CANADIAN PACIFIC RAILWAY LTD/CN
Form 6-K
July 24, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 6-K

Report of Foreign Issuer

Pursuant to Rule 13a-16 or 15d-16 under

the Securities Exchange Act of 1934

For the month of July, 2013

CANADIAN PACIFIC RAILWAY LIMITED

(Commission File No. 1-01342)

CANADIAN PACIFIC RAILWAY COMPANY

(Commission File No. 1-15272)

(translation of each Registrant s name into English)

Suite 500, Gulf Canada Square, 401 9th Avenue, S.W., Calgary, Alberta, Canada, T2P 4Z4

(address of principal executive offices)

Indicate by check mark whether the registrants file or will file annual reports under cover Form 20-F or Form 40-F.

Form 20-F ¨ Form 40-F x

Indicate by check mark if the registrants are submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(1): ¨

Indicate by check mark if the registrants are submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(7): ¨

The interim financial statements, Management s Discussion and Analysis, and updated earnings coverage calculations included in this Report furnished on Form 6-K shall be incorporated by reference into, or as an exhibit to, as applicable, the Registration Statements of Canadian Pacific Railway Limited on Form S-8 (File Nos. 333-127943, 333-13962, 333-140955, 333-183891, 333-183892, 333-183893, 333-188826 and 333-188827) and Form F-10 (File No. 333-175033) and the Registration Statement of Canadian Pacific Railway Company on Form F-10 (File No. 333-189815).

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, each registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

		CANADIAN PACIFIC RAILWAY LIMITED (Registrant)	
Date: July 24, 2013		Signed:	/s/ Paul Bachand
	By:	Name:	Paul Bachand
		Title:	Associate Corporate Secretary
		CANADIAN PACIFIC RAILWAY COMPANY (Registrant)	
Date: July 24, 2013		Signed:	/s/ Paul Bachand
	By:	Name:	Paul Bachand
		Title:	Associate Corporate Secretary

For Release Immediate July 24, 2013

Canadian Pacific reports record second-quarter results

Q2-2013 net income of C$252M or C$1.43 per diluted share and a record operating ratio

Calgary, AB Canadian Pacific Railway Limited (TSX: CP) (NYSE: CP) today announced record Q2 2013 results that continues to highlight the significant progress in its transformational journey.

SECOND-QUARTER 2013 RESULTS COMPARED WITH SECOND-QUARTER 2012:

Total revenues were $1.5 billion, an increase of 10 per cent and a quarterly record

Operating expenses were $1.1 billion, a decrease of 4 per cent

Operating income was $420 million, an increase of 76 per cent

Operating ratio was 71.9 per cent, a 1,060 basis-point improvement and an all-time quarterly record

Reported net income in the second-quarter was $252 million, or $1.43 per diluted share, versus $103 million, or $0.60 per share, in the second-quarter 2012. This represents a 138 per cent year-over-year improvement in earnings per share.

The second quarter was a significant test for our employees who worked tirelessly during extensive network outages, including more than 40 washouts over a four-day period of historic flooding in Calgary and Southern Alberta, said CP Chief Executive Officer, E. Hunter Harrison. Harrison also noted that network interruptions during the quarter impacted revenue growth by approximately $25 million or 2 per cent.

The disciplined execution of our model allowed us to quickly recover from these challenges and restore service for our customers in a timely manner, added Harrison. Moving forward, CP is well positioned to continue to build upon its strong first half and deliver record financial and operating results for 2013.

2013 OUTLOOK

CP remains confident with the financial guidance it issued on January 29, 2013. CP expects to generate high-single digit revenue growth, a low 70s operating ratio, and diluted EPS growth greater than 40 per cent, compared with diluted EPS, excluding significant items, of $4.34 in 2012.

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Note on Forward-Looking Information

This news release contains certain forward-looking information within the meaning of applicable securities laws relating, but not limited, to our operations, priorities and plans, anticipated financial performance, business prospects, planned capital expenditures, programs and strategies. This forward-looking information also includes, but is not limited to, statements concerning expectations, beliefs, plans, goals, objectives, assumptions and statements about possible future events, conditions, and results of operations or performance. Forward-looking information may contain statements with words or headings such as financial expectations , key assumptions , anticipate , believe , expect , plan , will , should or similar words suggesting future outcomes.

To the extent that CP has provided guidance that is a non-GAAP financial measure, the Company may not be able to provide a reconciliation to a GAAP measure, due to unknown variables and uncertainty related to future results.

Undue reliance should not be placed on forward-looking information as actual results may differ materially from the forward-looking information. Forward-looking information is not a guarantee of future performance. By its nature, CP s forward-looking information involves numerous assumptions, inherent risks and uncertainties that could cause actual results to differ materially from the forward-looking information, including but not limited to the following factors: changes in business strategies; general North American and global economic, credit and business conditions; risks in agricultural production such as weather conditions and insect populations; the availability and price of energy commodities; the effects of competition and pricing pressures; industry capacity; shifts in market demand; changes in commodity prices; uncertainty surrounding timing and volumes of commodities being shipped via CP; inflation; changes in laws and regulations, including regulation of rates; changes in taxes and tax rates; potential increases in maintenance and operating costs; uncertainties of investigations, proceedings or other types of claims and litigation; labour disputes; risks and liabilities arising from derailments; transportation of dangerous goods; timing of completion of capital and maintenance projects; currency and interest rate fluctuations; effects of changes in market conditions and discount rates on the financial position of pension plans and investments; and various events that could disrupt operations, including severe weather, droughts, floods, avalanches and earthquakes as well as security threats and governmental response to them, and technological changes. The foregoing list of factors is not exhaustive.

These and other factors are detailed from time to time in reports filed by CP with securities regulators in Canada and the United States. Reference should be made to Management s Discussion and Analysis in CP s annual and interim reports, Annual Information Form and Form 40-F. Readers are cautioned not to place undue reliance on forward-looking information. Forward-looking information is based on current expectations, estimates and projections and it is possible that predictions, forecasts, projections, and other forms of forward-looking information will not be achieved by CP. Except as required by law, CP undertakes no obligation to update publicly or otherwise revise any forward-looking information, whether as a result of new information, future events or otherwise.

Non-GAAP Measures

We present non-GAAP measures to provide a basis for evaluating underlying earnings in our business that can be compared with the results of our operations in prior periods. These non-GAAP measures have no standardized meaning and are not defined by GAAP and, therefore, are unlikely to be comparable to similar measures presented by other companies.

For further information regarding non-GAAP measures see our Management s Discussion and Analysis for the first quarter of 2013 or the document Non-GAAP Measures on our web site at www.cpr.ca.

About Canadian Pacific

Canadian Pacific (TSX:CP)(NYSE:CP) is a transcontinental railway in Canada and the United States with direct links to eight major ports, including Vancouver and Montreal, providing North American customers a competitive rail service with access to key markets in every corner of the globe. CP is a low-cost provider that is growing with its customers, offering a suite of freight transportation services, logistics solutions and supply chain expertise. Visit cpr.ca to see the rail advantages of Canadian Pacific.

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CANADIAN PACIFIC RAILWAY LIMITED

CONSOLIDATED STATEMENTS OF INCOME

(in millions of Canadian dollars, except per share data)

(unaudited)

	For the three months ended June 30		For the six months ended June 30	
	2013	**2012**	**2013**	**2012**
Revenues				
Freight	$ 1,458	$ 1,332	$ 2,917	$ 2,672
Other	39	34	75	70
Total revenues	1,497	1,366	2,992	2,742
Operating expenses				
Compensation and benefits	342	366	744	757
Fuel	246	242	516	511
Materials	58	57	130	121
Equipment rents	44	56	90	106
Depreciation and amortization	141	135	282	262
Purchased services and other	246	271	448	472
Total operating expenses	1,077	1,127	2,210	2,229
Operating income	**420**	**239**	**782**	**513**
Less:				
Other income and charges	8	19	11	32
Net interest expense	68	69	138	138
Income before income tax expense	344	151	633	343
Income tax expense *(Note 5)*	92	48	164	98
Net income	**$ 252**	**$ 103**	**$ 469**	**$ 245**
Earnings per share *(Note 6)*				
Basic earnings per share	**$ 1.44**	**$ 0.60**	**$ 2.68**	**$ 1.43**
Diluted earnings per share	**$ 1.43**	**$ 0.60**	**$ 2.66**	**$ 1.42**
Weighted-average number of shares (millions)				
Basic	174.9	171.1	174.6	170.8
Diluted	176.3	172.4	176.1	172.2
Dividends declared per share	**$ 0.3500**	**$ 0.3500**	**$ 0.7000**	**$ 0.6500**

See Notes to Interim Consolidated Financial Statements.

CANADIAN PACIFIC RAILWAY LIMITED

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in millions of Canadian dollars)

(unaudited)

	For the three months ended June 30		For the six months ended June 30	
	2013	**2012**	**2013**	**2012**
Net income	$ 252	$ 103	$ 469	$ 245
Net loss in foreign currency translation adjustments, net of hedging activities	(1)	(7)	(3)	(2)
Change in derivatives designated as cash flow hedges	(1)	(8)		2
Change in defined benefit pension and post-retirement plans	61	54	249	108
Other comprehensive income before income taxes	59	39	246	108
Income tax expense on above items	(1)	(4)	(41)	(28)
Other comprehensive income *(Note 3)*	58	35	205	80
Comprehensive income	$ 310	$ 138	$ 674	$ 325

See Notes to Interim Consolidated Financial Statements.

CANADIAN PACIFIC RAILWAY LIMITED

CONSOLIDATED BALANCE SHEETS

(in millions of Canadian dollars)

(unaudited)

	June 30 2013	December 31 2012
Assets		
Current assets		
Cash and cash equivalents	$ 442	$ 333
Restricted cash and cash equivalents *(Note 4)*	99	
Accounts receivable, net	547	546
Materials and supplies	174	136
Deferred income taxes	305	254
Other current assets	84	60
	1,651	1,329
Investments	89	83
Properties	13,422	13,013
Goodwill and intangible assets	170	161
Other assets	187	141
Total assets	$ 15,519	$ 14,727
Liabilities and shareholders equity		
Current liabilities		
Accounts payable and accrued liabilities	$ 1,086	$ 1,176
Long-term debt maturing within one year	172	54
	1,258	1,230
Pension and other benefit liabilities *(Note 9)*	1,104	1,366
Other long-term liabilities	337	306
Long-term debt	4,692	4,636
Deferred income taxes	2,403	2,092
Total liabilities	9,794	9,630
Shareholders equity		
Share capital	2,213	2,127
Additional paid-in capital	33	41
Accumulated other comprehensive loss *(Note 3)*	(2,563)	(2,768)
Retained earnings	6,042	5,697
	5,725	5,097
Total liabilities and shareholders equity	$ 15,519	$ 14,727

Commitments and contingencies *(Note 10)*

See Notes to Interim Consolidated Financial Statements.

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CANADIAN PACIFIC RAILWAY LIMITED

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in millions of Canadian dollars)

(unaudited)

	For the three months ended June 30		For the six months ended June 30	
	2013	**2012**	**2013**	**2012**
Operating activities				
Net income	$ 252	$ 103	$ 469	$ 245
Reconciliation of net income to cash provided by operating activities:				
Depreciation and amortization	141	135	282	262
Deferred income taxes *(Note 5)*	87	48	150	94
Pension funding in excess of expense *(Note 9)*	(14)	(23)	(23)	(30)
Other operating activities, net	(21)	6	(19)	(23)
Change in non-cash working capital balances related to operations	75	57	(72)	(21)
Cash provided by operating activities	**520**	**326**	**787**	**527**
Investing activities				
Additions to properties	(301)	(292)	(504)	(525)
Proceeds from the sale of properties and other assets	11	17	27	62
Change in restricted cash and cash equivalents *(Note 4)*	(99)		(99)	
Other *(Note 10)*	(1)		(26)	(1)
Cash used in investing activities	**(390)**	**(275)**	**(602)**	**(464)**
Financing activities				
Dividends paid	(60)	(51)	(121)	(102)
Issuance of common shares	23	17	63	55
Issuance of long-term debt				71
Repayment of long-term debt	(7)	(13)	(26)	(25)
Net decrease in short-term borrowing				(27)
Cash used in financing activities	**(44)**	**(47)**	**(84)**	**(28)**
Effect of foreign currency fluctuations on U.S. dollar-denominated cash and cash equivalents	**9**	**1**	**8**	
Cash position				
Increase in cash and cash equivalents	95	5	109	35
Cash and cash equivalents at beginning of period	347	77	333	47
Cash and cash equivalents at end of period	**$ 442**	**$ 82**	**$ 442**	**$ 82**
Supplemental disclosures of cash flow information:				
Income taxes paid (refunded)	$ 5	$ (11)	$ 11	$ (7)
Interest paid	$ 85	$ 83	$ 151	$ 134

See Notes to Interim Consolidated Financial Statements.

CANADIAN PACIFIC RAILWAY LIMITED

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY

(in millions of Canadian dollars, except common share amounts)

(unaudited)

	Common shares (in millions)	Share capital	Additional paid-in capital	Accumulated other comprehensive loss	Retained earnings	Total shareholders equity
Balance at January 1, 2013	173.9	$ 2,127	$ 41	$ (2,768)	$ 5,697	$ 5,097
Net income					469	469
Other comprehensive income *(Note 3)*				205		205
Dividends declared					(124)	(124)
Effect of stock-based compensation expense			10			10
Shares issued under stock option plans	1.1	86	(18)			68
Balance at June 30, 2013	175.0	$ 2,213	$ 33	$ (2,563)	$ 6,042	$ 5,725

	Common shares (in millions)	Share capital	Additional paid-in capital	Accumulated other comprehensive loss	Retained earnings	Total shareholders equity
Balance at January 1, 2012	170.0	$ 1,854	$ 86	$ (2,736)	$ 5,445	$ 4,649
Net income					245	245
Other comprehensive income *(Note 3)*				80		80
Dividends declared					(111)	(111)
Effect of stock-based compensation expense			18			18
Shares issued under stock option plans	1.3	80	(23)			57
Balance at June 30, 2012	171.3	$ 1,934	$ 81	$ (2,656)	$ 5,579	$ 4,938

See Notes to Interim Consolidated Financial Statements.

CANADIAN PACIFIC RAILWAY LIMITED

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2013

(unaudited)

1 Basis of presentation

These unaudited interim consolidated financial statements of Canadian Pacific Railway Limited (CP , or the Company) reflect management s estimates and assumptions that are necessary for their fair presentation in conformity with accounting principles generally accepted in the United States of America (GAAP). They do not include all disclosures required under GAAP for annual financial statements and should be read in conjunction with the 2012 consolidated financial statements. The accounting policies used are consistent with the accounting policies used in preparing the 2012 consolidated financial statements with the addition of Restricted cash and cash equivalents disclosed in Note 4 of these Interim Consolidated Financial Statements.

CP s operations can be affected by seasonal fluctuations such as changes in customer demand and weather-related issues. This seasonality could impact quarter-over-quarter comparisons.

In management s opinion, the unaudited interim consolidated financial statements include all adjustments (consisting solely of normal recurring adjustments) necessary to present fairly such information. Interim results are not necessarily indicative of the results expected for the fiscal year.

2 Accounting changes

Accumulated other comprehensive income

In February 2013, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2013-02, Reporting of Amounts Reclassified out of Accumulated Other Comprehensive Income, an amendment to FASB ASC Topic 220. The update requires disclosure of amounts reclassified out of accumulated other comprehensive income by component. In addition, an entity is required to present either on the face of the statement of operations or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income but only if the amount reclassified is required to be reclassified to net income in its entirety in the same reporting period. For amounts not reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures that provide additional detail about those amounts. This ASU is effective prospectively for fiscal years, and interim periods within those years, beginning after December 15, 2012. The disclosure requirements of this ASU for the three and six months ended June 30, 2013 are presented in Note 3.

CANADIAN PACIFIC RAILWAY LIMITED

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2013

(unaudited)

3 *Changes in accumulated other comprehensive loss (AOCL) by component*

	For the three months ended June 30				**For the six months ended June 30**			
(in millions of Canadian dollars)	**Foreign currency, net of hedging activities[(1)]**	**Derivatives and other[(1)]**	**Pension and post-retirement defined benefit plans[(1)(a)]**	**Total[(1)]**	**Foreign currency, net of hedging activities[(1)]**	**Derivatives and other[(1)]**	**Pension and post-retirement defined benefit plans[(1)(a)]**	**Total[(1)]**
Opening balance, 2013	$ 82	$ (15)	$ (2,688)	$ (2,621)	$ 74	$ (14)	$ (2,828)	$ (2,768)
Other comprehensive income before reclassifications	12	10	8	30	20	15	102	137
Amounts reclassified from accumulated other comprehensive loss		(9)	37	28		(15)	83	68
Net current-period other comprehensive income	12	1	45	58	20		185	205
Closing balance, 2013	**$ 94**	**$ (14)**	**$ (2,643)**	**$ (2,563)**	**$ 94**	**$ (14)**	**$ (2,643)**	**$ (2,563)**
Opening balance, 2012	$ 70	$ (13)	$ (2,748)	$ (2,691)	$ 72	$ (20)	$ (2,788)	$ (2,736)
Other comprehensive income (loss) before reclassifications	1	(2)		(1)	(1)	3		2
Amounts reclassified from accumulated other comprehensive loss		(3)	39	36		(1)	79	78
Net current-period other comprehensive income (loss)	1	(5)	39	35	(1)	2	79	80
Closing balance, 2012	**$ 71**	**$ (18)**	**$ (2,709)**	**$ (2,656)**	**$ 71**	**$ (18)**	**$ (2,709)**	**$ (2,656)**

(a) Amounts reclassified from accumulated other comprehensive loss

	For the three months ended June 30		**For the six months ended June 30**	
	2013	2012	2013	2012

Amortization of prior service costs[2]	$ (17)	$	$ (23)	$
Recognition of net actuarial loss[2]	70	54	137	107
Total before income tax	$ 53	$ 54	$ 114	$ 107
Income tax benefit	(16)	(15)	(31)	(28)
Net of income tax	$ 37	$ 39	$ 83	$ 79

(1) Amounts are presented net of tax.

(2) Impacts Compensation and benefits on the Consolidated Statements of Income.

CANADIAN PACIFIC RAILWAY LIMITED

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2013

(unaudited)

4 Restricted cash and cash equivalents

During the second quarter of 2013, the Company entered into committed and uncommitted bilateral letter of credit facility agreements with financial institutions to support its requirement to post letters of credit in the ordinary course of business. The committed facility expires June 2015. Under these agreements, the Company either is required to or has the option to post collateral in the form of cash or cash equivalents, equal at least to the face value of the line of credit issued. Restricted cash and cash equivalents is shown separately on the balance sheet and includes highly liquid investments purchased three months or less from maturity and is stated at cost, which approximate market value.

At June 30, 2013, under its bilateral facilities the Company had letters of credit drawn of $99 million from a total available amount of $285 million. Prior to the second quarter of 2013 these letters of credit were drawn under the Company s $1.0 billion revolving credit facility. At June 30, 2013, cash and cash equivalents of $99 million was pledged as collateral and recorded as Restricted cash and cash equivalents on the Consolidated Balance Sheets. The Company may withdraw this collateral during any month.

5 Income taxes

(in millions of Canadian dollars)	For the three months ended June 30 2013	2012	For the six months ended June 30 2013	2012
Current income tax expense	$ 5	$	$ 14	$ 4
Deferred income tax expense	87	48	150	94
Income tax expense	$ 92	$ 48	$ 164	$ 98

The effective income tax rate for the three and six months ended June 30, 2013 was 27% and 26%, respectively, (three and six months ended June 30, 2012 31.8% and 28.6% respectively), and the changes in tax rates are primarily due to a benefit recognized for the U.S. federal track maintenance credit of $6 million for 2012 enacted in the first three months of 2013.

CANADIAN PACIFIC RAILWAY LIMITED

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2013

(unaudited)

6 Earnings per share

At June 30, 2013, the number of shares outstanding was 175.0 million (June 30, 2012 171.3 million).

Basic earnings per share have been calculated using net income for the period divided by the weighted-average number of shares outstanding during the period.

The number of shares used in earnings per share calculations is reconciled as follows:

	For the three months ended June 30		For the six months ended June 30	
(in millions)	**2013**	**2012**	**2013**	**2012**
Weighted-average shares outstanding	174.9	171.1	174.6	170.8
Dilutive effect of stock options	1.4	1.3	1.5	1.4
Weighted-average diluted shares outstanding	176.3	172.4	176.1	172.2

For the three and six months ended June 30, 2013, there were 5,867 options and 55,375 options, respectively, excluded from the computation of diluted earnings per share because their effects were not dilutive (three and six months ended June 30, 2012 388,067 and 313,000, respectively).

7 Financial instruments

A. Fair values of financial instruments

The Company categorizes its financial assets and liabilities measured at fair value in line with the fair value hierarchy established by GAAP that prioritizes, with respect to reliability, the inputs to valuation techniques used to measure fair value. This hierarchy consists of three broad levels. Level 1 inputs consist of quoted prices (unadjusted) in active markets for identical assets and liabilities and have the highest priority. Level 2 and 3 inputs are based on significant other observable inputs and significant unobservable inputs, respectively, and have lower priorities.

When possible, the estimated fair value is based on quoted market prices and, if not available, estimates from third party brokers. For non-exchange traded derivatives classified in Level 2, the Company uses standard valuation techniques to calculate fair value. Primary inputs to these techniques include observable market prices (interest, foreign exchange and commodity) and volatility, depending on the type of derivative and nature of the underlying risk. The Company uses inputs and data used by willing market participants when valuing derivatives and considers its own credit default swap spread as well as those of its counterparties in its determination of fair value.

The carrying values of financial instruments equal or approximate their fair values with the exception of long-term debt which has a fair value of approximately $5,626 million and a carrying value of $4,864 million at June 30, 2013. At December 31, 2012, long-term debt had a fair value of $5,688 million and a carrying value of $4,690 million. The estimated fair value of current and long-term borrowings has been determined based on market information where available, or by discounting future payments of interest and principal at estimated interest rates expected to be available to the Company at period end. All derivatives and long-term debt are classified as Level 2.

B. Financial risk management

Derivative financial instruments may be used to selectively reduce volatility associated with fluctuations in interest rates, foreign exchange (FX) rates, the price of fuel and stock-based compensation expense. Where derivatives are designated as hedging instruments, the relationship between the hedging instruments and their associated hedged items is documented, as well as the risk management objective and strategy for the use of the hedging instruments. This documentation includes linking the derivatives that are designated as fair value or cash flow hedges to specific assets or liabilities on the Consolidated Balance Sheet, commitments or forecasted transactions. At the time a derivative contract is entered into and at least

CANADIAN PACIFIC RAILWAY LIMITED

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2013

(unaudited)

7 Financial instruments, continued

quarterly thereafter, an assessment is made whether the derivative item is effective in offsetting the changes in fair value or cash flows of the hedged items. The derivative qualifies for hedge accounting treatment if it is effective in substantially mitigating the risk it was designed to address.

It is not the Company s intent to use financial derivatives or commodity instruments for trading or speculative purposes.

Foreign exchange management

The Company conducts business transactions and owns assets in both Canada and the United States. As a result, the Company is exposed to fluctuations in value of financial commitments, assets, liabilities, income or cash flows due to changes in FX rates. The Company may enter into foreign exchange risk management transactions primarily to manage fluctuations in the exchange rate between Canadian and U.S. currencies. FX exposure is primarily mitigated through natural offsets created by revenues, expenditures and balance sheet positions incurred in the same currency. Where appropriate, the Company may negotiate with customers and suppliers to reduce the net exposure.

Occasionally the Company may enter into short-term FX forward contracts as part of its cash management strategy.

Net investment hedge

The FX gains and losses on long-term debt are mainly unrealized and can only be realized when U.S. dollar denominated long-term debt matures or is settled. The Company also has long-term FX exposure on its investment in U.S. affiliates. The majority of the Company s U.S. dollar denominated long-term debt has been designated as a hedge of the net investment in foreign subsidiaries. This designation has the effect of mitigating volatility on net income by offsetting long-term FX gains and losses on U.S. dollar denominated long-term debt and gains and losses on its net investment. The effective portion recognized in Other comprehensive income for the three and six months ended June 30, 2013 was an unrealized foreign exchange loss of $110 million and $177 million, respectively (three and six months ended June 30, 2012 unrealized foreign exchange loss of $66 million and $6 million, respectively). There was no ineffectiveness during the three and six months ended June 30, 2013, and comparative periods.

Foreign exchange forward contracts

The Company may enter into FX forward contracts to lock-in the amount of Canadian dollars it has to pay on its U.S. denominated debt maturities.

At June 30, 2013, the Company had FX forward contracts to fix the exchange rate on US$100 million of principal outstanding on a capital lease due in January 2014, US$175 million of its 6.50% Notes due in May 2018, and US$100 million of its 7.25% Notes due in May 2019, unchanged from December 31, 2012. At June 30, 2012, the Company had FX forward contracts to fix the exchange rate on US$50 million of principal outstanding on a capital lease due in January 2014, US$175 million of its 6.50% Notes due in May 2018, and US$100 million of its 7.25% Notes due in May 2019. These derivatives, which are accounted for as cash flow hedges, guarantee the amount of Canadian dollars that the Company will repay when these obligations mature.

During the three and six months ended June 30, 2013, an unrealized foreign exchange gain of $10 million and $15 million, respectively (three months and six months ended June 30, 2012 unrealized gain of $5 million and $1 million, respectively) was recorded in Other income and charges in relation to these derivatives. These gains recorded in Other income and charges were largely offset by the unrealized losses on the underlying debt which the derivatives were designated to hedge.

At June 30, 2013, the unrealized gain derived from these FX forwards was $23 million of which $5 million was included in Other current assets and $18 million in Other assets with the offset reflected as an unrealized gain of $6 million in Accumulated other comprehensive loss and as an unrealized gain of $17 million in Retained earnings. At December 31, 2012, the unrealized gain derived from these FX forwards was $8 million which was included in Other assets with the offset reflected as an unrealized gain of $6 million in Accumulated other comprehensive loss and as an unrealized gain of $2 million in Retained earnings.

CANADIAN PACIFIC RAILWAY LIMITED

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2013

(unaudited)

7 Financial instruments, continued

At June 30, 2013, the Company expected that, during the next twelve months, unrealized pre-tax losses of $2 million would be reclassified to Other income and charges .

Fuel price management

The Company is exposed to commodity risk related to purchases of diesel fuel and the potential reduction in net income due to increases in the price of diesel. Fuel expense constitutes a large portion of the Company s operating costs and volatility in diesel fuel prices can have a significant impact on the Company s income. Items affecting volatility in diesel prices include, but are not limited to, fluctuations in local and world markets for crude oil and distillate fuels, which can be affected by supply disruptions and geopolitical events.

The impact of variable fuel expense is mitigated substantially through fuel cost recovery programs which apportion incremental changes in fuel prices to shippers through price indices, tariffs, and by contract, within agreed upon guidelines. While these programs provide effective and meaningful coverage, residual exposure remains as the fuel expense risk may not be completely recovered from shippers due to timing and volatility in the market. In the past, to address the residual portion of CP s fuel costs not mitigated by its fuel recovery programs, CP had a systematic hedge program. As a result of improving coverage from its fuel cost recovery programs, CP exited its hedging program during the first quarter of 2013.

Energy futures

During the first quarter ended March 31, 2013, the Company settled its remaining diesel futures contracts, accounted for as cash flow hedges, to purchase 20 million U.S. gallons during the period January to December 2013 for a realized gain and proceeds of $2 million. In the three and six months ended June 30, 2013, a reduction to Fuel expense was recorded totalling a negligible amount and $1 million, respectively, as a result of the recognition in income of this previously realized gain. At June 30, 2013, the remaining realized gain of $1 million was reflected in Accumulated other comprehensive loss to be amortized to Fuel expense in 2013 as the related diesel is purchased. During the three months ended June 30, 2012, the impact of settled swaps increased Fuel expense by $1 million. During the six months ended June 30, 2012, these swaps had a negligible impact to Fuel expense.

At June 30, 2013, the Company had no remaining diesel futures contracts. At December 31, 2012, the unrealized loss on these contracts was negligible.

8 Stock-based compensation

At June 30, 2013, the Company had several stock-based compensation plans, including stock option plans, various cash settled liability plans, which are remeasured to fair value quarterly based on share price and vesting conditions, and an employee stock savings plan. These plans resulted in an expense of $10 million for the three months ended June 30, 2013 and an expense of $43 million for the six months ended June 30, 2013 (three and six months ended June 30, 2012 expense of $3 million and expense of $26 million, respectively).

Regular options

In the six months ended June 30, 2013, under CP s stock option plans, the Company issued 488,340 regular options at the weighted-average price of $118.35 per share, based on the closing price on the grant date.

Pursuant to the employee plans, these regular options vest between 12 and 48 months after the grant date, and will expire after 10 years.

CANADIAN PACIFIC RAILWAY LIMITED

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2013

(unaudited)

8 Stock-based compensation, continued

Under the fair value method, the fair value at the grant date of the regular options issued in the six months ended June 30, 2013 was $16 million, with a weighted-average fair value of $32.73 per option. The weighted-average fair value assumptions were approximately:

		For the six months ended June 30, 2013
Grant price	$	118.35
Expected option life (years)(1)		6.25
Risk-free interest rate(2)		1.55%
Expected stock price volatility(3)		30%
Expected annual dividends per share(4)	$	1.40
Expected forfeiture rate(5)		1.35%

(1) Represents the period of time that awards are expected to be outstanding. Historical data on exercise behaviour, or when available, specific expectations regarding future exercise behaviour, were used to estimate the expected life of the option.

(2) Based on the implied yield available on zero-coupon government issues with an equivalent remaining term at the time of the grant.

(3) Based on the historical stock price volatility of the Company s stock over a period commensurate with the expected term of the option.

(4) Determined by the current annual dividend at the time of grant. The Company does not employ different dividend yields throughout the contractual term of the option.

(5) The Company estimated forfeitures based on past experience. This rate is monitored on a periodic basis.

Performance share unit (PSU) plan

In the six months ended June 30, 2013, the Company issued 186,978 PSUs with a grant date fair value of $21 million. These units attract dividend equivalents in the form of additional units based on the dividends paid on the Company s Common Shares. PSUs vest and are settled in cash, or in CP common shares, at the discretion of the Chief Executive Officer, approximately three years after the grant date, contingent upon CP s performance (performance factor). The fair value of PSUs is measured, both on the grant date and each subsequent quarter until settlement, using a Monte Carlo simulation model. The model utilizes multiple input variables that determine the probability of satisfying the performance and market conditions stipulated in the grant.

Deferred share unit (DSU) plan

In the six months ended June 30, 2013, the Company granted 67,151 DSUs with a grant date fair value of $8 million. DSUs vest over various periods of up to 48 months and are only redeemable for a specified period after employment is terminated. An expense to income for DSUs is recognized over the vesting period for both the initial subscription price and the change in value between reporting periods.

Restricted share unit (RSU) plan

In the six months ended June 30, 2013, $9 million in RSUs were paid out.

CANADIAN PACIFIC RAILWAY LIMITED

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2013

(unaudited)

9 *Pensions and other benefits*

In the three and six months ended June 30, 2013, the Company made contributions of $22 million and $52 million, respectively (three and six months ended June 30, 2012 $33 million and $50 million, respectively) to its defined benefit pension plans. The elements of net periodic benefit cost for defined benefit pension plans and other benefits recognized in the three and six months ended June 30, 2013 and 2012, included the following components:

	For the three months ended June 30			
	Pensions		Other benefits	
(in millions of Canadian dollars)	2013	2012	2013	2012
Current service cost (benefits earned by employees in the period)	$ 33	$ 33	$ 4	$ 5
Interest cost on benefit obligation	111	113	6	6
Expected return on fund assets	(187)	(188)		
Recognized net actuarial loss	68	52	2	2
Amortization of prior service costs	(17)			
Net periodic benefit cost	$ 8	$ 10	$ 12	$ 13

	For the six months ended June 30			
	Pensions		Other benefits	
(in millions of Canadian dollars)	2013	2012	2013	2012
Current service cost (benefits earned by employees in the period)	$ 68	$ 66	$ 8	$ 10
Interest cost on benefit obligation	223	226	11	12
Expected return on fund assets	(373)	(376)		
Recognized net actuarial loss	134	104	3	3
Amortization of prior service costs	(23)			
Net periodic benefit cost	$ 29	$ 20	$ 22	$ 25

CP reached agreements with all of the unions which it had been bargaining with in Canada in 2012. The new agreements introduced amendments to pension plans. Among other changes, the amendments established a cap on pension for each year of pensionable service, including a cap on some non-union employees pensions. Under the amendments, the plan participant will continue to earn additional pensionable years of service as normal but with a limit of the cap for each year earned. Plan amendments resulting from collective bargaining are accounted for in the periods the new agreements are ratified. The plan amendments resulting from the December 2012 arbitration award were contingent on Canadian Pacific making plan amendments for non-union employees, and consequently were accounted for in the period Canadian Pacific made such amendments. As a result of the plan amendments, the projected benefit obligation decreased by $135 million from December 31, 2012, with a corresponding increase to Other comprehensive income and resulting in a reduction of Accumulated other comprehensive loss through the amortization of prior service credits. The prior service credits are recognized in net periodic pension expense over the remaining terms of the applicable union agreements (averaging approximately two years), and over the expected average remaining service life of non-union employees.

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CANADIAN PACIFIC RAILWAY LIMITED

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2013

(unaudited)

9 Pensions and other benefits, continued

At the date of the plan amendments, CP has assessed the significance of such amendments to the consolidated financial statements and has determined that a remeasurement of plan assets and obligations as of the date of the above plan amendments was not warranted.

10 Commitments and contingencies

In the normal course of its operations, the Company becomes involved in various legal actions, including claims relating to injuries and damages to property. The Company maintains provisions it considers to be adequate for such actions. While the final outcome with respect to actions outstanding or pending at June 30, 2013 cannot be predicted with certainty, it is the opinion of management that their resolution will not have a material adverse effect on the Company s financial position or results of operations.

At June 30, 2013, the Company had committed to total future capital expenditures amounting to $536 million and operating expenditures relating to supplier purchase obligations, such as locomotive maintenance and overhaul agreements, as well as agreements to purchase other goods and services amounting to approximately $1.8 billion for the years 2013-2031.

Minimum payments under operating leases were estimated at $734 million in aggregate, with annual payments in each of the five years following 2013 of (in millions): 2014 $117; 2015 $100; 2016 $81; 2017 $63; and 2018 $52.

Environmental remediation accruals cover site-specific remediation programs. Environmental remediation accruals are measured on an undiscounted basis and are recorded when the costs to remediate are probable and reasonably estimable.

The accruals for environmental remediation represent CP s best estimate of its probable future obligation and include both asserted and unasserted claims, without reduction for anticipated recoveries from third parties. Although the recorded accruals include CP s best estimate of all probable costs, CP s total environmental remediation costs cannot be predicted with certainty. Accruals for environmental remediation may change from time to time as new information about previously untested sites becomes known, environmental laws and regulations evolve and advances are made in environmental remediation technology. The accruals may also vary as the courts decide legal proceedings against outside parties responsible for contamination. These potential charges, which cannot be quantified at this time, are not expected to be material to CP s financial position, but may materially affect income in the particular period in which a charge is recognized. Costs related to existing, but as yet unknown, or future contamination will be accrued in the period in which they become probable and reasonably estimable.

The expense included in Purchased services and other for the three and six months ended June 30, 2013 was $nil and $1 million, respectively (three and six months ended June 30, 2012 $1 million and $1 million, respectively). Provisions for environmental remediation costs are recorded in Other long-term liabilities , except for the current portion which is recorded in Accounts payable and accrued liabilities . The total amount provided at June 30, 2013 was $92 million (December 31, 2012 $89 million). Payments are expected to be made over 10 years to 2023.

During the three months ended March 31, 2013, CP provided an interest free loan pursuant to a court order in the amount of $20 million to a corporation owned by a court appointed trustee to facilitate the acquisition of a building. The building will be held in trust until the resolution of legal proceedings with regard to CP s entitlement to an exercised purchase option of the building. If CP is successful in these proceedings, title to the building will transfer to CP with an additional payment of $20 million; otherwise the loan will be repaid.

Summary of Rail Data

Second Quarter 2013	Second Quarter 2012	Fav/(Unfav)	%	Financial (millions, except per share data)	Year-to-date 2013	Year-to-date 2012	Fav/(Unfav)	%
				Revenues				
$ 1,458	$ 1,332	$ 126	**9**	Freight revenue	$ 2,917	$ 2,672	$ 245	**9**
39	34	5	**15**	Other revenue	75	70	5	**7**
1,497	1,366	131	**10**	Total revenues	2,992	2,742	250	**9**
				Operating expenses				
342	366	24	**7**	Compensation and benefits	744	757	13	**2**
246	242	(4)	**(2)**	Fuel	516	511	(5)	**(1)**
58	57	(1)	**(2)**	Materials	130	121	(9)	**(7)**
44	56	12	**21**	Equipment rents	90	106	16	**15**
141	135	(6)	**(4)**	Depreciation and amortization	282	262	(20)	**(8)**
246	271	25	**9**	Purchased services and other	448	472	24	**5**
1,077	1,127	50	**4**	Total operating expenses	2,210	2,229	19	**1**
420	239	181	**76**	Operating income	782	513	269	**52**
				Less:				
8	19	11	**58**	Other income and charges	11	32	21	**66**
68	69	1	**1**	Net interest expense	138	138		
344	151	193	**128**	Income before income tax expense	633	343	290	**85**
92	48	(44)	**(92)**	Income tax expense	164	98	(66)	**(67)**
$ 252	**$ 103**	**$ 149**	**145**	Net income	**$ 469**	**$ 245**	**$ 224**	**91**
71.9	82.5	10.6	**1,060 bps**	Operating ratio (%)	73.9	81.3	7.4	**740 bps**
$ 1.44	**$ 0.60**	**$ 0.84**	**140**	Basic earnings per share	**$ 2.68**	**$ 1.43**	**$ 1.25**	**87**
$ 1.43	**$ 0.60**	**$ 0.83**	**138**	Diluted earnings per share	**$ 2.66**	**$ 1.42**	**$ 1.24**	**87**
				Shares Outstanding				
174.9	171.1	3.8	**2**	Weighted average number of shares outstanding (millions)	174.6	170.8	3.8	**2**
176.3	172.4	3.9	**2**	Weighted average number of diluted shares outstanding (millions)	176.1	172.2	3.9	**2**
				Foreign Exchange				
0.98	0.99	0.01	**1**	Average foreign exchange rate (US$/Canadian$)	0.99	0.99		
1.02	1.01	0.01	**1**	Average foreign exchange rate (Canadian$/US$)	1.01	1.01		

Summary of Rail Data (Page 2)

Second Quarter 2013	2012	Fav/(Unfav)	%		Year-to-date 2013	2012	Fav/(Unfav)	%
				Commodity Data				
				Freight Revenues (millions)				
$ 282	$ 233	$ 49	**21**	- Grain	$ 596	$ 521	$ 75	**14**
144	148	(4)	**(3)**	- Coal	293	285	8	**3**
163	150	13	**9**	- Fertilizers and sulphur	315	276	39	**14**
379	306	73	**24**	- Industrial and consumer products	751	604	147	**24**
106	116	(10)	**(9)**	- Automotive	203	221	(18)	**(8)**
53	48	5	**10**	- Forest products	106	98	8	**8**
331	331			- Intermodal	653	667	(14)	**(2)**
$ 1,458	$ 1,332	$ 126	**9**	Total Freight Revenues	$ 2,917	$ 2,672	$ 245	**9**
				Millions of Revenue Ton-Miles (RTM)				
7,683	6,712	971	**14**	- Grain	16,113	15,312	801	**5**
5,316	5,329	(13)		- Coal	10,956	10,534	422	**4**
5,606	5,617	(11)		- Fertilizers and sulphur	10,558	9,659	899	**9**
9,414	7,020	2,394	**34**	- Industrial and consumer products	18,950	14,056	4,894	**35**
629	658	(29)	**(4)**	- Automotive	1,233	1,317	(84)	**(6)**
1,267	1,169	98	**8**	- Forest products	2,490	2,384	106	**4**
6,076	6,054	22		- Intermodal	11,854	12,108	(254)	**(2)**
35,991	32,559	3,432	**11**	Total RTMs	72,154	65,370	6,784	**10**
				Freight Revenue per RTM (cents)				
3.67	3.47	0.20	**6**	- Grain	3.70	3.40	0.30	**9**
2.70	2.78	(0.08)	**(3)**	- Coal	2.67	2.71	(0.04)	**(1)**
2.91	2.67	0.24	**9**	- Fertilizers and sulphur	2.98	2.86	0.12	**4**
4.03	4.36	(0.33)	**(8)**	- Industrial and consumer products	3.97	4.30	(0.33)	**(8)**
16.87	17.63	(0.76)	**(4)**	- Automotive	16.46	16.78	(0.32)	**(2)**
4.20	4.11	0.09	**2**	- Forest products	4.26	4.11	0.15	**4**
5.44	5.47	(0.03)	**(1)**	- Intermodal	5.51	5.51		
4.05	4.09	(0.04)	**(1)**	Total Freight Revenue per RTM	4.04	4.09	(0.05)	**(1)**
				Carloads (thousands)				
103	91	12	**13**	- Grain	211	201	10	**5**
75	82	(7)	**(9)**	- Coal	156	160	(4)	**(3)**
54	54			- Fertilizers and sulphur	103	96	7	**7**
130	113	17	**15**	- Industrial and consumer products	257	228	29	**13**
38	42	(4)	**(10)**	- Automotive	73	84	(11)	**(13)**
18	16	2	**13**	- Forest products	36	34	2	**6**
250	248	2	**1**	- Intermodal	491	499	(8)	**(2)**
668	646	22	**3**	Total Carloads	1,327	1,302	25	**2**
				Freight Revenue per Carload				
$ 2,733	$ 2,560	$ 173	**7**	- Grain	$ 2,821	$ 2,592	$ 229	**9**
1,921	1,805	116	**6**	- Coal	1,878	1,781	97	**5**

3,020	2,778	242	**9**	- Fertilizers and sulphur	3,043	2,875	168	**6**
2,923	2,708	215	**8**	- Industrial and consumer products	2,923	2,649	274	**10**
2,759	2,762	(3)		- Automotive	2,781	2,631	150	**6**
2,998	3,000	(2)		- Forest products	2,944	2,882	62	**2**
1,323	1,335	(12)	**(1)**	- Intermodal	1,331	1,337	(6)	
$ 2,183	$ 2,062	$ 121	**6**	Total Freight Revenue per Carload	$ 2,198	$ 2,052	$ 146	**7**

Summary of Rail Data (Page 3)

Second Quarter 2013	2012[1]	Fav/(Unfav)	%		Year-to-date 2013	2012[1]	Fav/(Unfav)	%
				Operations Performance				
67,232	60,926	6,306	**10**	Freight gross ton-miles (millions)	134,910	123,614	11,296	**9**
9,645	9,681	36		Train miles (thousands)	19,639	20,023	384	**2**
7,471	6,690	781	**12**	Average train weight - excluding local traffic (tons)	7,337	6,550	787	**12**
6,444	5,955	489	**8**	Average train length - excluding local traffic (feet)[2]	6,369	5,853	516	**9**
24.1	23.7	0.4	**2**	Average train speed - AAR definition (mph)	24.2	24.5	(0.3)	**(1)**
16.1	18.0	1.9	**11**	Average terminal dwell - AAR definition (hours)	15.7	17.7	2.0	**11**
222.2	194.2	28.0	**14**	Car miles per car day	222.1	201.2	20.9	**10**
218.0	164.7	53.3	**32**	Locomotive productivity (daily average GTMs/active HP)	211.5	169.7	41.8	**25**
1.05	1.14	0.09	**8**	Fuel efficiency[3]	1.09	1.19	0.10	**8**
69.8	68.8	(1.0)	**(1)**	U.S. gallons of locomotive fuel consumed (millions)[4]	145.6	145.4	(0.2)	
3.45	3.49	0.04	**1**	Average fuel price (U.S. dollars per U.S. gallon)	3.50	3.49	(0.01)	
15,471	17,327	1,856	**11**	Total employees (average)[5][6]	15,196	16,999	1,803	**11**
15,355	17,998	2,643	**15**	Total employees (end of period)[5]	15,355	17,998	2,643	**15**
16,053	19,505	3,452	**18**	Workforce (end of period)[7]	16,053	19,505	3,452	**18**
				Safety				
1.35	1.31	(0.04)	**(3)**	FRA personal injuries per 200,000 employee-hours	1.51	1.24	(0.27)	**(22)**
1.78	1.43	(0.35)	**(24)**	FRA train accidents per million train-miles	1.91	1.51	(0.40)	**(26)**

(1) Certain prior period figures have been revised to conform with current presentation or have been updated to reflect new information.
(2) Incorporates a new reporting methodology where average train length is the sum of each car and locomotive s equipment length multiplied by the distance travelled, divided by train miles. Local trains are excluded from this measure.
(3) Fuel efficiency is defined as U.S. gallons of locomotive fuel consumed per 1,000 GTMs freight and yard.
(4) Includes gallons of fuel consumed from freight, yard and commuter service but excludes fuel used in capital projects and other non-freight activities.
(5) An employee is defined as an individual, including trainees, who has worked more than 40 hours in a standard biweekly pay period. This excludes part time employees, contractors, and consultants.
(6) 2012 average number of employees has been adjusted for the strike.
(7) Workforce is defined as total employees plus part time employees, contractors, and consultants.

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This Management s Discussion and Analysis (MD&A) is provided in conjunction with the Consolidated Financial Statements and related notes for the three and six months ended June 30, 2013 prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). All information has been prepared in accordance with GAAP, except as described in Section 14, Non-GAAP Measures of this MD&A. Except where otherwise indicated, all financial information reflected herein is expressed in Canadian dollars.

July 24, 2013

In this MD&A, our , us , we , CP and the Company refer to Canadian Pacific Railway Limited (CPRL), CPRL and its subsidiaries, CPRL and one or more of its subsidiaries, or one or more of CPRL s subsidiaries, as the context may require. Other terms not defined in the body of this MD&A are defined in Section 23, Glossary of Terms.

Unless otherwise indicated, all comparisons of results for the second quarter and year to date of 2013 are against the results for the second quarter and year to date of 2012.

1. BUSINESS PROFILE

Canadian Pacific Railway Limited, through its subsidiaries, operates a transcontinental railway in Canada and the United States (U.S.) and provides logistics and supply chain expertise. We provide rail and intermodal transportation services over a network of approximately 14,400 miles, serving the principal business centres of Canada from Montreal, Quebec, to Vancouver, British Columbia (B.C.), and the U.S. Northeast and Midwest regions. Our railway feeds directly into the U.S. heartland from the East and West coasts. Agreements with other carriers extend our market reach east of Montreal in Canada, throughout the U.S. and into Mexico. We transport bulk commodities, merchandise freight and intermodal traffic. Bulk commodities include grain, coal, fertilizers and sulphur. Merchandise freight consists of finished vehicles and automotive parts, as well as forest and industrial and consumer products. Intermodal traffic consists largely of high-value, time-sensitive retail goods in overseas containers that can be transported by train, ship and truck, and in domestic containers and trailers that can be moved by train and truck.

2. STRATEGY

Canadian Pacific is driving change as it moves through its transformational journey to become the best railroad in North America, while creating long-term value for shareholders. The Company is focused on providing customers with industry leading rail service; driving sustainable, profitable growth; optimizing our assets; and reducing costs, while remaining a leader in rail safety.

Looking forward, CP is executing its strategic plan while aggressively targeting a mid-60s operating ratio for 2016. This plan is centered on five key foundations, which are the Company s performance drivers.

Provide Service: Providing efficient and consistent transportation solutions for our customers. Doing what we say we are going to do is what drives CP by providing a reliable product with a lower cost operating model. Centralized planning aligned with local execution is bringing the Company closer to the customer and accelerating decision-making.

Control Costs: Controlling and removing unnecessary costs from the organization, eliminating bureaucracy and continuing to identify productivity enhancements are the keys to success.

Optimize Assets: Through longer sidings, improved asset utilization, and increased train lengths, the Company will move increased volumes with fewer locomotives and cars while unlocking capacity for future growth potential.

Operate Safely: Each year, CP safely moves millions of carloads of freight across North America while ensuring the safety of our people and the communities through which we operate. Safety is never to be compromised.

Continuous research and development in state-of-the-art safety technology and highly focused employees ensure our trains are built for safe, efficient operations across our network.

Develop People: CP recognizes that none of the other foundations can be achieved without its people. Every CP employee is a railroader and the Company is shaping a new culture focused on a passion for service with integrity in everything it does. Coaching and mentoring managers into becoming leaders will help drive CP forward.

3. FORWARD-LOOKING INFORMATION

This MD&A contains certain forward-looking statements within the meaning of the United States *Private Securities Litigation Reform Act of 1995* and other relevant securities legislation. These forward-looking statements include, but are not limited to statements concerning our defined benefit pension expectations for 2013 to 2016, our financial expectations for 2013 and 2016, as well as statements concerning our operations, anticipated financial performance, business prospects and strategies, as well as statements concerning the anticipation that cash flow from operations and various sources of financing will be sufficient to meet debt repayments and future obligations in the foreseeable future, statements regarding future payments including income taxes and pension contributions, and capital expenditures. Forward-looking information typically contains statements with words such as anticipate , believe , expect , plan or similar words suggesting future outcomes.

Readers are cautioned not to place undue reliance on forward-looking information because it is possible that we will not achieve predictions, forecasts, projections and other forms of forward-looking information. Current economic conditions render assumptions, although reasonable when made, subject to greater uncertainty. In addition, except as required by law, we undertake no obligation to update publicly or otherwise revise any forward-looking information, whether as a result of new information, future events or otherwise.

By its nature, our forward-looking information involves numerous assumptions, inherent risks and uncertainties, including but not limited to the following factors: changes in business strategies; general North American and global economic, credit and business conditions; risks in agricultural production such as weather conditions and insect populations; the availability and price of energy commodities; the effects of competition and pricing pressures; industry capacity; shifts in market demand; inflation; changes in laws and regulations, including regulation of rates; changes in taxes and tax rates; potential increases in maintenance and operating costs; uncertainties of investigations, proceedings or other types of claims and litigation; labour disputes; risks and liabilities arising from derailments; transportation of dangerous goods; timing of completion of capital and maintenance projects; currency and interest rate fluctuations; effects of changes in market conditions on the financial position of pension plans and investments; and various events that could disrupt operations, including severe weather, droughts, floods, avalanches and earthquakes as well as security threats and the governmental response to them, and technological changes.

There are more specific factors that could cause actual results to differ materially from those described in the forward-looking statements contained in this MD&A. These more specific factors are identified and discussed in Section 20, Business Risks and elsewhere in this MD&A. Other risks are detailed from time to time in reports filed by CP with securities regulators in Canada and the United States.

Financial Assumptions

Defined benefit pension expectations for 2013 to 2016

Defined benefit pension contributions are currently estimated to be between $100 million and $125 million in each year to 2016. These contribution levels reflect the Company s intentions with respect to the rate at which we apply the voluntary prepayments to reduce contribution requirements. Defined benefit pension expense for 2013 and 2014 is expected to be in the range of $50 million to $60 million per year, increasing to be in the range of $90 million to $110 million in 2015 and 2016. These pension contributions and pension expense estimates assume normal equity market returns and modest increases in bond yields over this period. In addition, there are a number of other economic and demographic assumptions on which these estimates are based. Adverse experience with respect to equity returns, bond yields or other factors may put upward pressure on pension expense and contributions in later

years. We continue to monitor these factors. Pensions are discussed further in Section 21, Critical Accounting Estimates.

Financial expectations for 2013

The Company expects revenue growth to be in the high single digits; operating ratio to be in the low 70 s; and diluted earnings per share (EPS) growth to be in excess of 40% from 2012 annual diluted EPS, excluding significant items, discussed further in Section 14, Non-GAAP Measures, of $4.34. CP plans to spend up to $1.2 billion on capital programs in 2013, discussed further in Section 13, Liquidity and Capital Resources. This amount reflects an increase of $75 million to $100 million, which was announced on May 7, 2013 to accelerate the timing of certain capital projects originally targeted for future years. Key assumptions for full year 2013 financial expectations include:

- an average fuel cost per gallon of $3.45 U.S. per U.S. gallon;
- Canadian and U.S. dollar exchange rate at par; and
- an income tax rate in the range of 25% to 27%, discussed further in Section 10, Other Income Statement Items.

Financial expectations for 2016

CP is aiming for a full-year operating ratio in the mid-60s, cash flow before dividends of $900 million to $1,400 million for 2016, discussed further in Section 14, Non-GAAP Measures, and compound annual revenue growth of 4%-7% off the 2012 base. CP is also planning on annual capital spending in the range of $1.0 billion to $1.1 billion over this period. Key assumptions to reaching these goals include:

- an average fuel cost per gallon of $3.45 U.S. per U.S. gallon;
- Canadian and U.S dollar exchange rate at par;
- an income tax rate in the range of 25% to 27%;
- CP becoming fully cash taxable during the four year period; and
- the defined benefit pension expectations outlined above.

Undue reliance should not be placed on these assumptions and other forward-looking information.

4. ADDITIONAL INFORMATION

Additional information, including our Consolidated Financial Statements, Annual Information Form, press releases and other required filing documents, are available on SEDAR at www.sedar.com in Canada, on EDGAR at www.sec.gov in the U.S. and on our website at www.cpr.ca. The aforementioned documents are issued and made available in accordance with legal requirements and are not incorporated by reference into this MD&A.

5. FINANCIAL HIGHLIGHTS

(in millions, except percentages and per-share data)	For the three months ended June 30 **2013**	2012	For the six months ended June 30 **2013**	2012
Revenues	**$ 1,497**	$ 1,366	**$ 2,992**	$ 2,742
Operating income	**420**	239	**782**	513
Net income	**252**	103	**469**	245
Basic earnings per share (EPS)	**1.44**	0.60	**2.68**	1.43
Diluted earnings per share	**1.43**	0.60	**2.66**	1.42
Dividends declared per share	**0.3500**	0.3500	**0.7000**	0.6500
Return on capital employed (ROCE[1])	**8.7%**	8.4%	**8.7%**	8.4%
Adjusted ROCE[2][3]	**10.9%**	9.0%	**10.9%**	9.0%
Operating ratio	**71.9%**	82.5%	**73.9%**	81.3%
Free cash[3][4]	**178**	1	**171**	(39)
Total assets at June 30	**15,519**	14,406	**15,519**	14,406
Total long-term financial liabilities at June 30[5]	**4,800**	4,857	**4,799**	4,857

(1) ROCE is defined as earnings before interest and taxes (EBIT) (on a rolling twelve month basis), divided by the average for the year of total assets, less current liabilities excluding current portion of long-term debt, as measured under GAAP, and is discussed further in Section 14, Non-GAAP Measures.

(2) Adjusted ROCE is defined as EBIT excluding significant items (on a rolling twelve month basis) divided by the average for the year of total assets, less current liabilities, excluding current portion of long-term debt, as measured under GAAP. Adjusted ROCE and EBIT excluding significant items are discussed further in Section 14, Non-GAAP Measures.

(3) This measure has no standardized meaning prescribed by GAAP and, therefore, is unlikely to be comparable to similar measures, presented by other companies. This measure is discussed in Section 14, Non-GAAP Measures.

(4) A reconciliation of free cash to GAAP cash position is provided in Section 13, Liquidity and Capital Resources.

(5) Excludes deferred income taxes: $2,403 million and $2,017 million; and other non-financial deferred liabilities of $1,333 million and $1,441 million at June 30, 2013 and 2012 respectively.

6. OPERATING RESULTS

Income

Operating income in the second quarter of 2013 was $420 million, an increase of $181 million, or 76%, from $239 million in the same period of 2012.

Operating income increased primarily due to:

- efficiency savings derived from improved operating performance and asset utilization;
- the net impact of the strike in the second quarter of 2012, discussed in Section 2, Strategy in our 2012 Annual MD&A;
- increased volumes of traffic, as measured by revenue ton-miles (RTMs), generating higher freight revenue;

management transition costs in 2012, discussed further in Section 14, Non-GAAP Measures;

higher freight rates; and

higher fuel surcharge revenues due to an increase in traffic volumes with full margin coverage.

This increase in Operating income was partially offset by:

the impact of the extensive network outages, including more than 40 washouts over a four-day period of historic flooding in Calgary and Southern Alberta and the derailment in Wanup, Ontario on June 2, 2013;

higher volume variable expenses;

higher incentive and stock-based compensation expenses;

wage and benefits inflation; and

higher depreciation and amortization expenses.

Operating income in the first six months of 2013 was $782 million, an increase of $269 million, or 52% from $513 million in the same period of 2012.

Operating income increased primarily due to:

efficiency savings derived from improved operating performance and asset utilization;

- increased volumes of traffic, as measured by RTMs, generating higher freight revenue;
- the net impact of the strike in the second quarter of 2012;
- management transition costs in 2012;
- higher fuel surcharge revenues due to an increase in traffic volumes with full margin coverage;
- higher freight rates; and
- a settlement of litigation in 2013 related to management transition.

This increase in Operating income was partially offset by:

- higher volume variable expenses;
- higher incentive and stock-based compensation expenses;
- the impact of the extensive network outages;
- wage and benefits inflation;
- higher depreciation and amortization expenses;
- the 2012 receipt of a business interruption insurance recovery; and
- higher pension expense.

Net income was $252 million in the second quarter of 2013, an increase of $149 million, or 145%, from $103 million in the same period of 2012.

Net income increased primarily due to higher Operating income and lower Other income and charges, partially offset by higher income tax expense due to the impact of higher earnings.

Net income was $469 million for the first six months of 2013, an increase of $224 million, or 91%, from $245 million in the same period of 2012.

Net income increased primarily due to higher Operating income and lower Other income and charges, partially offset by higher income tax expense due to the impact of higher earnings and the province of Ontario s corporate income tax rate change.

Diluted Earnings per Share

Diluted earnings per share (EPS) was $1.43 in the second quarter of 2013, an increase of $0.83, or 138%, from $0.60 in the same period of 2012. Diluted EPS for the first six months of 2013 was $2.66, an increase of $1.24, or 87%, from $1.42 in the same period of 2012. These increases were primarily due to higher net income.

Operating Ratio

The operating ratio provides the percentage of revenues used to operate the railway, and is calculated as total operating expenses divided by total revenues. A lower percentage normally indicates higher efficiency in the operation of the railway. The operating ratio was 71.9% in the second quarter of 2013, compared with 82.5% in the same period of 2012. The operating ratio was 73.9% for the six months ended June 30, 2013, compared with 81.3% in the same period of 2012. These improvements were primarily due to improved operational performance driving efficiencies and higher traffic volumes, as measured by RTMs, discussed further in Section 8, Lines of Business, the net impact of the strike in 2012 and management transition costs in 2012.

Return on Capital Employed

The calculation of ROCE utilizes EBIT on a rolling twelve month basis. ROCE was 8.7% at June 30, 2013, compared with 8.4% in the same period of 2012. This increase was primarily due to an increase in EBIT, partially offset by an increase in Total assets. EBIT was negatively impacted by labour restructuring, asset impairment charges, advisory costs due to shareholder matters, and management transition costs in 2012.

Excluding these significant items from EBIT, Adjusted ROCE was 10.9% at June 30, 2013, compared with 9.0% at June 30, 2012. This increase was primarily due to an increase in Adjusted EBIT, discussed further in Section 14, Non-GAAP Measures. ROCE, Adjusted ROCE and significant items are discussed further in Section 14, Non-GAAP Measures.

Calculation of Adjusted ROCE

(in millions)	2013	2012
EBIT for the twelve months ended June 30[(1)(2)]	**$ 1,202**	$ 1,084
Adjusted EBIT for the twelve months ended June 30[(1)(2)]	**$ 1,511**	$ 1,159
Average for the twelve months of total assets, less current liabilities excluding the current portion of long-term debt	**$ 13,869**	$ 12,935
ROCE[(1)(2)]	**8.7%**	8.4%
Adjusted ROCE[(1)(2)(3)]	**10.9%**	9.0%

(1) EBIT, Adjusted EBIT, ROCE and Adjusted ROCE have no standardized meaning prescribed by GAAP and, therefore, are unlikely to be comparable to similar measures of other companies. These earnings measures are discussed further in Section 14, Non-GAAP Measures, which also includes a reconciliation of Operating income for the twelve months ended June 30, 2013 and 2012 to EBIT and Adjusted EBIT.

(2) The amount is calculated on a twelve month rolling basis.

(3) Adjusted ROCE is defined as Adjusted EBIT (on a rolling twelve month basis) divided by the average for the year of Total assets, less current liabilities, excluding current portion of long-term debt, as measured under GAAP.

Impact of Foreign Exchange on Earnings

Fluctuations in foreign exchange (FX) affect our results because U.S. dollar-denominated revenues and expenses are translated into Canadian dollars. U.S. dollar-denominated revenues and expenses decrease when the Canadian dollar strengthens in relation to the U.S. dollar.

Canadian to U.S. dollar

Average exchange rates	2013	2012
For the three months ended - June 30	**$ 1.02**	$ 1.01
For the six months ended - June 30	**$ 1.01**	$ 1.01

Canadian to U.S. dollar

Exchange rates	2013	2012
Beginning of year - January 1	**$ 0.99**	$ 1.02
Beginning of quarter - April 1	**$ 1.02**	$ 1.00
End of quarter - June 30	**$ 1.05**	$ 1.02

Average Fuel Price

(U.S. dollars per U.S. gallon)	2013	2012
For the three months ended - June 30	**$ 3.45**	$ 3.49
For the six months ended - June 30	**$ 3.50**	$ 3.49

7. PERFORMANCE INDICATORS

	For the three months ended June 30			For the six months ended June 30		
	2013	2012 [(1)]	% Change	**2013**	2012 [(1)]	% Change
Operations performance						
Freight gross ton-miles (GTMs) (millions)	**67,232**	60,926	10	**134,910**	123,614	9
Train miles (thousands)	**9,645**	9,681		**19,639**	20,023	(2)
Average train weight - excluding local traffic (tons)	**7,471**	6,690	12	**7,337**	6,550	12
Average train length - excluding local traffic (feet)[(2)]	**6,444**	5,955	8	**6,369**	5,853	9
Average train speed AAR definition (mph)	**24.1**	23.7	2	**24.2**	24.5	(1)
Average terminal dwell AAR definition (hours)	**16.1**	18.0	(11)	**15.7**	17.7	(11)
Car miles per car day	**222.2**	194.2	14	**222.1**	201.2	10
Locomotive productivity (daily average GTMs/active horse power (HP))	**218.0**	164.7	32	**211.5**	169.7	25
Fuel efficiency[(3)]	**1.05**	1.14	(8)	**1.09**	1.19	(8)
Total employees (average)[(4)(5)]	**15,471**	17,327	(11)	**15,196**	16,999	(11)
Workforce (end of period)[(6)]	**16,053**	19,505	(18)	**16,053**	19,505	(18)
Safety indicators						
FRA personal injuries per 200,000 employee-hours	**1.35**	1.31	3	**1.51**	1.24	22
FRA train accidents per million train-miles	**1.78**	1.43	24	**1.91**	1.51	26

(1) Certain prior period figures have been revised to conform with current presentation or have been updated to reflect new information.
(2) Incorporates a new reporting methodology where average train length is the sum of each car and locomotive s equipment length multiplied by the distance travelled, divided by train miles. Local trains are excluded from this measure.
(3) Fuel efficiency is defined as U.S. gallons of locomotive fuel consumed per 1,000 GTMs freight and yard.
(4) An employee is defined as an individual, including trainees, who has worked more than 40 hours in a standard biweekly pay period. This excludes part time employees, contractors, and consultants.
(5) 2012 average number of employees has been adjusted for the strike.
(6) Workforce is defined as total employees plus part time employees, contractors, and consultants.

The indicators listed in this table are key measures of our operating performance. Definitions of these performance indicators are provided in Section 23, Glossary of Terms.

Operations Performance

GTMs for the second quarter of 2013 were 67,232 million, an increase of 10%, compared with 60,926 million in the same period of 2012. GTMs for the first six months of 2013 increased by 9% compared to the same period of 2012. These increases were primarily due to higher traffic volumes in Grain and Industrial and Consumer products and the impact of volumes lost during the strike in the second quarter 2012.

Train miles were essentially unchanged in the second quarter of 2013, compared with the same period of 2012, with increased workload offset by increases in both train weights and lengths. Train miles decreased by 2% for the first six months of 2013, compared to the same period of 2012. This improvement was due to higher workload offset by the Company s successful execution of the operating plan.

Average train weight for the second quarter of 2013 was 7,471 tons, an increase of 781 tons, or 12%, compared with 6,690 tons in the same period of 2012. Average train weights for the first six months of 2013 reflect an increase of 787 tons, or 12%, compared with the same period in 2012.

Average train length for the second quarter of 2013 was 6,444 feet, an increase of 489 feet, or 8%, compared with 5,955 feet in the same period of 2012. Average train length for the first six months of 2013 was 6,369 feet, an increase of 9% compared with the same period of 2012.

Average train weight and average length benefited from increased workload and the successful execution of our operating plan. Improvements to average train weight and train length were further enabled by the siding extension strategy, which allowed for the operation of longer and heavier trains.

Average train speed increased by 2% in the second quarter compared with the same period of 2012. This increase was primarily due to ongoing infrastructure capacity investments and the successful execution of the Company s operating plan.

Average train speed decreased by 1% in the first six months of 2013 compared with the same period of 2012. This decrease was primarily due to a relative increase in bulk franchise workload, which moves at a slower average speed than merchandise and intermodal traffic.

Average terminal dwell, the average time a freight car resides in a terminal, decreased by 11% in each of the second quarter and first six months of 2013, compared with the same periods of 2012. These decreases were primarily due to our maintained focus on yard productivity, terminal redesign and the successful execution of the Company s operating plan.

Car miles per car day were 222.2 in the second quarter of 2013, an increase of 14% compared to 194.2 in the same period of 2012 and increased by 10% in the first six months of 2013, compared to the same period of 2012. These increases were primarily due to the successful execution of the Company s operating plan, terminal dwell improvements and a reduction in active cars on-line.

Locomotive productivity, which is daily average GTMs per active HP, for the second quarter of 2013 was 218.0, an increase of 32% compared to the same period of 2012. Locomotive productivity for the first six months of 2013 was 211.5, an improvement of 25%, compared with the same period of 2012. These improvements were primarily the result of increased asset velocity due to more efficient operations, improved fleet reliability and the successful execution of the Company s operating plan.

Fuel efficiency in the second quarter and the first six months of 2013 improved by 8% compared to the same periods of 2012. These improvements were primarily due to the advancement of the Company s fuel conservation strategies, including replacement of older units with new more fuel efficient locomotives, the successful execution of the Company s operating plan, and the inefficiencies of the strike in 2012 including the impact of winding down and subsequent resumption of train operations.

The average number of total employees in the second quarter of 2013 decreased by 1,856, or 11%, from 17,327 compared with the same period in 2012. The average number of total employees in the first six months of 2013 decreased by 1,803, or 11% compared with the same period in 2012. These decreases were primarily due to job reductions as a result of continuing strong operational performance. The 2012 average number of employees has been adjusted for the strike.

The workforce at the end of the second quarter of 2013 decreased by 3,452, or 18%, compared with the end of the same period of 2012. This decrease was primarily due to job reductions as a result of continuing strong operational performance and fewer contractors. At Canadian Pacific s Investor Conference in New York on December 4-5, 2012, the Company outlined plans to reduce approximately 4,500 employee and/or contractor positions, from June 30, 2012 to 2016, through job reductions, natural attrition and reducing the number of contractors, which the Company may possibly exceed.

Safety Indicators

Safety is a key priority for our management, employees and Board of Directors. Our two main safety indicators personal injuries and train accidents follow strict U.S. Federal Railroad Administration (FRA) reporting guidelines.

The FRA personal injury rate per 200,000 employee-hours for CP was 1.35 for the second quarter of 2013, compared with 1.31 in the same period of 2012. This rate was 1.51 for the first six months of 2013, compared with 1.24 for the same period of 2012.

The FRA train accident rate for CP for the second quarter of 2013 was 1.78 accidents per million train-miles, compared with 1.43 in the same period of 2012. This rate was 1.91 for the first six months of 2013, compared with 1.51 for the same period of 2012.

8. LINES OF BUSINESS

Revenues

(in millions)	For the three months ended June 30 **2013**	2012	% Change	For the six months ended June 30 **2013**	2012	% Change
Freight revenues						
Grain	**$ 282**	$ 233	21	**$ 596**	$ 521	14
Coal	**144**	148	(3)	**293**	285	3
Fertilizers and sulphur	**163**	150	9	**315**	276	14
Industrial and consumer products	**379**	306	24	**751**	604	24
Automotive	**106**	116	(9)	**203**	221	(8)
Forest products	**53**	48	10	**106**	98	8
Intermodal	**331**	331		**653**	667	(2)
Total freight revenues	**1,458**	1,332	9	**2,917**	2,672	9
Other revenue	**39**	34	15	**75**	70	7
Total revenues	**$ 1,497**	$ 1,366	10	**$ 2,992**	$ 2,742	9

Our revenues are primarily derived from transporting freight. Other revenues are generated primarily from the leasing of certain assets, switching fees, contracts with passenger service operators, and logistical services.

Freight Revenues

Freight revenues are earned from transporting bulk commodities, merchandise and intermodal goods, and include fuel recoveries billed to our customers. Freight revenues were $1,458 million in the second quarter of 2013, an increase of $126 million, or 9%, from $1,332 million in the same period of 2012.

This increase was primarily due to:

- the impact of the strike in 2012 on Canadian shipments;
- higher shipments of Industrial and consumer products, Grain, and Forest products;
- higher freight rates; and
- higher fuel surcharge revenues due to an increase in traffic volumes with full margin coverage.

This increase was partially offset by the impact of the extensive network outages and lower traffic volumes for Automotive and Coal.

Freight revenues were $2,917 million in the first six months of 2013, an increase of $245 million, or 9%, from $2,672 million in the same period of 2012.

This increase was primarily due to:

- higher shipments of Industrial and consumer products, Grain, Fertilizers and sulphur and Forest products;
- the impact of the strike in 2012 on Canadian shipments;
- higher fuel surcharge revenues due to an increase in traffic volumes with full margin coverage; and
- higher freight rates.

This increase was partially offset by the impact of the extensive network outages and lower traffic volumes for Automotive, Intermodal and Coal.

Fuel Cost Recovery Programs

The short-term volatility in fuel prices may adversely or positively impact expenses and revenues. CP employs a fuel cost recovery program designed to automatically respond to fluctuations in fuel prices and help mitigate the financial impact of rising fuel prices.

Grain

Grain revenue was $282 million in the second quarter of 2013, an increase of $49 million, or 21%, from $233 million in the same period of 2012.

This increase was primarily due to:

higher Canadian grain shipments to the west coast due to stronger demand;

higher U.S. originating grain volumes to the U.S. Midwest due to increased U.S. crop production in CP s draw territory;

increased freight rates for Canadian grain; and

the impact of the strike in 2012 on Canadian grain shipments.

Grain revenue was $596 million for the first six months of 2013, an increase of $75 million, or 14%, from $521 million in the same period of 2012.

This increase was primarily due to:

higher U.S. originating grain volumes to the U.S. Midwest due to increased U.S. crop production in CP s draw territory;

increased freight rates;

higher Canadian grain shipments to the west coast due to stronger demand; and

the impact of the strike in 2012 on Canadian grain shipments.

Coal

Coal revenue was $144 million in the second quarter of 2013, a decrease of $4 million, or 3%, from $148 million in the same period of 2012.

This decrease was primarily due to the impact of the extensive network outages and lower U.S. originating thermal coal shipments as a result of soft market conditions.

This decrease was partially offset by lower 2012 Canadian originating shipments of metallurgical coal due to the strike in 2012 and higher freight rates.

Coal revenue was $293 million for the first six months of 2013, an increase of $8 million, or 3%, from $285 million in the same period of 2012.

This increase was primarily due to the impact of the strike in 2012 on Canadian originating shipments of metallurgical coal. This increase was partially offset by the impact of the extensive network outages and lower U.S. originating thermal coal shipments as a result of soft market conditions.

Fertilizers and Sulphur

Fertilizers and sulphur revenue was $163 million in the second quarter of 2013, an increase of $13 million, or 9%, from $150 million in the same period of 2012. Revenues increased due to fuel surcharge revenues as a result of an increase in traffic volumes with full margin coverage and the impact of the strike in 2012 on Canadian originating shipments, partially offset by the impact of the extensive network outages and lower export potash shipments which are no longer contracted exclusively with CP as was the case in 2012.

Fertilizers and sulphur revenue was $315 million for the first six months of 2013, an increase of $39 million, or 14%, from $276 million in the same period of 2012.

This increase was due to higher fertilizers and sulphur shipments due to strong demand and the impact of the strike in 2012 on Canadian originating shipments, partially offset by the impact of the extensive network outages.

Industrial and Consumer Products

Industrial and consumer products revenue was $379 million in the second quarter of 2013, an increase of $73 million, or 24%, from $306 million in the same period of 2012.

This increase was primarily due to higher volumes as a result of strong market demand and growth in movement of energy related commodities and energy related inputs and the impact of the strike in 2012 on Canadian originating shipments.

Industrial and consumer products revenue was $751 million for the first six months of 2013, an increase of $147 million, or 24%, from $604 million in the same period of 2012.

This increase was primarily due to higher volumes as a result of strong market demand and growth in movement of energy related commodities and energy related inputs and the impact of the strike in 2012 on Canadian originating shipments.

Automotive

Automotive revenue was $106 million in the second quarter of 2013, a decrease of $10 million, or 9%, from $116 millio0pt">Non controlling interest 5 -

Total equity
18,548 18,537
Total liabilities and shareholders' equity
$151,907 $171,878

See notes to the consolidated financial statements.

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ISRAMCO INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except share and per share amounts)

Year Ended December 31	2011	2010	2009
Revenues			
Oil and gas sales	$ 44,228	$ 39,329	$ 30,768
Production services	896	-	-
Office services	437	655	845
Other	87	2,216	111
Total revenues	45,648	42,200	31,724
Operating expenses			
Lease operating expense, transportation and taxes	20,981	19,894	15,651
Depreciation, depletion and amortization	9,982	12,142	15,368
Impairments of oil and gas assets	4,034	1,751	5,751
Accretion expense	853	849	829
Production services	675	-	-
Loss from plug and abandonment	315	1,300	312
General and administrative	4,438	5,123	4,113
Total operating expenses	41,278	41,059	42,024
Operating income (loss)	4,370	1,141	(10,300)
Other expenses (income)			
Interest expense, net	7,760	7,646	9,219
Realized gain on marketable securities	(15,910)	-	(250)
Net loss (gain) on derivative contracts	922	(1,862)	4,400
Currency exchange rate differences	237	-	-
Total other expenses (income)	(6,991)	5,784	13,369
Income (loss) before income taxes	11,361	(4,643)	(23,669)
Income tax benefit (expense)	(3,975)	1,856	10,090
Net income (loss)	$ 7,386	$ (2,787)	$ (13,579)
Net income attributable to non-controlling interests	5	-	-
Net income (loss) attributable to Isramco	$ 7,381	$ (2,787)	$ (13,579)
Earnings (loss) per share – basic:	$ 2.72	$ (1.03)	$ (5.00)
Earnings (loss) per share – diluted:	$ 2.72	$ (1.03)	$ (5.00)
Weighted average number of shares outstanding-basic:	2,717,691	2,717,691	2,717,691
Weighted average number of shares outstanding-diluted:	2,717,691	2,717,691	2,717,691

See notes to the consolidated financial statements.

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ISRAMCO INC.
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2011, 2010 and 2009

	Common stock							
	Number of shares	Amount	Additional Paid-In Capital	Accumulated other comprehensive income (loss)	Retained Earnings (Accumulated Deficit)	Treasury stock	Non-controlling interests	Total Shareholders' Equity
	$ in thousands, except share amounts							
Balances at January 1, 2009	2,717,691	$27	$23,194	$ (240)	$ 2,217	$(164)	-	$ 25,034
Net loss					(13,579)			(13,579)
Net unrealized gain on available for sale marketable securities, net of taxes of $1,035				2,011				2,011
Net gain on derivative contracts, net of taxes $138				267				267
Total comprehensive loss								2,278
Balance of December 31, 2009	2,717,691	$27	$23,194	$ 2,038	$ (11,362)	$(164)	$ -	$ 13,733
Net loss					(2,787)			(2,787)
Net unrealized gain on available for sale marketable securities, net of taxes of $3,965				7,258				7,258
Net gain (loss) on derivative contracts, net of taxes $171				333				333
Total comprehensive loss								7,591
Balance of December 31, 2010	2,717,691	$27	$23,194	$ 9,629	$ (14,149)	$(164)	$ -	$ 18,537
Net income					7,381		5	7,386

Net unrealized loss on available for sale marketable securities, net of taxes of $3,983				(7,397)				(7,397)
Net gain (loss) on derivative contracts, net of taxes $12				22				22
Total comprehensive gain								(7,375)
Balance of December 31, 2011	2,717,691	$27	$23,194	$ 2,254	$ (6,768)	$(164)	$ 5	$ 18,548

See notes to consolidated financial statements.

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ISRAMCO INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

Year Ended December 31	2011	2010	2009
Cash Flows From Operating Activities:			
Net income (loss)	$ 7,386	$ (2,787)	$ (13,579)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation, depletion, amortization and impairment	14,016	13,893	21,119
Accretion expense	853	849	829
Realized gain on marketable securities	(15,910)	-	(250)
Changes in deferred taxes	3,975	(1,856)	(9,841)
Net unrealized loss (gain) on derivative contracts	(3,384)	4,727	19,298
Amortization of debt cost	252	252	252
Realized gain on sale of investment and capital gain	-	(2,160)	(3)
Changes in components of working capital and other assets and liabilities			
Accounts receivable	(349)	1,314	(2,008)
Prepaid expenses and other current assets	(86)	(59)	(167)
Due to related party	959	(2,360)	3,866
Inventories	(86)	-	-
Accounts payable and accrued expenses	(680)	250	2,003
Net cash provided by operating activities	6,946	12,063	21,519
Cash flows from investing activities:			
Addition to property and equipment, net	(9,060)	(3,611)	(645)
Proceeds from sale of gas properties and equipment	32	2,236	1
Restricted cash and deposit, net	598	(62)	(70)
Purchase of marketable securities	-	-	(370)
Proceeds from sale of marketable securities	16,073	-	752
Net cash provided by (used in) investing activities	7,643	(1,437)	(332)
Cash flows from financing activities:			
Repayments on loans – related parties, net	(12,537)	-	(963)
Proceeds on loans-related parties , net	11,000	-	2,000
Repayment of long-term debt	(17,075)	(7,875)	(21,250)
Borrowings (repayments) of bank overdraft, net	488	(1)	(1,208)
Net cash used in financing activities	(18,124)	(7,876)	(21,421)
Net increase (decrease) in cash and cash equivalents	(3,535)	2,750	(234)
Cash and cash equivalents at beginning of year	5,657	2,907	3,141
Cash and cash equivalents at end of year	$ 2,122	$ 5,657	$ 2,907

See notes to the consolidated financial statements.

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ISRAMCO INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

Basis of Presentation and Principles of Consolidation

Isramco, Inc. and its subsidiaries ("Isramco", "we", "our" or the "Company") are primarily engaged in the acquisition, development, production and exploration of onshore oil and natural gas properties located in the United States of America ("United States"). The Company operates in one segment, oil and natural gas exploration and exploitation. The Company's consolidated financial statements include the accounts of all majority-owned, controlled subsidiaries. All intercompany accounts and transactions have been eliminated. The Company has evaluated events or transactions through the date of issuance of this report in conjunction with the preparation of these consolidated financial statements.

Use of Estimates

In preparing financial statements in accordance with accounting principles generally accepted in the United States, management makes informed judgments and estimates that affect the reported amounts of assets, liabilities, revenues, and expenses. Management evaluates its estimates and related assumptions regularly, including those related to the value of properties and equipment; proved reserves; intangible assets; asset retirement obligations; litigation reserves; environmental liabilities; liabilities, and costs; income taxes; and fair values. Changes in facts and circumstances or additional information may result in revised estimates, and actual results may differ from these estimates.

Fair Value Measurements

Certain of Isramco's assets and liabilities are measured at fair value at each reporting date. Fair value represents the price that would be received to sell the asset or paid to transfer the liability in an orderly transaction between market participants. This price is commonly referred to as the "exit price." Fair value measurements are classified according to a hierarchy that prioritizes the inputs underlying the valuation techniques. This hierarchy consists of three broad levels:

- Level 1 – Inputs consist of unadjusted quoted prices in active markets for identical assets and liabilities and have the highest priority. When available, Isramco measures fair value using Level 1 inputs because they generally provide the most reliable evidence of fair value.

- Level 2 – Inputs consist of quoted prices that are generally observable for the asset or liability. Common examples of Level 2 inputs include quoted prices for similar assets and liabilities in active markets or quoted prices for identical assets and liabilities in markets not considered to be active.

- Level 3 – Inputs are not observable from objective sources and have the lowest priority. The most common Level 3 fair value measurement is an internally developed cash flow model.

Cash and Cash Equivalents.

Isramco records as cash equivalents all highly liquid short-term investments with original maturities of three months or less.

Allowance for Doubtful Accounts

The Company establishes provisions for losses on accounts receivable if it determines that it will not collect all or part of the outstanding balance. The Company regularly reviews collectability and establishes or adjusts the allowance as necessary using the specific identification method.

Oil and Gas Operations.

The Company applies the successful efforts method of accounting for oil and gas properties. Under the successful efforts method, exploration costs such as exploratory geological and geophysical costs, delay rentals and exploration overhead are charged against earnings as incurred. Acquisition costs and costs of drilling exploratory wells are capitalized pending determination of whether proved reserves can be attributed to the area as a result of drilling the well. If management determines that commercial quantities of hydrocarbons have not been discovered, capitalized costs associated with exploratory wells are charged to exploration expense. Acquisition costs of unproved leaseholds are assessed for impairment during the holding period and transferred to proved oil and gas properties to the extent associated with successful exploration activities. Significant undeveloped leases are assessed individually for impairment, based on the Company’s current exploration plans, and a valuation allowance is provided if impairment is indicated.

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Depreciation, depletion and amortization of the cost of proved oil and gas properties are calculated using the unit-of-production method. The reserve base used to calculate depreciation, depletion and amortization is the sum of proved developed reserves and proved undeveloped reserves for leasehold acquisition costs and the cost to acquire proved properties. With respect to lease and well equipment costs, which include development costs and successful exploration drilling costs, the reserve base includes only proved developed reserves. Estimated future dismantlement, restoration and abandonment costs, net of salvage values, are taken into account.

Amortization rates are updated to reflect: 1) the addition of capital costs, 2) reserve revisions (upwards or downwards) and additions, 3) property acquisitions and/or property dispositions and 4) impairments.

The Company reviews its property and equipment in accordance with Accounting Standard Codification (ASC) 360, Property, Plant, and Equipment (ASC 360). ASC 360 requires the Company to evaluate property and equipment as an event occurs or circumstances change that would more likely than not reduce the fair value of the property and equipment below the carrying amount. If the carrying amount of property and equipment is not recoverable from its undiscounted cash flows, then the Company would recognize an impairment loss for the difference between the carrying amount and the discounted cash flow.

In 2011, 2010 and 2009, we reported an impairment charge of $4,034,000, $1,751,000 and $5,751,000, respectively, relating to our oil and gas properties.

Property, Plant and Equipment Other than Oil and Natural Gas Properties

Property and equipment are carried at cost less accumulated depreciation. Depreciation is provided for our assets over the estimated depreciable lives of the assets using the straight-line method. Depreciation expense for the years ended December 31, 2011, 2010 and 2009 was $246,000, $165,000 and $111,000 respectively. We depreciate our operational assets over their depreciable lives to their salvage value, which is a fair value higher than the assets' value as scrap. Salvage value approximates 15% of an operational asset's acquisition cost. When an operational asset is stacked or taken out of service, we review its physical condition, depreciable life and ultimate salvage value to determine if the asset is no longer operable and whether the remaining depreciable life and salvage value should be adjusted. When we scrap an asset, we accelerate the depreciation of the asset down to its salvage value. When we dispose of an asset, a gain or loss is recognized. We did not identify any triggering events or record any asset impairments during 2011, 2010 and 2009.

As of December 31, 2011, the estimated useful lives of our asset classes are as follows:

Description	Years
Well service rigs and components	15
Oilfield trucks, vehicles and related equipment	7-10
Well service auxiliary equipment	7-15
Furniture and equipment	3-7

A long-lived asset or asset group should be tested for recoverability whenever events or changes in circumstances indicate that its carrying amount may not be recoverable. For purposes of testing for impairment, we group our long-lived assets along our lines of business based on the services provided, which is the lowest level for which identifiable cash flows are largely independent of the cash flows of other assets and liabilities. We would record an impairment charge, reducing the net carrying value to an estimated fair value, if the asset group's estimated future cash flows were less than its net carrying value. Events or changes in circumstance that cause us to evaluate our fixed assets for recoverability and possible impairment may include changes in market conditions, such as adverse movements in the prices of oil and natural gas, or changes of an asset group, such as its expected future life, intended use or physical condition, which could reduce the fair value of certain of our property and equipment. The development of future cash flows and the determination of fair value for an asset group involves significant judgment and estimates.

Marketable Securities

The Company may invest a portion of its cash in money market mutual funds which are highly liquid marketable securities. The Company accounts for marketable securities in accordance with Financial Accounting Standards Board's (FASB) ASC 320, Investments—Debt and Equity Securities, (ASC 320) and classifies marketable securities as trading, available-for-sale, or held-to-maturity. The appropriate classification of its marketable securities is determined at the time of purchase and reevaluated at each balance sheet date.

Trading and available-for-sale securities are recorded at fair market value. Isramco holds no held-to-maturity securities. Unrealized holding gains and losses on trading securities are included in earnings. Unrealized holding gains or losses, net of the related tax effects, on available-for-sale securities are excluded from earnings and are reported net of applicable taxes as accumulated other comprehensive income, a separate component of shareholders' equity, until realized.

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Asset Retirement Obligation

ASC 410, Asset Retirement and Environmental Obligations (ASC 410) requires that the fair value of an asset retirement cost, and corresponding liability, should be recorded as part of the cost of the related long-lived asset and subsequently allocated to expense using a systematic and rational method. The Company records asset retirement obligations to reflect the Company's legal obligations related to future plugging and abandonment of its oil and natural gas wells and gas gathering systems. The Company estimates the expected cash flow associated with the obligation and discounts the amounts using a credit-adjusted, risk-free interest rate. At least annually, the Company reassesses the obligation to determine whether a change in the estimated obligation is necessary. The Company evaluates whether there are indicators that suggest the estimated cash flows underlying the obligation have materially changed. Should those indicators suggest the estimated obligation may have materially changed on an interim basis (quarterly), the Company will accordingly update its assessment. Additional retirement obligations increase the liability associated with new oil and natural gas wells as these obligations are incurred. See "Note 14. Asset Retirement Obligations."

Concentrations of Credit Risk

The Company through its wholly-owned subsidiary Jay Management Company, LLC ("Jay Management") operates a substantial portion of its oil and natural gas properties. As the operator of a property, the Company makes full payments for costs associated with the property and seeks reimbursement from the other working interest owners in the property for their share of those costs. The Company's joint interest partners consist primarily of independent oil and natural gas producers. If the oil and natural gas exploration and production industry in general were adversely affected, the ability of the Company's joint interest partners to reimburse the Company could also be adversely affected.

The purchasers of the Company's oil and natural gas production consist primarily of independent marketers, major oil and natural gas companies and gas pipeline companies. The Company has not experienced any significant losses from uncollectible accounts. The Company does not believe the loss of any one of its purchasers would materially affect the Company's ability to sell the oil and natural gas it produces. The Company believes other purchasers are available in the Company's areas of operations.

In 2011, one individual purchaser of the Company's production accounted for 30% of the Company's total sales and an additional three individual purchasers of the Company's production accounted for approximately 26% of its total sales (two purchasers approximately 9% each and another approximately 8%), collectively representing 56% of the Company's total sales. In 2010, one individual purchaser of the Company's production accounted for 23% of the Company's total sales and an additional three individual purchasers of the Company's production accounted for approximately 27% of its total sales (approximately 9% each), collectively representing 50% of the Company's total sales. In 2009, two individual purchasers of the Company's production each accounted for in excess of 10% of the Company's total sales and an additional three individual purchasers of the Company's production accounted for approximately 25.5% of its total sales (approximately 8.5% each), collectively representing 50% of the Company's total sales.

Revenue Recognition

Revenues from the sale of oil and natural gas are recognized when the products are sold to a purchaser at a fixed or determinable price, delivery has occurred and title has transferred, and collectability of the revenue is reasonably assured. The Company follows the entitlement method of accounting for recording oil and gas revenues. Under this method, any revenues received in excess of the Company's interest in production are treated as a liability. If revenues received are less than Company's interest in production, the deficiency is recorded as an asset. The Company's imbalance position was not significant in terms of volumes or values at December 31, 2011 and 2010.

Revenues from our well service activities are recognized when all of the following criteria have been met: (i) evidence of an arrangement exists, (ii) delivery has occurred or services have been rendered, (iii) the price to the customer is fixed and determinable and (iv) collectability is reasonably assured.

- Evidence of an arrangement exists when a final understanding between us and our customer has occurred, and can be evidenced by a completed customer purchase order, field ticket, supplier contract, or master service agreement.

- Delivery has occurred or services have been rendered when we have completed requirements pursuant to the terms of the arrangement as evidenced by a field ticket.

- The price to the customer is fixed and determinable when the amount that is required to be paid is agreed upon. Evidence of the price being fixed and determinable is evidenced by contractual terms, our price book, a completed customer purchase order, or a field ticket.

- Collectability is reasonably assured when we screen our customers and provide goods and services to customers according to determined credit terms that have been granted based on credit evaluation and assessment.

We present our revenues net of any sales taxes collected by us from our customers that are required to be remitted to local or state governmental taxing authorities.

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Price Risk Management Activities

The Company follows ASC 815, Derivatives and Hedging. From time to time, the Company may hedge a portion of its forecasted oil and natural gas production. Derivative contracts entered into by the Company have consisted of transactions in which the Company hedges the variability of cash flow related to a forecasted transaction. The Company has elected to not designate any of its positions for hedge accounting. Accordingly, the Company records the net change in the mark-to-market valuation of these positions, as well as payments and receipts on settled contracts, in “Net gain (loss) on derivative contracts” on the Company’s consolidated statements of operations.

In 2011, 2010 and 2009, we recorded gain (loss) of ($0.9) million, $1.9 million and ($4.4) million, respectively, related to our derivative instruments. Fair values are derived principally from market quoted and other independent third-party quotes.

During the second quarter of 2008, we made the decision to mitigate a portion of our interest rate risk with interest rate swaps. These swap instruments reduce our exposure to market rate fluctuations by converting variable interest rates to fixed interest rates. These interest rate swaps convert a portion of our variable rate interest of our Scotia debt (as defined in Note 6, “Long-term Debt and Interest Expense”) to a fixed rate obligation, thereby reducing the exposure to market rate fluctuations. We have elected to designate these positions for hedge accounting and therefore the unrealized gains and losses are recorded in accumulated other comprehensive loss. The Company measures hedge effectiveness by assessing the changes in the fair value or expected future cash flows of the hedged item.

As of the date of this report there are no open interest rate swap positions.

Income Taxes

We account for deferred income taxes using the asset and liability method and provide income taxes for all significant temporary differences. Management determines our current tax liability as well as taxes incurred as a result of current operations, but which are deferred until future periods. Current taxes payable represent our liability related to our income tax returns for the current year, while net deferred tax expense or benefit represents the change in the balance of deferred tax assets and liabilities reported on our consolidated balance sheets. Management estimates the changes in both deferred tax assets and liabilities using the basis of assets and liabilities for financial reporting purposes and for enacted rates that management estimates will be in effect when the differences reverse. Further, management makes certain assumptions about the timing of temporary tax differences for the differing treatments of certain items for tax and accounting purposes or whether such differences are permanent. The final determination of our tax liability involves the interpretation of local tax laws, tax treaties, and related authorities in each jurisdiction as well as the significant use of estimates and assumptions regarding the scope of future operations and results achieved and the timing and nature of income earned and expenditures incurred.

We establish valuation allowances to reduce deferred tax assets if we determine that it is more likely than not (e.g., a likelihood of more than 50%) that some portion or all of the deferred tax assets will not be realized in future periods. To assess the likelihood, we use estimates and judgment regarding our future taxable income, as well as the jurisdiction in which this taxable income is generated, to determine whether a valuation allowance is required. Such evidence can include our current financial position, our results of operations, both actual and forecasted results, the reversal of deferred tax liabilities, and tax planning strategies as well as the current and forecasted business economics of our industry. Additionally, we record uncertain tax positions at their net recognizable amount, based on the amount that management deems is more likely than not to be sustained upon ultimate settlement with the tax authorities in the domestic and international tax jurisdictions in which we operate.

See "Note 8. Income Taxes" for further discussion of accounting for income taxes, changes in our valuation allowance, components of our tax rate reconciliation and realization of loss carryforwards.

Legal Contingencies

When estimating our liabilities related to litigation, we take into account all available facts and circumstances in order to determine whether a loss is probable and reasonably estimable.

Various suits and claims arising in the ordinary course of business are pending against us. We conduct business throughout the continental United States and may be subject to jury verdicts or arbitrations that result in outcomes in favor of the plaintiffs. We continually assess our contingent liabilities, including potential litigation liabilities, as well as the adequacy of our accruals and our need for the disclosure of these items. We establish a provision for a contingent liability when it is probable that a liability has been incurred and the amount is reasonably estimable.

Earnings per Share

The Company's basic earnings per share (EPS) amounts have been computed based on the average number of shares of common stock outstanding for the period and include the effect of any participating securities as appropriate. Diluted EPS includes the effect of the Company's outstanding stock options, restricted stock awards, restricted stock units and performance-based stock awards if the inclusion of these items is dilutive.

For the year ended December 31, 2011, Isramco's stock options were anti-dilutive.

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Noncontrolling Interests

Noncontrolling interests represent third-party ownership in the net assets of the Company's consolidated subsidiary and are presented as a component of equity.

Environmental

The Company accrues for losses associated with environmental remediation obligations when such losses are probable and can be reasonably estimated. Accruals for estimated losses from environmental remediation obligations are recognized no later than the time of the completion of the remediation feasibility study or remediation plan. These accruals are adjusted as additional information becomes available or as circumstances change. Costs of future expenditures for environmental remediation obligations are not discounted to their present value.

Recently Issued Accounting Pronouncements

ASU 2010-13. In April 2010, the FASB issued ASU No. 2010-13, Compensation — Stock Compensation (Topic 718): Effect of Denominating the Exercise Price of a Share-Based Payment Award in the Currency of the Market in Which the Underlying Equity Security Trades. This ASU codifies the consensus reached in EITF Issue No. 09-J, "Effect of Denominating the Exercise Price of a Share-Based Payment Award in the Currency of the Market in Which the Underlying Equity Security Trades." The amendments to the Codification clarify that an employee share-based payment award with an exercise price denominated in the currency of a market in which a substantial portion of the entity's equity shares trades should not be considered to contain a condition that is not a market, performance, or service condition. Therefore, an entity would not classify such an award as a liability if it otherwise qualifies as equity. ASU 2010-13 is effective for fiscal years beginning on or after December 15, 2010. The amendments in this update should be applied by recording a cumulative-effect adjustment to the opening balance of retained earnings. The cumulative-effect adjustment should be calculated for all awards outstanding as of the beginning of the fiscal year in which the amendments are initially applied, as if the amendments had been applied consistently since the inception of the award. The cumulative-effect adjustment should be presented separately. We adopted the provisions of ASU 2010-13 on January 1, 2011, and the adoption of this standard did not have a material impact on our financial position, results of operations, or cash flows.

ASU 2011-05. In June 2011, the FASB issued ASU 2011-05, Comprehensive Income (Topic 220): Presentation of Comprehensive Income. The amendments in this ASU allow an entity the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both choices, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. This ASU eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders' equity. ASU 2011-05 should be applied retrospectively for interim and annual reporting periods beginning after December 15, 2011 with early adoption permitted. Adoption of this ASU will have no impact on the Company's consolidated financial statements.

ASU 2011-12. In December 2011, the FASB issued ASU 2011-12, Deferral of the Effective Date for Amendment to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income (Topic 220): Presentation of Comprehensive Income. This ASU defers the guidance on whether to require entities to present reclassification adjustments out of accumulated other comprehensive income by component in both the statement where net income is presented and the statement where other comprehensive income is presented for both interim and annual financial statements. ASU 2011-12 reinstated the requirements for the presentation of reclassifications that were in place prior to the issuance of ASU 2011-05 and did not change the effective date of ASU 2011-05. ASU

2011-12 should be applied consistently with ASU 2011-05; accordingly, this ASU is to be applied retrospectively for interim and annual reporting periods beginning after December 15, 2011, with early adoption permitted. Adoption of this ASU will have no impact on the Company's consolidated financial statements.

ASU 2011-04. In May 2011, the FASB issued ASU 2011-04, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS. This ASU represents the converged guidance of the FASB and the IASB on measuring fair value and for disclosing information about fair value measurements. The amendments in this ASU clarify the Board's intent about the application of existing fair value measurement and disclosure requirements and changes particular principles or requirements for measuring fair value and for disclosing information about fair value measurements. ASU 2011-04 is effective prospectively for interim and annual reporting periods beginning after December 15, 2011. Adoption of this ASU will have no impact on the Company's consolidated financial statements.

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2. New Subsidiaries

In August 2011 the Company created three new subsidiaries. Only one of them has started activity and has acquired equipment and been providing a full range of well services to major oil companies and independent oil and natural gas production companies. The services include rig-based and workover services, well completion and recompletion services, plugging and abandonment of wells at the end of their useful lives and other ancillary oilfield services. The Company operates in major oil and natural gas producing regions in Texas and New Mexico.

3. Transactions with Affiliates and Related Parties

On November 17, 2008, the Company and Goodrich Global, Ltd. ("Goodrich") entered into an Amended and Restated Agreement, as subsequently amended on November 24, 2008 ("Restated Agreement"). The Restated Agreement replaced the consulting agreement originally entered into in May 1996. Under the the Restated Agreement, the Company pays to Goodrich, which is owned and controlled by Haim Tsuff, the Chairman of the Board of Directors and Chief Executive Officer of Isramco, $360,000 per annum in installments of $30,000 per month, in addition to reimbursing Goodrich for all reasonable expenses incurred in connection with services rendered on behalf of the Company. Goodrich is entitled to receive, with respect to each completed fiscal year beginning with the fiscal year ended on December 31, 2008, an amount in cash equal to five percent (5%) of the Company's pre-tax recorded profit calculated without reference to gain or loss in derivative transactions (the "Supplemental Payment"). The Supplemental payment is to be made within ten (10) business days after the filing with the Securities and Exchange Commission of the Company's Annual Report on Form 10-K for such fiscal year. For purposes of the Supplemental Payment in the Restated Agreement, "profit" means the pre – tax recorded profit as specified in the Company's annual report on Form 10-K, but excluding unrealized gain or loss on derivative transactions. The Restated Agreement has an initial term through May 31, 2011; provided that the term of the Restated Agreement will be deemed to have been automatically extended for an additional three year period unless the Company furnishes Goodrich, by March 3, 2011, with written notice of its election to not extend the term of such agreement. The Company did not furnish notice of termination, and the Restated Agreement was accordingly extended. The Restated Agreement contains certain customary confidentiality and non-compete provisions. If the Restated Agreement is terminated by the Company other than for cause, then Goodrich is entitled to receive the equivalent of payments due through the then remaining term of the agreement. For the year ended December 31, 2011, 2010 and 2009 we paid Goodrich the total amount of $360,000, $360,000 and $360,000, respectively. The conditions precedent for Supplemental Payments were not met and no Supplemental Payments have been made. In addition, in connection settlement of the Derivative Litigation, the parties to the Restated Agreement amend the Restated Agreement to eliminate the provisions providing for Supplemental Payment.

4. Marketable Securities

In August 2011 the Company sold all of its investment in a company called MediaMind Ltd. The realized gain from this transaction amounted to $15,910,000.

Sales of marketable securities resulted in realized gains of $15,910,000, $0 and $250,000 for the years ended December 31, 2011, 2010 and 2009, respectively.

Available-for-sale securities, which are primarily traded on the Tel-Aviv Stock Exchange and on the National Association of Securities Dealers Automated Quotation ("NASDAQ"), consist of the following (in thousands):

As of December 31	2011		2010	
	Cost	Market Value	Cost	Market Value

	$	1,087	$	4,554	$	1,200	$	16,099

In January and February 2012, the Company sold its investment of 278,408 shares of stock in an affiliated company Jerusalem Oil Exploration Ltd. The total consideration received from the sale was approximately $4,833,000.

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5. Derivative and Hedging Activities

The Company enters into derivative commodity contracts to economically hedge its exposure to price fluctuations on a portion of its anticipated oil and natural gas production. It is the Company's policy to enter into derivative contracts only with counterparties that are creditworthy financial institutions deemed by management as competent and competitive market makers. Each of the counterparties to the Company's derivative contracts is a lender in the Company's Senior Credit Agreement. The Company did not post collateral under any of these contracts as they are secured under the Senior Credit Agreement.

As of December 31, 2011, the Company has swaps agreements. A swap requires the Company to make a payment to, or receive receipts from, the counterparty based upon the differential between a specified fixed price and a price related to those quoted on the New York Mercantile Exchange (NYMEX) for each respective period.

As of December 31, 2011 we had swap contracts for volume of 48,567 barrels of crude oil during 36 months, commencing January 2012, and swap contracts for volume of 270,613 MMBTU of natural gas during 3 months commencing January 2012. Derivative commodity contracts settle based on NYMEX West Texas Intermediate and Henry Hub prices, which may differ from the actual price received by the Company. During 2011, 2010 and 2009 the Company did not elect to designate any positions as cash flow hedges for accounting purposes, and accordingly, recorded the net change in the mark-to-market valuation of these contracts, as well as all payments and receipts on settled contracts, in current earnings as a component of other income and expenses on the consolidated statements of operations.

At December 31, 2011, the Company had a $2.4 million derivative asset, of which $1 million was classified as current. For the year ended December 31, 2011, the Company recorded a net derivative loss of $0.9 million (a $3.4 million unrealized gain offset by a $4.3 million loss from net cash paid on settled contracts).

At December 31, 2010, the Company had a $2.5 million derivative asset, of which $2.2 million was classified as current and a $3.5 million derivative liability, of which $1.1 million was classified as current. For the year ended December 31, 2010, the Company recorded a net derivative gain of $1.86 million (a $4.7 million unrealized loss partially offset by a $6.6 million gain from net cash received on settled contracts).

At December 31, 2009, the Company had a $5.6 million derivative asset, of which $3.4 million was classified as current and a $1.8 million derivative liability, of which $0.1 million was classified as current. For the year ended December 31, 2009, the Company recorded a net derivative loss of $4.4 million (a $19.3 million unrealized loss partially offset by a $14.9 million gain from net cash received on settled contracts).

Natural Gas

At December 31, 2011, the Company had the following natural gas swap positions:

Period	Volume in MMbtu's	Swaps Price / Price Range	Weighted Average Price
January 2012 – March 2012	174,222	8.65	8.65

Crude Oil

At December 31, 2011, the Company had the following crude oil swap positions:

Period	Volume in Bbls	Swaps Price / Price Range	Weighted Average Price
January 2012 – December 2012	127,473	88.20-103.51	99.67
January 2013 – December 2013	89,400	103.51	103.51
January 2014 – December 2014	66,000	103.51	103.51

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On March 9, 2011, pursuant to an agreement with Wells Fargo, the derivative contracts between Isramco and Wells Fargo were terminated and the Company signed new swap contracts with Macquarie Bank, N.A. for an aggregate volume of 336,780 barrels of crude oil during the 46 month period commencing March 2011. The payment required for the termination of these contracts was approximately $7 million.

During the second quarter of 2008, we made the decision to mitigate a portion of our interest rate risk with interest rate swaps. These swap instruments reduce our exposure to market rate fluctuations by converting variable interest rates to fixed interest rates.

Under these swaps, the Company makes payments to, or receives payments from, the counterparties based upon the differential between a specified fixed price and a price related to the one-month London Interbank Offered Rate ("LIBOR"). These interest rate swaps convert a portion of the variable rate interest of our Scotia Senior Credit Facility (as defined in Note 6, "Long-term Debt and Interest Expenses") to a fixed rate obligation, thereby reducing the exposure to market rate fluctuations. We have elected to designate these positions for hedge accounting and therefore the unrealized gains and losses are recorded in accumulated other comprehensive loss. The Company measures hedge effectiveness by assessing the changes in the fair value or expected future cash flows of the hedged item.

As of December 31, 2011 the Company did not have open interest rate swap positions.

6. Long-Term Debt and Interest Expense

Long-Term Debt as December 31 consisted of the following (in thousands):

	2011	2010
Libor + 2% Bank Revolving Credit Facility due 2011	-	9,450
Libor + 2% Bank Revolving Credit Facility due 2012	20,000	27,625
Libor + 6% Related party Debt	12,000	12,000
Libor + 5.5% Related party Debt	-	954
Libor + 6% Related party Debt	11,500	11,500
Libor + 6% Related party Debt	6,000	6,000
Libor + 6% Related party Debt	41,861	48,900
Libor + 5.5% Related party Debt	6,456	-
	97,817	116,429
Less: Current Portion of Long-Term Debt	(37,642)	(17,350)
Total	60,175	99,079

Senior Revolving Credit Facilities

The Company entered into a Senior Secured Revolving Credit Agreement, dated as of March 27, 2008 and Amended and Restated as of December 19, 2008 (the "Scotia Senior Credit Agreement"), with each of the lenders from time to time party thereto (the "Lenders"). The Bank of Nova Scotia is the administrative agent for the Lenders and Capital One, N.A. is the syndication agent for the Lenders. The Scotia Senior Credit Agreement originally provided for a $150 million facility due in 2012 with a borrowing base of $54 million that is redetermined from time to time and adjusted based on the Company's oil and gas properties, reserves, other indebtedness and other relevant factors. During the first quarter of 2011, the Lenders reduced the borrowing base to $28 million. On July 28, 2011 the borrowing base available under the other credit facility with the Bank of Nova Scotia ("Scotia") was redetermined to $20,000,000.

During the fourth quarter of 2011 the Lenders reduced the borrowing base to $0. The Company is repaying the approximately $20,000,000 outstanding balance in six installments of $3,333,000 each with the first two payments already made for January and February 2012 and the remaining installments due each month thereafter through June 2012 when the entire balance will be repaid.

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The Company is also in negotiations for similar credit facilities with several other commercial lenders, to obtain terms most favorable to the Company. While optimistic of a positive outcome of our consolidation efforts, the Company is uncertain as to whether it will be successful in obtaining new replacement financing or, if is obtained, the timetable upon which such facility will be closed and other material terms and conditions.

Amounts outstanding under the Scotia Senior Credit Agreement bear interest at specified margins over the LIBOR of 1.25% to 2.00% for LIBOR loans or at specified margins over the Base Rate (as defined in the agreement) of 0.25% to 1.25% for base rate loans. Such margins fluctuate based on the utilization of the borrowing base. Borrowings under the Scotia Senior Credit Agreement are secured by first lien and security interest on the real and personal property of Isramco Resources.

The Scotia Senior Credit Agreement contains customary financial and other covenants, including minimum working capital levels of not less than 1.0 to 1.0, leverage ratio of not greater than 3.5 to 1.0 and minimum coverage of interest of not less than 2.5 to 1.0. In addition, the Company is subject to covenants limiting dividends and other restricted payments, transactions with affiliates, changes of control, asset sales, and liens on properties.

The Company entered into a Senior Secured Revolving Credit Agreement, dated as of March 2, 2007 as Amended and Restated as of June 15, 2007 (the “Wells Fargo Senior Credit Agreement”), with the lenders from time to time party thereto (the “Lenders”) and Wells Fargo Bank, N.A, as administrative agent for the Lenders. The Wells Fargo Senior Credit Agreement originally provided for a $150 million facility due in March, 2011 with a borrowing base of $35.3 million that is redetermined from time to time and adjusted based on the Company’s oil and gas properties, reserves, other indebtedness and other relevant factors.

On or about March 3, 2011, the Corporation paid the outstanding principal balance of the Wells Fargo Senior Credit Facility. By agreement of the parties, the derivative contracts remained in place until March 9, 2011, when these contracts were novated and replaced by new derivative contracts, for the same volumes but at current market prices, with Macquarie Bank, N.A. In connection with this transaction, the Wells Fargo Senior Credit Facility was transferred to and assumed by Macquarie Bank, N.A. This facility currently has no outstanding principal or current availability. The credit facility was assigned and transferred to Macquarie Bank, N.A. in anticipation of the finalization of a successor credit facility pursuant to which all of the Corporation’s debt (including its related party debt) will be consolidated into a single facility at Macquarie Bank, N.A., or some other commercial lender. As of the date of this report the credit facility is about to be terminated and all collateral related thereto will be released. The Company is also in negotiations for similar credit facilities with several other commercial lenders, to obtain terms most favorable to the Company. While optimistic of a positive outcome of our consolidation efforts, the Company is uncertain as to whether it will be successful in obtaining new replacement financing or, if is obtained, the timetable upon which such facility will be closed and other material terms and conditions.

Related Party Debt

In July 2009 the Company entered into a loan transaction with I.O.C. Israel Oil Company, Ltd. (“IOC”), related party, pursuant to which the Company borrowed $6 million (the “IOC Loan”). The purpose of the IOC Loan was to provide funds to Isramco Resources, LLC, which in turn paid this amount to Bank of Nova Scotia, as administrative agent, and Capital One, N.A., as a syndication agent, under the Scotia Senior Credit Agreement. This payment reduced the outstanding balance below the borrowing base and avoided the imposition of additional interest under the Scotia Senior Credit Agreement.

Amounts outstanding under the IOC Loan bear interest at LIBOR plus 6.0%. The IOC Loan matures in five years, with accrued interest payable annually on each anniversary date of the loan. The IOC Loan may be prepaid at any time without penalty.

In connection with GFB Acquisition (see Note 2), we obtained the following financing from related parties:

Pursuant to a Loan Agreement dated as of February 26, 2007 Isramco obtained a loan from JOEL Jerusalem Oil Exploration Ltd, a related party ("JOEL"), a related party, in the principal amount of $7 million, repayable at the end of 3 months (that was extended until July 11, 2007). Interest accrues at a per annum rate of 5.36%.

On July 2007, the Company and JOEL reached an agreement to revise the period of the Loan to seven years and the interest rate to LIBOR plus 6%.

In February and March, 2008 we obtained loans from JOEL in the aggregate principal amount of $48.9 million, repayable at the end of 4 months at an interest rate of LIBOR plus 1.25% per annum. Pursuant to a loan agreement signed in June 2009, the maturity date of this loan was extended for an additional period of seven years. Interest accrues at a per annum rate of LIBOR plus 6%. Principal and interest are due and payable in four equal annual installments, commencing on June 30, 2012. At any time we can make prepayments without premium or penalty.

Mr. Jackob Maimon, Isramco's president at the time and a former director of the Company is a director of JOEL. Mr. Haim Tsuff, Isramco's Chief Executive Officer and Chairman, is a controlling shareholder of JOEL.

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In connection with the Company's purchase of certain oil and gas interests mainly in New Mexico and Texas in February 2007 (See Note 2), the Company obtained loans in the total principal amount of $42 million from Naphtha Israel Petroleum Corp. Ltd., ("Naphtha") with terms and conditions as below:

Pursuant to a Loan Agreement dated as of February 27, 2007 (the "First Loan Agreement"); Isramco obtained an $18.5 million loan from Naphtha. The outstanding principal amount of the loan accrues interest at per annum rate equal to the London Inter-bank Offered Rate (LIBOR) plus 5.5%, not to exceed 11% per annum. Interest is payable at the end of each loan year. Principal plus any accrued and unpaid interest are due and payable on February 26, 2014. Interest after the maturity date accrues at the per annum rate of LIBOR plus 12% until paid in full. At any time, Isramco is entitled to prepay the outstanding amount of the loan without penalty or prepayment. To secure its obligations that may be incurred under the Loan Agreement, Jay Petroleum, LLC, a wholly – owned subsidiary of Isramco, agreed to guarantee the indebtedness. Naphtha can accelerate the loan and exercise its rights under the collateral upon the occurrence any one or more of the following events of default: (i) Isramco's failure to pay any amount that may become due in connection with the loan within five (5) days of the due date (whether by extension, renewal, acceleration, maturity or otherwise) or fail to make any payment due under any hedge agreement entered into in connection with the transaction, (ii) Isramco's material breach of any of the representations or warranties made in the loan agreement or security instruments or any writing furnished pursuant thereto, (iii) Isramco's failure to observe any undertaking contained in transaction documents if such failure continues for 30 calendar days after notice, (iv) Isramco's insolvency or liquidation or a bankruptcy event or (v) Isramco's criminal indictment or conviction under any law pursuant to which such indictment or conviction can lead to a forfeiture by Isramco of any of the properties securing the loan.

Pursuant to a Loan Agreement dated as of February 27, 2007 (the "Second Loan Agreement") Isramco obtained a loan (the "Second Loan" , in the principal amount of $11.5 million from Naphtha, repayable at the end of seven years. Interest accrues at a per annum rate of LIBOR plus 6%. Principal is due and payable in four equal installments, commencing on the fourth anniversary of the date of the loan. Interest is payable annually upon each anniversary date of this loan. At any time Isramco can make prepayments without premium or penalty. The Second Loan is not secured. The other terms of the Second Loan Agreement are identical to the terms of the First Loan Agreement.

Pursuant to a Loan Agreement dated as of February 27, 2007 (the "Third Loan Agreement ") Isramco obtained a loan in the principal amount of $12 million (the "Third Loan") from Naphtha, repayable at the end of five years. Interest accrues at a per annum rate of LIBOR plus 6%. Principal is due and payable in four equal annual installments, commencing on the second anniversary of the loan. Accrued interest is payable in equal annual installments. At any time Isramco can make prepayments without premium or penalty. The Third Loan is not secured. The other terms of the Third Loan Agreement are identical to the terms of the Loan Agreement.

Effective February 1, 2009, each of the loans from IOC and Naphtha to the Company were amended and restated to extend all payment deadlines arising on and after February, 2009, by two years.

On March 3, 2011, the Company entered into a Loan Agreement with IOC pursuant to which it borrowed the sum of $11 million. The loan bears interest at a rate of 10% per annum and is payable in quarterly payments of interest only until March 3, 2012, when all accrued interest and principal is due and payable. The loan may be prepaid at any time without penalty. The loan is unsecured. The purpose of the loan was to provide funds to Isramco for the payment of amounts due under the Wells Fargo Senior Credit Facility at maturity. On March 3, 2011 Isramco paid the outstanding principal balance due under the Wells Fargo Senior Credit Agreement. Subsequently, on March 9, 2011, pursuant to an agreement with Wells Fargo, the derivative contracts between Isramco and Wells Fargo were terminated at a cost to the Company of approximately $7,000,000. Concurrently, the Company entered into new derivative contracts for 336,780 barrels of crude oil during the 46 month period commencing March 2011 with Macquarie Bank, N.A. During September 2011 Isramco paid $5,096,000 of principal and interest pursuant to Loan agreement with IOC. The Company is actively pursuing a consolidation of all outstanding debt with Macquarie Bank and other commercial lenders.

In October 2011 the agreement with IOC, pertaining to a loan in the outstanding principal amount of $6,456,000 was renegotiated. The payoff of principal amount was extended by 6 month to September 9, 2012. Interest accrued per annum was determined on LIBOR+5.5% from initial 10%.

Mr. Haim Tsuff, Isramco's Chief Executive Officer and Chairman, is a controlling shareholder of Naphtha and IOC.

Debt Maturities

Aggregate maturities of long-term debt at December 31, 2011 are due in future years as follows (in thousands):

2012	37,642
2013	18,100
2014	24,100
2015	15,100
2016	2,875
Total	$ 97,817

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Interest Expense

The following table summarizes the amounts included in interest expense for the years ended December 31, 2011, 2010 and 2009:

	Years Ended December 31, 2011	2010	2009
		(In thousands)	
Current debt, long-term debt and other - banks	$ 1,323	$ 1,719	$ 2,658
Long-term debt – related parties	6,437	5,927	6,561
	$ 7,760	$ 7,646	$ 9,219

7. Fair Value of Financial Instruments

Pursuant to ASC 820, Fair Value Measurements and Disclosures (ASC 820) the Company's determination of fair value incorporates not only the credit standing of the counterparties involved in transactions with the Company resulting in receivables on the Company's consolidated balance sheets, but also the impact of the Company's nonperformance risk on its own liabilities. ASC 820 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit price). The Company utilizes market data or assumptions that market participants would use in pricing the asset or liability, including assumptions about risk and the risks inherent in the inputs to the valuation technique. These inputs can be readily observable, market corroborated, or generally unobservable. The Company classifies fair value balances based on the observability of those inputs.

The following tables set forth by level within the fair value hierarchy the Company's financial assets and liabilities that were accounted for at fair value as of December 31, 2011 and 2010. As required by ASC 820, a financial instrument's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement. The Company's assessment of the significance of a particular input to the fair value measurement requires judgment, and may affect the valuation of fair value assets and liabilities and their placement within the fair value hierarchy levels. There were no transfers between fair value hierarchy levels for the years ended December 31, 2011 and 2010.

	December 31, 2011			
	Level 1	Level 2	Level 3	Total
Assets				
Marketable securities	$ 4,554	$ —	$ —	$ 4,554
Commodity derivatives	—	2,382	—	2,382
Total	$ 4,554	$ 2,382	$ —	$ 6,936

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	December 31, 2010			
	Level 1	Level 2	Level 3	Total
Assets				
Marketable securities	$ 16,099	$ —	$ —	$ 16,099
Commodity derivatives	—	2,499	—	2,499
Total	$ 16,099	$ 2,499	$ —	$ 18,598
Liabilities				
Commodity derivatives	$ —	$ 3,501	$ —	$ 3,501
Interest rate derivatives	—	34	—	34
Total	$ —	$ 3,535	$ —	$ 3,535

Marketable securities listed above are carried at fair value. The Company is able to value its marketable securities based on quoted fair values for identical instruments, which resulted in the Company reporting its marketable securities as Level 1.

Derivatives listed above include swaps that are carried at fair value. The Company records the net change in the fair value of these positions in "Net gain (loss) on derivative contracts" in the Company's consolidated statements of operations, in case of commodity derivatives, and in "Other comprehensive income", in case of interest rate derivatives. The Company is able to value these assets and liabilities based on observable market data for similar instruments, which resulted in the Company reporting its derivatives as Level 2. This observable data includes the forward curve for commodity prices based on quoted market prices and prospective volatility factors related to changes in the forward curves.

As of December 31, 2011 and 2010, the Company's derivative contracts were with major financial institutions with investment grade credit ratings which are believed to have a minimal credit risk. As such, the Company is exposed to credit risk to the extent of nonperformance by the counterparties in the derivative contracts discussed above; however, while no assurance to this effect can be provided, the Company does not anticipate such nonperformance. Each of the counterparties to the Company's derivative contracts is a lender in the Company's Senior Credit Agreement. The Company did not post collateral under any of these contracts as they are secured under the Senior Credit Agreements.

8. Income Taxes

Isramco operates through its various subsidiaries in the United States ("U.S."); accordingly, income taxes have been provided based upon the tax laws and federal and state income tax rates in the U.S. as they apply to Isramco's current ownership structure.

Isramco accounts for income taxes pursuant to Accounting Standards Codification (ASC) 740, Accounting for Income Taxes, which requires recognition of deferred income tax liabilities and assets for the expected future tax consequences of events that have been recognized in Isramco's financial statements or tax returns. Isramco provides for deferred taxes on temporary differences between the financial statements and tax bases of its assets using the enacted tax rates that are expected to apply to taxable income when the temporary differences are expected to reverse.

Isramco adopted Accounting Standards Codification (ASC) 740-10, effective January 1, 2007. Isramco recognizes interest and penalties related to unrecognized tax benefits within the provision for income taxes on continuing operations. There were no unrecognized tax benefits that if recognized would affect the tax rate. There were no interest or penalties recognized as of the date of adoption or for the twelve months ended December 31, 2011. The Company's tax years subsequent to 2006 are either currently under audit or remain open and subject to examination by federal tax authorities and the tax authorities in Louisiana, New Mexico, Oklahoma and Texas, which are the jurisdictions in which the Company has had its principal operations. In certain of these jurisdictions, the Company operates through more than one legal entity, each of which may have different open years subject to examination. It is important to note that years are technically open for examination until the statute of limitations in each respective jurisdiction expires.

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The income tax provision differs from the amount of income tax determined by applying the Federal Income Tax Rate to pre-tax income from continuing operations due to the following items:

	Years Ended December 31, 2011	2010	2009
		(In thousands)	
Expected tax (benefit) expense	$ 3,975	$ (1,632)	$ (8,285)
State income taxes, net	-	18	4
Foreign income taxes	-	-	-
Change in estimate of income tax basis (1)	-	-	(1,637)
Other	-	(242)	(172)
Total tax expense (benefit)	$ 3,975	$ (1,856)	$ (10,090)

(1) Changes in estimated income tax basis in connection with the preparation of 2006 and 2008 amended federal income tax returns.

Deferred tax assets at December 31, 2011 and 2010 are comprised primarily of net operating loss carry forwards and book impairment from write downs of assets. Deferred tax liabilities consist primarily of the difference between book and tax basis depreciation, depletion and amortization (DD&A) and impairment. Book basis in excess of tax basis for oil and gas properties and equipment primarily results from differing methodologies for recording property costs and depreciation, depletion and amortization under accounting principles generally accepted in the United States and the applicable income tax statutes and regulations in the jurisdictions in which the Company operates. There is a net deferred tax asset and it is management’s opinion that a valuation allowance is not needed, as it is more likely than not based on objective evidence that realization of the deferred tax assets is reasonably assured.

The principal components of Isramco’s deferred tax assets and liabilities as of December 31 were as follows (in thousands):

	2011	2010
Deferred current tax assets:		
Unrealized hedging transactions	$ -	$ 385
Accrued interest	2,875	3,738
Deferred current tax assets	$ 2,875	$ 4,123
Deferred current tax liabilities:		
Unrealized hedging transactions	$ (336)	$ (755)
	$ (336)	$ (755)
Net current deferred tax assets	$ 2,539	$ 3,368
Deferred noncurrent tax assets:		
Unrealized hedging transactions	$ -	$ 841
Book-tax differences in property basis		
Net operating loss carry-forwards	12,020	12,154
Other		33
Deferred noncurrent tax assets	$ 12,020	$ 13,028

Deferred noncurrent tax liabilities:				
Unrealized hedging transactions	$	(497)	$	(120)
Book-tax differences in property basis		(4,538)		(1,344)
Book-tax differences in marketable securities		(1,214)		(5,265)
Other		(310)		(1,664)
Deferred noncurrent tax liabilities	$	(6,559)	$	(8,393)
Net noncurrent deferred tax assets	$	5,461	$	4,635

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The principal components of Isramco's Income Tax Provision for the years indicated below were as follows (in thousands):

	2011	2010	2009
Current income tax:			
Federal	$ -	$ -	$ -
Foreign	-	-	-
State	-	-	-
Total current income tax	$ -	$ -	$ -
Deferred income tax			
Federal	$ 3,975	$ (1,874)	$ (10,094)
Foreign	-	-	-
State	-	18	4
Total deferred income tax	$ 3,975	$ (1,856)	$ (10,090)
Provision for income tax	$ 3,975	$ (1,856)	$ (10,090)

At December 31, 2011 the Company has U.S. tax loss carry forwards of approximately $34,343,000 which will expire in various amounts beginning in 2023 and ending in 2030. Utilization of such loss carry forwards could be limited to the extent Isramco has an ownership change that triggers the limitation under Section 382 of Internal Revenue Code of 1986, as amended.

9. Earnings Per Share

The following table sets forth the computation of Net Income (Loss) Per Share Available to Common Stockholders for the years ended December 31 (in thousands, except per share data):

	2011	2010	2009
Numerator for Basic and Diluted Earnings per Share - Net Income (loss)	$ 7,381	$ (2,787)	$ (13,579)
Denominator for Basic Earnings per Share - Weighted Average Shares	2,717,691	2,717,691	2,717,691
Potential Dilutive Common Shares -	-	-	-
Adjusted Weighted Average Shares	2,717,691	2,717,691	2,717,691
Net Income (Loss) Per Share Available to Common Stockholders – Basic	$ 2.72	$ (1.03)	$ (5.00)
Net Income (Loss) Per Share Available to Common Stockholders – Diluted	$ 2.72	$ (1.03)	$ (5.00)

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10. Stock Options

The 1993 Stock Option Plan (the 1993 Plan) was approved at the annual meeting of shareholders held in August 1993. As of December 31, 2009, 20,050 shares of common stock were reserved for issuance under the 1993 Plan. Options granted under the 1993 Plan may be either incentive stock options under the Internal Revenue Code or options that do not qualify as incentive stock options. Options granted under the 1993 Plan may be exercised for a period of up to ten years from the grant date. The exercise price for an incentive stock option may not be less than 100% of the fair market value of Isramco's common stock on the date of grant. All the options granted under the 1993 Plan to date were fully vested on the date of grant. The administrator of the 1993 Plan may set the exercise price for a nonqualified stock option at less than 100% of the fair market value of Isramco's common stock on the date of grant.

No stock options were granted during 2011, 2010 and 2009. Shares of common stock reserved for future issuance under the 1993 plan are 20,050 shares. There are no granted stock options outstanding under the 1993 Plan as of balance sheet date.

At the Annual Shareholders Meeting in 2011, the shareholders adopted the 2011 Stock Incentive Plan. That plan will be administered by the Compensation Committee of the Board of Directors and there are 200,000 shares under that plan that may be awarded. Independent members of the board of directors as well as employee of and consultants to the Company are eligible to receive awards. The awards can be in the form of stock options, restricted stock or other stock–based awards. The awards are intended to qualify as performance-based compensation for purposes of Section 162(m) of the Internal Revenue Code. There are no granted awards outstanding under the 2011 Stock Incentive Plan.

11. Supplemental Cash Flow Information

Cash paid for interest and income taxes was as follows for the years ended December 31 (in thousands):

	2011	2010	2009
Interest	$ 6,723	$ 9,160	$ 6,263
Income taxes	$ -	$ -	$ -

The consolidated statements of cash flows for the year ended December 31, 2011 exclude the following non-cash transactions:

- Property and equipment of $484,000 included in accounts payable

12. Concentrations of Credit Risk

Financial instruments, which potentially expose Isramco to concentrations of credit risk, consist primarily of trade accounts receivable and oil and gas derivative assets. Isramco's customer base includes several of the major United States oil and gas operating and production companies. Although Isramco is directly affected by the well-being of the oil and gas production industry, management does not believe a significant credit risk existed as of December 31, 2011. The fair value of oil and gas derivatives contracts will be significantly impacted by the change in oil and gas future prices. Isramco continues to monitor and review credit exposure of its marketing counter-parties.

Isramco maintains deposits in banks, which may exceed the amount of federal deposit insurance available. Management periodically assesses the financial condition of the institutions and believes that any possible deposit loss is minimal.

A significant portion of Isramco's cash and cash equivalents is invested in marketable securities. Substantially all marketable securities owned by Isramco are held by banks in Israel and Switzerland.

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13. Commitments and Contingencies

Commitments

Isramco has a few immaterial lease agreements.

Contingencies

From time to time, the Company may be a plaintiff or defendant in a pending or threatened legal proceeding arising in the normal course of its business. All known liabilities are accrued based on the Company's best estimate of the potential loss. In the opinion of management, Isramco's ultimate liability, if any, in these pending actions would not have a material adverse effect on the financial position, operating results or liquidity of Isramco.

14. Asset Retirement Obligation

If a reasonable estimate of the fair value of an obligation to perform site reclamation, dismantle facilities or plug and abandon wells can be made, the Company records a liability (an asset retirement obligation or ARO) on the consolidated balance sheet and capitalizes the asset retirement cost in oil and natural gas properties in the period in which the retirement obligation is incurred. In general, the amount of an ARO and the costs capitalized will be equal to the estimated future cost to satisfy the abandonment obligation using current prices that are escalated by an assumed inflation factor up to the estimated settlement date, which is then discounted back to the date that the abandonment obligation was incurred using an assumed cost of funds for the company. After recording these amounts, the ARO is accreted to its future estimated value using the same assumed cost of funds and the additional capitalized costs are depreciated on a unit-of-production basis.

The following table presents the reconciliation of the beginning and ending aggregate carrying amount legal obligations associated with the retirement of oil and gas properties at December 31 (in thousands):

	2011	2010	2009
Liability for asset retirement obligation at the beginning of the year	$ 16,577	$ 16,248	$ 15,733
Liabilities Incurred	62	4	-
Liabilities settled and divested	(242)	(524)	(314)
Accretion expense	853	849	829
Liability for asset retirement obligation at the end of the year	$ 17,250	$ 16,577	$ 16,248

15. Subsequent Events

The Company has evaluated subsequent events through March 23, 2012 which is the date the consolidated financial statements were issued.

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16. Supplementary Oil and Gas Information (Unaudited)

The following supplemental information regarding the oil and gas activities of Isramco for 2011, 2010 and 2009 is presented pursuant to the disclosure requirements promulgated by the Securities and Exchange Commission and SFAS No. 69, "Disclosures About Oil and Gas Producing Activities." Capitalized costs relating to oil and gas activities and costs incurred in oil and gas property acquisition, exploration and development activities for each year are shown below.

CAPITALIZED COST OF OIL AND GAS PRODUCING ACTIVITIES (IN THOUSANDS)

As of December 31	2011 United States	2010 United States
Unproved properties not being amortized	$ -	$ -
Proved property being amortized	225,108	222,122
Accumulated depreciation, depletion amortization and impairment	(104,522)	(90,752)
Net capitalized costs	120,586	131,370

COSTS INCURRED IN OIL AND GAS PROPERTY ACQUISITION, EXPLORATION, AND DEVELOPMENT ACTIVITIES (IN THOUSANDS)

As of December 31	2011	2010 United States	2009
Property acquisition costs—proved and unproved properties	$ 151	$ -	$ -
Exploration costs	$ -	$ -	$ -
Development costs	$ 2,398	$ 3,454	$ 423

OIL AND GAS RESERVES

Users of this information should be aware that the process of estimating quantities of "proved" and "proved developed" oil and natural gas reserves is very complex, requiring significant subjective decisions in the evaluation of all available geological, engineering and economic data for each reservoir. The data for a given reservoir may also change substantially over time as a result of numerous factors including, but not limited to, additional development activity, evolving production history and continual reassessment of the viability of production under varying economic conditions. As a result, revisions to existing reserve estimates may occur from time to time. Although every reasonable effort is made to ensure reserve estimates reported represent the most accurate assessments possible, the subjective decisions and variances in available data for various reservoirs make these estimates generally less precise than other estimates included in the financial statement disclosures.

Proved reserves represent estimated quantities of natural gas, crude oil and condensate that geological and engineering data demonstrate, with reasonable certainty, to be recoverable in future years from known reservoirs under economic and operating conditions in effect when the estimates were made. Proved developed reserves are proved reserves expected to be recovered through wells and equipment in place and under operating methods used when the estimates were made.

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The following table illustrates the Company's estimated net proved reserves, including changes, and proved developed reserves for the periods indicated, as estimated by our independent reserve engineering firms, Netherland, Sewell & Associates, Inc and Cawley, Gillespie & Associates, Inc.

In December 2009, Isramco adopted revised oil and gas reserve estimation and disclosure requirements that conformed the definition of proved reserves to the Securities and Exchange Commission (SEC) Modernization of Oil and Gas Reporting rules, issued by the SEC in 2008. An accounting standards update revised the definition of proved oil and gas reserves to require that the average, first-day-of-the-month price during the 12-month period before the end of the year rather than the year-end price, must be used when estimating whether reserve quantities are economic to produce. This same 12-month average price is also used in calculating the aggregate amount of (and changes in) future cash inflows related to the standardized measure of discounted future net cash flows. The rules also allow for the use of reliable technologies to estimate proved oil, natural-gas, and natural-gas liquids (NGLs) reserves if those technologies have been demonstrated to result in reliable conclusions about reserve volumes.

The unaudited supplemental information on oil and gas exploration and production activities for 2011, 2010, and 2009 has been presented in accordance with the revised reserve estimation and disclosure rules, which were not applied retrospectively. The December 31, 2008 data is presented in accordance with Financial Accounting Standards Board (FASB) oil and gas disclosure requirements effective at that time.

	Oil Bbls			Gas Mcf		
	United States	Israel	Total	United States	Israel	Total
December 31, 2008	2,678,994	-	2,678,994	25,696,175	-	25,696,175
Revisions of previous estimates	616,674	-	616,674	1,378,468	-	1,378,468
Acquisition of minerals in place	-	-	-	-	-	-
Sales of minerals in place	-	-	-	-	-	-
Production	(293,601)	-	(293,601)	(2,622,389)	-	(2,622,389)
December 31, 2009	3,002,067	-	3,002,067	24,452,254	-	24,452,254
Revisions of previous estimates	606,445	-	606,445	1,616,809	-	1,616,809
Acquisition of minerals in place	-	-	-	-	-	-
Sales of minerals in place	-	-	-	-	-	-
Production	(290,589)		(290,589)	(2,368,158)	-	(2,368,158)
December 31, 2010	3,317,923	-	3,317,923	23,700,905	-	23,700,905
Revisions of previous estimates	180,104	-	180,104	3,573,698	-	3,573,698
Extensions, discoveries, and	15,033	-	15,033	21,847	154,100,000	154,121,847

other additions						
Acquisition of minerals in place	-	-	-	-	-	-
Sales of minerals in place	-		-	-		-
Production	(278,601)	-	(278,601)	(2,241,384)	-	(2,241,384)
December 31, 2011	3,234,459	-	3,234,459	25,055,066	154,100,000	179,155,066
Proved Developed Reserves						
December 31, 2011	3,234,459	-	3,234,459	25,055,066	-	25,055,066
December 31, 2010	3,317,923	-	3,317,923	23,700,905	-	23,700,905
December 31, 2009	3,002,067	-	3,002,067	24,452,254	-	24,452,254
December 31, 2008	2,678,994	-	2,678,994	25,696,175	-	25,696,175
Proved Undeveloped Reserves						
December 31, 2011	-	-	-	-	154,100,000	154,100,000
December 31, 2010	-	-	-	-	-	-
December 31, 2009	-	-	-	-	-	-
December 31, 2008	-	-	-	-	-	-
						-

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	NGL Bbls			Total MBOE		
	United States	Israel	Total	United States	Israel	Total
December 31, 2008	1,252,003	-	1,252,003	8,213,693	-	8,213,693
Revisions of previous estimates	391,115	-	391,115	1,237,534	-	1,237,534
Acquisition of minerals in place	-	-	-	-	-	-
Sales of minerals in place	-	-	-	-	-	-
Production	(155,793)	-	(155,793)	(886,459)	-	(886,459)
December 31, 2009	1,487,325	-	1,487,325	8,564,768	-	8,564,768
Revisions of previous estimates	431,465	-	431,465	1,307,378	-	1,307,378
Acquisition of minerals in place	-	-	-	-	-	-
Sales of minerals in place	-	-	-	-	-	-
Production	(155,640)	-	(155,640)	(840,922)	-	(840,922)
December 31, 2010	1,763,150	-	1,763,150	9,031,224	-	9,031,224
Revisions of previous estimates	265,863	-	265,863	1,041,583	-	1,041,583
Extensions, discoveries, and other additions	3,897	-	3,897	22,571	25,683,333	25,705,904
Acquisition of minerals in place	-	-	-	-	-	-
Sales of minerals in place	-	-	-	-	-	-
Production	(136,446)	-	(136,446)	(788,611)	-	(788,611)
December 31, 2011	1,896,464	-	1,896,464	9,306,767	25,683,333	34,990,100
Proved Developed Reserves						
December 31, 2011	1,896,464	-	1,896,464	9,306,767	-	9,306,767
December 31, 2010	1,763,150	-	1,763,150	9,031,224	-	9,031,224
December 31, 2009	1,487,325	-	1,487,325	8,564,768	-	8,564,768
	1,252,003	-	1,252,003	8,213,693	-	8,213,693

December 31, 2008						
Proved Undeveloped Reserves						
December 31, 2011	-	-	-	-	25,683,333	25,683,333
December 31, 2010	-	-	-	-	-	-
December 31, 2009	-	-	-	-	-	-
December 31, 2008	-	-	-	-	-	-

(1) Gas reserves are converted to BOE at the rate of six Mcf per Bbl of oil, based upon the approximate relative energy content of gas and oil. This rate is not necessarily indicative of the relationship of natural gas and oil prices. Natural gas liquids reserves are converted to BOE on a one-to-one basis with oil.

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Extensions, discoveries, and other additions —

2011 — the increase in Israel is due to the recording of reserves at the Tamar development offshore Israel.

Revisions of Previous Estimates —

2011 — Proved reserves must be estimated using the assumption that prices and costs remain constant for the duration of the reservoir life. The upward Revisions of Previous Estimates was due to significantly higher average first-day of the month oil gas and NGLs prices calculated for the 12 months ended December 31, 2011 compared to prices as of December 31, 2010.

2010 — Proved reserves must be estimated using the assumption that prices and costs remain constant for the duration of the reservoir life. The upward Revisions of Previous Estimates was due to significantly higher average first-day of the month oil, gas and NGLs prices calculated for the 12 months ended December 31, 2011 compared to prices as of December 31, 2009.

The SEC amended its definitions of oil and natural gas reserves effective December 31, 2009. Previous periods were not restated for the new rules. Key revisions include a change in pricing used to prepare reserve estimates to a 12-month unweighted average of the first-day-of-the-month prices, the inclusion of non-traditional resources in reserves, definitional changes, allowing the application of reliable technologies in determining proved reserves, and other new disclosures (Revised SEC rules).

STANDARDIZED MEASURE OF DISCOUNTED FUTURE NET CASH FLOW

The following Standardized Measure of Discounted Future Net Cash Flow information has been developed utilizing ASC 932, Extractive Activities —Oil and Gas, (ASC 932) procedures and based on oil and natural gas reserve and production volumes estimated by Cawley, Gillespie & Associates, Inc. It can be used for some comparisons, but should not be the only method used to evaluate the Company or its performance. Further, the information in the following table may not represent realistic assessments of future cash flows, nor should the Standardized Measure of Discounted Future Net Cash Flow be viewed as representative of the current value of the Company.

The Company believes that the following factors should be taken into account when reviewing the following information:

- future costs and selling prices will probably differ from those required to be used in these calculations;
- due to future market conditions and governmental regulations, actual rates of production in future years may vary significantly from the rate of production assumed in the calculations;
- a 10% discount rate may not be reasonable as a measure of the relative risk inherent in realizing future net oil and natural gas revenues; and
- future net revenues may be subject to different rates of income taxation.

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Under the Standardized Measure for the year ended December 31, 2009, the future cash inflows were estimated by applying year-end oil and natural gas prices to the estimated future production of year-end proved reserves. Estimates of future income taxes are computed using current statutory income tax rates including consideration for estimated future statutory depletion and tax credits. The resulting net cash flows are reduced to present value amounts by applying a 10% discount factor. Use of a 10% discount rate and year-end prices were required. At December 31, 2011 and 2010, as specified by the SEC, the prices for oil and natural gas used in this calculation were the unweighted 12-month average of the first day of the month prices, except for volumes subject to fixed price contracts.

millions	United States	Israel	Total
December 31, 2011			
Future cash inflows (1)	$ 506,668,204	$ 634,462,200	$ 1,141,130,404
Future development costs	(875,854)	-	(875,854)
Future production costs	(240,176,108)	-	(240,176,108)
Future income tax expenses (2)	(45,477,986)	(341,573,223)	(387,051,209)
Future net cash flows	220,138,256	292,888,977	513,027,233
10% annual discount for estimated timing of cash flows	(107,734,348)	(168,565,572)	(276,299,920)
Standardized measure of discounted future net cash flows	$ 112,403,908	$ 124,323,405	$ 236,727,313
December 31, 2010			
Future cash inflows	$ 429,260,906	$ -	$ 429,260,906
Future development costs	(740,588)	-	(740,588)
Future production costs	(208,228,155)	-	(208,228,155)
Future income tax expenses	(33,475,234)	-	(33,475,234)
Future net cash flows	186,816,929	-	186,816,929
10% annual discount for estimated timing of cash flows	(89,183,575)	-	(89,183,575)
Standardized measure of discounted future net cash flows	$ 97,633,354	$ -	$ 97,633,354
December 31, 2009			
Future cash inflows	$ 294,721,432	$ -	$ 294,721,432
Future development costs	(556,810)	-	(556,810)
Future production costs	(147,470,220)	-	(147,470,220)
Future income tax expenses	-	-	-
Future net cash flows	146,694,402	-	146,694,402
10% annual discount for estimated timing of cash flows	(68,284,971)	-	(68,284,971)
Standardized measure of discounted future net cash flows	$ 78,409,431	$ -	$ 78,409,431

(1) The increase in Israel is due to the recording of reserves at the Tamar development offshore Israel.

(2) The government of Israel imposes a tax or charge upon oil and gas revenues, including revenues from oil and gas produced from the Tamar well. Currently, such oil and gas revenues would be subject to a sliding scale of taxation, beginning with the imposition of a 20% charge on oil and gas revenues at such time as total revenues received equal 1.5 times the costs expended and increasing in steps to a 50% charge imposed at such time as revenues received equal 1.5 times the costs

expended. The current tax law provides some relief for oil and gas revenues received from reservoirs developed before January 2014 by delaying the imposition of the charges; i.e. the 20% charge would become effective at such time as total revenues received equal 2 times the costs expended and the maximum 50% charge would not become effective until revenues received equaled 2.8 times costs expended. Isramco's overriding royalty would be subject to the above taxation at such time, and at the same rates, as the revenues attributable to the operating interest. The income tax expenses include the taxation and income tax.

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CHANGES IN STANDARDIZED MEASURE OF DISCOUNTED FUTURE NET CASH FLOWS

The following is a summary of the changes in the Standardized Measure of discounted future net cash flows for the Company's proved oil and natural gas reserves during each of the years in the three year period ended December 31, 2011

Changes in Standardized Measure of Discounted Future Net Cash Flows
Relating to Proved Oil and Gas Reserves

millions	United States	International	Total
2011			
Balance at January 1	$97,633,354	$-	$97,633,354
Sales and transfers of oil and gas produced, net of production costs	(23,247,735)	-	(23,247,735)
Net changes in prices and production costs	18,142,794	-	18,142,794
Changes in estimated future development costs, net of current development costs	(1,213,256)	-	(1,213,256)
Extensions, discoveries, additions, and improved recovery, less related costs	-	124,323,405	124,323,405
Development costs incurred during the period		-	
Revisions of previous quantity estimates	14,623,353	-	14,623,353
Purchases of minerals in place	-	-	-
Sales of minerals in place	-	-	-
Accretion of discount	10,476,340	-	10,476,340
Net change in income taxes	(5,726,668)	-	(5,726,668)
Change in production rates and other	1,599,863	-	1,599,863
Balance at December 31	$112,288,045	$124,323,405	$236,611,450
2010			
Balance at January 1	$78,409,431	$-	$78,409,431
Sales and transfers of oil and gas produced, net of production costs	(19,435,256)	-	(19,435,256)
Net changes in prices and production costs	28,652,935	-	28,652,935
Changes in estimated future development costs, net of current development costs	(2,930,885)	-	(2,930,885)
Extensions, discoveries, additions, and improved recovery, less related costs	-	-	-
Development costs incurred during the period	-	-	-
Revisions of previous quantity estimates	17,549,795	-	17,549,795
Purchases of minerals in place	-	-	
Sales of minerals in place	-	-	
Accretion of discount	7,092,982	-	7,092,982
Net change in income taxes	(17,494,664)	-	(17,494,664)
Change in production rates and other	5,789,016	-	5,789,016
Balance at December 31	$97,633,354	$-	$97,633,354

2009	$	$	$
Balance at January 1	73,377,612	-	73,377,612
Sales and transfers of oil and gas produced, net of production costs	(15,116,990)	-	(15,116,990)
Net changes in prices and production costs	4,638,711	-	4,638,711
Changes in estimated future development costs, net of current development costs	211,024	-	211,024
Extensions, discoveries, additions, and improved recovery, less related costs	-	-	-
Development costs incurred during the period	-	-	-
Revisions of previous quantity estimates	11,948,600	-	11,948,600
Purchases of minerals in place	-	-	-
Sales of minerals in place	-	-	-
Accretion of discount	6,626,173	-	6,626,173
Net change in income taxes	-	-	-
Change in production rates and other	(3,275,699)	-	(3,275,699)
Balance at December 31	$78,409,431	$-	$78,409,431

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Unaudited Quarterly Financial Information
(In Thousands, Except Per Share Data)

Quarter Ended		March 31		June 30		September 30		December 31
2011								
Total Revenues	$	11,150		11,747		11,177		11,574
Net Income (loss) before taxes		(6,623)		2,001		22,607		(6,624)
Net Income (loss) attributable to common shareholders		(4,306)		1,301		14,694		(4,303)
Net income attributable to noncontrolling interests		-		-		-		5
Net income (loss) attributable to Isramco		(4,306)		1,301		14,694		(4,308)
Earnings (loss) per share:								
Net income (loss) attributable to common stockholders - basic	$	(1.58)		0.48		5.41		(1.59)
Net income (loss) attributable to common stockholders - diluted	$	(1.58)		0.48		5.41		(1.59)
Average number common shares outstanding - basic		2,717,691		2,717,691		2,717,691		2,717,691
Average number common shares outstanding - diluted		2,717,691		2,717,691		2,717,691		2,717,691
2010								
Total Revenues	$	10,165		9,527		9,928		12,580
Net Income (loss) before taxes	$	2,057		1,464		(3,802)		(4,362)
Net Income (loss)	$	1,357		966		(2,510)		(2,600)
Earnings (loss) per share:								
Net income (loss) attributable to common stockholders - basic	$	0.50	$	0.36	$	(0.92)	$	(0.96)
Net income (loss) attributable to common stockholders - diluted	$	0.50	$	0.36	$	(0.92)	$	(0.96)
Average number common shares outstanding - basic		2,717,691		2,717,691		2,717,691		2,717,691
Average number common shares outstanding - diluted		2,717,691		2,717,691		2,717,691		2,717,691
2009								
Total Revenues	$	7,007	$	7,399	$	7,810	$	9,508
Net Income (loss) before taxes	$	2,713	$	(12,223)	$	(3,236)	$	(10,923)
Net Income (loss)	$	1,790	$	(8,014)	$	(2,018)	$	(5,337)
Earnings (loss) per share:								
Net income (loss) attributable to common stockholders - basic	$	0.66	$	(2.95)	$	(0.74)	$	(1.96)
Net income (loss) attributable to common stockholders - diluted	$	0.66	$	(2.95)	$	(0.74)	$	(1.96)
Average number common shares outstanding - basic		2,717,691		2,717,691		2,717,691		2,717,691

Average number common shares outstanding - diluted	2,717,691	2,717,691	2,717,691	2,717,691

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