, 2004:

(In millions)	**Total**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010 & thereafter**

Long-term debt obligations (a)	**$ 4,403**	$ 497	$ 308	$ 60	$ 207	$ 363	$ 2,968
Capital lease obligations (b)	**1,103**	113	106	130	52	93	609
Operating lease obligations	**992**	206	194	146	116	90	240
Purchase obligations (c)	**212**	191	10	5	3	3	-
Total obligations	**$ 6,710**	**$ 1,007**	**$ 618**	**$ 341**	**$ 378**	**$ 549**	**$ 3,817**

(a) Presented net of unamortized discounts, of which $838 million relates to non-interest bearing notes due in 2094 assumed as part of the BC Rail acquisition and excludes capital lease obligations of $761 million which are included in Capital lease obligations.

(b) Includes $342 million of imputed interest on capital leases at rates ranging from approximately 2.23% to 13.13%.

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

For 2005 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.

IDENTIFICATION OF THE AUDIT COMMITTEE

The Registrants audit committee is composed of the following directors: Robert Pace (Chair), Michael R. Armellino, A. Charles Baillie, Hugh J. Bolton, J.V. Raymond Cyr, James K. Gray, Edith E. Holiday, Gilbert H. Lamphere, and Denis Losier.

CORPORATE GOVERNANCE PRACTICES

The Registrants board of directors has also reviewed the Registrants corporate governance practices in response to the U.S. Sarbanes-Oxley Act of 2002, applicable rules of the U.S. Securities and Exchange Commission, as well as the NYSE Corporate Governance Standards (the NYSE Standards). The board of directors will continue to review its corporate governance practices on an ongoing basis in response to the evolving standards. The Registrants corporate governance does not differ significantly from that followed by U.S. domestic companies under the NYSE Standards. A discussion of differences is available at the Registrants Internet website, www.cn.ca under the caption Corporate Governance.

UNDERTAKING

Registrant undertakes to make available, in person or by telephone, representatives to respond to inquiries made by the Commission staff, and to furnish promptly, when requested to do so by the Commission staff, information relating to the securities in relation to which the obligation to file an annual report on Form 40-F arises.

2004

ANNUAL INFORMATION FORM

March 24, 2005

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ITEM 1 INCORPORATION

1.1 INCORPORATION OF THE ISSUER

Canadian National Railway Company (“CN” or the “Company”) was incorporated in 1922 by special act of the Parliament of Canada. CN’s continuance under the *Canada Business Corporations Act* was authorized by the *CN Commercialization Act* and was effected by Certificate of Continuance dated August 24, 1995. On November 9, 1995, CN filed Articles of Amendment in order to subdivide its outstanding Common Shares. As of November 28, 1995, CN ceased to be a Crown corporation. On April 19, 2002, CN filed Articles of Amendment in order to provide that shareholder meetings may be held at certain specified places in the United States.

The Company’s registered and head office is located at 935 de La Gauchetière Street West, Montreal, Quebec, H3B 2M9, Canada, and its telephone number is (514) 399-5430.

All references in this Annual Information Form (“AIF”) to “dollars” or “$” are to Canadian dollars and all financial information reflected herein is determined on the basis of, and prepared in accordance with United States generally accepted accounting principles (“U.S. GAAP”), unless otherwise indicated.

The information in this Annual Information Form includes the railroad and related holdings of Great Lakes Transportation LLC (“GLT”) as of May 10, 2004 and BC Rail as of July 14, 2004.

This AIF contains or makes reference to Non-GAAP measures that do not have any standardized meaning prescribed by GAAP and are therefore not necessarily comparable to similar measures presented by other companies and as such, should not be considered in isolation. Management believes free cash flow to be a useful measure of performance as it demonstrates the Company’s ability to generate cash after the payment of capital expenditures and dividends. Schedule A attached to this AIF provides a reconciliation of this non-GAAP measure to comparable U.S. GAAP measures.

1.2 SUBSIDIARIES

CN’s principal subsidiaries as of December 31, 2004, all of which are wholly owned (directly or indirectly), and their jurisdiction of incorporation, are indicated below:

Name	Jurisdiction of incorporation
Grand Trunk Corporation	Delaware
Illinois Central Corporation (“IC” or “Illinois Central”)	Delaware
Illinois Central Railroad Company (“ICRR”)	Illinois

The financial statements of each of the above principal subsidiaries are consolidated within CN’s financial statements.

ITEM 2 GENERAL DEVELOPMENT OF THE BUSINESS

2.1 OVERVIEW

As of December 31, 2004, CN operated approximately 12,900 route miles in eight Canadian provinces and 6,400 route miles in sixteen U.S. states totaling approximately 19,300 route miles with principal routes to every major metropolitan area in Canada and to the major U.S. rail hubs of Buffalo, Detroit, Duluth/Superior, Minneapolis/St. Paul, Chicago, St. Louis, Jackson, Memphis, New Orleans, Baton Rouge and Mobile. The Company is North America's only transcontinental railroad, and Canada's largest railroad serving all five major Canadian ports on the Atlantic and Pacific oceans and the Great Lakes as well as New Orleans on the Gulf of Mexico.

The Company's revenues derive from the movement of a diversified and balanced portfolio of goods. In 2004, no single commodity group accounted for more than 22% of revenues. The sources of revenue also reflect a balanced mix of destinations. In 2004, 23% of revenues came from U.S. domestic traffic, 34% from transborder traffic, 23% from Canadian domestic traffic, and 20% from overseas traffic.

CN originated approximately 85% of traffic moving along its network in 2004. This allowed the Company both to capitalize on service advantages and to build on opportunities to efficiently use assets.

2.2 GENERAL DEVELOPMENT OF THE BUSINESS DURING THE LAST THREE YEARS

CN's financial performance, when measured on the basis of profit margin, balance sheet strength and free cash flow performance, has been amongst the best in the industry since 1999. To maintain that position, CN has focused on strategies to grow the business profitably. Profitable growth is driven by high-quality service that meets customer needs and the relentless pursuit of productivity to contain and reduce its cost base. At CN, the ultimate goal is to achieve sustainable financial performance.

2.2.1 Growth

CN's revenues have increased from a level of $3.9 billion in 1995, the year in which it was privatized, to $5.65 billion in 2001 and $6.5 billion in 2004. This has resulted from a combination of organic growth and well-executed acquisitions.

Revenues for 2004 were up 11% compared to 2003. This improvement reflected solid growth in the base business and the addition of two companies to the CN organization through acquisitions, namely the railroad and related holding of GLT in the United States during May 2004 and BC Rail in Canada during July 2004. Excluding the conversion impact of a stronger Canadian dollar – approximately $255 million - on U.S. dollar-denominated revenues, CN's revenues were up 16% compared to 2003, showing growth across the business.

CN's strategy of extending reach and providing service to North American customers was launched when it took control of IC in 1999. The acquisition of Wisconsin Central Transportation Corporation ("WC") in 2001 was another key step in increasing CN's ability to offer seamless service in the North American Free Trade Agreement ("NAFTA") market. The addition of GLT and BC Rail has allowed CN to extend its reach even further.

The acquisition of GLT strengthens CN's position in the steel industry, in addition to driving new efficiencies in the network by giving the Company ownership of an essential link in the important Chicago-Western Canada corridor. The Company received all necessary regulatory approvals, including the U.S. Surface Transportation Board ("STB") ruling by April 2004, and it assumed control of GLT on May 10, 2004.

The acquisition of BC Rail, which included all of the issued and outstanding shares of BC Rail Ltd., the partnership units of BC Rail Partnership ("BC Rail"), and the right to operate over BC Rail's roadbed under a long-term lease, was completed on July 14, 2004. The acquisition extends CN's business reach in Western Canada and is expected to open up growth opportunities in the Company's already solid forest products franchise. It represents a good network fit and allows CN to offer seamless service to all its customers in the Province of British Columbia.

CNs revenue growth in 2004 has already illustrated some of the opportunities coming from GLT and BC Rail. It also reflected a good economy, particularly in the U.S., and a rebound in Canadian grain production following two poor crop years, 2001-02 and 2002-03. Ultimately, CNs growth in 2004 was driven by its ability to improve revenue yield through quality service and a solid relationship with customers.

2.2.2 Service

CN understands that the best way to increase shareholder value is to create value for its customers. The purpose of CNs service plan, which was originally introduced in 1998, is to put the tools in place to deliver the quality and reliability of service that customers require. Under the plan, CN runs regularly scheduled trains that leave at predetermined times. Each car or container has a specific trip plan that fits into the design of the train schedule.

CNs success in the implementation of the service plan is seen in the performance of traffic compared to the trip plans set for each shipment on each day, with a very tight window of compliance. CN believes its success in growing traffic and improving yield would not be possible without the quality of service afforded by precise execution of the service plan.

The largest portion of CNs capital expenditures is focused on rail infrastructure to maintain the quality and enhance the fluidity of the network, and to provide safe, reliable service to customers across the U.S. and Canada. In the last three years, CN has spent in excess of $600 million per year in this respect. CNs investments to expand capacity through siding extensions and improved signaling have also been substantial during the last 3-4 years. This has been and will continue to be a major factor allowing CN to grow the business without the service or the capacity problems recently experienced by other railroads.

Quality service also equates to providing quality equipment, including both cars and locomotives. The Company acquired 90 new high-horsepower units in the last three years and made targeted investments to improve the car fleet. Going forward, CN intends to step up its acquisition of cars in order to offer the quality and equipment characteristics that customers need in the marketplace.

For CN, service also entails ease of doing business. Major efforts have been and are being made in this regard, such as the emphasis on pro-active account management and the availability of a product catalogue providing the sales force with the details of CNs service offering. CN has expanded its local sales force to ensure a more effective interface with its customer base. Over the past several years, CN has been working to improve its interface with customers by enhancing its ebusiness capabilities.

The most recent effort to improve service and the ease of doing business with CN, is the creation of a Service department within the Sales and Marketing groups. The Service department is designed to provide a new level of responsiveness to customer needs, help them to quickly resolve issues beyond normal shipment tracking and transactional questions. CN service professionals have the tools and authority to coordinate solutions across the CN system, working with customers to identify new avenues for faster and more consistent problem resolution.

In 2004, CN continued to expand its routing protocol initiative, announcing a series of agreements with CNs U.S. interline partners. The agreements established a structured plan to direct rail traffic flows through the most efficient interchange locations. This will improve transit times and asset utilization. Traffic is expedited by reducing the number of handlings, shortening routes and avoiding the most congested gateways.

Shippers value quality service because it allows them to better plan production schedules and inventory levels, reduce distribution costs, and deal reliably with their own customers. With the quality of service that CN offers, the

Company is confident that it has built a solid base on which to grow its business and continue to improve yield in the future.

2.2.3 Productivity

CNs focus on profitable, top-line growth implies a relentless pursuit of efficiency and productivity improvements in all aspects of the business and in all corners of the organization. With an asset-intensive business, one of CNs top priorities is to constantly improve asset utilization in the network, the yards, and the terminals. The service plan plays a central role in the pursuit of better asset utilization. It allows CN to simultaneously improve the quality of service and the productivity of assets.

The reliability that is now achieved at CN has opened a whole new perspective on the intermodal business. Generally characterized by highly uneven traffic flows on different days of the week, intermodal traffic traditionally generates significant asset requirements for railways to meet peak demand. With the ability to deliver as promised each and every day, a high level of reliability is allowing CN to smooth out traffic, improve the management of capacity on a daily basis, and grow intermodal margins through its Intermodal Excellence (IMX) program. The success of IMX in smoothing the traffic with better capacity management throughout the week is now being carried over to the carload business, putting a new major emphasis on 7/24 service and week-end business.

The pursuit of efficiency and productivity has also been enhanced thanks to new and innovative agreements with several labor unions representing running trades employeeslocomotive engineers, conductors and brakemenin the U.S. The agreements change the method of pay to hourly wages, giving CN the flexibility to run trains based on the needs of the customer and not on antiquated mileage rules, in return for a predictable work schedule, improved job security and higher pay.

Productivity improvements are also being pursued through the implementation of the latest information technology. Over the past several years, CN has implemented a new SAP enterprise system, a powerful integrated software application. After the completion of the third phase of the implementation of SAP in 2002, CN had replaced more than 70 fragmented mainframe component systems. During 2003, CN continued its implementation of the SAP system on the former WC. The Company has applied the same careful step-by-step systems integration on the former GLT which was cut over to SAP in January 2005, and it is expected that the SAP system will be implemented on the former BC Rail property by the end of the second quarter of this year. With such tools, new savings opportunities can be identified, to an extent that was not previously possible, across all functions of the railroad, including transportation, mechanical and engineering.

In an ongoing effort to improve labor productivity, the Company has streamlined the organization. In that context, the Company recorded a charge of $120 million in 2002 for workforce reductions. During the last two years and particularly in 2004, the largest gains in productivity were obtained through cost containment and the absorption of volume growth with existing assets and trains. For example, trainload as measured by GTMs per train mile increased 6% in 2004 compared to 2003.

2.2.4 Sustainable Financial Health

Over the last three years, CN has continued to improve its financial performance. In spite of a severe drought in Canada and continued economic uncertainty, the Company managed to post solid earnings in 2002 and 2003. During 2004, the financial improvement was substantial. Net income was $1,258 million, up 24% compared to 2003.

CN continues to be an industry leader in free cash flow generation. In 2004, CN produced $1,025 million of free cash flow1, reaching 16% of revenues, compared to $443 million or approximately 8% of revenues in 2001. The improvement in free cash flow continued while CN increased its dividend to shareholders for the eighth consecutive year. An additional increase in the dividend was announced in January 2005.

The Company is constantly seeking ways to improve cash flow through increased earnings, better asset utilization, tighter control of working capital, and the monetization of surplus assets. In 2002, CN sold Tranz Rail Holdings Inc. in New Zealand and Australian Transport Network Limited in Australia for aggregate net proceeds of $69 million. CN also sold IC Terminal Holdings Company, a U.S. subsidiary of IC in 2002 for $28 million. In 2004, CANAC Inc. and Beltpack Corporation, subsidiaries of CN involved in railroad operations consulting services and remote control locomotive technology respectively, were sold for net proceeds of $52 million.

In January 2004, the shareholders of English Welsh & Scottish Railway Holdings Limited (EWS), a company which provides rail services in the United Kingdom, approved a plan to reduce the EWS share capital by offering shareholders the ability to cancel a portion of their EWS shares. CN elected to have the maximum allowable number of shares cancelled under the plan, thereby reducing its ownership interest in EWS to approximately 31% on a fully diluted basis. CN received £57.7 million ($141 million) in cash and an 8% note receivable due in 2009 of £23.9 million ($58 million) from EWS.

Given strong free cash flow and a solid balance sheet, CNs Board of Directors authorized a share repurchase program over the course of one year beginning in October 2002 at prevailing market prices. That program was completed in September 2003, with 19.5 million common shares repurchased at a total cost of $859 million at an average price per share of $44.04, adjusted for the three-for-two common share split which occurred in February 2004. The Board authorized a new program beginning in November 2004, allowing for the repurchase of up to 14

1 See Schedule A of the AIF for a reconciliation of this non-GAAP measure.

million common shares over a one-year period. By December 31, 2004, a total of 4.0 million shares had been repurchased for $273 million at an average price per share of $68.31.

CNs ultimate goal is to achieve sustainable financial health through the ups and downs of the business environment. This means generating solid earnings on an ongoing basis, but also solid free cash flow, after payment of capital expenditures and dividends.

ITEM 3 NARRATIVE DESCRIPTION OF THE BUSINESS

3.1 CORPORATE ORGANIZATION

In order to foster accountability for results, while bringing responsibility closer to the line of sight, CN is organized along the following lines. All activities which require company-wide controls are centred at the corporate level. Overall planning and control of infrastructure and rolling assets are the responsibility of the Network Operations department. Overall responsibility for marketing strategy and planning, revenue forecasting and account management for large customers lies with the Sales and Marketing departments. All activities related to corporate support functions, including human resources, financial planning and budgeting, information technology, treasury operations, public affairs, accounting, and legal support, are the responsibility of CNs headquarters departments.

All activities focused on the ability to meet day-to-day service requirements and cost control, and on growing local accounts, are the purview of CNs Regions. The Regions, as of December 31, 2004, are described as follows:

- **Western Canada Region**

The Western Canada Region, headquartered in Edmonton, Alberta, extends from Thunder Bay and Armstrong in northwestern Ontario to the Pacific Ocean. The Region operates approximately 8,400 route miles of track including approximately 1,400 route miles of track from the purchase of BC Rail. The Western Canada Region serves the Port of Vancouver, the inland port of Thunder Bay and is the exclusive rail link to Prince Rupert, the closest North American port to Northeast Asia. CNs Western Canada Region carries bulk export commodities such as grain and fertilizers, coal, potash and sulfur, as well as forest products, petroleum and chemicals, and intermodal destined for international and domestic markets.

- **Eastern Canada Region**

The Eastern Canada Region, headquartered in Toronto, Ontario, extends east from Armstrong in northwestern Ontario to the Atlantic Ocean, and from Chibougamau, Quebec south to the Ontario-Michigan border. The Region operates approximately 4,500 route miles of track and serves the ports of Montreal, Saint John, New Brunswick and Halifax. The principal commodities carried by the Region are automotive, intermodal, ferrous and non-ferrous metals, petroleum and chemicals and forest products.

- **United States Region**

The United States Region, headquartered in Homewood, Illinois, extends from International Falls just south of Fort Francis, Ontario, to Chicago, Illinois then on to New Orleans on the Gulf of Mexico, and from Minneapolis and St. Paul, Minnesota to Sault Ste. Marie, Michigan, and from Sioux City, Iowa and Omaha, Nebraska heading east to Port Huron and Detroit, Michigan. The United States Region operates approximately 6,400 route miles of track including 353 route miles of track from the purchase of the GLT. The United States Region serves the Gulf ports of Mobile, Alabama and New Orleans and the river ports of Memphis, Tennessee and Baton Rouge, Louisiana. Major commodities transported include automotive, intermodal, iron and steel, petroleum and chemicals, forest products, coal, fertilizers and grain. The Region interchanges traffic with Kansas City Southern Railroad (KCS) at Jackson, Mississippi, as part of the marketing alliance that provides CN customers access to Mexico and the U.S. Southwest. With connections in Chicago and other locations to all North American Class 1 carriers, the United States Region serves as a critical link for the Companys NAFTA strategy.

3.2 COMMODITY GROUPS

In April of 2004, CN announced a new management structure for its Sales and Marketing departments that eliminated, with the exception of bulk commodities, the business unit structure in favour of a consolidated Sales department and a consolidated Marketing department, each under its own vice-president, reporting in turn to CNs Executive Vice-President, Sales and Marketing. This new structure will allow CN to streamline and standardize traditional, and often antiquated, sales and marketing business activities across the system and fully leverage CNs electronic business capabilities.

In the new structure, sales activities previously in the business units have been consolidated into the Sales department. The coal and grain business units in Canada and the United States were consolidated into a single group for bulk commodities. Similarly, marketing activities previously performed in the business units are now consolidated into the Marketing department. At the same time, the regional sales structure will remain in place. This innovative, geographically-based sales force is primarily responsible for developing new customers and managing customers whose activities are limited to one of CN□s operating Regions. The regional sales force will continue to report directly to each respective regional senior vice-president.

The following table sets forth revenue and carload information by commodity group for each of the years in the three-year period ended December 31, 2004:

	Rail Operating Revenues			**Carloads**			**Freight Revenue per Carload**		
	2004	2003	2002	2004	2003	2002	2004	2003	2002
	(In million $)			(In thousands)			(In $)		
Petroleum and Chemicals	1,123	1,058	1,102	637	604	587	1,763	1,752	1,877
Metals and Minerals	713	527	521	809	396	388	881	1,331	1,343
Forest Products	1,452	1,284	1,323	653	594	600	2,224	2,162	2,205
Coal	284	261	326	486	471	499	584	554	653
Grain and Fertilizers	1,053	938	986	572	548	535	1,841	1,712	1,843
Intermodal	1,117	1,101	1,052	1,202	1,276	1,237	929	863	850
Automotive(1)	510	525	591	295	288	307	1,729	1,823	1,925
Other(2)	296	190	209	n/a	n/a	n/a	n/a	n/a	n/a
Total	**6,548**	**5,884**	**6,110**	**4,654**	**4,177**	**4,153**	**1,343(3)**	**1,363**(3)	**1,421**(3)

(1) *Restated to reflect changes to estimated statistical data previously reported.*

(2) *Principally non-freight revenues derived from third parties.*

(3) *Total Freight Revenues per Carload is calculated by subtracting Other Rail Operating Revenues from Total Rail Operating Revenues and dividing the result by the Total Carloads.*

The following describes the various commodity groups transported by CN:

3.2.1 Petroleum and Chemicals

The Petroleum and Chemicals commodity group includes a wide range of commodities which can be divided into the following categories: chemicals, representing 43% of the commodity group□s revenues in 2004, and plastics, sulfur, petroleum and gas products, representing 57%.

Although off-shore markets have been growing strongly, the primary markets are still within North America, and the business is closely correlated with the North American economy. The consolidation and rationalization of industrial production facilities have resulted in increased rail-based business opportunities in both the Canadian and U.S. markets.

This group of commodities is a strong originator of traffic. CN has access to northern Alberta, a major center for natural gas, feedstock and world scale petrochemicals and plastics complex derivatives, as well as the Oil Sands development. The Company also enjoys access to the low-cost Louisiana petrochemical corridor between New Orleans and Baton Rouge and a large number of Eastern Canadian regional plants. CN provides a highly efficient route to the large consuming areas in the Midwest and Northeast of the United States.

3.2.2 Metals and Minerals

The Metals and Minerals commodity group comprises metals, representing 55% of the commodity group's revenues in 2004, equipment and parts, and construction materials, representing 24%, and iron ore, representing 21%. CN's unique rail access to major mines, ports and smelters makes it a transportation leader of copper, lead, zinc concentrates, iron ore, steel and aluminum. Copper and zinc commodities, such as ores, concentrates and anodes are produced in northern Quebec, Ontario and Manitoba. The commodities are shipped to refineries for further processing and then shipped to manufacturers of finished goods.

Major producers of steel, primarily in Ontario and the U.S. Midwest, ship their products throughout North America and Mexico. Such products are mainly used in the automotive and construction industries.

Construction materials are mainly aggregates (stone and sand) and cement. CN enjoys access to major cement producers and aggregate mines in Canada as well as in the U.S.

CN's Metals and Minerals traffic is sensitive to fluctuations in the economy. CN serves a variety of major industries along its network and has the most direct route to the Ports of New Orleans and Mobile from the Midwest, as well as an efficient route into Mexico via its marketing alliance with KCS.

3.2.3 Forest Products

CN is the largest rail carrier of forest products in North America. CN has superior rail access to the Western and Eastern Canadian fiber-producing regions, which are among the largest fiber source areas in North America. This geographic position, coupled with CN transload facilities, allows CN's customers to take full advantage of the rail offering and extend their reach to new markets. CN serves customers that are leaders in all areas of forest products.

The Forest Products commodity group consists of four major commodity segments: lumber accounted for 33% of the commodity group's revenues in 2004, fibers 29%, paper 26%, and panels 12%.

The key drivers for newsprint are advertising lineage and overall economic conditions, primarily in the U.S. Housing starts and renovation activities in the United States are the key drivers for the lumber and panels traffic.

The ability to provide consistent, reliable service gives railroads the opportunity to convert traffic from truck to rail. Although demand for forest products tends to be cyclical, CN believes that its geographical advantages and product diversity tend to reduce the impact of market fluctuations. CN's scheduled service offering and guaranteed car order program have also been significant contributors to growing CN traffic.

3.2.4 Coal

Of the coal traffic moved by CN in 2004, 31% originated in Canada and 69% in the United States, with coal providing 82% of revenues and petroleum coke 18%.

CN's coal business consists primarily of thermal grades of bituminous coal. Canadian thermal coal is delivered to power utilities primarily in Eastern Canada. In the United States, shipments of U.S. thermal coal are transported from

mines served in southern Illinois, or from western U.S. mines via interchange with other railroads, to major utilities in the Midwest and southeast United States. CN's origin base continues to shrink as more industrial receivers look to Powder River Basin (PRB) coal as their primary energy source due to its low sulfur content, which is more environmentally compliant. As more PRB coal moves into these markets, however, CN has been able to aggressively market seamless service options through connections with western rail carriers. This strategy has allowed CN to stabilize volumes and target growth areas.

The coal business also includes Canadian metallurgical coal, which is generally exported to steel makers in Japan and other Asian markets from three coal terminals in British Columbia. Reversing the recent trend of declining Canadian production, the strong market for metallurgical coal facilitated the opening of three mines along the CN network in 2004. The improvement in this market is expected to continue as strong Asian demand for metallurgical coal is driving increased Canadian production.

3.2.5 Grain and Fertilizers

This commodity group depends primarily on crops grown and fertilizers processed in Western Canada and the U.S. Midwest. Of the grain traffic moved by CN in 2004, 70% originated in Canada, almost all in the west, and 30% in the United States.

The grain segment, which represents 75% of the commodity group's revenues, consists of three primary commodities: food grains, mainly wheat, representing 38% of the grain segment's revenues in 2004; oilseeds and oilseed products (primarily canola seed, oil and meal, and soybeans), 32%; and feed grains (including feed barley, feed wheat and corn), 30%.

The vast majority of the grain produced in Western Canada is exported. Production of grain in Canada varies considerably from year to year, affected primarily by weather conditions. Grain exports are highly volatile, reflecting the size of the crop produced, international market conditions and foreign government policy. Most of the Western Canadian grain destined to offshore markets is moved to the ports of Vancouver, Prince Rupert, B.C., or Thunder Bay, Ontario. Both major Canadian railroads, CN and Canadian Pacific Railway, operate branch lines and mainlines by which grain is moved from primary elevators to terminals at the ports of Vancouver and Thunder Bay. The port of Prince Rupert is served solely by CN. The principal offshore markets for Canadian grain are in the Pacific Rim and in the Middle East. CN also moves grain rail-direct into the domestic U.S. and into the Mexican market.

In the U.S., the CN rail system is well positioned in the heart of the grain-producing territory. Two of the states in which CN has direct access, Illinois and Iowa, have had historically the largest annual production of corn and soybeans. This allows CN to serve large grain processors in Illinois, Iowa, Tennessee, and Mississippi. Other domestic grain movements are to the poultry feeder markets in the southeastern United States, which rely on corn for feed. Exports of grain and grain products represent another market for CN due to its access to major export facilities on the Mississippi River and the Gulf of Mexico.

Some of the world's largest grain companies have processing plants located on the CN system. As a result, much of the grain traffic in which CN participates involves the movement of grain products that are produced and then shipped to other receiver markets. Soybean meal, corn gluten feed, vegetable oils, corn syrups and starches are some of the products moved by CN.

Fertilizers and potash represent 25% of this commodity group's revenues. CN is a significant player in the Canadian rail market for nitrogen-based fertilizers, with production centered primarily in Western Canada. CN serves or has access to all major potash mines in Saskatchewan, the center for Western Canadian production. CN also serves a major production facility on Canada's east coast. Virtually all Canadian potash moves by rail to markets in the U.S. or overseas.

In the United States, CN serves producers of various types of fertilizers, including nitrogen solutions, ammonium nitrate, urea and phosphate fertilizers. U.S. and Canadian fertilizer production is heavily impacted by the price of natural gas that is a main raw material for most fertilizer production. When gas prices are high, many of the local producers reduce production. At the same time, however, imports can become more competitive and CN is positioned to handle this business through access to Gulf ports in Louisiana.

3.2.6 Intermodal

This commodity group is comprised of the following two segments:

Domestic, which represented 52% of the commodity groups revenues in 2004, includes domestic Canada, transborder, Mexico and domestic U.S. traffic. Domestic provides intermodal services through a number of channels in which services are retailed directly to beneficial owners of freight, and wholesaled to motor carriers, intermodal marketing companies, third-party logistics companies, and other transportation intermediaries. The Domestic segment is driven by consumer markets, with market growth generally expected to be tied to the economy. The service is market-driven and very competitive with the trucking industry. The segments focus is to define its services as truck competitive and cost-effective.

International, which represented 48% of the Intermodals revenues in 2004, transports import/export container business on behalf of ocean carrier companies. Within Canada, CN ships from/to the ports of Vancouver, Montreal, St. John and Halifax. In the United States, CN ships from/to the ports of New Orleans and Gulfport and via rail connections at Chicago and Detroit to both the U.S. East and West Coast ports. Key growth markets for the international segment have been between the ports of Vancouver and Montreal and locations in the Midwest. Connections with other Class 1 railways in Chicago have further extended the reach of CNs international business into the U.S. Southeast. The international segment is driven mainly by North American economic conditions and shifting trade patterns between countries.

In 2004, CN continued to reap the benefits of its IMX program to smooth traffic flows, increase speed and reliability, and improve asset utilization and margins. IMX applies the discipline and precision of scheduled railroading to intermodal transportation. With IMX, shippers are required to make reservations for spots on trains, while day-of-the-week pricing encourages the traffic to shift to off-peak days. This, in combination with required gate reservations at CNs largest terminals, enables CN to align traffic with equipment and gate capacity and to improve speed and asset utilization. As a result of IMX, CN is seeing improvements in profit margins and CNs customers are benefiting from improvements in speed and service reliability.

3.2.7 Automotive

CN is a leading carrier of automotive products originating in southern Ontario, Michigan and Mississippi and moves finished vehicles and parts within Canada, the United States and in both directions across the border. The principal commodities within the automotive unit are finished vehicles, with 82% of the commodity groups revenues in 2004, and automotive parts, with the remaining 18%.

CNs automotive revenues are closely correlated to automotive production and sales in North America. CN can access traffic from all Canadian vehicle assembly plants, nine assembly plants in Michigan and one in Mississippi. CN also has access to parts production facilities in both the U.S. and Canada. CNs broad coverage enables it to consolidate full trainloads of automotive traffic for delivery to connecting railroads at key interchange points. CN has the most direct rail link from southern Ontario to the Chicago gateway, providing efficient service in this time-sensitive sector. The Paul M. Tellier tunnel provides the ability to handle the tallest multi-level vehicle carriers as well as maximum clearance for stacking vehicle frames. CN also offers single-line service through Chicago to a variety of other interchange locations for automotive traffic and CNs marketing alliance with KCS provides automotive customers with single-line service between facilities in Canada and Mexico. CN also serves shippers of import vehicles via the ports of Halifax and Vancouver, and through interchange with other railroads.

3.3 TECHNOLOGY

CN runs a 7/24 operation, servicing all of Canada and central U.S. CN had approximately 10,000 PCs across North America at year-end, 2004. CNs mission-critical systems run on large central mainframes in a secured environment with full backup and disaster recovery. These are linked to geographically distributed servers supporting process control and specialized applications across its three Regions. CNs modern PC workstations are connected to Local Area Networks (LANs). These networks, as well as the internal telephone network, railroad signals and radio systems all share basic communication services on a Company-owned, high-capacity fiber network, supplemented with public facilities, as required. CNs customers, vendors and partners tie into this network through secured Internet, direct connect or third-party communication links, providing CN with the ability to conduct business electronically with its critical business customers and contacts at the best cost/quality mix. In 2004, CNs network was expanded to include the BC Rail and GLT properties.

In 2004, CN invested approximately $85.4 million in new and upgraded infrastructure and software development programs. Key among these were the completion of the move to Windows XP on the desktop and to Windows 2000 on its servers to ensure compatibility for major investments it has made in other technologies including SAP and ebusiness. This also included commencement of major projects to integrate the systems of its new acquisitions scheduled for completion by mid-year in 2005. CN continues to apply its philosophy of one set of systems for the entire company implemented as quickly as possible without jeopardizing continued smooth operations.

Software development initiatives included systems to support the companys IMX program; a new Car Accounting system and continued focus on the A+B industry instantaneous interline pricing initiative.

CN continues to invest heavily in ebusiness and Customer Service Systems. CN developed the ability to track and charge customers who continue to fax bills of lading manually rather than moving to the preferred electronic channels of Electronic Data Interchange (EDI) and ebusiness. Major investments were also made in the E world in CNs intranet and employee self-serve capabilities. As well, CNs running trades were provided access to systems for crew assignments from home or other external locations. CN remains vigilant in ensuring that all services it provides remain secure and virus-free.

Continued development in CNs Datacity also took place in 2004. This strategic information system provides CN executives, managers and employees with drill-down capability into information regarding CNs daily operational results. CN can react quickly and make changes based on these results. This system is seen as an industry-leading tool to assist in achieving effective behavioral and operational results and is fed directly from the Service Reliability System (SRS) software that provides CN with its service scheduling capability.

In order to continue leveraging its investment in SAP, CN continued to develop new functionality in the areas of mechanical, engineering, employee health, financial, supply management, human resource and payroll systems. These initiatives will continue in order to maximize the investment in this strategic platform.

To further improve safety and efficiency, CN continues to develop its new train signaling and dispatch systems, targeted for 2005 in Canada. This multi-year project will replace CNs current dispatch systems. CN also moved forward to replace its Hump process control system in Macmillan Yard, CNs principal classification and marshalling yard, with new equipment and systems a critical multi-year undertaking.

As in prior years, CN will continue to implement and leverage strategic investments in information technology that will help to improve CNs already industry-leading practices in safety, reliability and customer service.

3.4 LABOR

3.4.1 Canada

As of December 31, 2004, CN employed a total of 15,784 employees in Canada. Labor agreements covering approximately 97% of the Companys Canadian unionized workforce expired on December 31, 2003. As of March

2005, the Company has successfully negotiated collective agreements with the Canadian Auto Workers (CAW) union, retroactive to January 1, 2004, covering the Companys shopcraft forces, clerical workers, intermodal yard employees and owner operators. Agreements were also reached with the Companys Rail Traffic Controllers, the United Steelworkers of America, the Toronto Terminal employees and the Canadian Railway Police Association as

well as a United Transportation Union (UTU) group that represents employees in the Companys Northern Quebec Territory (CFIL). In addition, the Company has reached a tentative labor agreement with the United Transportation Union representing 2,520 brakemen and conductors whose agreement also expired on December 31, 2003.

The Teamsters Canada Rail Conference (TCRC), which represents 1,750 locomotive engineers, and the 630-member International Brotherhood of Electrical Workers (IBEW), representing close to 20% of the unionized workforce in Canada, filed for conciliation in the fourth quarter of 2004 and the negotiations have since been conducted with government assistance. On March 15, 2005, CN and the TCRC signed an agreement extending the date on which either party can issue a 72-hour strike or lockout notice to May 12, 2005. With respect to the IBEW, it served a 72 hour strike notice to be effective at 12:01 a.m. on Saturday, March 26, 2005, if no tentative agreement is reached in the interim. CN will continue its efforts to reach a settlement with the IBEW before the strike deadline.

In the third quarter of 2004, the Company acquired BC Rail. In December 2004, CN reached implementing agreements for BC Rail employees with the Council of Trade Unions and its members, representing all unions, regarding the integration of the various collective agreements.

In the first quarter of 2004, the Companys shopcraft forces, clerical workers and intermodal yard employees, represented by the CAW, had rejected three tentative agreements signed by the CAW and the Company on January 23, 2004. The strike that ensued lasted one month and disrupted the Companys operations and affected operating income by approximately $35 million in the first quarter of 2004. There can be no assurance that the Company will be able to have all its collective agreements renewed and ratified without any other strikes or lockouts or that the resolution of these collective bargaining negotiations will not have a material adverse effect on the Companys financial position or results of operations.

3.4.2 United States

As of December 31, 2004, CN employed a total of 6,895 employees in the United States.

The general approach to labor negotiations by U.S. Class 1 railroads is to bargain on a collective national basis. The Company believes the potential mutual benefits of local bargaining outweigh the risks. All CN entities in the U.S., Grand Trunk Western Railroad Incorporated (GTW), Duluth, Winnipeg and Pacific (DWP), ICRR, CCP Holdings, Inc. (CCP), and WC, have bargained on a local basis rather than holding national, industry-wide negotiations because, they believe, it results in agreements that better address bot