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 Company's Interim Consolidated Financial Statements and the related notes for the three months ended March 31, 2018 in Item 1. Financial Statements, other information in this report, and Item 8. Financial Statements and Supplementary Data of the Company's 2017 Annual Report on Form 10-K. 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 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.

In the first quarter of 2018, the comparative figures contained in or derived from the Consolidated Statement of Income were restated to reflect the adoption of the new Accounting Standards Update ("ASU") ASU 2017-07 for presentation of net periodic benefit recovery. These changes in presentation do not result in any changes to net income or earnings per share. For further information, refer to Item 1. Financial Statements, Note 2 Accounting Changes.

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”). Our website also contains charters for our Board of Directors and each of its committees, 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 Exhibits to this report.

Executive Summary

First Quarter of 2018 Results

- *Financial performance* - In the first quarter of 2018, CP reported Diluted earnings per share ("EPS") of $2.41, a decrease of 18% as compared to 2017 primarily due to foreign exchange ("FX") losses on U.S. dollar-denominated debt in 2018 and a management transition recovery in 2017. Adjusted diluted EPS, which excludes these two factors, was $2.70 in the first quarter of 2018, an increase of 8% compared to last year primarily due to higher volumes.

  CP reported Net income of $348 million in the first quarter of 2018, a decrease of 19% as compared to 2017, primarily due to the FX losses and the prior year transition recovery described above. Adjusted income, which excludes these two factors, was $390 million in the first quarter of 2018, an increase of 6% compared to last year primarily due to higher volumes.

  CP reported an Operating ratio of 67.5% in the first quarter of 2018, a 510 basis point increase and a 190 basis points increase as compared to last year's operating ratio and adjusted operating ratio, respectively. Operating ratio was adjusted in 2017 to remove the effects of the management transition recovery. Excluding this adjustment, the increase was primarily due to additional costs caused by hasher winter operating conditions, cost inflation and higher fuel prices, partially offset by the contribution from higher volumes.

  Adjusted diluted EPS, Adjusted income, 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.

- *Total revenues* - Total revenues increased by 4% in the first quarter of 2018 to $1,662 million from $1,603 million in the same period in 2017. This increase was driven primarily by a 6% volume growth as measured in revenue ton miles ("RTMs"), partially offset by the unfavorable impact of the change in FX.

- *Operating performance* - CP's average train speed decreased by 8% to 20.6 miles per hour and terminal dwell time increased by 11% to 7.9 hours as a result of harsher winter operating conditions. Average train weight increased by 4% to 8,989 tons and average train length increased by 1% to 7,229 feet, primarily driven by mix of business and productivity improvements. These metrics are discussed further in Performance Indicators of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Recent Development

- On April 18, 2018, CP received 72-hour strike notice from the Teamsters Canada Rail Conference-Train & Engine ("TCRC") and the International Brotherhood of Electrical Workers ("IBEW") of their respective plans to strike at 12:01 a.m. eastern time on April 21, 2018. CP continues to work closely with the TCRC and the IBEW to reach a negotiated settlement.

Performance Indicators

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

	For the three months ended March 31		
	2018	2017[(1)]	% Change
Operations Performance			
Gross ton-miles ("GTMs") (millions)	**64,411**	60,827	6
Train miles (thousands)	**7,642**	7,511	2
Average train weight – excluding local traffic (tons)	**8,989**	8,647	4
Average train length – excluding local traffic (feet)	**7,229**	7,143	1
Average terminal dwell (hours)	**7.9**	7.1	11
Average train speed (miles per hour, or "mph")	**20.6**	22.3	(8)
Fuel efficiency (U.S. gallons of locomotive fuel consumed / 1,000 GTMs)	**0.984**	1.012	(3)
Total Employees and Workforce			
Total employees (average)	**12,173**	11,648	5
Total employees (end of period)	**12,328**	11,794	5
Workforce (end of period)	**12,398**	11,829	5
Safety Indicators			
FRA personal injuries per 200,000 employee-hours	**1.74**	1.85	(6)
FRA train accidents per million train miles	**1.07**	0.85	26

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

Operations Performance

These key measures of operating performance reflect how effective CP's management is at controlling costs and executing the Company's operating plan and strategy. CP continues to drive further productivity improvements in its operations, allowing the Company to deliver superior service and grow its business at low incremental cost.

Three months ended March 31, 2018 compared to the three months ended March 31, 2017

- A **GTM** is the movement of one ton of train weight over one mile. GTMs are calculated by multiplying total train weight by the distance the train moved. 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 first quarter of 2018 were 64,411, an increase of 6% compared with 60,827 in the same period of 2017. This increase was primarily due to increased volumes of Intermodal, Potash, crude, and frac sand, partially offset by decreases in Grain.

- **Train miles** are defined as the sum of the distance moved by all trains operated on the network. Train miles increased by 2% for the first quarter of 2018 compared to the same period of 2017. This reflects the impact of a 6% increase in workload, as measured in GTMs, partially offset by continuous improvements in train weights.

- 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 4% for the first quarter of 2018 compared to the same period of 2017. This increase was due to continuous improvements in operating plan efficiency and bulk train weights, as well as higher volumes of heavier commodities such as Potash, crude and frac sand compared to the same period in 2017. These improvements were partially offset by lower volumes of Grain moving in shorter, lighter trains due to harsher winter operating conditions.

- The **average train length** is defined as the average total length of CP trains, both loaded and empty. This includes all cars and locomotives on the train and is calculated as the sum of each car or locomotive's length multiplied by the distance travelled, divided by train miles. Local trains are excluded from this measure. Average train length increased by 1% for the first quarter of 2018 compared to the same period of 2017. This is a result of improvements in operating plan efficiency and increased Intermodal, Potash and export Coal volumes which move in longer trains. These improvements were partially offset by lower volumes of Grain moving in shorter trains due to harsher winter operating conditions.

- 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 at 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 11% in the first quarter of 2018 compared to the same period of 2017. This unfavourable increase was primarily due to harsher winter operating conditions and network disruptions as compared to the same period in 2017.

- 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 travelled 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 travelled by: i) trains used in or around CP's yards; ii) passenger trains; and iii) trains used for repairing track. Average train speed decreased by 8% in the first quarter of 2018 compared to the same period of 2017. This unfavourable decrease was primarily due to harsher winter operating conditions and network disruptions as compared to the same period in 2017.

- **Fuel efficiency** is defined as U.S. gallons of locomotive fuel consumed per 1,000 GTMs - freight and yard. Fuel efficiency improved by 3% in the first quarter of 2018 compared to the same period of 2017. Improvements in fuel efficiency were primarily due to increased train capacity utilization as a result of volume growth.

Total Employees and Workforce

An **employee** is defined as an individual currently engaged in full-time, part-time or seasonal employment with CP. The average number of total employees increased by 5% in the first three months of 2018, compared to the same periods of 2017 to accommodate current and anticipated volume growth.

The **workforce** is defined as total employees plus contractors and consultants. The Company's total workforce as at March 31, 2018, was 12,398, an increase of 156, when compared to 12,242 as at December 31, 2017. As at March 31, 2018, the total workforce increased by 569, or 5%, compared to March 31, 2017. The increase in workforce is to accommodate current and anticipated volume growth.

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 injuries per 200,000 employee-hours** frequency 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 injuries per 200,000 employee-hours frequency for CP was 1.74 in the first quarter of 2018, a decrease from 1.85 in the same period of 2017.

The **FRA train accidents per million train miles** frequency is the number of train accidents, multiplied by 1,000,000 and divided by total train miles. Train accidents included in this metric meet or exceed the FRA reporting threshold of U.S. $10,700 in damage. The FRA train accidents per million train miles was 1.07 in the first quarter of 2018, an increase from 0.85 in the same period of 2017.

Financial Highlights

The following table presents selected financial data related to the Company's financial results as of, and for the first quarter ended March 31, 2018 and the comparative figures in 2017. The financial highlights should be read in conjunction with Item 1. Financial Statements and this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

	For the three months ended March 31	
(in millions, except per share data, percentages and ratios)	**2018**	2017
Financial Performance		
Revenues	**$ 1,662**	$ 1,603
Operating income[(1)]	**540**	604
Adjusted operating income[(1)(2)]	**540**	553
Net income	**348**	431
Adjusted income[(2)]	**390**	368
Basic EPS	**2.41**	2.94
Diluted EPS	**2.41**	2.93
Adjusted diluted EPS[(2)]	**2.70**	2.50
Dividends declared per share	**0.5625**	0.5000
Cash provided by operating activities	**397**	311
Free cash[(2)]	**164**	87
	As at March 31, 2018	As at December 31, 2017
Financial Position		
Total assets	**$ 20,318**	$ 20,135
Total long-term debt, including current portion	**8,357**	8,159
Shareholders' equity	**6,434**	6,437
	For the twelve months ended March 31	
	2018	2017
Financial Ratios		
Return on invested capital ("ROIC")[(2)]	**19.5%**	13.4%
Adjusted ROIC[(2)]	**14.6%**	13.7%
Operating ratio[(1)(3)]	**67.5%**	62.4%
Adjusted operating ratio[(1)(2)]	**67.5%**	65.6%

(1) 2017 comparative period figure has been restated for the retrospective adoption of ASU 2017-07, discussed further in Item 1. Financial Statements, Note 2 Accounting changes.

(2) 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.

(3) 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.

Results of Operations

Three months ended March 31, 2018 compared to the three months ended March 31, 2017

Income

Operating income was $540 million in the first quarter of 2018, a decrease of $64 million, or 11%, from $604 million in the same period of 2017. This decrease was primarily due to:

- management transition recovery of $51 million associated with Mr. E. Hunter Harrison's retirement as CEO of CP in 2017;
- harsher winter operating conditions
- the unfavourable impact of the change in FX of $16 million;
- cost inflation consisting primarily of wage and benefit inflation of approximately 3%;
- higher depreciation and amortization expense; and
- higher defined benefit current service costs.

This decrease was partially offset by higher volumes and efficiencies generated from improved operating performance and asset utilization.

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 $540 million in the first quarter of 2018, a decrease of $13 million, or 2% from $553 million in the first quarter of 2017. This decrease reflects the same factors discussed above, except that Adjusted operating income in 2017 excludes the management transition recovery of $51 million.

Net income was $348 million in the first quarter of 2018, a decrease of $83 million, or 19%, from $431 million in the same period of 2017. This decrease was primarily due to the unfavourable impact of FX translation on U.S. dollar-denominated debt and lower Operating income. This decrease was partially offset by higher income from other components of net periodic benefit recoveries and lower income tax expense associated with lower pre-tax earnings.

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 $390 million in the first quarter of 2018, an increase of $22 million, or 6%, from $368 million in the same period of 2017. This increase was primarily due to higher income from other components of net periodic benefits recoveries and lower income tax expense associated with a lower effective tax rate, partially offset by lower Adjusted operating income.

Diluted Earnings per Share

Diluted earnings per share was $2.41 in the first quarter of 2018, a decrease of $0.52, or 18%, from $2.93 in the same period of 2017. This decrease was primarily due to lower Net income, partially offset by 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 $2.70 in the first quarter of 2018, an increase of $0.20, or 8%, from $2.50 in the same period of 2017. This increase was primarily due to higher Adjusted income and lower average outstanding shares due to the Company's share repurchase program.

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 67.5% in the first quarter of 2018, a 510 basis point increase from 62.4% in the same period of 2017. This increase was primarily due to:

- management transition recovery of $51 million associated with Mr. E. Hunter Harrison's retirement as CEO of CP in 2017;
- harsher winter operating conditions;
- cost inflation consisting primarily of wage and benefit inflation of approximately 3%; and
- the unfavourable impact of changes in fuel prices.

This increase was partially offset by higher volumes.

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 67.5% in the first quarter of 2018, a 190 basis point increase from 65.6% in the same period of 2017. This increase reflects the same factors discussed above except that Adjusted operating ratio for 2017 excludes the impact of the management transition recovery of 320 basis points.

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 19.5% for the twelve months ended March 31, 2018, a 610 basis point increase compared to 13.4% for the twelve months ended March 31, 2017. The increase was due to:

- lower tax expense due to income tax rate changes;
- favourable FX translation on U.S. dollar-denominated debt; and
- higher other components of net periodic benefit recoveries.

This increase is partially offset by a higher invested capital base due to higher Retained earnings from Net income.

Adjusted ROIC was 14.6% for the twelve months ended March 31, 2018, a 90 basis point increase compared to 13.7% for the twelve months ended March 31, 2017. This increase was primarily due to higher other components of net periodic benefit recoveries and higher Adjusted operating income, partially offset by the increase in adjusted average Shareholders' equity primarily due to higher Net income. 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.

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 months ended March 31, 2018 and the comparative periods in 2017.

Average exchange rates (Canadian/U.S. dollar)	**2018**	2017
For the three months ended - March 31	**$ 1.26**	$ 1.32

Exchange rates (Canadian/U.S. dollar)	**2018**	2017
Beginning of quarter - January 1	**$ 1.25**	$ 1.34
End of quarter - March 31	**$ 1.29**	$ 1.33

In the first quarter of 2018, the impact of a weaker U.S. dollar resulted in a decrease in total revenues of $37 million, a decrease in total operating expenses of $21 million and a decrease in interest expense of $4 million from the same period in 2017.

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

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 months ended March 31, 2018 and the comparative periods in 2017.

Average Fuel Price (U.S. dollars per U.S. gallon)	**2018**	2017
For the three months ended - March 31	**$ 2.70**	$ 2.11

The impact of fuel price on earnings includes the impacts of carbon taxes, levies, and obligations under cap-and-trade programs recovered and paid, on revenues and expenses, respectively.

In the first quarter of 2018, the impact of higher fuel prices resulted in an increase in total revenues of $42 million and an increase in total operating expenses of $40 million from the same period in 2017.

Impact of Share Price on Earnings

Fluctuations in the Common Share price affect the Company's operating expenses because share-based liabilities are measured at fair value. The following tables indicate the opening and closing CP Common Share Price on the Toronto Stock Exchange ("TSX") and the New York Stock Exchange ("NYSE") for the three months ended March 31, 2018 and the comparative period in 2017.

TSX (in Canadian dollars)	**2018**	2017
Opening Common Share Price, as at January 1	**$ 229.66**	$ 191.56
Ending Common Share Price, as at March 31	**$ 227.20**	$ 195.35
Change in Common Share Price	**$ (2.46)**	$ 3.79

NYSE (in U.S. dollars)	**2018**	2017
Opening Common Share Price, as at January 1	**$ 182.76**	$ 142.77
Ending Common Share Price, as at March 31	**$ 176.50**	$ 146.92
Change in Common Share Price	**$ (6.26)**	$ 4.15

In the first quarter of 2018, the impact of the change in Common Share prices resulted in a decrease in stock-based compensation expense of $2 million compared to an increase of $2 million in the same period in 2017.

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

Operating Revenues

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

For the three months ended March 31		**2018**		2017		Total Change	% Change	FX Adjusted % Change[2]
Freight revenues (in millions)[1]	**$**	**1,625**	$	1,563	$	62	4	6
Non-freight revenues (in millions)		**37**		40		(3)	(8)	(8)
Total revenues (in millions)	**$**	**1,662**	$	1,603	$	59	4	6
Carloads (in thousands)[3]		**649.1**		625.2		23.9	4	N/A
Revenue ton-miles (in millions)		**36,355**		34,212		2,143	6	N/A
Freight revenue per carload (in dollars)	**$**	**2,503**	$	2,499	$	4	—	3
Freight revenue per revenue ton-mile (in cents)		**4.47**		4.57		(0.10)	(2)	—

(1) Freight revenues include fuel surcharge revenues of $101 million in 2018, and $53 million in 2017. 2018 and 2017 fuel surcharge revenues include carbon taxes, levies, and obligations under cap-and-trade programs recovered.

(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.

(3) Certain figures have been revised to conform with current presentation.

- **Freight revenues** were $1,625 million in the first quarter of 2018, an increase of $62 million, or 4%, from $1,563 million in the same period of 2017. This increase was primarily due to higher volumes, as measured by RTMs, of Intermodal, Potash, crude, and frac sand and the favourable impact of higher fuel surcharge revenue as a result of higher fuel prices of $42 million, partially offset by lower volumes of Grain and the unfavourable impact of the change in FX of $37 million.

- **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 first quarter of 2018 were 36,355 million, an increase of 6% compared with 34,212 million in the same period of 2017. This increase was primarily due to increases in Intermodal, Potash, crude, and frac sand, partially offset by decreases in Grain.

- **Non-freight revenues** were $37 million in the first quarter of 2018, a decrease of $3 million, or 8%, from $40 million in the same period of 2017. This decrease was primarily due to lower passenger revenues following the expiration of a passenger service contract in 2017.

Fuel Cost Adjustment Program

Freight revenues include fuel surcharge revenues associated with CP's fuel cost adjustment program, which is designed to respond to fluctuations in fuel prices and help reduce exposure to changing fuel prices. The surcharge is applied to shippers through price indices, tariffs and by contract, within agreed-upon guidelines. This program includes recoveries of carbon taxes, levies, and obligations under cap-and-trade programs. Freight revenues include fuel surcharge revenues of $101 million in the first quarter of 2018, an increase of $48 million, or 91%, from $53 million in the same period in 2017. This increase was primarily due to higher fuel prices, which represented $42 million of the change.

Lines of Business

Grain

For the three months ended March 31		**2018**		2017		Total Change	% Change	FX Adjusted % Change
Freight revenues (in millions)	**$**	**357**	$	393	$	(36)	(9)	(7)
Carloads (in thousands)		**97.7**		106.6		(8.9)	(8)	N/A
Revenue ton-miles (in millions)		**8,729**		9,383		(654)	(7)	N/A
Freight revenue per carload (in dollars)	**$**	**3,650**	$	3,688	$	(38)	(1)	1
Freight revenue per revenue ton-mile (in cents)		**4.09**		4.19		(0.10)	(2)	—

Grain revenue was $357 million in the first quarter of 2018, a decrease of $36 million, or 9%, from $393 million in the same period of 2017. The decrease in revenue was primarily due to lower shipments of U.S. wheat primarily to the U.S. Pacific North West, lower shipments of Canadian grain to Vancouver due to harsher winter operating conditions, and the unfavourable impact of the change in FX. This decrease was partially offset by higher fuel surcharge revenue as a result of higher fuel prices. Carloads decreased greater than RTMs due to moving proportionately less U.S. grain which has a shorter length of haul versus Canadian grain.

Coal

For the three months ended March 31	**2018**	2017	Total Change	% Change	FX Adjusted % Change
Freight revenues (in millions)	**$ 151**	$ 148	$ 3	2	3
Carloads (in thousands)	**72.8**	70.4	2.4	3	N/A
Revenue ton-miles (in millions)	**5,218**	5,123	95	2	N/A
Freight revenue per carload (in dollars)	**$ 2,079**	$ 2,096	$ (17)	(1)	—
Freight revenue per revenue ton-mile (in cents)	**2.90**	2.88	0.02	1	1

Coal revenue was $151 million in the first quarter of 2018, an increase of $3 million, or 2%, from $148 million in the same period of 2017. This increase was primarily due to higher fuel surcharge revenues as a result of higher fuel prices, and higher volumes of Canadian export coal and U.S. coal, partially offset by the unfavourable impact of the change in FX. Freight revenue per ton-mile increased due to higher freight rates and increased shorter haul U.S. coal volumes.

Potash

For the three months ended March 31	**2018**	2017	Total Change	% Change	FX Adjusted % Change
Freight revenues (in millions)	**$ 112**	$ 98	$ 14	14	18
Carloads (in thousands)	**37.3**	31.4	5.9	19	N/A
Revenue ton-miles (in millions)	**4,381**	3,677	704	19	N/A
Freight revenue per carload (in dollars)	**$ 3,010**	$ 3,130	$ (120)	(4)	(1)
Freight revenue per revenue ton-mile (in cents)	**2.56**	2.67	(0.11)	(4)	(2)

Potash revenue was $112 million in the first quarter of 2018, an increase of $14 million, or 14%, from $98 million in the same period of 2017. This increase was primarily due to higher export potash volumes and higher fuel surcharge revenue as a result of higher fuel prices, partially offset by the unfavourable impact of the change in FX. The decrease in freight revenue per revenue ton-mile was due to moving proportionately more export potash versus domestic potash, which has a longer length of haul.

Fertilizers and Sulphur

For the three months ended March 31	**2018**	2017	Total Change	% Change	FX Adjusted % Change
Freight revenues (in millions)	**$ 61**	$ 59	$ 2	3	5
Carloads (in thousands)	**14.9**	14.1	0.8	6	N/A
Revenue ton-miles (in millions)	**1,061**	962	99	10	N/A
Freight revenue per carload (in dollars)	**$ 4,074**	$ 4,217	$ (143)	(3)	(1)
Freight revenue per revenue ton-mile (in cents)	**5.74**	6.17	(0.43)	(7)	(4)

Fertilizers and sulphur revenue was $61 million in the first quarter of 2018, an increase of $2 million, or 3%, from $59 million in the same period of 2017. This increase was primarily due to higher fertilizer and sulphur volumes, and higher fuel surcharge revenue as a result of higher fuel prices, partially offset by the unfavourable impact of the change in FX. Freight revenue per revenue ton-mile decreased due to increased volumes of longer haul cross border traffic, which was also responsible for the greater increase in RTMs compared to carloads.

Forest Products

For the three months ended March 31		2018		2017		Total Change	% Change	FX Adjusted % Change
Freight revenues (in millions)	$	**66**	$	67	$	(1)	(1)	2
Carloads (in thousands)		**16.7**		16.3		0.4	2	N/A
Revenue ton-miles (in millions)		**1,122**		1,102		20	2	N/A
Freight revenue per carload (in dollars)	$	**3,937**	$	4,128	$	(191)	(5)	(1)
Freight revenue per revenue ton-mile (in cents)		**5.84**		6.11		(0.27)	(4)	(1)

Forest products revenue was $66 million in the first quarter of 2018, a decrease of $1 million, or 1%, from $67 million in the same period of 2017. This decrease was due to the unfavourable impact of the change in FX and a decrease in freight revenue per revenue ton-mile, partially offset by higher fuel surcharge revenue as a result of higher fuel prices and higher volumes. Freight revenue per revenue ton-mile decreased due to increased volumes of longer haul export wood pulp from Eastern Canada to Vancouver.

Energy, Chemicals and Plastics

For the three months ended March 31		2018		2017		Total Change	% Change	FX Adjusted % Change
Freight revenues (in millions)	$	**257**	$	227	$	30	13	17
Carloads (in thousands)		**74.2**		66.6		7.6	11	N/A
Revenue ton-miles (in millions)		**6,157**		5,340		817	15	N/A
Freight revenue per carload (in dollars)	$	**3,468**	$	3,412	$	56	2	5
Freight revenue per revenue ton-mile (in cents)		**4.18**		4.25		(0.07)	(2)	1

Energy, chemicals and plastics revenue was $257 million in the first quarter of 2018, an increase of $30 million, or 13%, from $227 million in the same period of 2017. This increase was primarily due to higher volumes of crude and liquefied petroleum gas ("L.P.G."), and higher fuel surcharge revenue as a result of higher fuel prices, partly offset by the unfavourable impact of the change in FX. The decrease in freight revenue per revenue ton-mile was primarily due to moving proportionately more crude, which has a longer length of haul. This was also responsible for a greater increase in RTMs compared to carloads.

Metals, Minerals and Consumer Products

For the three months ended March 31		2018		2017		Total Change	% Change	FX Adjusted % Change
Freight revenues (in millions)	$	**183**	$	170	$	13	8	12
Carloads (in thousands)		**58.6**		59.5		(0.9)	(2)	N/A
Revenue ton-miles (in millions)		**2,924**		2,560		364	14	N/A
Freight revenue per carload (in dollars)	$	**3,126**	$	2,851	$	275	10	14
Freight revenue per revenue ton-mile (in cents)		**6.27**		6.63		(0.36)	(5)	(2)

Metals, minerals and consumer products revenue was $183 million in the first quarter of 2018, an increase of $13 million, or 8%, from $170 million in the same period of 2017. This increase was primarily due to higher frac sand volumes and higher fuel surcharge revenue as a result of higher fuel prices, partially offset by the unfavourable impact of the change in FX. The decrease in freight revenue per revenue ton-mile was primarily due to moving proportionately more frac sand. Carloads decreased due to a decrease in volumes of short haul copper ore.

Automotive

For the three months ended March 31		2018		2017		Total Change	% Change	FX Adjusted % Change
Freight revenues (in millions)	$	**71**	$	76	$	(5)	(7)	(3)
Carloads (in thousands)		**25.5**		27.1		(1.6)	(6)	N/A
Revenue ton-miles (in millions)		**305**		340		(35)	(10)	N/A
Freight revenue per carload (in dollars)	$	**2,792**	$	2,792	$	—	—	4
Freight revenue per revenue ton-mile (in cents)		**23.32**		22.29		1.03	5	9

Automotive revenue was $71 million in the first quarter of 2018, a decrease of $5 million, or 7%, from $76 million in the same period of 2017. This decrease was primarily due to lower volumes and the unfavourable impact of the change in FX, partially offset by higher fuel surcharge revenue as a result of higher fuel prices, and a higher freight revenue per revenue ton-mile. The increase in freight revenue per revenue ton-mile was primarily due to higher freight rates and proportionally more trucks and sport utility vehicles ("SUV") shipped. RTMs decreased more than carloads as a result of lower tons per carload driven by moving more trucks and SUVs and fewer automobiles.

Intermodal

For the three months ended March 31		2018		2017		Total Change	% Change	FX Adjusted % Change
Freight revenues (in millions)	**$**	**367**	$	325	$	42	13	14
Carloads (in thousands)		**251.4**		233.2		18.2	8	N/A
Revenue ton-miles (in millions)		**6,458**		5,725		733	13	N/A
Freight revenue per carload (in dollars)	**$**	**1,458**	$	1,391	$	67	5	6
Freight revenue per revenue ton-mile (in cents)		**5.68**		5.66		0.02	—	1

Intermodal revenue was $367 million in the first quarter of 2018, an increase of $42 million, or 13%, from $325 million in the same period of 2017. This increase was primarily due to higher wholesale and temperature controlled domestic volumes, and higher international volumes through the Port of Vancouver and Detroit; as well as higher fuel surcharge revenue as a result of higher fuel prices. This increase was partially offset by the unfavourable impact of the change in FX. RTMs increased more than carloads due to moving proportionately more wholesale domestic intermodal volumes which is also driving RTMs to increase more than carloads.

Operating Expenses

						2018 vs. 2017		
For the three months ended March 31 (in millions)		2018		2017		Total Change	% Change	FX Adjusted % Change[(2)]
Compensation and benefits[(1)]	**$**	**374**	$	300	$	74	25	27
Fuel		**215**		170		45	26	31
Materials		**55**		49		6	12	15
Equipment rents		**33**		36		(3)	(8)	(6)
Depreciation and amortization		**170**		166		4	2	4
Purchased services and other		**275**		278		(3)	(1)	1
Total operating expenses[(1)]	**$**	**1,122**	$	999	$	123	12	15

(1) 2017 comparative period figure has been restated for the retrospective adoption of ASU 2017-07, discussed further in Item 1. Financial Statements, Note 2 Accounting changes.
(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.

Operating expenses were $1,122 million in the first quarter of 2018, an increase of $123 million, or 12%, from $999 million in the same period of 2017. This increase was primarily due to:

- management transition recovery of $51 million associated with Mr. E. Hunter Harrison's retirement as CEO of CP in 2017;
- the unfavourable impact of increases in fuel price of $40 million;
- higher volume variable expenses;
- harsher winter operating conditions; and
- cost inflation consisting primarily of wage and benefit inflation of approximately 3%.

This increase was partially offset by the favourable impact of the change in FX of $21 million and efficiencies generated from improved operating performance and asset utilization.

Compensation and Benefits

Compensation and benefits expense includes employee wages, salaries, fringe benefits and stock-based compensation. Compensation and benefits expense was $374 million in the first quarter of 2018, an increase of $74 million, or 25%, from $300 million in the same period of 2017. This increase was primarily due to:

- management transition recovery of $51 million associated with Mr. E. Hunter Harrison's retirement as CEO of CP in 2017;
- wage and benefit inflation of approximately 3%;

- harsher winter operating conditions;
- higher volume variable expenses as a result of an increase in workload as measured by GTMs;
- higher pension current service cost; and
- higher incentive compensation.

This increase was partially offset by the benefit of operational efficiencies and the favourable impact of the change in FX.

Fuel

Fuel expense consists mainly of fuel used by locomotives and includes provincial, state and federal fuel taxes. Fuel expense was $215 million in the first quarter of 2018, an increase of $45 million, or 26%, from $170 million in the same period of 2017. This increase was primarily due to the unfavourable impact of $40 million from higher fuel prices and an increase in workload, as measured by GTMs. This increase was partially offset by the favourable impact of the change in FX of $6 million and improvements in fuel efficiency of approximately 3% primarily due to increased train capacity utilization as a result of volume growth.

Materials

Materials expense includes the cost of material used for track, locomotive, freight car and building maintenance and software sustainment. Materials expense was $55 million in the first quarter of 2018, an increase of $6 million, or 12%, from $49 million in the same period of 2017. This increase was primarily due to higher wheel expenses, partially driven by harsher winter operating conditions, and non-locomotive fuel costs, partially offset by higher material recoveries on other railroads' car repairs.

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 $33 million in the first quarter of 2018, a decrease of $3 million, or 8%, from $36 million in the same period of 2017. The decrease was primarily due to the purchase or return of leased freight cars reducing rental expense. This decrease was partially offset by lower receipts from other railroads for use of CP's equipment.

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 $170 million in the first quarter of 2018, an increase of $4 million, or 2%, from $166 million in the same period of 2017. This increase was primarily due to a higher depreciable asset base partially offset by the favourable impact of the change in FX of $2 million.

Purchased Services and Other

			2018 vs. 2017	
For the three months ended March 31 (in millions)	**2018**	2017	Total Change	% Change
Support and facilities	**$ 66**	$ 67	$ (1)	(1)
Track and operations	**72**	66	6	9
Intermodal	**53**	47	6	13
Equipment	**34**	41	(7)	(17)
Casualty	**17**	20	(3)	(15)
Property taxes	**34**	32	2	6
Other	**1**	7	(6)	(86)
Land sales	**(2)**	(2)	—	—
Total Purchased services and other	**$ 275**	$ 278	$ (3)	(1)

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 $275 million in the first quarter of 2018, a decrease of $3 million, or 1%, from $278 million in the same period of 2017. This decrease was primarily due to:
- the favourable impact of the change in FX of $6 million;
- lower engine overhaul expenses due to the capital nature of overhaul activities in 2018, reported in Equipment; and
- charges related to assets held for sale in 2017, reported in Other.

This decrease was partially offset by weather related impacts including higher snow removal, reported in Track and operations and Intermodal, and higher intermodal expenses related to pickup and delivery, reported in Intermodal.

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 $51 million in the first quarter of 2018, compared to a gain of $28 million in the same period of 2017, a change of $79 million, or 282%. This change was primarily due to the unfavourable impact of FX translation of $49 million on U.S. dollar-denominated debt during the first quarter of 2018, compared to the favourable impact of FX translation of $28 million in the same period of 2017, discussed further in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Other Components of Net Periodic Benefit

Other components of net periodic benefit was a recovery of $96 million in the first quarter of 2018, compared to a recovery of $67 million in the same period of 2017, a change of $29 million or 43%. This change was primarily due to an increase in the expected return on fund assets and a decrease in the recognized net actuarial loss.

Net Interest Expense

Net interest expense includes interest on long-term debt and capital leases. Net interest expense was $115 million in the first quarter of 2018, a decrease of $5 million, or 4%, from $120 million in the same period of 2017. This decrease was primarily due to the favourable impact of the change in FX of $4 million.

Income Tax Expense

Income tax expense was $122 million in the first quarter of 2018, a decrease of $26 million, or 18%, from $148 million in the same period of 2017. This decrease was due to lower taxable earnings.

The effective tax rate in the first quarter of 2018, including discrete items was 25.92%, compared with 25.60% in the same period of 2017. The effective tax rate in the first quarter of 2018, excluding discrete items, was 24.75% compared to 26.50% in 2017. This decrease is primarily due to the reduction in the U.S. federal income tax rate under the Tax Cuts and Jobs Act enacted in the fourth quarter of 2017, effective January 1, 2018.

The Company expects an annualized effective tax rate in 2018 of approximately 24.5% to 25%. The Company's 2018 outlook for its annualized effective 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 new events and developments. This is discussed further in Item 1A. Risk Factors of CP's 2017 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 letter of credit facilities, and its revolving credit facility.

As at March 31, 2018, the Company had $125 million of Cash and cash equivalents, U.S. $2.0 billion available under its revolving credit facility and up to $299 million available under its letters of credit (December 31, 2017 - $338 million of Cash and cash equivalents, U.S. $2.0 billion available under its revolving credit facility and up to $281 million available under its letters of credit).

As at March 31, 2018, 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 (December 31, 2017 - undrawn). The Company did not draw from its revolving credit facility during the three months ended March 31, 2018. 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 March 31, 2018, the Company was in compliance with the threshold stipulated in this financial covenant.

The Company has a commercial paper program that 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. As at March 31, 2018, total commercial paper borrowings were U.S. $nil (December 31, 2017 - $nil).

As at March 31, 2018, under its bilateral letters of credit facility, the Company had letters of credit drawn of $301 million from a total available amount of $600 million. This compares to letters of credit drawn of $319 million from a total available amount of $600 million as at December 31, 2017. 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. As at March 31, 2018, the Company had no collateral posted on its bilateral letters of credit facility (December 31, 2017 - $150 million).

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

Operating Activities

Cash provided by operating activities was $397 million in the first quarter of 2018, an increase of $86 million compared to $311 million in the same period of 2017. This increase was primarily due to a favourable change in working capital mainly as a result of lower taxes paid in the first quarter of 2018.

Investing Activities

Cash used in investing activities was $238 million in the first quarter of 2018, an increase of $16 million compared to $222 million in the same period of 2017. This increase was primarily due to higher capital additions during 2018 compared to the same period in 2017.

Free Cash

CP generated positive Free cash of $164 million in the first quarter of 2018, an increase of $77 million from $87 million in the same period of 2017. This increase was primarily due to an increase in cash provided by operating activities compared to the same period of 2017.

Free cash is affected by seasonal fluctuations and by other factors including the size of the Company's additions to properties. 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.

Financing Activities

Cash used in financing activities was $377 million in the first quarter of 2018, an increase of $327 million compared to $50 million in the same period of 2017. This increase was primarily due to payments to buy back shares under the Company's share repurchase program in 2018.

Credit Measures

Credit ratings provide information relating to the Company's financing costs, liquidity and operations and affect 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 March 31, 2018, CP's credit ratings from Standard & Poor's Rating Services ("Standard & Poor's") and Moody's Investor Service ("Moody's") remain unchanged from December 31, 2017.

Credit ratings as at March 31, 2018[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**	stable
$1 billion Commercial paper program			
Standard & Poor's		**A-2**	N/A
Moody's		**P-2**	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 Adjusted net debt to Adjusted earnings before interest, tax, depreciation and amortization ("EBITDA") ratio for the twelve months ended March 31, 2018 and March 31, 2017 was 2.7 and 2.9, respectively. This decrease was primarily due to lower Adjusted net debt as a result of the favourable impact from the change in FX on U.S. dollar-denominated debt, as well as an increase in Adjusted EBITDA for the twelve months ended March 31, 2018. 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. Over the long term, CP targets an Adjusted net debt to Adjusted EBITDA ratio of 2.0 to 2.5.

Share Capital

At April 16, 2018, the latest practicable date, there were 143,074,798 Common Shares and no preferred shares issued and outstanding, which consists of 14,515 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 Common Shares. Each option granted can be exercised for one Common Share. At April 16, 2018, 1.6 million options were outstanding under the Company's MSOIP and stand-alone option agreements entered into with Mr. Keith Creel. There are 1.4 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 Common Shares. There are no outstanding options under the DSOP, which has 0.3 million options available to be issued in the future.

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 income, Adjusted diluted earnings per share, Adjusted operating income 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 the first quarter of 2018, there was one significant item included in Net income as follows:

- a net non-cash loss of $49 million ($42 million after deferred tax) due to FX translation of the Company's U.S. dollar-denominated debt that unfavourably impacted Diluted EPS by 29 cents.

In 2017, there were five significant items included in Net income as follows:

- in the second quarter, a charge on hedge roll and de-designation of $13 million ($10 million after deferred tax) that unfavourably impacted Diluted EPS by 7 cents;
- in the second quarter, an insurance recovery of a legal settlement of $10 million ($7 million after current tax) that favourably impacted Diluted EPS by 5 cents;
- in the first quarter, a management transition recovery of $51 million related to the retirement of Mr. E. Hunter Harrison as CEO of CP ($39 million after deferred tax) that favourably impacted Diluted EPS by 27 cents;
- during the course of the year, a net deferred tax recovery of $541 million as a result of changes in income tax rates as follows:
    - in the fourth quarter, a deferred tax recovery of $527 million, primarily due to the U.S. tax reform, that favourably impacted Diluted EPS by $3.63;
    - in the third quarter, a deferred tax expense of $3 million as a result of the change in the Illinois state corporate income tax rate change that unfavourably impacted Diluted EPS by 2 cents;
    - in the second quarter, a deferred tax recovery of $17 million as a result of the change in the Saskatchewan provincial corporate income tax rate that favourably impacted Diluted EPS by 12 cents; and
- during the course of the year, a net non-cash gain of $186 million ($162 million after deferred tax) due to FX translation of the Company's U.S. dollar-denominated debt as follows:
    - in the fourth quarter, a $14 million loss ($12 million after deferred tax) that unfavourably impacted Diluted EPS by 8 cents;
    - in the third quarter, a $105 million gain ($91 million after deferred tax) that favourably impacted Diluted EPS by 62 cents;
    - in the second quarter, a $67 million gain ($59 million after deferred tax) that favourably impacted Diluted EPS by 40 cents; and
    - in the first quarter, a $28 million gain ($24 million after deferred tax) that favourably impacted Diluted EPS by 16 cents.

In the nine months ended December 31, 2016, there were two significant items included in Net income as follows:

- in the third quarter, a $25 million expense ($18 million after current tax) related to a legal settlement that unfavourably impacted Diluted EPS by 12 cents; and
- during the first nine months, a net non-cash loss of $102 million ($88 million after deferred tax) due to FX translation of the Company's U.S. dollar-denominated debt as follows:
    - in the fourth quarter, a $74 million loss ($64 million after deferred tax) that unfavourably impacted Diluted EPS by 43 cents;
    - in the third quarter, a $46 million loss ($40 million after deferred tax) that unfavourably impacted Diluted EPS by 27 cents; and
    - in the second quarter, an $18 million gain ($16 million after deferred tax) that favourably impacted Diluted EPS by 10 cents.

Reconciliation of GAAP Performance Measures to Non-GAAP Performance Measures

The following tables reconcile the most directly comparable measures presented in accordance with GAAP to the 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 for the three months ended March 31, 2018 and 2017:

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

	For the three months ended March 31	
(in millions)	**2018**	2017
Net income as reported	**$ 348**	$ 431
Less significant items (pretax):		
Management transition recovery	**—**	51
Impact of FX translation on U.S. dollar-denominated debt	**(49)**	28
Add:		
Tax effect of adjustments[(1)]	**(7)**	16
Adjusted income	**$ 390**	$ 368

(1) The tax effect of adjustments was calculated as the pretax effect of the adjustments multiplied by the applicable tax rate for the above items of 13.43% and 19.88% for the three months ended March 31, 2018 and 2017, respectively. The applicable tax rates reflect the taxable jurisdictions and nature, being on account of capital or income, of the significant items.

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.

	For the three months ended March 31	
	2018	2017
Diluted earnings per share as reported	**$ 2.41**	$ 2.93
Less significant items (pretax):		
Management transition recovery	**—**	0.35
Impact of FX translation on U.S. dollar-denominated debt	**(0.34)**	0.19
Add:		
Tax effect of adjustments[1]	**(0.05)**	0.11
Adjusted diluted earnings per share	**$ 2.70**	$ 2.50

(1) The tax effect of adjustments was calculated as the pretax effect of the adjustments multiplied by the applicable tax rate for the above items of 13.43% and 19.88% for the three months ended March 31, 2018 and 2017, respectively. The applicable tax rates reflect the taxable jurisdictions and nature, being on account of capital or income, of the significant items.

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

	For the three months ended March 31	
(in millions)	**2018**	2017
Operating income as reported[1]	**$ 540**	$ 604
Less significant item:		
Management transition recovery	**—**	51
Adjusted operating income[1]	**$ 540**	$ 553

(1)2017 comparative period figure has been restated for the retrospective adoption of ASU 2017-07, discussed further in Item 1. Financial Statements, Note 2 Accounting changes.

Adjusted operating ratio excludes those significant items that are reported within Operating income.

	For the three months ended March 31	
	2018	2017
Operating ratio as reported[1]	**67.5 %**	62.4%
Less significant item:		
Management transition recovery	**—**	(3.2)
Adjusted operating ratio[1]	**67.5 %**	65.6%

(1)2017 comparative period figure has been restated for the retrospective adoption of ASU 2017-07, discussed further in Item 1. Financial Statements, Note 2 Accounting changes.

ROIC and Adjusted ROIC

ROIC is calculated as Operating income less Other income and charges, tax effected 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. Total Shareholders' equity, Long-term debt, Long-term debt maturing within one year and Short-term borrowing is similarly adjusted for the impact of these significant items, net of tax, on closing balances as part of this average. 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)	For the twelve months ended March 31 2018	2017
Operating income as reported[(1)]	**$ 2,455**	$ 2,405
Less:		
Other income and charges	**(99)**	108
Other components of net periodic benefit recovery[(1)]	**(303)**	(191)
Tax[(2)]	**86**	654
	$ 2,771	$ 1,834
Average of total shareholders' equity, long-term debt, long-term debt maturing within one year and short-term borrowing	**14,222**	13,698
ROIC	**19.5%**	13.4%

(1) 2017 comparative period figure has been restated for the retrospective adoption of ASU 2017-07, discussed further in Item 1. Financial Statements, Note 2 Accounting changes.

(2) Tax was calculated at the annualized effective tax rate of 2.99% and 26.27% for each of the above items for the twelve months ended March 31, 2018 and 2017, respectively.

(in millions, except for percentages)	For the twelve months ended March 31 2018	2017
Operating income as reported[(1)]	**$ 2,455**	$ 2,405
Less significant item:		
Management transition recovery	**—**	51
Adjusted operating income	**2,455**	2,354
Less:		
Other income and charges	**(99)**	108
Other components of net periodic benefit recovery[(1)]	**(303)**	(191)
Add significant items (pretax):		
Legal settlement charge	**—**	25
Insurance recovery of legal settlement	**(10)**	—
Charge on hedge roll and de-designation	**13**	—
Impact of FX translation on U.S. dollar-denominated debt	**(109)**	74
Less:		
Tax[(2)]	**716**	657
	$ 2,035	$ 1,879
Average for the twelve months of total shareholders' equity, long-term debt, long-term debt maturing within one year and short-term borrowing	**14,222**	13,698
Add:		
Impact of periodic significant items net of tax on the above average	**(269)**	(11)
Adjusted average for the twelve months of total shareholders' equity, long-term debt, long-term debt maturing within one year and short-term borrowing	**13,953**	13,687
Adjusted ROIC[(3)]	**14.6%**	13.7%

(1) 2017 comparative period figure has been restated for the retrospective adoption of ASU 2017-07, discussed further in Item 1. Financial Statements, Note 2 Accounting changes.

(2) Tax was calculated at the adjusted annualized effective tax rate of 26.02% and 25.91% for each of the above items for the twelve months ended March 31, 2018 and 2017, respectively.

(3) The definition of Adjusted ROIC has been revised to exclude the impact of periodic significant items net of tax on closing total Shareholders' equity, Long-term debt, Long-term debt maturing within one year and Short-term borrowing as part of the average calculation. The change did not have a significant impact on the 2017 comparative period.

Free Cash

Free cash is calculated as Cash provided by operating activities, less Cash used in investing activities, 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 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 March 31	
(in millions)	**2018**	2017
Cash provided by operating activities	**$ 397**	$ 311
Cash used in investing activities	**(238)**	(222)
Effect of foreign currency fluctuations on U.S. dollar-denominated cash and cash equivalents	**5**	(2)
Free cash	**$ 164**	$ 87

FX Adjusted Variance

FX adjusted variance allows certain financial results 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. 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 variances are discussed in Operating Revenues and Operating Expenses of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

	For the three months ended March 31				
(in millions)	**Reported 2018**	Reported 2017	Variance due to FX	FX Adjusted 2017	FX Adjusted % Change
Freight revenues	1,625	1,563	(37)	$ 1,526	6
Non-freight revenues	37	40	—	40	(8)
Total revenues	**1,662**	**1,603**	**(37)**	1,566	6
Compensation and benefits[(1)]	374	300	(5)	295	27
Fuel	215	170	(6)	164	31
Materials	55	49	(1)	48	15
Equipment rents	33	36	(1)	35	(6)
Depreciation and amortization	170	166	(2)	164	4
Purchased services and other	275	278	(6)	272	1
Total operating expenses[(1)]	**1,122**	**999**	**(21)**	978	15
Operating income[(1)]	**540**	**604**	**(16)**	$ 588	(8)

(1) 2017 comparative period figure has been restated for the retrospective adoption of ASU 2017-07, discussed further in Item 1. Financial Statements, Note 2 Accounting changes.

Reconciliation of Net Income to EBIT, Adjusted EBIT and Adjusted EBITDA

EBIT is calculated as Net income before Net interest expense and Income tax expense. Adjusted EBIT excludes significant items reported in Operating income and Other income and charges. Adjusted EBITDA is calculated as Adjusted EBIT plus Depreciation and amortization, net periodic pension and other benefit cost other than current service costs, and operating lease expense.

(in millions)	For the twelve months ended March 31 2018	2017
Net income as reported	**$ 2,322**	$ 1,490
Add:		
Net interest expense	**468**	467
Income tax expense	**67**	531
EBIT	**2,857**	2,488
Less significant items (pretax):		
Legal settlement charge	**—**	(25)
Insurance recovery of legal settlement	**10**	—
Charge on hedge roll and de-designation	**(13)**	—
Management transition recovery	**—**	51
Impact of FX translation on U.S. dollar-denominated debt	**109**	(74)
Adjusted EBIT	**2,751**	2,536
Less:		
Other components of net periodic benefit recovery	**303**	191
Operating lease expense	**(98)**	(106)
Depreciation and amortization	**(665)**	(644)
Adjusted EBITDA	**$ 3,211**	$ 3,095

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 years 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 a key credit measure used to assess the Company's financial capacity. The ratio provides information on the Company's ability to service its debt and other long-term obligations. 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.

Reconciliation of Long-term Debt to Adjusted Net Debt

(in millions)	2018	2017
Long-term debt including long-term debt maturing within one year as at March 31	**$ 8,357**	$ 8,614
Less:		
Pension plans in deficit[1]	**(278)**	(271)
Net present value of operating leases[2]	**(276)**	(330)
Cash and cash equivalents	**125**	201
Adjusted net debt as at March 31	**$ 8,786**	$ 9,014

[1] Pension plans deficit is the total funded status of the Pension plans in deficit only.
[2] Operating leases were discounted at the Company's effective interest rate for each of the periods presented.

Calculation of Adjusted Net Debt to Adjusted EBITDA Ratio

(in millions, except for ratios)	2018	2017
Adjusted net debt as at March 31	**$ 8,786**	$ 9,014
Adjusted EBITDA for the year ended March 31	**3,211**	3,095
Adjusted net debt to Adjusted EBITDA ratio	**2.7**	2.9

Off-Balance Sheet Arrangements

Guarantees

At March 31, 2018, the Company had residual value guarantees on operating lease commitments of $6 million, compared to $6 million at December 31, 2017. 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 March 31, 2018, the fair value of these guarantees recognized as a liability was $10 million, compared to $9 million at December 31, 2017.

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, as at March 31, 2018.

Payments due by period (in millions)	**Total**	2018	2019 & 2020	2021 & 2022	2023 & beyond
Contractual commitments					
Interest on long-term debt and capital lease	**$ 11,438**	$ 304	$ 798	$ 722	$ 9,614
Long-term debt	**8,290**	748	538	837	6,167
Capital leases	**154**	3	10	110	31
Operating lease[1]	**346**	53	111	71	111
Supplier purchase	**1,575**	481	636	133	325
Other long-term liabilities[2]	**479**	40	101	101	237
Total contractual commitments	**$ 22,282**	$ 1,629	$ 2,194	$ 1,974	$ 16,485

[1] Residual value guarantees on certain leased equipment with a maximum exposure of $1 million are not included in the minimum payments shown above. Where management believes that CP will be required to make payments under these residual value guarantees, the fair value of these guarantees as at March 31, 2018 of $5 million has been recognized as a liability.

[2] Includes expected cash payments for restructuring, environmental remediation, 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 2018 to 2027. 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 discussed below.

Letters of Credit

Letters of credit are obtained mainly to provide security to third parties under the terms of various agreements, including the 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 letter of credit facilities.

Capital Commitments

The Company remains committed to maintaining the current high level of quality of our capital assets in pursuing sustainable growth. 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 2018 through 2032. These expenditures are expected to be financed by cash generated from operations or by issuing new debt.

The accompanying table indicates the Company's commitments to make future payments for letters of credit and capital expenditures as at March 31, 2018.

Payments due by period (in millions)	**Total**	2018	2019 & 2020	2021 & 2022	2023 & beyond
Certain other financial commitments					
Letters of credit	**$ 301**	$ 301	$ —	$ —	$ —
Capital commitments	**757**	327	190	74	166
Total certain other financial commitments	**$ 1,058**	$ 628	$ 190	$ 74	$ 166

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, and personal injury and other claims liabilities. Additional information concerning critical accounting estimates is supplemented in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations of the Company's 2017 Annual Report on 10-K. There have not been any material changes to the Company's critical accounting estimates in the first three months of 2018.

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.

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, statements concerning the Company's defined benefit pension expectations for 2018 and through 2021, our expectations for 2018 which includes an effective tax rate in the range of 24.5 to 25 percent, as well as 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. To the extent that CP has provided guidance using non-GAAP financial measures, the Company may not be able to provide a reconciliation to a GAAP measure, due to unknown variables and uncertainty related to future results.

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 2017 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 months ended March 31, 2018 from the information provided in Item 7A. Quantitative and Qualitative Disclosure about Market Risk of CP's 2017 Annual Report on Form 10-K. Refer to information on 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 $27 million and negatively (or positively) impacts Operating expenses by approximately $14 million.

CP uses U.S. dollar-denominated debt to hedge its net investment in U.S. operations. As at March 31, 2018, the net investment in U.S. operations is less than the total U.S. denominated debt. Consequently, FX translation on the Company's undesignated U.S. dollar-denominated long-term debt causes additional impacts on earnings in Other income and charges. For further information, please refer to Item 8. Financial Statements and Supplementary Data, Note 17 Financial Instruments, in CP's 2017 Annual Report on Form 10-K.

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.

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 $0.3 million to $0.5 million based on information available at March 31, 2018. This excludes the impact of changes in share price relative to the S&P/TSX 60 Index, the S&P/TSX Capped Industrial Index, the S&P 1500 Road and Rail Index, and to Class I railways, which may trigger different performance share unit payouts. Share based compensation may also be impacted by non-market performance conditions.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

As of March 31, 2018, 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 March 31, 2018, 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 first quarter of 2018, 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.