ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis should be read in conjunction with the Interim Consolidated Financial Statements and related notes for the three and nine months ended September 30, 2016 in Item 1. Financial Statements, and other information in this report. Except where otherwise indicated, all financial information reflected herein is expressed in Canadian dollars.

For purposes of this report, all references herein to “CP,” “the Company,” “we,” “our” and “us” 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.

Available Information

CP makes available on or through its website www.cpr.ca free of charge, its annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and all amendments to those reports as soon as reasonably practicable after such reports are filed with or furnished to the Securities and Exchange Commission (“SEC”). Also, filings made pursuant to Section 16 of the Securities Exchange Act of 1934 (“Exchange Act”) with the SEC by our executive officers, directors and other reporting persons with respect to the Company's Common Shares are made available free of charge, through our website. Our website also contains charters for each of the committees of our Board of Directors, our corporate governance guidelines and our Code of Business Ethics. SEC filings made by CP are also accessible through the SEC’s website at www.sec.gov. The information on our website is not part of this quarterly report on Form 10-Q.

The Company has included the Chief Executive Officer (“CEO”) and Chief Financial Officer (“CFO”) certifications regarding the Company's public disclosure required by Section 302 of the Sarbanes-Oxley Act of 2002 as an Exhibit to this report.

Executive Summary

Third Quarter of 2016 Results

Financial Performance - In the third quarter of 2016, CP reported Diluted earnings per share ("EPS") of $2.34 and Adjusted diluted EPS of $2.73, an improvement of 15% and 1% respectively when compared to the same period of 2015. Third quarter reported operating ratio of 57.7% was 180 basis points higher than the same period last year, due to the effects of the gain on sale of Delaware and Hudson South ("D&H South") last year which lowered the operating ratio by 400 basis points. Excluding the effects of this gain, adjusted operating ratio of 57.7% was a 220 basis points improvement from 59.9% in the same period of 2015, as the Company continued to adapt its cost structure to the decrease in volumes. Adjusted diluted EPS and Adjusted operating ratio are defined and reconciled in Non-GAAP Measures and discussed further in Results of Operations of this Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations.

Operating performance - CP’s continued focus on asset utilization and network investments resulted in improvements to a number of CP’s key operating metrics. The following metrics are discussed further in Performance Indicators of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

- Average train speed increased by 8% to 23.9 miles per hour;
- Average train weight increased by 7% to 8,915 tons; and
- Average train length increased by 7% to 7,418 feet.

Recent Developments

- On August 3, 2016, the Company and Pershing Square Capital Management L.P. ("Pershing Square") announced the commencement of a public offering of 9,840,890 of CP Common Shares by certain funds managed by Pershing Square. CP was not selling any common shares in the offering and did not receive any of the proceeds from the offering of common shares by the funds managed by Pershing Square. After the closing of the sale, funds managed by Pershing Square no longer own any common shares of Canadian Pacific.

- On September 6, 2016, the Company announced the appointment of Ms. Jill Denham and Mr. William R. Fatt to CP's Board of Directors. The Company also announced Mr. William Ackman's resignation from the Board of Directors.

- On September 8, 2016, the Company announced the resignation of Mr. Mark J. Erceg from his position as Chief Financial Officer effective September 9, 2016. The Company appointed Mr. Nadeem Velani as Vice-President and interim Chief Financial Officer. Mr. Velani joined CP in March 2013 and most recently served as Vice-President Investor Relations. On October 18, 2016, Mr. Velani was appointed Vice-President and Chief Financial Officer.

- On October 19, 2016, the Company communicated a revision of its full-year 2016 outlook, including expected mid-single-digit EPS growth from full-year 2015 Adjusted diluted EPS of $10.10. The change is primarily due to the delayed grain harvest, a dramatic decline in crude volumes and other persistent unfavourable economic factors such as the strengthening of the Canadian dollar since the beginning of the year. Capital expenditures are now expected to be approximately $1.2 billion, primarily due to higher costs associated with a key project. Operating ratio continues to be expected below 59%.

Previous Developments

- On April 20, 2016, CP announced a new normal course issuer bid ("NCIB") to repurchase, for cancellation, up to 6.91 million of its Common Shares, which received Toronto Stock Exchange ("TSX") approval on April 28, 2016. As at September 30, 2016, the Company had repurchased the maximum number of shares for total consideration of $1,210 million, including brokerage fees.

- Also on April 20, 2016, CP announced an increase to the Company's quarterly dividend to $0.50 per share from $0.35 per share.

- On April 20, 2016, the Company announced that Mr. Robert Johnson was appointed Executive Vice-President, Operations.

- On July 19, 2016, Dr. Anthony R. Melman resigned as a member of the Company’s Board of Directors.

Performance Indicators

The following table lists the key measures of the Company’s operating performance:

	For the three months ended September 30			**For the nine months ended September 30**		
	2016	2015[1]	% Change	**2016**	2015[1]	% Change
Operations Performance						
Gross ton-miles (“GTMs”) (millions)	**59,899**	65,273	(8)	**179,272**	197,226	(9)
Train miles (thousands)	**7,214**	8,426	(14)	**22,359**	25,670	(13)
Average train weight – excluding local traffic (tons)	**8,915**	8,322	7	**8,646**	8,252	5
Average train length – excluding local traffic (feet)	**7,418**	6,944	7	**7,262**	6,902	5
Average terminal dwell (hours)	**6.9**	6.6	5	**6.8**	7.3	(7)
Average train speed (mph)	**23.9**	22.2	8	**23.8**	21.1	13
Fuel efficiency (U.S. gallons of locomotive fuel consumed / 1,000 GTMs)	**0.936**	0.948	(1)	**0.971**	0.996	(3)
Total employees (average)	**11,750**	13,709	(14)	**12,175**	14,089	(14)
Total employees (end of period)	**11,773**	13,530	(13)	**11,773**	13,530	(13)
Workforce (end of period)	**11,827**	13,601	(13)	**11,827**	13,601	(13)
Safety Indicators						
FRA personal injuries per 200,000 employee-hours	**1.94**	1.87	4	**1.56**	1.79	(13)
FRA train accidents per million train miles	**1.00**	1.08	(7)	**0.85**	1.30	(35)

[1] Certain figures have been revised to conform with current presentation or have been updated to reflect new information.

Operations Performance

Three months ended September 30, 2016 compared to the three months ended September 30, 2015

- **GTMs** are defined as the movement of total train weight over a distance of one mile. Total train weight comprises the weight of the freight cars, their contents, and any inactive locomotives. An increase in GTMs indicates additional workload. GTMs for the third quarter of 2016 were 59,899 million, a decrease of 8% compared with 65,273 million in the same period of 2015. This decrease was primarily due to lower volumes in the Crude and Canadian Grain lines of business.

- **Train miles** decreased by 14% for the third quarter of 2016 compared to the same period of 2015. This reflects the impact of lower volumes and continuous improvements in operating efficiency from longer, heavier trains.

- The **average train weight** is defined as the average gross weight of CP trains, both loaded and empty. This excludes trains in short-haul service, work trains used to move CP’s track equipment and materials, and the haulage of other railways’ trains on CP’s network. Average train weight increased by 7% for the third quarter of 2016 compared to the same period of 2015. This increase was due to improvements made in operating plan efficiency.

- The **average train length** is defined as the sum of each car length multiplied by the distance traveled, divided by train miles. Local trains are excluded from this measure. Average train length increased by 7% for the third quarter of 2016 compared to the same period of 2015. Similar to benefits to the average train weight, this was also due to improvements made in operating plan efficiency.

- The **average terminal dwell** is defined as the average time a freight car resides within terminal boundaries expressed in hours. The timing starts with a train arriving in the terminal, a customer releasing the car to the Company, or a car arriving at interchange from another railway. The timing ends when the train leaves, a customer receives the car from CP, or the freight car is transferred to another railway. Freight cars are excluded if they are being stored at the terminal or used in track repairs. Average terminal dwell increased by 5% in the third quarter of 2016 compared to the same period of 2015. This increase was primarily due to time to assemble longer, heavier trains as a result of lower volumes.

- The **average train speed** is defined as a measure of the line-haul movement from origin to destination including terminal dwell hours. It is calculated by dividing the total train miles traveled by the total train hours operated. This calculation does not include delay time related to customer or foreign railways and excludes the time and distance traveled by: i) trains used in or around CP's yards; ii) passenger trains; and iii) trains used for repairing track. Average train speed increased by 8% in the third quarter of 2016 compared to the same period of 2015. This favourable increase was primarily due to improved train design and operating plan execution.

- **Fuel efficiency** improved by 1% in the third quarter of 2016 compared to the same period of 2015. Improvements in fuel efficiency were a result of increased locomotive productivity, operational fluidity and execution of the Company's fuel conservation strategies.

Nine months ended September 30, 2016 compared to the nine months ended September 30, 2015

- **GTMs** for the first nine months of 2016 were 179,272 million, a decrease of 9% compared with 197,226 million in the same period of 2015. This decrease was primarily due to a drop in volumes in the Crude, Potash, and Canadian Grain lines of business.

- **Train miles** decreased by 13% for the first nine months of 2016 compared to the same period of 2015. This reflects the impact of lower volumes and continuous improvements in operating efficiency from longer, heavier trains.

- **Average train weight** increased by 5% for the first nine months of 2016 compared to the same period of 2015. This increase was due to improvements made in operating plan efficiency.

- **Average train length** increased by 5% for the first nine months of 2016 from the same period of 2015. This favourable increase was also due to improvements made in operating plan efficiency.

- **Average terminal dwell** decreased by 7% in the first nine months of 2016 compared to the same period of 2015. This favourable decrease was primarily due to continued improvements in yard operating performance.

- **Average train speed** increased by 13% in the first nine months of 2016 compared to the same period of 2015. This favourable increase was primarily due to improved train design and operating plan execution.

- **Fuel efficiency** improved by 3% in the first nine months of 2016 compared to the same period of 2015. Improvements in fuel efficiency were a result of increased locomotive productivity, operational fluidity and execution of the Company's fuel conservation strategies.

Total Employees and Workforce

An employee is defined by the Company as an individual currently engaged in full-time or part-time employment with CP. Employees could be engaged in a full-time, part-time or seasonal capacity. The average number of total employees decreased by 14% and 14% in the third quarter and first nine months of 2016, respectively, compared to the same periods of 2015. This reduction was primarily due to lower volumes, improved operational efficiency and natural attrition.

The Company's workforce is defined as total employees, plus contractors and consultants. The Company's reduction of total workforce during 2016 has been consistent with the reduction in the number of total employees. As at September 30, 2016, the total workforce was 11,827, a decrease of 1,072 or 8%, when compared to 12,899 as at December 31, 2015. As at September 30, 2016, the total workforce decreased by 1,774 or 13% compared to 13,601 as at September 30, 2015.

Safety Indicators

Safety is a key priority and core strategy for CP's management, employees and Board of Directors. The Company's 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 is the number of personal injuries multiplied by 200,000 and divided by total employee hours. Personal injuries are defined as injuries that require employees to lose time away from work, modify their normal duties or obtain medical treatment beyond minor first aid. FRA employee-hours are the total hours worked, excluding vacation and sick time, by all employees, excluding contractors. The FRA personal injury rate per 200,000 employee-hours for CP was 1.94 in the third quarter of 2016, up from 1.87 in the same period of 2015. For the first nine months of 2016, the FRA personal injury rate per 200,000 employee-hours for CP was 1.56, down from 1.79 in the same period of 2015. The FRA train accidents per million train miles was 1.00 in the third quarter of 2016, a decrease from 1.08 in the same period of 2015. For the first nine months of 2016, FRA train accidents per million train miles was 0.85, a decrease from 1.30 in the same period of 2015.

Financial Highlights

(in millions, except per share data, percentages and ratios)	For the three months ended September 30 2016	2015	For the nine months ended September 30 2016	2015
Financial Performance				
Revenues	**$ 1,554**	$ 1,709	**$ 4,595**	$ 5,025
Operating income	**657**	753	**1,861**	2,011
Adjusted operating income(1)	**657**	685	**1,861**	1,943
Net income	**347**	323	**1,215**	1,033
Adjusted income(1)	**405**	427	**1,101**	1,206
Basic earnings per share	**2.35**	2.05	**8.06**	6.37
Diluted earnings per share	**2.34**	2.04	**8.02**	6.32
Adjusted diluted earnings per share(1)	**2.73**	2.69	**7.26**	7.39
Dividends declared per share	**0.50**	0.35	**1.35**	1.05
Cash provided by operating activities	**591**	696	**1,321**	1,836
Free cash(1)	**240**	494	**306**	979
Operating ratio(2)	**57.7%**	55.9%	**59.5%**	60.0%
Adjusted operating ratio(1)	**57.7%**	59.9%	**59.5%**	61.3%
	As at September 30, 2016		As at December 31, 2015	
Financial Position				
Total assets	**$ 19,421**		$ 19,637	
Total long-term obligations(3)	**8,563**		9,012	
Shareholders' equity	**4,669**		4,796	
	For the twelve months ended September 30			
	2016		2015	
Financial Ratios				
Return on invested capital ("ROIC")(1)	**14.3%**		14.1%	
Adjusted ROIC(1)	**14.2%**		15.6%	

(1) These measures have no standardized meanings prescribed by accounting principles generally accepted in the United States of America ("GAAP") and, therefore, may not be comparable to similar measures presented by other companies. These measures are defined and reconciled in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.
(2) Operating ratio is defined as operating expenses divided by revenues, further discussed in Results of Operations of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.
(3) Excludes deferred income taxes: $3,591 million and $3,391 million; and other non-financial deferred liabilities of $961 million and $991 million at September 30, 2016 and December 31, 2015, respectively.

Results of Operations

Three months ended September 30, 2016 compared to the three months ended September 30, 2015

Income

Operating income was $657 million in the third quarter of 2016, a decrease of $96 million, or 13%, from $753 million in the same period of 2015. This decrease was primarily due to a $68 million gain on disposition of D&H South in 2015, and lower volumes in 2016. This decrease in operating income was partially offset by efficiencies generated from improved operating performance and asset utilization, and higher defined benefit pension plan income of $32 million.

Adjusted operating income, defined and reconciled in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations, was $657 million in the third quarter of 2016, a decrease of $28 million, or 4%, from $685 million in the same period of 2015. This decrease was primarily due to the same factors discussed above for the decrease in Operating income, except that Adjusted operating income for 2015 excluded the gain on disposition of D&H South.

Net income was $347 million in the third quarter of 2016, an increase of $24 million, or 7%, from $323 million in the same period of 2015. This increase was primarily due to a smaller unfavourable impact of FX translation on U.S. dollar-denominated debt and a decrease in income tax expense due to lower taxable earnings along with a lower effective tax rate, compared to 2015. This increase was partially offset by lower Operating income and higher interest expense on new debt issued in 2015.

Adjusted income, defined and reconciled in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations, was $405 million in the third quarter of 2016, a decrease of $22 million, or 5%, from $427 million in the same period of 2015. This decrease was primarily due to lower Adjusted operating income.

Diluted Earnings per Share

Diluted earnings per share was $2.34 in the third quarter of 2016, an increase of $0.30, or 15% from $2.04 in the same period of 2015. This increase was primarily due to higher Net income and lower average outstanding shares due to the Company's share repurchase program.

Adjusted diluted EPS, defined and reconciled in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations, was $2.73 in the third quarter of 2016, an increase of $0.04, or 1%, from $2.69 in the same period of 2015. This increase was primarily due to lower average outstanding shares due to the Company's share repurchase program, partially offset by lower Adjusted income.

Operating Ratio

The Operating ratio provides the percentage of revenues used to operate the railway. A lower percentage normally indicates higher efficiency in the operation of the railway. The Company's Operating ratio was 57.7% in the third quarter of 2016, 180 basis points higher from 55.9% in the same period of 2015. This increase was primarily due to the gain on disposition of D&H South in 2015.

Adjusted operating ratio, defined and reconciled in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations, was 57.7% in the third quarter of 2016, a 220 basis point improvement from 59.9% in the same period of 2015. This improvement was primarily due to efficiencies generated from improved operating performance and asset utilization, and higher defined benefit pension plan income, partially offset by lower volumes. The Adjusted operating ratio excluded the gain on disposition of D&H South recorded in 2015.

Return on Invested Capital (ROIC)

ROIC is a measure of how productively the Company uses its long-term capital investments, representing critical indicators of good operating and investment decisions made by management, and is an important performance criteria in determining certain elements of the Company's long-term incentive plan. ROIC was 14.3% for the twelve months ended September 30, 2016, a 20 basis point increase compared to 14.1% for the twelve months ended September 30, 2015. This increase was largely due to higher income, partially offset by the issuance of commercial paper in 2016. Adjusted ROIC was 14.2% for the twelve months ended September 30, 2016, a 140 basis point decrease compared to 15.6% for the twelve months ended September 30, 2015. This decrease was largely due to lower Adjusted income and the issuance of commercial paper in 2016. ROIC and Adjusted ROIC are defined and reconciled in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Nine months ended September 30, 2016 compared to the nine months ended September 30, 2015

Income

Operating income was $1,861 million in the first nine months of 2016, a decrease of $150 million, or 7%, from $2,011 million in the same period of 2015. This decrease was primarily due to lower volumes and to a $68 million gain on disposition of D&H South in 2015. This decrease was partially offset by:

- efficiencies generated from improved operating performance and asset utilization;
- higher defined benefit pension plan income of $88 million; and
- the favourable impact of the change in FX of $70 million.

Adjusted operating income, defined and reconciled in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations, was $1,861 million in the first nine months of 2016, a decrease of $82 million, or 4%, from $1,943 million in the same period of 2015. This decrease was primarily due to the same factors discussed above for the decrease in Operating income, except that Adjusted operating income excluded the gain on disposition of D&H South recorded in the third quarter of 2015.

Net income was $1,215 million in the first nine months of 2016, an increase of $182 million, or 18%, from $1,033 million in the same period of 2015. This increase was primarily due to the favourable impact of FX translation on U.S. dollar-denominated debt and a decrease in Income tax expense due to lower taxable earnings along with lower effective tax rate compared to 2015. This increase was partially offset by lower operating income and higher interest expense on new debt issued in 2015.

Adjusted income, defined and reconciled in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations, was $1,101 million in the first nine months of 2016, a decrease of $105 million, or 9%, from $1,206 million in the same period of 2015. This decrease was due to lower Adjusted operating income and higher interest expense on new debt issued in 2015.

Diluted Earnings per Share

Diluted earnings per share was $8.02 in the first nine months of 2016, an increase of $1.70, or 27% from $6.32 in the same period of 2015. This increase was primarily due to higher Net income and lower average outstanding shares due to the Company's share repurchase program.

Adjusted diluted EPS was $7.26 in the first nine months of 2016, a decrease of $0.13, or 2%, from $7.39 in the same period of 2015. This decrease was primarily due to lower Adjusted income, partially offset by lower average outstanding shares due to the Company's share repurchase program.

Operating Ratio

The Company's Operating ratio was 59.5% in the first nine months of 2016, a 50 basis point improvement compared to the same period of 2015. Adjusted operating ratio was 59.5% in the first nine months of 2016, a 180 basis point improvement from 61.3% in the same period of 2015. These improvements were primarily due to efficiencies generated from improved operating performance and asset utilization, and higher defined benefit pension plan income, partially offset by lower volumes. The Adjusted operating ratio excluded the gain on disposition of D&H South recorded in the third quarter of 2015.

Impact of FX on Earnings

Fluctuations in FX affect the Company's results because U.S. dollar-denominated revenues and expenses are translated into Canadian dollars. U.S. dollar-denominated revenues and expenses increase (decrease) when the Canadian dollar weakens (strengthens) in relation to the U.S. dollar. The following tables indicate the average and periodic exchange rates when converting U.S. dollars to Canadian dollars for the three and nine months ended September 30, 2016 and the comparative periods in 2015.

Canadian to U.S. dollar

Average exchange rates		**2016**		2015
For the three months ended – September 30	**$**	**1.30**	$	1.31
For the nine months ended – September 30	**$**	**1.32**	$	1.26

Canadian to U.S. dollar

Exchange rates		**2016**		2015
Beginning of year – January 1	**$**	**1.38**	$	1.16
Beginning of quarter – July 1	**$**	**1.29**	$	1.25
End of quarter – September 30	**$**	**1.31**	$	1.33

In the third quarter of 2016, the impact of a weaker U.S. dollar resulted in a decrease in total revenues of $2 million and a decrease in total operating expenses of $1 million from the same period in 2015. There was no impact on net interest expense.

In the first nine months of 2016, the impact of a stronger U.S. dollar resulted in an increase in total revenues of $146 million, an increase in total operating expenses of $76 million and an increase in interest expense of $10 million from the same period in 2015.

The impact of FX on total revenues and operating expenses is discussed further in Item 3. Quantitative and Qualitative Disclosures About Market Risk, Foreign Exchange Risk.

Impact of Fuel Price on Earnings

Fluctuations in fuel prices affect the Company’s results because fuel expense constitutes a significant portion of CP's operating costs. As fuel prices fluctuate, there will be a timing impact on earnings. The following table indicates the average fuel price for the three and nine months ended September 30, 2016 and the comparative periods in 2015.

Average Fuel Price (U.S. dollars per U.S. gallon)		**2016**		2015
For the three months ended – September 30	**$**	**1.90**	$	2.00
For the nine months ended – September 30	**$**	**1.74**	$	2.21

In the third quarter of 2016, the impact of lower fuel prices resulted in a decrease in total revenues of $30 million and a decrease in total operating expenses of $8 million from the same period in 2015.

Similarly, in the first nine months of 2016, the impact of lower fuel prices resulted in a decrease in total revenues of $165 million and a decrease in total operating expenses of $108 million from the same period in 2015. The wildfires in northern Alberta negatively impacted fuel input costs by an estimated $9 million without triggering a commensurate offsetting impact to benchmark fuel recovery prices during the second quarter of 2016.

Impact of Share Price on Earnings

Fluctuations in the Common Share price affect the Company's operating expenses because share-based liabilities are fair valued. The following tables indicate the opening and closing CP Common Share Price on the TSX and the New York Stock Exchange for the three and nine months ended September 30, 2016 and the comparative periods in 2015.

CP Common Share Price *Toronto Stock Exchange (in Canadian dollars)*		**2016**		2015
Opening Common Share Price, as at January 1	**$**	**176.73**	$	223.75
Ending Common Share Price, as at June 30	**$**	**166.33**	$	200.02
Ending Common Share Price, as at September 30	**$**	**200.19**	$	191.54
Change in Common Share Price for the three months ended September 30	**$**	**33.86**	$	(8.48)
Change in Common Share Price for the nine months ended September 30	**$**	**23.46**	$	(32.21)

CP Common Share Price *New York Stock Exchange (in U.S. dollars)*		**2016**		2015
Opening Common Share Price, as at January 1	**$**	**127.60**	$	192.69
Ending Common Share Price, as at June 30	**$**	**128.79**	$	160.23
Ending Common Share Price, as at September 30	**$**	**152.70**	$	143.57
Change in Common Share Price for the three months ended September 30	**$**	**23.91**	$	(16.66)
Change in Common Share Price for the nine months ended September 30	**$**	**25.10**	$	(49.12)

In the third quarter of 2016, the impact of the change in Common Share price resulted in an increase in stock-based compensation expense of $18 million compared to a decrease of $8 million in the same period in 2015.

In the first nine months of 2016, the impact of the change in Common Share price resulted in an increase in stock-based compensation expense of $14 million compared to a decrease of $26 million in the same period in 2015.

The impact of share price on stock-based compensation is discussed further in Item 3. Quantitative and Qualitative Disclosures About Market Risk, Share Price Impact on Stock-Based Compensation.

Operating Revenues

The Company's revenues are primarily derived from transporting freight. Non-freight revenue is generated from leasing of certain assets, contracts with passenger service operators, switching fees, transload activities and logistical management services. Changes in freight volumes generally contribute to corresponding changes in freight revenues and certain variable expenses, such as fuel, equipment rents and crew costs.

For the three months ended September 30		2016		2015		2016 vs. 2015 Total Change	% Change	FX Adjusted % Change[2]
Freight revenues (in millions)[1]	**$**	**1,510**	$	1,667	$	(157)	(9)	(9)
Non-freight revenues (in millions)		**44**		42		2	5	5
Total revenues (in millions)	**$**	**1,554**	$	1,709	$	(155)	(9)	(9)
Carloads (in thousands)		**649**		669		(20)	(3)	N/A
Revenue ton-miles (in millions)		**33,915**		36,138		(2,223)	(6)	N/A
Freight revenue per carload (dollars)	**$**	**2,328**	$	2,493	$	(165)	(7)	
Freight revenue per revenue ton-miles (cents)		**4.45**		4.61		(0.16)	(3)	

(1) Freight revenues include fuel surcharge revenues of $36 million in 2016, and $70 million in 2015.

(2) FX Adjusted % Change does not have any standardized meaning prescribed by GAAP and, therefore, is unlikely to be comparable to similar measures presented by other companies. FX adjusted variance is defined and reconciled in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

- **Freight revenues** were $1,510 million in the third quarter of 2016, a decrease of $157 million, or 9% from $1,667 million in the same period of 2015. This decrease was primarily due to a decline in volumes for certain lines of business and the impact of lower fuel prices on fuel surcharge revenue.

- **RTMs** are defined as the movement of one revenue-producing ton of freight over a distance of one mile. RTMs measure the relative weight and distance of rail freight moved by the Company. RTMs for the third quarter of 2016 were 33,915 million, a decrease of 6% compared with 36,138 million in the same period of 2015. This decrease was mainly attributable to Crude and Canadian Grain. These volume decreases were partially offset by increases in Coal, U.S. Grain, and International Intermodal.

- **Non-freight revenues** were $44 million in the third quarter of 2016, an increase of $2 million, or 5% from $42 million in the same period of 2015. This increase was primarily due to higher transload revenues following the acquisition of Steelcare Inc. near the end of the third quarter of 2015.

For the nine months ended September 30		2016		2015		2016 vs. 2015 Total Change	% Change	FX Adjusted % Change[2]
Freight revenues (in millions)[1]	**$**	**4,464**	$	4,907	$	(443)	(9)	(12)
Non-freight revenues (in millions)		**131**		118		13	11	10
Total revenues (in millions)	**$**	**4,595**	$	5,025	$	(430)	(9)	(11)
Carloads (in thousands)		**1,877**		1,979		(102)	(5)	N/A
Revenue ton-miles (in millions)		**100,341**		108,482		(8,141)	(8)	N/A
Freight revenue per carload (dollars)	**$**	**2,379**	$	2,480	$	(101)	(4)	
Freight revenue per revenue ton-miles (cents)		**4.45**		4.52		(0.07)	(2)	

(1) Freight revenues include fuel surcharge revenues of $77 million in 2016, and $246 million in 2015.

(2) FX Adjusted % Change does not have any standardized meaning prescribed by GAAP and, therefore, is unlikely to be comparable to similar measures presented by other companies. FX adjusted variance is defined and reconciled in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

- **Freight revenues** were $4,464 million in the first nine months of 2016, a decrease of $443 million, or 9% from $4,907 million in the same period of 2015. This decrease was primarily due to an overall decline in volumes and the impact of lower fuel prices on fuel surcharge revenue. The favourable impact of the change in FX partially offset this decrease.

- **RTMs** for the first nine months of 2016 were 100,341 million, a decrease of 8% compared with 108,482 million in the same period of 2015. This decrease was mainly attributable to decreased shipments of Crude, Potash, Canadian Grain, and Metals, Minerals and Consumer Products. These volume decreases were partially offset by increased shipments of International Intermodal, Forest Products and Chemicals and Plastics.

- **Non-freight revenues** were $131 million in the first nine months of 2016, an increase of $13 million, or 11% from $118 million in the same period of 2015. This increase was primarily due to higher transload revenue following the acquisition of Steelcare Inc. near the end of the third quarter of 2015, and from higher logistic services and leasing revenues.

Lines of Business

Canadian Grain

For the three months ended September 30		2016		2015		Total Change	% Change	FX Adjusted % Change
						2016 vs. 2015		
Freight revenues (in millions)	**$**	**222**	$	261	$	(39)	(15)	(15)
Carloads (in thousands)		**65**		72		(7)	(10)	N/A
Revenue ton-miles (in millions)		**6,017**		6,639		(622)	(9)	N/A
Freight revenue per carload (dollars)	**$**	**3,435**	$	3,613	$	(178)	(5)	
Freight revenue per revenue ton-mile (cents)		**3.71**		3.93		(0.22)	(6)	

Canadian grain revenue was $222 million in the third quarter of 2016, a decrease of $39 million, or 15% from $261 million in the same period of 2015. This decrease was mainly attributable to a decline in volumes as a result of wet weather conditions that delayed the harvest of the 2016/2017 crop, as well as lower freight rates consistent with the Maximum Revenue Entitlement for Canadian regulated grain for the crop year 2015/2016.

For the nine months ended September 30		2016		2015		Total Change	% Change	FX Adjusted % Change
						2016 vs. 2015		
Freight revenues (in millions)	**$**	**677**	$	772	$	(95)	(12)	(14)
Carloads (in thousands)		**195**		205		(10)	(5)	N/A
Revenue ton-miles (in millions)		**18,685**		19,666		(981)	(5)	N/A
Freight revenue per carload (dollars)	**$**	**3,487**	$	3,767	$	(280)	(7)	
Freight revenue per revenue ton-mile (cents)		**3.63**		3.93		(0.30)	(8)	

Canadian grain revenue was $677 million in the first nine months of 2016, a decrease of $95 million, or 12% from $772 million in the same period of 2015. This decrease was primarily due to lower freight rates that reflect the decrease in the Maximum Revenue Entitlement for Canadian regulated grain in the crop year 2015/2016, and a decline in volumes due to lower available supply. This decrease was partially offset by the favourable impact of the change in FX.

U.S. Grain

For the three months ended September 30		2016		2015		Total Change	% Change	FX Adjusted % Change
						2016 vs. 2015		
Freight revenues (in millions)	**$**	**150**	$	148	$	2	1	1
Carloads (in thousands)		**49**		44		5	11	N/A
Revenue ton-miles (in millions)		**3,163**		2,727		436	16	N/A
Freight revenue per carload (dollars)	**$**	**3,077**	$	3,413	$	(336)	(10)	
Freight revenue per revenue ton-mile (cents)		**4.74**		5.43		(0.69)	(13)	

U.S. grain revenue was $150 million in the third quarter of 2016, an increase of $2 million, or 1% from $148 million in the same period of 2015. This increase was the result of increased shipments of mostly corn and soybeans, partially offset by lower average freight revenue per revenue ton-mile. The decrease in average freight revenue per revenue per ton-mile is primarily due to the increased length of haul as export grain represented a greater proportion of U.S. grain shipments and the impact of lower fuel prices on fuel surcharge revenue.

For the nine months ended September 30		2016		2015		2016 vs. 2015 Total Change	% Change	FX Adjusted % Change
Freight revenues (in millions)	$	**364**	$	391	$	(27)	(7)	(12)
Carloads (in thousands)		**118**		117		1	1	N/A
Revenue ton-miles (in millions)		**7,719**		7,855		(136)	(2)	N/A
Freight revenue per carload (dollars)	$	**3,096**	$	3,347	$	(251)	(7)	
Freight revenue per revenue ton-mile (cents)		**4.72**		4.98		(0.26)	(5)	

U.S. grain revenue was $364 million in the first nine months of 2016, a decrease of $27 million, or 7% from $391 million in the same period of 2015. The decrease was primarily due to a decrease in average freight revenue per revenue ton-mile, as a result of a change in the mix of commodities being shipped, and the impact of lower fuel prices on fuel surcharge revenue. The favourable impact of the change in FX partially offset this decrease.

Coal

For the three months ended September 30		2016		2015		2016 vs. 2015 Total Change	% Change	FX Adjusted % Change
Freight revenues (in millions)	$	**160**	$	163	$	(3)	(2)	(2)
Carloads (in thousands)		**80**		79		1	1	N/A
Revenue ton-miles (in millions)		**5,798**		5,316		482	9	N/A
Freight revenue per carload (dollars)	$	**2,007**	$	2,057	$	(50)	(2)	
Freight revenue per revenue ton-mile (cents)		**2.77**		3.07		(0.30)	(10)	

Coal revenue was $160 million in the third quarter of 2016, a decrease of $3 million, or 2% from $163 million in the same period of 2015. This decrease was primarily due to lower fuel surcharge revenue as a result of lower fuel prices, and lower average freight revenue per revenue ton-mile, partially offset by increased shipments of export metallurgical coal.

For the nine months ended September 30		2016		2015		2016 vs. 2015 Total Change	% Change	FX Adjusted % Change
Freight revenues (in millions)	$	**454**	$	490	$	(36)	(7)	(8)
Carloads (in thousands)		**227**		245		(18)	(7)	N/A
Revenue ton-miles (in millions)		**16,540**		16,914		(374)	(2)	N/A
Freight revenue per carload (dollars)	$	**2,003**	$	1,997	$	6	—	
Freight revenue per revenue ton-mile (cents)		**2.75**		2.89		(0.14)	(5)	

Coal revenue was $454 million in the first nine months of 2016, a decrease of $36 million, or 7% from $490 million in the same period of 2015. This decrease was primarily due to decline in volumes of U.S. thermal coal and the impact of lower fuel prices on fuel surcharge revenue. The favourable impact of the change in FX partially offset this decrease.

Potash

For the three months ended September 30		2016		2015		2016 vs. 2015 Total Change	% Change	FX Adjusted % Change
Freight revenues (in millions)	$	**81**	$	82	$	(1)	(1)	(1)
Carloads (in thousands)		**29**		29		—	—	N/A
Revenue ton-miles (in millions)		**3,651**		3,569		82	2	N/A
Freight revenue per carload (dollars)	$	**2,782**	$	2,816	$	(34)	(1)	
Freight revenue per revenue ton-mile (cents)		**2.21**		2.29		(0.08)	(3)	

Potash revenue was $81 million in the third quarter of 2016, a decrease of $1 million, or 1% from $82 million in the same period of 2015. This decrease was primarily due to the impact of lower fuel prices on fuel surcharge revenue.

For the nine months ended September 30		2016		2015		2016 vs. 2015 Total Change	% Change	FX Adjusted % Change
Freight revenues (in millions)	**$**	**242**	$	281	$	(39)	(14)	(16)
Carloads (in thousands)		**84**		97		(13)	(13)	N/A
Revenue ton-miles (in millions)		**10,333**		11,758		(1,425)	(12)	N/A
Freight revenue per carload (dollars)	**$**	**2,878**	$	2,898	$	(20)	(1)	
Freight revenue per revenue ton-mile (cents)		**2.35**		2.39		(0.04)	(2)	

Potash revenue was $242 million in the first nine months of 2016, a decrease of $39 million, or 14% from $281 million in the same period of 2015. This decrease was primarily due to a decline in export potash volumes and lower fuel surcharge revenue as a result of lower fuel prices, partially offset by the favourable impact of the change in FX.

Fertilizers and Sulphur

For the three months ended September 30		2016		2015		2016 vs. 2015 Total Change	% Change	FX Adjusted % Change
Freight revenues (in millions)	**$**	**64**	$	62	$	2	3	5
Carloads (in thousands)		**14**		14		—	—	N/A
Revenue ton-miles (in millions)		**958**		973		(15)	(2)	N/A
Freight revenue per carload (dollars)	**$**	**4,476**	$	4,265	$	211	5	
Freight revenue per revenue ton-mile (cents)		**6.68**		6.38		0.30	5	

Fertilizers and sulphur revenue was $64 million in the third quarter of 2016, an increase of $2 million from $62 million in the same period of 2015. This increase was primarily due to an increase in average freight rates, partially offset by lower fuel surcharge revenue as a result of lower fuel prices.

For the nine months ended September 30		2016		2015		2016 vs. 2015 Total Change	% Change	FX Adjusted % Change
Freight revenues (in millions)	**$**	**218**	$	200	$	18	9	5
Carloads (in thousands)		**45**		46		(1)	(2)	N/A
Revenue ton-miles (in millions)		**3,144**		3,023		121	4	N/A
Freight revenue per carload (dollars)	**$**	**4,825**	$	4,344	$	481	11	
Freight revenue per revenue ton-mile (cents)		**6.93**		6.62		0.31	5	

Fertilizers and sulphur revenue was $218 million in the first nine months of 2016, an increase of $18 million, or 9% from $200 million in the same period of 2015. This increase was due to higher fertilizer shipments and the favourable impact of the change in FX, partially offset by lower fuel surcharge revenue as a result of lower fuel prices.

Forest Products

For the three months ended September 30		2016		2015		2016 vs. 2015 Total Change	% Change	FX Adjusted % Change
Freight revenues (in millions)	**$**	**71**	$	66	$	5	8	8
Carloads (in thousands)		**17**		16		1	6	N/A
Revenue ton-miles (in millions)		**1,217**		1,083		134	12	N/A
Freight revenue per carload (dollars)	**$**	**4,211**	$	4,113	$	98	2	
Freight revenue per revenue ton-mile (cents)		**5.86**		6.07		(0.21)	(3)	

Forest products revenue was $71 million in the third quarter of 2016, an increase of $5 million, or 8% from $66 million in the same period of 2015. This increase was primarily due to higher volumes, particularly of lumber and panel products, partially offset by lower fuel surcharge revenue as a result of lower fuel prices.

For the nine months ended September 30	2016	2015	Total Change	2016 vs. 2015 % Change	FX Adjusted % Change
Freight revenues (in millions)	$ 212	$ 184	$ 28	15	11
Carloads (in thousands)	51	46	5	11	N/A
Revenue ton-miles (in millions)	3,619	3,163	456	14	N/A
Freight revenue per carload (dollars)	$ 4,160	$ 3,960	$ 200	5	
Freight revenue per revenue ton-mile (cents)	5.87	5.82	0.05	1	

Forest products revenue was $212 million in the first nine months of 2016, an increase of $28 million, or 15% from $184 million in the same period of 2015. This increase was due to higher volumes, particularly of lumber and panel products and the favourable impact of the change in FX. Lower fuel surcharge revenue as a result of lower fuel prices partially offset this increase.

Chemicals and Plastics

For the three months ended September 30	2016	2015	Total Change	2016 vs. 2015 % Change	FX Adjusted % Change
Freight revenues (in millions)	$ 174	$ 173	$ 1	1	1
Carloads (in thousands)	53	50	3	6	N/A
Revenue ton-miles (in millions)	3,547	3,227	320	10	N/A
Freight revenue per carload (dollars)	$ 3,306	$ 3,479	$ (173)	(5)	
Freight revenue per revenue ton-mile (cents)	4.92	5.37	(0.45)	(8)	

Chemicals and plastics revenue was $174 million in the third quarter of 2016, an increase of $1 million, or 1% from $173 million in the same period of 2015. This increase was primarily due to higher volumes. This increase was partially offset by the impact of lower fuel prices on fuel surcharge revenue, and lower average freight revenue per revenue ton-mile due to fewer liquefied petroleum gas product shipments.

For the nine months ended September 30	2016	2015	Total Change	2016 vs. 2015 % Change	FX Adjusted % Change
Freight revenues (in millions)	$ 530	$ 522	$ 8	2	(3)
Carloads (in thousands)	156	152	4	3	N/A
Revenue ton-miles (in millions)	10,557	10,220	337	3	N/A
Freight revenue per carload (dollars)	$ 3,396	$ 3,444	$ (48)	(1)	
Freight revenue per revenue ton-mile (cents)	5.03	5.11	(0.08)	(2)	

Chemicals and plastics revenue was $530 million in the first nine months of 2016, an increase of $8 million, or 2% from $522 million in the same period of 2015. This increase was primarily due to the favourable impact of the change in FX and higher volumes. This increase was partially offset by the impact of lower fuel prices on fuel surcharge revenue, and lower average freight revenue per revenue ton-mile due to fewer liquefied petroleum gas product shipments.

Crude

For the three months ended September 30	2016	2015	Total Change	2016 vs. 2015 % Change	FX Adjusted % Change
Freight revenues (in millions)	$ 13	$ 109	$ (96)	(88)	(88)
Carloads (in thousands)	5	25	(20)	(80)	N/A
Revenue ton-miles (in millions)	424	3,703	(3,279)	(89)	N/A
Freight revenue per carload (dollars)	$ 2,732	$ 4,281	$ (1,549)	(36)	
Freight revenue per revenue ton-mile (cents)	3.01	2.92	0.09	3	

Crude revenue was $13 million in the third quarter of 2016, a decrease of $96 million, or 88% from $109 million in the same period of 2015. This decrease was primarily due to a decline in volumes as a result of the fall in crude oil prices and an increase in available pipeline capacity, as well as lower fuel surcharge revenue as a result of lower fuel prices. Freight revenue per carload also declined due to a reduction in length of haul following a significant reduction in traffic destined to the north-east U.S. and lower fuel surcharge revenue as a result of lower fuel prices. Freight revenue per revenue ton-mile increased primarily due to the reduction in average length of haul, offset in part by lower fuel surcharge revenues.

For the nine months ended September 30		2016		2015		2016 vs. 2015 Total Change	% Change	FX Adjusted % Change
Freight revenues (in millions)	$	**108**	$	288	$	(180)	(63)	(64)
Carloads (in thousands)		**29**		66		(37)	(56)	N/A
Revenue ton-miles (in millions)		**3,738**		9,531		(5,793)	(61)	N/A
Freight revenue per carload (dollars)	$	**3,719**	$	4,357	$	(638)	(15)	
Freight revenue per revenue ton-mile (cents)		**2.88**		3.02		(0.14)	(5)	

Crude revenue was $108 million in the first nine months of 2016, a decrease of $180 million, or 63% from $288 million in the same period of 2015. This decrease was primarily due to a decline in volumes as a result of the fall in crude oil prices and an increase in available pipeline capacity, as well as lower fuel surcharge revenue as a result of lower fuel prices. The favourable impact of the change in FX partially offset this decrease.

Metals, Minerals and Consumer Products

For the three months ended September 30		2016		2015		2016 vs. 2015 Total Change	% Change	Total Change
Freight revenues (in millions)	$	**142**	$	173	$	(31)	(18)	(18)
Carloads (in thousands)		**50**		58		(8)	(14)	N/A
Revenue ton-miles (in millions)		**2,171**		2,451		(280)	(11)	N/A
Freight revenue per carload (dollars)	$	**2,821**	$	3,026	$	(205)	(7)	
Freight revenue per revenue ton-mile (cents)		**6.53**		7.08		(0.55)	(8)	

Metals, minerals and consumer products revenue was $142 million in the third quarter of 2016, a decrease of $31 million, or 18% from $173 million in the same period of 2015. This decrease was primarily due to a decline in shipments of steel products and waste products, and reduced fuel surcharge revenue as a result of lower fuel prices. The decrease in average freight revenue per revenue per ton-mile is primarily due to a change in mix of commodities.

For the nine months ended September 30		2016		2015		2016 vs. 2015 Total Change	% Change	FX Adjusted % Change
Freight revenues (in millions)	$	**415**	$	492	$	(77)	(16)	(19)
Carloads (in thousands)		**145**		167		(22)	(13)	N/A
Revenue ton-miles (in millions)		**6,067**		6,906		(839)	(12)	N/A
Freight revenue per carload (dollars)	$	**2,862**	$	2,951	$	(89)	(3)	
Freight revenue per revenue ton-mile (cents)		**6.83**		7.13		(0.30)	(4)	

Metals, minerals and consumer products revenue was $415 million in the first nine months of 2016, a decrease of $77 million, or 16% from $492 million in the same period of 2015. This decrease was primarily due to a decline in shipments of steel, sand and aggregates products, and reduced fuel surcharge revenue as a result of lower fuel prices. The favourable impact of the change in FX partially offset this decrease. The decrease in average freight revenue per revenue per ton-mile is primarily due to a change in mix of commodities.

Automotive

For the three months ended September 30	2016	2015	Total Change	% Change	FX Adjusted % Change
			2016 vs. 2015		
Freight revenues (in millions)	**$ 86**	$ 87	$ (1)	(1)	(1)
Carloads (in thousands)	**29**	32	(3)	(9)	N/A
Revenue ton-miles (in millions)	**393**	424	(31)	(7)	N/A
Freight revenue per carload (dollars)	**$ 2,985**	$ 2,719	$ 266	10	
Freight revenue per revenue ton-mile (cents)	**21.91**	20.64	1.27	6	

Automotive revenue was $86 million in the third quarter of 2016, a decrease of $1 million, or 1% from $87 million in the same period of 2015. This decrease was primarily due to declines in volume, and reduced fuel surcharge revenue as a result of lower fuel prices. This decrease was partially offset by an increase in the average freight rate.

For the nine months ended September 30	2016	2015	Total Change	% Change	FX Adjusted % Change
			2016 vs. 2015		
Freight revenues (in millions)	**$ 270**	$ 260	$ 10	4	—
Carloads (in thousands)	**97**	98	(1)	(1)	N/A
Revenue ton-miles (in millions)	**1,305**	1,339	(34)	(3)	N/A
Freight revenue per carload (dollars)	**$ 2,777**	$ 2,646	$ 131	5	
Freight revenue per revenue ton-mile (cents)	**20.68**	19.44	1.24	6	

Automotive revenue was $270 million in the first nine months of 2016, an increase of $10 million, or 4% from $260 million in the same period of 2015. This increase was primarily due to increased average freight rate, and the favourable impact of the change in FX. This increase was partially offset by lower volumes and reduced fuel surcharge revenue as a result of lower fuel prices.

Domestic Intermodal

For the three months ended September 30	2016	2015	Total Change	% Change	FX Adjusted % Change
			2016 vs. 2015		
Freight revenues (in millions)	**$ 186**	$ 189	$ (3)	(2)	(2)
Carloads (in thousands)	**113**	105	8	8	N/A
Revenue ton-miles (in millions)	**3,089**	3,027	62	2	N/A
Freight revenue per carload (dollars)	**$ 1,659**	$ 1,795	$ (136)	(8)	
Freight revenue per revenue ton-mile (cents)	**6.03**	6.24	(0.21)	(3)	

Domestic intermodal revenue was $186 million in the third quarter of 2016, a decrease of $3 million, or 2% from $189 million in the same period of 2015. This decrease was primarily due to lower fuel surcharge revenues as a result of lower fuel prices and lower average freight revenue per revenue ton-mile due to fewer shipments using temperature controlled equipment. This decrease was partially offset by higher volumes.

For the nine months ended September 30	2016	2015	Total Change	% Change	FX Adjusted % Change
			2016 vs. 2015		
Freight revenues (in millions)	**$ 534**	$ 575	$ (41)	(7)	(8)
Carloads (in thousands)	**317**	314	3	1	N/A
Revenue ton-miles (in millions)	**8,932**	9,114	(182)	(2)	N/A
Freight revenue per carload (dollars)	**$ 1,686**	$ 1,833	$ (147)	(8)	
Freight revenue per revenue ton-mile (cents)	**5.98**	6.31	(0.33)	(5)	

Domestic intermodal revenue was $534 million in the first nine months of 2016, a decrease of $41 million, or 7% from $575 million in the same period of 2015. This decrease was primarily due to lower fuel surcharge revenue as a result of lower fuel prices and lower average freight revenue per revenue ton-mile due to fewer shipments using temperature controlled equipment. This decrease was partially offset by the favourable impact of the change in FX.

International Intermodal

For the three months ended September 30		2016		2015		2016 vs. 2015 Total Change	% Change	FX Adjusted % Change
Freight revenues (in millions)	**$**	**161**	$	154	$	7	5	5
Carloads (in thousands)		**145**		145		—	—	N/A
Revenue ton-miles (in millions)		**3,487**		2,999		488	16	N/A
Freight revenue per carload (dollars)	**$**	**1,106**	$	1,067	$	39	4	
Freight revenue per revenue ton-mile (cents)		**4.61**		5.14		(0.53)	(10)	

International intermodal revenue was $161 million in the third quarter of 2016, an increase of $7 million, or 5% from $154 million in the same period of 2015. This increase was primarily due to increased revenue ton-miles due to longer haul shipments through the Port of Vancouver. This decrease was partially offset by lower fuel surcharge revenue as a result of lower fuel prices. The decrease in freight revenue per revenue ton-mile was primarily due to fewer revenue generating moves of empty customer containers.

For the nine months ended September 30		2016		2015		2016 vs. 2015 Total Change	% Change	FX Adjusted % Change
Freight revenues (in millions)	**$**	**440**	$	452	$	(12)	(3)	(5)
Carloads (in thousands)		**413**		426		(13)	(3)	N/A
Revenue ton-miles (in millions)		**9,702**		8,993		709	8	N/A
Freight revenue per carload (dollars)	**$**	**1,065**	$	1,061	$	4	—	
Freight revenue per revenue ton-mile (cents)		**4.54**		5.02		(0.48)	(10)	

International intermodal revenue was $440 million in the first nine months of 2016, a decrease of $12 million, or 3% from $452 million in the same period of 2015. This decrease was primarily due to lower fuel surcharge revenue as a result of lower fuel prices. This decrease was partially offset by the favourable impact of the change in FX. The decrease in freight revenue per revenue ton-mile was primarily due to fewer revenue generating moves of empty customer containers. The increase in revenue ton-miles was due to longer haul shipments through the Port of Vancouver.

Operating Expenses

For the three months ended September 30 (in millions)		2016		2015		2016 vs. 2015 Total Change	% Change	FX Adjusted % Change[1]
Compensation and benefits	**$**	**294**	$	352	$	(58)	(16)	(16)
Fuel		**138**		162		(24)	(15)	(15)
Materials		**39**		47		(8)	(17)	(17)
Equipment rents		**43**		42		1	2	2
Depreciation and amortization		**155**		149		6	4	4
Purchased services and other		**228**		272		(44)	(16)	(16)
Gain on sale of Delaware & Hudson South		**—**		(68)		68	(100)	(100)
Total operating expenses	**$**	**897**	$	956	$	(59)	(6)	(6)

[1] FX Adjusted % Change does not have any standardized meaning prescribed by GAAP and, therefore, is unlikely to be comparable to similar measures presented by other companies. FX adjusted variance is defined and reconciled in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Operating expenses were $897 million in the third quarter of 2016, a decrease of $59 million, or 6%, from $956 million in the same period of 2015. This decrease was primarily due to:

- efficiencies generated from improved operating performance and asset utilization;
- lower volume variable expenses; and
- higher defined benefit pension plan income of $32 million.

This decrease was partially offset by the impact of the gain on sale of D&H South in 2015 and by wage and benefit inflation of approximately 3%.

For the nine months ended September 30 (in millions)		2016		2015		2016 vs. 2015 Total Change	% Change	FX Adjusted % Change[1]
Compensation and benefits	$	**907**	$	1,038	$	(131)	(13)	(14)
Fuel		**394**		542		(148)	(27)	(31)
Materials		**133**		144		(11)	(8)	(10)
Equipment rents		**132**		130		2	2	(2)
Depreciation and amortization		**478**		440		38	9	7
Purchased services and other		**690**		788		(98)	(12)	(15)
Gain on sale of D&H South		**—**		(68)	$	68	(100)	(100)
Total operating expenses	**$**	**2,734**	$	3,014	$	(280)	(9)	(12)

[1] FX Adjusted % Change does not have any standardized meaning prescribed by GAAP and, therefore, is unlikely to be comparable to similar measures presented by other companies. FX adjusted variance is defined and reconciled in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Operating expenses were $2,734 million in the first nine months of 2016, a decrease of $280 million, or 9%, from $3,014 million in the same period of 2015. This decrease was primarily due to:

- efficiencies generated from improved operating performance and asset utilization;
- the favourable impact of $108 million from lower fuel prices;
- lower volume variable expenses; and
- higher defined benefit pension plan income of $88 million.

This decrease was partially offset by the unfavourable impact of the change in FX of $76 million and by the gain on sale of D&H South in 2015.

Compensation and Benefits

Compensation and benefits expense includes employee wages, salaries, fringe benefits and stock-based compensation. Compensation and benefits expense was $294 million in the third quarter of 2016, a decrease of $58 million, or 16%, from $352 million in the same period of 2015. This decrease was primarily due to fewer employees and higher defined benefit pension plan income of $32 million. This decrease was partially offset by the impact of wage and benefit inflation of approximately 3%.

Compensation and benefits expense was $907 million in the first nine months of 2016, a decrease of $131 million, or 13%, from $1,038 million in the same period of 2015. This decrease was primarily due to fewer employees and higher defined benefit pension plan income of $88 million. This decrease was partially offset by the impact of wage and benefit inflation of approximately 3% and the unfavourable impact of the change in FX of $18 million.

Fuel

Fuel expense consists mainly of fuel used by locomotives and includes provincial, state and federal fuel taxes. Fuel expense was $138 million in the third quarter of 2016, a decrease of $24 million, or 15%, from $162 million in the same period of 2015. This decrease was primarily due to:

- a reduction in workload, as measured by GTMs;
- the favourable impact of $8 million from lower fuel prices; and
- improvements in fuel efficiency of approximately 1%.

Fuel expense was $394 million in the first nine months of 2016, a decrease of $148 million, or 27%, from $542 million in the same period of 2015. This decrease was primarily due to:

- the favourable impact of $108 million from lower fuel prices;
- a reduction in workload, as measured by GTMs; and
- improvements in fuel efficiency of approximately 3%.

This decrease was partially offset by the unfavourable impact of the change in FX of $25 million.

Materials

Materials expense includes the cost of material used for track, locomotive, freight car and building maintenance and software sustainment. Materials expense was $39 million in the third quarter of 2016, a decrease of $8 million, or 17%, from $47 million in the same period of 2015. This decrease was primarily due to lower volumes.

Materials expense was $133 million in the first nine months of 2016, a decrease of $11 million, or 8%, from $144 million in the same period of 2015. This decrease was primarily due to lower volumes, partially offset by the unfavourable impact of the change in FX of $3 million.

Equipment Rents

Equipment rents expense includes the cost associated with using other railways freight cars, intermodal equipment, and locomotives, net of rental income received from other railways for the use of CP's equipment. Equipment rents expense was $43 million in the third quarter of 2016, an increase of $1 million or 2% from $42 million in the same period of 2015. This increase was primarily due to lower rental income due to the return of subleased freight cars.

Equipment rents expense was $132 million in the first nine months of 2016, an increase of $2 million, or 2%, from $130 million in the same period of 2015. This increase was primarily due to the return of subleased locomotives and freight cars reducing rental income by $6 million and the unfavourable impact of the change in FX of $5 million. This increase was largely offset by the purchase or return of leased freight cars reducing rental expenses by $10 million.

Depreciation and Amortization

Depreciation and amortization expense represents the charge associated with the use of track and roadway, buildings, rolling stock, information systems and other depreciable assets. Depreciation and amortization expense was $155 million in the third quarter of 2016, an increase of $6 million, or 4%, from $149 million in the same period of 2015. This increase was primarily due to a higher depreciable asset base.

Depreciation and amortization expense was $478 million in the first nine months of 2016, an increase of $38 million, or 9%, from $440 million in the same period of 2015. This increase was primarily due to a higher depreciable asset base and the unfavourable impact of the change in FX of $5 million.

Purchased Services and Other

			2016 vs. 2015	
For the three months ended September 30 (in millions)	**2016**	2015	Total Change	% Change
Support and facilities	**$ 73**	$ 69	$ 4	6
Track and operations	**44**	70	(26)	(37)
Intermodal	**44**	46	(2)	(4)
Equipment	**38**	48	(10)	(21)
Casualty	**15**	10	5	50
Property taxes	**29**	26	3	12
Other	**(10)**	4	(14)	(350)
Land sales	**(5)**	(1)	(4)	400
Total Purchased services and other	**$ 228**	$ 272	$ (44)	(16)

Purchased services and other expense encompasses a wide range of third-party costs, including expenses for joint facilities, personal injuries and damage, environmental remediation, property and other taxes, contractor and consulting fees, insurance, and gains on land sales. Purchased services and other expense was $228 million in the third quarter of 2016, a decrease of $44 million, or 16%, from $272 million in the same period of 2015. This decrease was primarily due to:

- a reduction in discontinuance costs for certain branch lines, reported in Other;
- lower crew travel and accommodations costs, reported in Track and operations; and
- lower third-party locomotive overhauls and maintenance costs, reported in Equipment.

This decrease was partially offset by higher casualty expenses of $5 million due to higher personal injuries costs and more costly mishaps, partially offset by lower loss and damages, reported in Casualty and higher property taxes of $3 million.

For the nine months ended September 30 (in millions)	2016	2015	2016 vs. 2015 Total Change	2016 vs. 2015 % Change
Support and facilities	**$ 230**	$ 219	$ 11	5
Track and operations	**156**	195	(39)	(20)
Intermodal	**133**	139	(6)	(4)
Equipment	**121**	151	(30)	(20)
Casualty	**49**	54	(5)	(9)
Property taxes	**88**	79	9	11
Other	**(26)**	14	(40)	(286)
Land sales	**(61)**	(63)	2	(3)
Total Purchased services and other	**$ 690**	$ 788	$ (98)	(12)

Purchased services and other expense was $690 million in the first nine months of 2016, a decrease of $98 million, or 12%, from $788 million in the same period of 2015. This decrease was primarily due to:

- a $17 million gain on sale of surplus freight cars, and a reduction in discontinuance costs for certain branch lines, reported in Other;
- lower third-party services cost, reported in Track and operations and Support and facilities;
- lower crew travel and accommodations costs, reported in Track and operations;
- lower third-party freight car and locomotive maintenance costs, reported in Equipment;
- lower casualty expenses of $7 million (excluding an unfavourable FX impact of $2 million) as a result of lower personal injury costs and lower incident costs, reported in Casualty; and
- lower intermodal expenses, reported in Intermodal.

This decrease was partially offset by the unfavourable impact of the change in FX of $20 million and higher property taxes of $8 million (excluding an unfavourable FX impact of $1 million).

As part of optimizing its assets, the Company may identify and dispose of property used or formerly used in operating activities. In compliance with U.S. GAAP, the Company includes as part of operating expenses the gains and losses that arise on disposal of such long-lived assets. The following disposals have impacted Purchased services and other during the current and comparative periods:

- In the second quarter of 2016, the Company disposed of 1,000 surplus freight cars that had reached or were nearing the end of their useful life, in a non-monetary exchange for new freight cars. The Company recognized a gain on sale of $17 million from the transaction and the sale did not impact cash from investing activities.
- In the first quarter of 2016, the Company completed the sale of CP's Arbutus Corridor to the City of Vancouver for gross proceeds of $55 million and a gain on sale of $50 million. The agreement allows the Company to share in future proceeds on the eventual development and/or sale of certain parcels of the Arbutus Corridor.
- In the first quarter of 2015, the Company recorded a gain of $31 million following the sale of a building after resolution of legal proceedings, and the Company sold various sections of land in eastern Canada for transit purposes, recognizing gains totaling $60 million.

Other Income Statement Items

Other Income and Charges

Other income and charges consists of gains and losses from the change in FX on long-term debt and working capital, various costs related to financing activities, shareholder costs, equity income and other non-operating expenditures. Other income and charges was an expense of $71 million in the third quarter of 2016, compared to an expense of $168 million in the same period of 2015, a change of $97 million. This change was primarily due to a smaller unfavourable impact of FX translation of $46 million on U.S. dollar-denominated long-term debt during the third quarter of 2016 compared to $128 million in the same period of 2015 and a $47 million premium charged upon early redemption of notes in the third quarter of 2015, partially offset by a legal settlement charge of $25 million in the third quarter of 2016. These items are discussed further in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Other income and charges was a gain of $119 million in the first nine months of 2016, compared to an expense of $236 million in the same period of 2015, a change of $355 million. This change was primarily due to a favourable impact of FX translation of $153 million on U.S. dollar-denominated debt in the first nine months of 2016, compared to an unfavourable FX impact of $182 million in the same period of 2015.

Net Interest Expense

Net interest expense includes interest on long-term debt and capital leases. Net interest expense was $116 million in the third quarter of 2016, an increase of $13 million, or 13%, from $103 million in the same period of 2015. This increase was primarily due to an additional $22 million of interest on new debt issued during the third quarter in 2015. This increase was partially offset by interest savings due to principal payments and higher capitalized interest.

Net interest expense was $355 million in the first nine months of 2016, an increase of $83 million, or 31%, from $272 million in the same period of 2015. This increase was primarily due to an additional $92 million of interest on new debt issued during the third quarter in 2015 and the unfavourable impact of the change in FX of $10 million. This increase was also partially offset by interest savings due to principal payments and higher capitalized interest.

Income Tax Expense

Income tax expense was $123 million in the third quarter of 2016, a decrease of $36 million, or 23%, from $159 million in the same period of 2015. Income tax expense was $410 million in the first nine months of 2016, a decrease of $60 million, or 13%, from $470 million in the same period of 2015. These decreases were due to lower taxable earnings along with a lower effective tax rate in 2016.

The estimated annualized effective tax rate for the third quarter of 2016 excluding discrete items (FX translation on U.S. dollar-denominated debt) was 25.17%, compared to 27.50% during the same period of 2015. For the first nine months of 2016, the estimated annualized effective tax rate was 26.50%, compared to 27.50% during the same period of 2015.

The effective tax rate including discrete items in the third quarter of 2016 was 26.23%, compared with 32.92% in the same period of 2015. The effective tax rate including discrete items is higher than the effective tax rate of 25.17% in the current period due to a tax recovery related to FX translation losses on U.S. dollar-denominated debt assessed at a significantly lower rate. The effective tax rate including discrete items in the prior period is higher than the effective tax rate of 27.50% during the third quarter of 2015 due to a tax expense related to the gain on sale of D&H South assessed at a higher tax rate and a tax recovery related to FX translation losses on U.S. dollar-denominated debt assessed at a significantly lower rate.

The effective tax rate including discrete items in the first nine months of 2016 was 25.26%, compared with 31.28% in the same period of 2015. The effective tax rate including discrete items is lower than the effective tax rate of 26.50% in the first nine months of 2016 due to a tax expense related to FX translation gains on U.S. dollar-denominated debt assessed at a significantly lower rate. The effective tax rate including discrete items is higher than the effective tax rate of 27.50% in the first nine months of 2015 due to a tax expense related to the gain on sale of D&H South, in the third quarter of 2015 assessed at a higher rate, a tax recovery related to FX translation losses on U.S dollar-denominated debt assessed at a significantly lower rate, and legislation enacted to increase the Alberta provincial corporate income tax rate which resulted in the Company recording an income tax expense of $23 million, in the second quarter of 2015, related to the revaluation of its deferred income tax balances as at January 1, 2015.

The Company expects an annualized effective tax rate in 2016 of approximately 26.50%. The Company’s 2016 outlook for its normalized income tax rate is based on certain assumptions about events and developments that may or may not materialize or that may be offset entirely or partially by other events and developments, discussed further in Item 1A. Risk Factors of CP's 2015 Annual Report on Form 10-K.

Liquidity and Capital Resources

The Company believes adequate amounts of Cash and cash equivalents are available in the normal course of business to provide for ongoing operations, including the obligations identified in the tables in Contractual Commitments of this Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations. The Company is not aware of any trends or expected fluctuations in the Company's liquidity that would create any deficiencies. The Company's primary sources of liquidity include its Cash and cash equivalents, its bilateral letters of credit and its revolving credit facility.

As at September 30, 2016, the Company had $103 million of Cash and cash equivalents, U.S. $1.7 billion available under its revolving credit facility and up to $296 million available under its letters of credit facility (December 31, 2015 - $650 million of Cash and cash equivalents, U.S. $2.0 billion available under revolving credit facilities and up to $225 million under letters of credit facility).

As at September 30, 2016, the Company's U.S. $2.0 billion revolving credit facility, which includes a U.S. $1.0 billion five-year portion and U.S. $1.0 billion one-year plus one-year term-out portion, was undrawn. On June 28, 2016, the maturity date on the U.S. $1.0 billion one-year plus one-year term-out portion was extended to June 28, 2018, and the maturity date on the U.S. $1.0 billion five-year portion was extended to June 28, 2021. The Company did not draw from its revolving credit facility during the nine months ended September 30, 2016. This facility was also undrawn as at December 31, 2015. The revolving credit facility agreement requires the Company not to exceed a maximum debt to earnings before interest, tax, depreciation, and amortization ratio. As at September 30, 2016, the Company was in compliance with the threshold stipulated in this financial covenant.

The Company has a commercial paper program which enables it to issue commercial paper up to a maximum aggregate principal amount of U.S. $1.0 billion in the form of unsecured promissory notes. The commercial paper is backed by the U.S. $1.0 billion one-year plus one-year term-out portion of the revolving credit facility. At September 30, 2016, total commercial paper borrowings were U.S. $280 million (December 31, 2015 - $nil), decreasing the amount available under the revolving credit facility to U.S. $1.7 billion at September 30, 2016. As at September 30, 2016, the Company does not intend to refinance outstanding commercial paper borrowings on a long-term basis.

As at September 30, 2016, under its bilateral letters of credit facility, the Company had letters of credit drawn of $304 million from a total available amount of $600 million. This compares to letters of credit drawn of $375 million from a total available amount of $600 million as at December 31, 2015. Under the bilateral letters of credit facility, the Company has the option to post collateral in the form of Cash or cash equivalents, equal at least to the face value of the letters of credit issued. Collateral provided may include highly liquid investments purchased three months or less from maturity and is stated at cost, which approximates market value. As at September 30, 2016, the Company had posted $nil in collateral on the bilateral letters of credit facility (December 31, 2015 - $nil). The Company can largely withdraw this collateral during any month.

The following discussion of operating, investing and financing activities describes the Company's indicators of liquidity and capital resources and financial performance.

Operating Activities

Cash provided by operating activities was $591 million in the third quarter of 2016 compared to $696 million in the same period of 2015, a decrease of $105 million. The decrease in cash provided by operating activities is primarily due to lower cash generating income and increased interest payments in the third quarter of 2016 compared to the same period of 2015.

Cash provided by operating activities was $1,321 million in the first nine months of 2016 compared to $1,836 million in the same period of 2015, a decrease of $515 million. The decrease in cash provided by operating activities is primarily due to lower cash generating income, and an unfavourable change in working capital primarily as a result of higher income taxes paid in 2016 and an increase in interest payments resulting from debt issued in 2015.

Investing Activities

Cash used in investing activities was $278 million in the third quarter of 2016, an increase of $115 million from $163 million in the same period of 2015. For the first nine months of 2016, cash used in investing activities was $817 million, an increase of $109 million from $708 million in the same period of 2015. These increases in cash used in investing activities were primarily due to proceeds from the sale of D&H South in the third quarter of 2015, partially offset by lower additions to properties during the third quarter and first nine months of 2016.

Financing Activities

Cash used in financing activities was $304 million in the third quarter of 2016, an increase of $229 million from $75 million in the same period of 2015. For the first nine months of 2016, cash used in financing activities was $1,035 million, an increase of $319 million from $716 million in the same period of 2015. These increases in cash used in financing activities were primarily due to issuance of long term debt in 2015. This increase is partially offset by net issuance of commercial paper during the third quarter and first nine months of 2016 versus net repayment of commercial paper in the same periods of 2015, and lower purchases of CP Common Shares.

Interest Coverage Ratio

For the twelve months ended September 30, 2016, the Company's interest coverage ratio was 5.4, compared with 7.2 for the twelve months ended September 30, 2015. This decrease was primarily due to an increase in Net interest expense of $132 million based on the twelve months ended September 30, 2016, compared to the same period of 2015, partially offset by year over year increase in Earnings before interest and taxes ("EBIT").

Excluding significant items from EBIT, Adjusted interest coverage ratio was 5.3 for the twelve months ended September 30, 2016, compared with 7.7 for the twelve months ended September 30, 2015. This decrease was primarily due to an increase in Net interest expense, as well as a year over year decrease in Adjusted EBIT. Interest coverage ratio, Adjusted interest coverage ratio, EBIT, Adjusted EBIT, and significant items are defined and reconciled in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Credit Measures

Credit ratings provide information relating to the Company's financing costs, liquidity and operations, which impacts the Company's ability to obtain short-term and long-term financing and/or the cost of such financing.

A mid-investment grade credit rating is an important measure in assessing the Company's ability to maintain access to public financing and to minimize the cost of capital. It also affects the ability of the Company to engage in certain collateralized business activities on a cost-effective basis.

Credit ratings and outlooks are based on the rating agencies' methodologies and can change from time to time to reflect their views of CP. Their views are affected by numerous factors including, but not limited to, the Company's financial position and liquidity along with external factors beyond the Company's control.

As at September 30, 2016, the Company's credit rating from Standard & Poor's Rating Services ("Standard & Poor's"), and Moody's Investor Service ("Moody's") have remained unchanged from December 31, 2015. During the second quarter of 2016, Moody's changed the outlook on CP's Senior unsecured debt to negative from stable, and Dominion Bond Rating Service Limited ("DBRS") changed the outlook on CP's Unsecured debentures and Medium-term notes to negative from stable. On August 2, 2016, DBRS downgraded the Company's credit rating from BBB (high) to BBB for unsecured debentures and medium-term notes and from R-2 (high) to R-2 (middle) for the $1 billion Commercial paper program. Standard & Poor's affirmed a stable rating on CP's Long-term corporate credit, Senior secured debt and Senior unsecured debt.

Credit ratings as at September 30, 2016[(1)]

Long-term debt			Outlook
Standard & Poor's			
	Long-term corporate credit	**BBB+**	stable
	Senior secured debt	**A**	stable
	Senior unsecured debt	**BBB+**	stable
Moody's			
	Senior unsecured debt	**Baa1**	negative
DBRS			
	Unsecured debentures	**BBB**	stable
	Medium-term notes	**BBB**	stable
$1 billion Commercial paper program			
Standard & Poor's		**A-2**	N/A
Moody's		**P-2**	N/A
DBRS		**R-2 (middle)**	N/A

[(1)] Credit ratings are not recommendations to purchase, hold or sell securities and do not address the market price or suitability of a specific security for a particular investor. Credit ratings are based on the rating agencies' methodologies and may be subject to revision or withdrawal at any time by the rating agencies.

The Company's goal is to maintain a degree of continuity and predictability for investors by meeting a minimum threshold. The Adjusted net debt to Adjusted earnings before interest, tax, depreciation and amortization ("EBITDA") ratio for the twelve months ended September 30, 2016 and September 30, 2015 was 3.0 and 2.7, respectively. This increase was primarily due to additional debt issued during the 2015 fiscal year and commercial paper issued during the 2016 fiscal year, as well as a decrease in Adjusted EBITDA for the twelve months ended September 30, 2016. Adjusted net debt to Adjusted EBITDA ratio is defined and reconciled in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Free Cash

CP generated positive Free cash of $240 million in the third quarter of 2016, a decrease of $254 million from positive Free cash of $494 million in the same period of 2015. For the first nine months of 2016, CP generated positive Free cash of $306 million, a decrease of $673 million from positive Free cash of $979 million in the same period of 2015. The decrease was primarily due to a decrease in cash provided by operating activities and proceeds from sale of D&H South in the third quarter of 2015. Free cash is defined and reconciled in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Free cash is affected by seasonal fluctuations and by other factors including the size of the Company's additions to properties. Capital additions were $294 million in the third quarter of 2016, $155 million lower than in the same period of 2015. In the first nine months of 2016, capital additions were $902 million, $165 million lower than in the same period of 2015.

Share Capital

At October 17, 2016, the latest practicable date, there were 146,262,114 Common Shares and no preferred shares issued and outstanding, which consists of 15,042 holders of record of the Company's Common Shares. In addition, CP has a Management Stock Option Incentive Plan ("MSOIP"), under which key officers and employees are granted options to purchase CP shares. Each option granted can be exercised for one Common Share. At October 17, 2016, 2.5 million options were outstanding under the Company's MSOIP and stand-alone option agreements entered into with Mr. E. Hunter Harrison and Mr. Keith E. Creel. There are 1.5 million options available to be issued by the Company's MSOIP in the future.

CP has a Director's Stock Option Plan ("DSOP"), under which directors are granted options to purchase CP shares. There are no outstanding options under the DSOP, which has 0.3 million options available to be issued in the future.

An aggregate of 178,618 Common Shares of the Company beneficially owned or controlled by Mr. E. Hunter Harrison have been pledged as security for his personal line of credit. 153,100 of those Common Shares were pledged on December 30, 2014 and 25,518 of those Common Shares were pledged on June 3, 2016. Effective July 18, 2016, the Board of Directors of the Company approved an anti-pledging policy, which prohibits transactions after the effective date of policy that result in the holding of Common Shares or securities exercisable or convertible into Common Shares, in a margin account, or otherwise pledging such securities as collateral for a loan, subject only to Board approved exceptions where the person wishing to pledge indicates his or her financial capacity to repay the loan without resort to the pledged securities.

Non-GAAP Measures

The Company presents non-GAAP measures and cash flow information to provide a basis for evaluating underlying earnings and liquidity trends in the Company's business that can be compared with the results of operations in prior periods. In addition, these non-GAAP measures facilitate a multi-period assessment of long-term profitability allowing management and other external users of the Company's consolidated financial information to compare profitability on a long-term basis, including assessing future profitability, with that of the Company's peers.

These non-GAAP measures have no standardized meaning and are not defined by GAAP and, therefore, may not be comparable to similar measures presented by other companies. The presentation of these non-GAAP measures is not intended to be considered in isolation from, as a substitute for, or as superior to, the financial information presented in accordance with GAAP.

Adjusted Performance Measures

The Company uses Adjusted operating income, Adjusted income, Adjusted diluted earnings per share and Adjusted operating ratio to evaluate the Company's operating performance and for planning and forecasting future business operations and future profitability. These non-GAAP measures are presented in Financial Highlights and discussed further in other sections of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations. These non-GAAP measures provide meaningful supplemental information regarding operating results because they exclude certain significant items that are not considered indicative of future financial trends either by nature or amount. As a result, these items are excluded for management assessment of operational performance, allocation of resources and preparation of annual budgets. These significant items may include, but are not limited to, restructuring and asset impairment charges, individually significant gains and losses from sales of assets and certain items outside the control of management. These items may not be non-recurring. However, excluding these significant items from GAAP results allows for a consistent understanding of the Company's consolidated financial performance when performing a multi-period assessment including assessing the likelihood of future results. Accordingly, these non-GAAP financial measures may provide insight to investors and other external users of the Company's consolidated financial information.

In 2016, there were two significant items included in Net income:

- in the third quarter, a $25 million expense ($18 million after current tax) related to a legal settlement; and
- during the nine months ended September 30, 2016, a net non-cash gain of $153 million ($132 million after deferred tax) due to FX translation of the Company's U.S. dollar-denominated debt as follows:
    - in the third quarter, a $46 million loss ($40 million after deferred tax);
    - in the second quarter, an $18 million gain ($16 million after deferred tax); and
    - in the first quarter, a $181 million gain ($156 million after deferred tax).

In 2015, there were four significant items included in Net income:

- in the third quarter, a $68 million gain ($42 million after current tax) related to the sale of D&H South;
- in the third quarter, a $47 million charge ($35 million after deferred tax) related to the early redemption premium on notes;
- in the second quarter, a deferred income tax expense of $23 million as a result of the change in the Alberta provincial corporate income tax rate; and
- during the course of the year, a net non-cash loss of $297 million ($257 million after deferred tax) due to FX translation of the Company's U.S. dollar-denominated debt as follows:
  - in the fourth quarter, a $115 million loss ($100 million after deferred tax);
  - in the third quarter, a $128 million loss ($111 million after deferred tax);
  - in the second quarter, a $10 million gain ($9 million after deferred tax); and
  - in the first quarter, a $64 million loss ($55 million after deferred tax).

In 2014, there was one significant item included in Net income:

- in the fourth quarter, a $12 million net non-cash loss ($9 million after deferred tax) due to FX translation on the Company's U.S. dollar-denominated debt.

Reconciliation of Non-GAAP Measures to GAAP Measures

The following tables reconcile non-GAAP measures presented in Financial Highlights, and discussed further in other sections of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations, to the most directly comparable measures presented in accordance with GAAP for the three and nine months ended September 30, 2016 and 2015:

Adjusted operating income is calculated as Operating income reported on a GAAP basis less significant items.

Operating income	**For the three months ended September 30**		**For the nine months ended September 30**	
(in millions)	**2016**	2015	**2016**	2015
Adjusted Operating income	**$ 657**	$ 685	**$ 1,861**	$ 1,943
Add significant items:				
Gain on sale of D&H South	**—**	68	**—**	68
Operating income as reported	**$ 657**	$ 753	**$ 1,861**	$ 2,011

Adjusted income is calculated as Net income reported on a GAAP basis less significant items.

Net income	**For the three months ended September 30**		**For the nine months ended September 30**	
(in millions)	**2016**	2015	**2016**	2015
Adjusted income	**$ 405**	$ 427	**$ 1,101**	$ 1,206
Add significant items (pretax):				
Legal settlement charge	**(25)**	—	**(25)**	—
Gain on sale of D&H South	**—**	68	**—**	68
Impact of FX translation on U.S. dollar-denominated debt	**(46)**	(128)	**153**	(182)
Early redemption premium on notes	**—**	(47)	**—**	(47)
Income tax rate change	**—**	—	**—**	(23)
Tax effect of adjustments[1]	**13**	3	**(14)**	11
Net income as reported	**$ 347**	$ 323	**$ 1,215**	$ 1,033

[1] Tax effect of adjustments was calculated as the pretax effect of the adjustments multiplied by the effective tax rate for each of the above items for the periods presented.

Adjusted diluted earnings per share is calculated using Adjusted income, as defined above, divided by the weighted-average diluted shares outstanding during the period as determined in accordance with GAAP.

Diluted earnings per share	For the three months ended September 30		For the nine months ended September 30	
	2016	2015	**2016**	2015
Adjusted diluted earnings per share	**$ 2.73**	$ 2.69	**$ 7.26**	$ 7.39
Add significant items (pretax):				
Legal settlement charge	**(0.17)**	—	**(0.16)**	—
Gain on sale of D&H South	**—**	0.42	**—**	0.42
Impact of FX translation on U.S. dollar-denominated debt	**(0.31)**	(0.81)	**1.01**	(1.12)
Early redemption premium on notes	**—**	(0.30)	**—**	(0.30)
Income tax rate change	**—**	—	**—**	(0.14)
Tax effect of adjustment[1]	**0.09**	0.04	**(0.09)**	0.07
Diluted earnings per share as reported	**$ 2.34**	$ 2.04	**$ 8.02**	$ 6.32

[1] Tax effect of adjustments was calculated as the pretax effect of the adjustments multiplied by the effective tax rate for each of the above items for the periods presented.

Adjusted operating ratio is calculated as Adjusted operating income divided by revenues.

Operating ratio	For the three months ended September 30		For the nine months ended September 30	
	2016	2015	**2016**	2015
Adjusted operating ratio	**57.7 %**	59.9 %	**59.5%**	61.3 %
Add significant items:				
Gain on sale of D&H South	**— %**	(4.0)%	**—%**	(1.3)%
Operating ratio as reported	**57.7 %**	55.9 %	**59.5%**	60.0 %

ROIC and Adjusted ROIC

ROIC is calculated as Operating income less Other income and charges, tax affected at the Company's annualized effective tax rate, on a rolling twelve-month basis, divided by the sum of Total shareholders' equity, Long-term debt, Long-term debt maturing within one year and Short-term borrowing, as presented in the Company's Consolidated Financial Statements, averaged between the beginning and ending balance over a rolling twelve-month period. Adjusted ROIC excludes significant items reported in Operating income and Other income and charges in the Company's Consolidated Financial Statements, as these significant items are not considered indicative of future financial trends either by nature or amount. ROIC and Adjusted ROIC are all-encompassing performance measures that measure how productively the Company uses its long-term capital investments, representing critical indicators of good operating and investment decisions made by management and are important performance criteria in determining certain elements of the Company's long-term incentive plan. ROIC and Adjusted ROIC are presented in Financial Highlights and discussed further in Results of Operations of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Calculation of ROIC and Adjusted ROIC

(in millions, except for percentages)	**2016**	2015
Operating income for the twelve months ended September 30	**$ 2,538**	$ 2,719
Less:		
Other income and charges	**(20)**	251
Tax[1]	**679**	736
	$ 1,879	$ 1,732
Average for the twelve months of total shareholders' equity, long-term debt, long-term debt maturing within one year and short-term borrowing	**13,109**	12,305
ROIC	**14.3%**	14.1%

[1] Tax was calculated at the annualized effective tax rate of 26.56% for 2016 and 29.81% for 2015 for each of the above items for the periods presented.

(in millions, except for percentages)		2016		2015
Operating income for the twelve months ended September 30	$	2,538	$	2,719
Less significant items:				
Gain on sale of D&H South		—		68
Adjusted operating income for the twelve months ended September 30		2,538		2,651
Less:				
Other income and charges		(20)		251
Add significant items (pretax):				
Legal settlement charge		25		—
Impact of FX translation on U.S. dollar-denominated debt		(38)		194
Early redemption premium on notes		—		47
Less: tax[(1)]		680		727
	$	1,865	$	1,914
Average for the twelve months of total shareholders' equity, long-term debt, long-term debt maturing within one year and short-term borrowing		13,109		12,305
Adjusted ROIC		14.2%		15.6%

(1) Tax was calculated at the adjusted annualized effective tax rate of 26.71% for 2016 and 27.52% for 2015 for each of the above items for the periods presented.

Free Cash

Free cash is calculated as Cash provided by operating activities, less Cash used in investing activities and Dividends paid, adjusted for changes in cash and cash equivalents balances resulting from FX fluctuations. Free cash is a measure that management considers to be an indicator of liquidity. Free cash is useful to investors and other external users of the consolidated financial statements as it assists with the evaluation of the Company's ability to generate cash from its operations without incurring additional external financing. Positive Free cash indicates the amount of cash available for reinvestment in the business, or cash that can be returned to investors through increased dividends, stock repurchase programs, debt retirements or a combination of these. Conversely, negative Free cash indicates the amount of cash that must be raised from investors through new debt or equity issues, reduction in available cash balances or a combination of these. Free cash should be considered in addition to, rather than as a substitute for, Cash provided by operating activities. Free cash is presented in Financial Highlights and discussed further in Liquidity and Capital Resources of this Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations.

Reconciliation of Cash Provided by Operating Activities to Free Cash

	For the three months ended September 30				For the nine months ended September 30			
(in millions)		2016		2015		2016		2015
Cash provided by operating activities	$	591	$	696	$	1,321	$	1,836
Cash used in investing activities		(278)		(163)		(817)		(708)
Dividends paid		(75)		(57)		(182)		(172)
Effect of foreign currency fluctuations on U.S. dollar-denominated cash and cash equivalents		2		18		(16)		23
Free cash	$	240	$	494	$	306	$	979

FX Adjusted Variance

Financial result variances at constant currency are obtained by translating the comparable period of the prior year results denominated in U.S. dollars at the foreign exchange rates of the current period. FX adjusted variance ("FX adj. variance") allows certain financial result variances to be viewed without the impact of fluctuations in foreign currency exchange rates, thereby facilitating period-to-period comparisons in the analysis of trends in business performance. FX adj. variances are presented in Operating Revenues and Operating Expenses of this Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations.

(in millions)	Reported 2016	Reported 2015	Variance due to FX	Adjusted 2015	FX Adj. %
	For the three months ended September 30				
Freight revenues	**$ 1,510**	$ 1,667	$ (2)	$ 1,665	(9)%
Non-freight revenues	**44**	42	—	42	5 %
Total revenues	**1,554**	1,709	(2)	1,707	(9)%
Compensation and benefits	**294**	352	—	352	(16)%
Fuel	**138**	162	—	162	(15)%
Materials	**39**	47	—	47	(17)%
Equipment rents	**43**	42	—	42	2 %
Depreciation and amortization	**155**	149	—	149	4 %
Purchased services and other	**228**	272	(1)	271	(16)%
Gain on sale of D&H South	**—**	(68)	—	(68)	(100)%
Total operating expenses	**897**	956	(1)	955	(6)%
Operating income	**$ 657**	$ 753	$ (1)	$ 752	(13)%

(in millions)	Reported 2016	Reported 2015	Variance due to FX	Adjusted 2015	FX Adj. %
	For the nine months ended September 30				
Freight revenues	**$ 4,464**	$ 4,907	$ 145	$ 5,052	(12)%
Non-freight revenues	**131**	118	1	119	10 %
Total revenues	**4,595**	5,025	146	5,171	(11)%
Compensation and benefits	**907**	1,038	18	1,056	(14)%
Fuel	**394**	542	25	567	(31)%
Materials	**133**	144	3	147	(10)%
Equipment rents	**132**	130	5	135	(2)%
Depreciation and amortization	**478**	440	5	445	7 %
Purchased services and other	**690**	788	20	808	(15)%
Gain on sale of D&H South	**—**	(68)	—	(68)	(100)%
Total operating expenses	**2,734**	3,014	76	3,090	(12)%
Operating income	**$ 1,861**	$ 2,011	$ 70	$ 2,081	(11)%

Interest Coverage Ratio

Interest coverage ratio is measured, on a rolling twelve-month basis, as EBIT divided by Net interest expense. This ratio provides investors, analysts, and lenders with useful information on how the Company's debt servicing capabilities have changed, period over period and in comparison to the Company’s peers. Interest coverage ratio is discussed further in Liquidity and Capital Resources of this Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations.

Adjusted interest coverage ratio is calculated as Adjusted EBIT divided by Net interest expense. By excluding significant items which affect EBIT, Adjusted interest coverage ratio assists management in comparing the Company's performance over various reporting periods on a consistent basis. Adjusted interest coverage ratio is discussed further in Liquidity and Capital Resources of this Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations.

Calculation of Interest Coverage Ratio and Adjusted Interest Coverage Ratio

	For the twelve months ended September 30	
(in millions, except for ratios)	**2016**	2015
EBIT	**$ 2,558**	$ 2,468
Adjusted EBIT	**2,545**	2,641
Net interest expense	**477**	345
Interest coverage ratio	**5.4**	7.2
Adjusted interest coverage ratio	**5.3**	7.7

Reconciliation of Adjusted earnings before interest, tax, depreciation and amortization and Earnings before interest and tax

Adjusted EBITDA is calculated as Adjusted EBIT plus Depreciation and amortization, adjusted for net periodic pension and other benefit cost and operating lease expense. EBIT is calculated as Operating income, less Other income and charges. Adjusted EBIT excludes significant items reported in Operating income and Other income and charges.

(in millions)	**2016**	2015
Adjusted EBITDA for the twelve months ended September 30	**$ 3,152**	$ 3,256
Add:		
Adjustment for net periodic pension and other benefit cost	**141**	93
Operating lease expense	**(115)**	(129)
Depreciation and amortization	**(633)**	(579)
Adjusted EBIT for the twelve months ended September 30	**2,545**	2,641
Add Significant items (pretax):		
Legal settlement charge	**(25)**	—
Gain on sale of D&H South	**—**	68
Impact of FX translation on U.S. dollar-denominated debt	**38**	(194)
Early redemption premium on notes	**—**	(47)
EBIT for the twelve months ended September 30	**2,558**	2,468
Less:		
Net interest expense	**477**	345
Income tax expense	**547**	639
Net income as reported	**$ 1,534**	$ 1,484

Adjusted Net Debt to Adjusted EBITDA Ratio

Adjusted net debt is defined as Long-term debt, Long-term debt maturing within one year and Short-term borrowing as reported on the Company's Consolidated Balance Sheets adjusted for pension plans deficit, the net present value of operating leases, which is discounted by the Company's effective interest rate for each of the periods presented, and Cash and cash equivalents. Adjusted net debt to adjusted EBITDA ratio is calculated as Adjusted net debt divided by Adjusted EBITDA.

The Adjusted net debt to adjusted EBITDA ratio is one of the key metrics used by credit rating agencies in assessing the Company's financial capacities and constraints and determining the credit rating of the Company. By excluding the impact of certain items that are not considered by management in developing a minimum threshold, Adjusted net debt to Adjusted EBITDA ratio provides a metric that management uses to evaluate the Company's financial discipline with respect to capital markets credit sensitivities from management's perspective and communicates it publicly with investors, analysts and credit rating agencies. Adjusted net debt to Adjusted EBITDA ratio is discussed further in Liquidity and Capital Resources of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Calculation of Adjusted Net Debt to Adjusted EBITDA Ratio

(in millions, except for ratios)	**2016**	2015
Adjusted net debt as at September 30	**$ 9,420**	$ 8,638
Adjusted EBITDA for the twelve months ended September 30	**3,152**	3,256
Adjusted net debt to Adjusted EBITDA ratio	**3.0**	2.7

Reconciliation of Adjusted Net Debt to Long-term Debt

(in millions)		2016		2015
Adjusted net debt as at September 30	**$**	**9,420**	$	8,638
Add:				
Pension plans deficit		**(292)**		(295)
Net present value of operating leases[(1)]		**(352)**		(327)
Cash and cash equivalents		**103**		661
Long-term debt including long term debt maturing within one year as at September 30	**$**	**8,879**	$	8,677

(1) Operating leases were discounted at the Company's effective interest rate for each of the periods presented.

Off-Balance Sheet Arrangements

Guarantees

At September 30, 2016, the Company had residual value guarantees on operating lease commitments of $19 million, compared to $28 million at December 31, 2015. The maximum amount that could be payable under these and all of the Company's other guarantees cannot be reasonably estimated due to the nature of certain guarantees. All or a portion of amounts paid under certain guarantees could be recoverable from other parties or through insurance. As at September 30, 2016, the fair value of these guarantees recognized as a liability was $6 million, compared to $4 million at December 31, 2015.

Contractual Commitments

The accompanying table indicates the Company's obligations and commitments to make future payments for contracts, such as debt, capital lease and commercial arrangements.

Contractual Commitments

At September 30, 2016:

Payments due by period (in millions)		Total		2016		2017 & 2018		2019 & 2020		2021 & beyond
Contractual commitments										
Interest on long-term debt and capital lease	**$**	**12,346**	$	93	$	937	$	811	$	10,505
Long-term debt		**8,813**		373		778		547		7,115
Capital leases		**163**		1		9		10		143
Operating lease[(1)]		**459**		23		156		93		187
Supplier purchase		**1,296**		91		351		169		685
Other long-term liabilities[(2)]		**501**		36		110		105		250
Total contractual commitments	**$**	**23,578**	$	617	$	2,341	$	1,735	$	18,885

(1) Residual value guarantees on certain leased equipment with a maximum exposure of $19 million are not included in the minimum payments shown above, as management believes that CP will not be required to make payments under these residual value guarantees.

(2) Includes expected cash payments for restructuring, environmental remediation, asset retirement obligations, post-retirement benefits, workers' compensation benefits, long-term disability benefits, pension benefit payments for the Company's non-registered supplemental pension plan and certain other long-term liabilities. Projected payments for post-retirement benefits, workers' compensation benefits and long-term disability benefits include the anticipated payments for years 2016 to 2025. Pension contributions for the Company's registered pension plans are not included due to the volatility in calculating them. Pension payments are discussed further in Critical Accounting Estimates of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Certain Other Financial Commitments

In addition to the financial commitments mentioned previously in Off-Balance Sheet Arrangements and Contractual Commitments of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations, the Company is party to certain other financial commitments set forth in the table and discussed below.

At September 30, 2016:

Amount of commitments per period (in millions)	Total	2016	2017 & 2018	2019 & 2020	2021 & beyond
Commitments					
Letters of credit	**$ 304**	$ 304	$ —	$ —	$ —
Capital commitments	**268**	153	77	24	14
Total commitments	**$ 572**	$ 457	$ 77	$ 24	$ 14

Letters of Credit

Letters of credit are obtained mainly to provide security to third parties under the terms of various agreements, including workers' compensation and supplemental pension plan. CP is liable for these contractual amounts in the case of non-performance under these agreements. Letters of credit are accommodated through a revolving credit facility and the Company's bilateral letters of credit facility.

Capital Commitments

The Company remains committed to maintaining the current high level of plant quality and renewing the franchise. As part of this commitment, CP has entered into contracts with suppliers to make various capital purchases related to track programs. Payments for these commitments are due in 2016 through 2032. These expenditures are expected to be financed by cash generated from operations or by issuing new debt.

Critical Accounting Estimates

To prepare consolidated financial statements that conform with GAAP, the Company is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reported periods. Using the most current information available, the Company reviews estimates on an ongoing basis, including those related to environmental liabilities, pensions and other benefits, property, plant and equipment, deferred income taxes, legal and personal injury liabilities and goodwill.

The development, selection and disclosure of these estimates, and this MD&A, have been reviewed by the Board of Directors' Audit Committee, which is composed entirely of independent directors.

Pensions and Other Benefits

Pension Liabilities and Pension Assets

The Company included pension benefit liabilities of $282 million in Pension and other benefit liabilities and $10 million in Accounts payable and accrued liabilities on the Company's Interim Consolidated Balance Sheets at September 30, 2016. The Company also included post-retirement benefits accruals of $388 million in Pension and other benefit liabilities and $21 million in Accounts payable and accrued liabilities on the Company's Interim Consolidated Balance Sheets at September 30, 2016.

The Company included pension benefit assets of $1,638 million in Pension assets on the Company's Interim Consolidated Balance Sheets at September 30, 2016.

Pension Plan Contributions

The Company made contributions of $4 million to the defined benefit pension plans in the third quarter of 2016, compared with $20 million in the same period of 2015. In the first nine months of 2016, the Company made contributions of $38 million to the defined benefit pension plans, compared with $61 million in the same period of 2015. The Company's main Canadian defined benefit pension plan accounts for 95% of CP's pension obligation and can produce significant volatility in pension funding requirements, given the pension fund's size, the many factors that drive the pension plan's funded status, and Canadian statutory pension funding requirements. The Company made voluntary prepayments of $600 million in 2011, $650 million in 2010 and $500 million in 2009 to the Company's main Canadian defined benefit pension plan. CP has applied $1,276 million of these voluntary prepayments to reduce its pension funding requirements in 2012–2015, leaving $474 million of the voluntary prepayments still available at December 31, 2015 to reduce CP's pension funding requirements in 2016 and future years. CP continues to have significant flexibility with respect to the rate at which the remaining voluntary prepayments are applied to reduce future years' pension contribution requirements, which allows CP to manage the volatility of future pension funding requirements. At this time, CP intends to apply $5 million of the remaining voluntary prepayments against its 2016 pension funding requirements.

CP estimates its aggregate pension contributions, including its defined benefit and defined contribution plans, to be in the range of $50 million to $60 million in 2016, and in the range of $50 million to $100 million per year from 2017 to 2019. These estimates reflect the Company's current intentions with respect to the rate at which CP will apply the remaining voluntary prepayments against contribution requirements in the next few years.

Future pension contributions will be highly dependent on the Company's actual experience with such variables as investment returns, interest rate fluctuations and demographic changes, on the rate at which previous years' voluntary prepayments are applied against pension contribution requirements, and on any changes in the regulatory environment. CP will continue to make contributions to the pension plans that, at a minimum, meet pension legislative requirements.

Deferred Income Taxes

A deferred income tax expense of $50 million was included in Income tax expense for the third quarter of 2016 compared to $nil for the same period of 2015. For the first nine months of 2016, deferred income tax expense of $233 million was included in Income tax expense compared to $106 million the same period of 2015.

The increase in deferred income tax expense in the third quarter of 2016 was primarily due to the effect of 2015 discrete items, which includes the reclassification of deferred tax expense to current tax expense related to the sale of D&H South and the deferred tax recovery related to unrealized FX translation losses on U.S. dollar-denominated debt, partially offset by lower pretax earnings compared to the same period of 2015. The increase in deferred income tax expense for the first nine months of 2016 was attributable to the increase in the third quarter, as well as unrealized FX translation gains on U.S. dollar-denominated debt, which does not give rise to current tax expense.

At September 30, 2016, deferred income tax liabilities of $3,591 million were recorded as a long-term liability and are composed largely of temporary differences related to accounting for properties.

Legal and Personal Injury Liabilities

Provisions for incidents, claims and litigation charged to income, of which $14 million were included in Purchase services and other expense and $25 million in Other charges, totaling $39 million in the third quarter of 2016 compared with $6 million for the same period of 2015. For the first nine months of 2016, these provisions amounted to $72 million compared with $60 million for the same period of 2015.

Forward-Looking Information

This MD&A and Quarterly Report on Form 10-Q 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, our updated expectations for 2016 which includes: operating ratio below 59%, mid-single-digit EPS growth from full-year 2015 adjusted EPS of $10.10, and capital expenditures of approximately $1.2 billion, statements concerning the Company's operations, anticipated financial performance, business prospects and strategies, including statements concerning the anticipation that cash flow from operations and various sources of financing will be sufficient to meet debt repayments and obligations in the foreseeable future and concerning anticipated capital programs, statements regarding future payments including income taxes and pension contributions, and capital expenditures. Forward-looking information typically contains statements with words such as "financial expectations", "key assumptions", "anticipate", "believe", "expect", "plan", "will", "outlook", "should" or similar words suggesting future outcomes.

Readers are cautioned not to place undue reliance on forward-looking information because it is possible that CP 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, 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.

By its nature, 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 Item 1A. Risk Factors of CP's 2015 Annual Report on Form 10-K. Other risks are detailed from time to time in reports filed by CP with securities regulators in Canada and the United States.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There have been no material changes to market risk during the three and nine months ended September 30, 2016 from the information provided in Item 7A. Quantitative and Qualitative Disclosure about Market Risk of CP's 2015 Annual Report on Form 10-K other than foreign exchange risk and share price impact on stock-based compensation discussed below:

Foreign Exchange Risk

Although CP conducts business primarily in Canada, a significant portion of its revenues, expenses, assets and liabilities including debt are denominated in U.S. dollars. The value of the Canadian dollar is affected by a number of domestic and international factors, including, without limitation, economic performance, and Canadian, U.S. and international monetary policies. Consequently, the Company's results are affected by fluctuations in the exchange rate between these currencies. On an annualized basis, a $0.01 weakening (or strengthening) of the Canadian dollar positively (or negatively) impacts Total revenues by approximately $25 million and negatively (or positively) impacts Operating expenses by approximately $13 million. To manage this exposure to fluctuations in exchange rates between Canadian and U.S. dollars, CP may sell or purchase U.S. dollar forwards at fixed rates in future periods. In addition, changes in the exchange rate between the Canadian dollar and other currencies (including the U.S. dollar) make the goods transported by the Company more or less competitive in the world marketplace and may in turn positively or negatively affect revenues.

FX translation on the Company's U.S. dollar-denominated long-term debt is also impacted by this risk. A weakening (or strengthening) of the Canadian dollar negatively (or positively) impacts Other income and charges in the Company's Consolidated Statements of Income. For further information, please refer to Item 8. Financial Statements and Supplementary Data, Note 20 Financial Instruments, in CP's 2015 Annual Report on Form 10-K.

Share Price Impact on Stock-Based Compensation

For every $1.00 change in share price, stock-based compensation expense has a corresponding change of approximately $0.5 million to $0.7 million based on information available at September 30, 2016. This excludes the impact of changes in share price relative to the S&P/TSX 60 index and relative to Class I railways, which may trigger different performance share unit payouts.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

As of September 30, 2016, an evaluation was carried out under the supervision of and with the participation of CP's management, including its CEO and CFO, of the effectiveness of the design and operation of the Company's disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act. Based on that evaluation, the CEO and CFO concluded that these disclosure controls and procedures were effective as of September 30, 2016, to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is (i) recorded, processed, summarized and reported within the time periods specified by the SEC rules and forms and (ii) accumulated and communicated to the Company’s management, including the CEO and CFO, as appropriate, to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

During the third quarter of 2016, the Company has not identified any changes in internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.