

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 and nine months ended September 30, 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

Third Quarter of 2018 Results

- **Financial performance** - In the third quarter of 2018, CP reported Diluted earnings per share ("EPS") of \$4.35, an increase of 24% as compared to 2017. Net income was \$622 million in the third quarter of 2018, an increase of 22% as compared to 2017. These increases were primarily due to higher volumes and higher income from defined benefit pension plans, partially offset by lower foreign exchange ("FX") gains on U.S. dollar-denominated debt in 2018 compared to 2017. Adjusted diluted EPS, which excludes FX on U.S. dollar-denominated debt, was \$4.12 in the third quarter of 2018, an increase of 42% compared to the same period of 2017. Adjusted income was \$589 million in the third quarter of 2018, an increase of 40% compared to last year. These increases were primarily due to higher volumes and higher income from defined benefit pension plans.

CP reported an Operating ratio of 58.3% in the third quarter of 2018, a 270 basis point improvement as compared to last year's operating ratio. This improvement was primarily due to higher volumes and efficiencies generated from improved operating performance and asset utilization. This was partially offset by higher fuel prices and higher stock-based compensation driven primarily by an increase in the stock price.

Adjusted diluted EPS and Adjusted income 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 19% in the third quarter of 2018 to \$1,898 million from \$1,595 million in the same period of 2017. This increase was driven primarily by a 13% volume growth as measured in Revenue Ton-Miles ("RTMs"), higher fuel surcharge revenue, and the favourable impact of the change in FX.
- **Operating performance** - CP's average train speed decreased by 6% to 21.6 miles per hour and terminal dwell time increased by 5% to 6.9 hours due to higher volumes and increased delays from accelerated track and roadway capital programs in the third quarter of 2018. Average train weight increased by 2% to 9,195 tons, average train length increased by 1% to 7,345 feet, and fuel efficiency improved by 3% primarily driven by improved productivity from running longer trains as a result of volume growth. 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 Developments

- On October 17, 2018, CP announced that it intends to implement a new normal course issuer bid to repurchase, for cancellation, up to approximately 5.68 million of its Common Shares, subject to Toronto Stock Exchange acceptance.
- On October 4, 2018, as part of CP's Investor Day, the Company announced updates to its 2018 full-year guidance, which included estimated adjusted EPS growth in excess of 20 percent.⁽¹⁾ The Company also announced financial targets for 2018-2020 of volume compound annual growth rate ("CAGR") of mid-single digits measured in RTMs, double-digit CAGR in adjusted diluted EPS, continued margin improvement through cost control and operating leverage, and capital expenditures of \$1.6 billion per year. These targets are based on the following key assumptions: exchange rate of 1.30 CAD/USD, On-Highway Diesel price of \$3.20 USD/US gallon, pension income consistent with 2018, and an annualized effective tax rate of 25%, excluding discrete items such as foreign-exchange gains or losses on U.S. dollar-denominated debt and any effects of changes in tax rates.

Adjusted diluted EPS is defined and discussed further in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations. Although CP has provided a forward-looking non-GAAP measure it is not practicable to provide a reconciliation to a forward-looking reported Diluted EPS, the most comparable GAAP measure, due to unknown variables and uncertainty related to future results. These unknown variables may include unpredictable transactions of significant value. In past years, CP has recognized significant asset impairment charges, management transition costs related to senior executives and charges or recoveries resulting from tax rate changes. These or other similar, large unforeseen transactions affect Diluted EPS but may be excluded from CP's Adjusted diluted EPS. Additionally, the Canadian-to-U.S. dollar exchange rate is unpredictable and can have a significant impact on CP's reported results but may be excluded from CP's Adjusted diluted EPS. In particular, CP's 2018 adjusted diluted EPS excludes FX impact of translating the Company's U.S. dollar denominated long-term debt and a deferred income tax recovery from changes in Iowa and Missouri corporate income tax rates.

⁽¹⁾ CP's expectations for adjusted diluted EPS growth in 2018 are based on adjusted diluted EPS of \$11.39 in 2017. CP expects approximately \$50 million of gains from land sales in the fourth quarter of 2018.

- On September 25, 2018, the Company announced the appointment of Edward L. Monser to CP's Board of Directors effective December 17, 2018.
- On September 17, 2018, CP declared a quarterly dividend of \$0.6500 per share on the outstanding Common Shares. The dividend is payable on October 29, 2018 to holders of record at the close of business on September 28, 2018.

Prior Developments

- On May 25, 2018, Mr. John Derry resigned from his position as Vice-President of Human Resources.
- On May 23, 2018, the Transportation Modernization Act, also known as Bill C-49, was passed. The bill included amendments to the Canada Transportation Act and the Railway Safety Act, among other acts, to: (1) replace the existing 160 kilometer extended interswitching limit and the competitive line rate provisions with a new long-haul interswitching regime; (2) modify the existing Level of Service remedy for shippers by instructing the Agency to determine, upon receipt of a complaint, if a railway company is fulfilling its common carrier obligation to provide "adequate and suitable accommodation" of traffic, if it is satisfied that the service provided is the "highest level of service that is reasonable in the circumstances"; (3) allow the existing Service Level Agreement arbitration remedy to include the consideration of reciprocal financial penalties; (4) increase the threshold for summary Final Offer Arbitrations from \$750,000 to \$2 million; (5) bifurcate the Volume-Related Composite Price Index component of the annual Maximum Revenue determination for transportation of regulated grain, to encourage hopper car investment by CP and CN; and (6) mandate the installation of locomotive voice and video recorders ("LVVRs"), with statutory permission for random access by railway companies and Transport Canada to the LVVR data in order to proactively strengthen railway safety in Canada.
- Following the passage of Bill C-49, CP announced that it would invest more than a half-billion dollars over the next four years on new high-capacity grain hopper cars as part of its commitment to the North American agricultural sector. As a result of that multi-year investment, CP anticipated that 2018 capital expenditures would be \$1.55 billion.
- On May 10, 2018, CP announced an increase to the Company's quarterly dividend to \$0.6500 per share from \$0.5625 per share. The dividend was payable on July 30, 2018 to holders of record at the close of business on June 29, 2018.
- *Labour Disruptions* - On April 18, 2018, CP received a 72-hour strike notice from the Teamsters Canada Rail Conference - Train & Engine ("TCRC"), representing approximately 3,000 conductors and locomotive engineers, and the International Brotherhood of Electrical Workers ("IBEW"), representing approximately 360 signal maintainers, of their respective plans to strike. At that time, CP commenced its work stoppage contingency plan to ensure a smooth, efficient and safe wind down of operations.

On April 20, 2018, CP reached an agreement with TCRC and IBEW to have the Canadian Industrial Relations Board administer a ratification vote on each of CP's final offers, which averted a potential work stoppage. The ratification votes occurred from May 18 to May 25, 2018 and both offers were voted down.

On May 26, 2018, CP received another 72-hour strike notice from TCRC and IBEW, and again CP commenced its work stoppage contingency plans. On May 29, 2018, CP reached a tentative three-year agreement with IBEW and averted strike action by its members. This agreement was ratified by the IBEW membership on June 29, 2018, with 78% of members voting for ratification. On May 30, 2018, CP reached a tentative four-year agreement with TCRC and ended strike action which began at 22:00EST on May 29, 2018. On July 20, 2018, this agreement was also ratified. The wind-down of operations and return to full service levels following the strike notices caused disruption to the network, losses in potential revenue and costs related to labour disruptions in the second quarter.

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		
	2018	2017 ⁽¹⁾	% Change	2018	2017 ⁽¹⁾	% Change
Operations Performance						
Gross ton-miles ("GTMs") (millions)	70,469	62,311	13	202,575	186,899	8
Train miles (thousands)	8,174	7,444	10	23,809	22,786	4
Average train weight – excluding local traffic (tons)	9,195	8,990	2	9,082	8,775	3
Average train length – excluding local traffic (feet)	7,345	7,301	1	7,297	7,193	1
Average terminal dwell (hours)	6.9	6.6	5	7.1	6.5	9
Average train speed (miles per hour, or "mph")	21.6	23.1	(6)	21.2	22.9	(7)
Fuel efficiency (U.S. gallons of locomotive fuel consumed / 1,000 GTMs)	0.916	0.944	(3)	0.952	0.978	(3)
Total Employees and Workforce						
Total employees (average)	12,941	12,149	7	12,623	11,990	5
Total employees (end of period)	13,000	12,135	7	13,000	12,135	7
Workforce (end of period)	13,029	12,219	7	13,029	12,219	7
Safety Indicators						
FRA personal injuries per 200,000 employee-hours	1.49	1.56	(4)	1.49	1.64	(9)
FRA train accidents per million train miles	1.12	0.99	13	1.11	1.01	10

⁽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 September 30, 2018 compared to the three months ended September 30, 2017

- A **GTM** is defined as 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 increased by 13% for the third quarter of 2018 compared to the same period of 2017. This increase was primarily due to increased volumes of crude, Intermodal, and Potash.
- **Train miles** are defined as the sum of the distance moved by all trains operated on the network. Train miles increased by 10% for the third quarter of 2018 compared to the same period of 2017. This reflects the impact of a 13% increase in workload, partially offset by improvements in train weight.
- **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 railroads' trains on CP's network. Average train weight increased by 2% for the third quarter of 2018 compared to the same period of 2017. This increase was due to continuous improvements in operating plan efficiency combined with higher volumes of heavier commodities, such as crude and Potash, compared to the same period of 2017.
- **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 third quarter of 2018 compared to the same period of 2017. This was a result of improvements in operating plan efficiency and increased Intermodal and Potash volumes, which move in longer trains.
- **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 railroad. The timing ends when the train leaves, a customer receives the car from CP, or the freight car is transferred to another railroad. 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 2018 compared to the same period of 2017.

This unfavourable increase in dwell was due to higher volumes and increased delays from accelerated track and roadway capital programs.

- **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 customers or foreign railroads 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 6% in the third quarter of 2018 compared to the same period of 2017. This decrease was due to higher volumes and increased delays from accelerated track and roadway capital programs.
- **Fuel efficiency** is defined as U.S. gallons of locomotive fuel consumed per 1,000 GTMs. Fuel efficiency improved by 3% in the third quarter of 2018 compared to the same period of 2017. This improvement in efficiency was primarily due to improved productivity from running longer trains as a result of volume growth.

Nine months ended September 30, 2018 compared to the nine months ended September 30, 2017

- **GTMs** increased by 8% for the first nine months of 2018 compared to the same period of 2017. This increase was primarily due to increased volumes of crude, Intermodal, and Potash.
- **Train miles** increased by 4% for the first nine months of 2018 compared to the same period of 2017. This reflects the impact of higher volumes, partially offset by improvements in train weights.
- **Average train weight** increased by 3% for the first nine months of 2018 compared to the same period of 2017. This was a result of improvements in operating plan efficiency combined with higher volumes of heavier commodities, such as crude and Potash.
- **Average train length** increased by 1% for the first nine months of 2018 from the same period of 2017. This increase was primarily due to improvements in operating plan efficiency and increased Intermodal and Potash volumes, which move in longer trains.
- **Average terminal dwell** increased by 9% in the first nine months of 2018 compared to the same period of 2017. This unfavourable increase was primarily due to network disruptions from labour negotiations in the second quarter of 2018, harsher winter conditions in the first quarter of 2018, and higher volumes and increased delays from accelerated track and roadway capital programs in the third quarter of 2018.
- **Average train speed** decreased by 7% in the first nine months of 2018 compared to the same period of 2017. This decrease was primarily due to network disruptions from labour negotiations in the second quarter of 2018, harsher winter conditions in the first quarter of 2018, and higher volumes and increased delays from accelerated track and roadway capital programs in the third quarter of 2018.
- **Fuel efficiency** improved by 3% in the first nine months of 2018 compared to the same period of 2017. This improvement in efficiency was primarily due to improved productivity from running longer trains 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 7% and 5% in the first three and nine months of 2018, respectively, compared to the same periods of 2017.

Workforce is defined as total employees plus contractors and consultants. The Company's total workforce as at September 30, 2018, was 13,029, an increase of 787, or 6%, when compared to 12,242 as at December 31, 2017. As at September 30, 2018, the total workforce increased by 810, or 7%, compared to September 30, 2017. The increases in the number of total employees and 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 1.49 in the third quarter of 2018, a decrease from 1.56 in the same period of 2017.

For the first nine months of 2018, the FRA personal injury rate per 200,000 employee-hours for CP was 1.49, a decrease from 1.64 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 1.12 in the third quarter of 2018, an increase from 0.99 in the same period of 2017. For the first nine months of 2018, FRA train accidents per million train miles was 1.11, an increase from 1.01 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 three and nine months ended September 30, 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.

(in millions, except per share data, percentages and ratios)	For the three months ended September 30		For the nine months ended September 30	
	2018	2017	2018	2017
Financial Performance				
Revenues	\$ 1,898	\$ 1,595	\$ 5,310	\$ 4,841
Operating income ⁽¹⁾	790	622	1,957	1,837
Adjusted operating income ⁽¹⁾⁽²⁾	790	622	1,957	1,786
Net income	622	510	1,406	1,421
Adjusted income ⁽²⁾	589	422	1,432	1,197
Basic EPS	4.36	3.50	9.81	9.72
Diluted EPS	4.35	3.50	9.78	9.70
Adjusted diluted EPS ⁽²⁾	4.12	2.90	9.97	8.17
Dividends declared per share	0.6500	0.5625	1.8625	1.6250
Cash provided by operating activities	673	527	1,781	1,449
Free cash ⁽²⁾	245	214	740	575
	As at September 30, 2018		As at December 31, 2017	
Financial Position				
Total assets	\$ 21,109		\$ 20,135	
Total long-term debt, including current portion	8,286		8,159	
Shareholders' equity	7,128		6,437	
	For the twelve months ended September 30			
	2018		2017	
Financial Ratios				
Return on invested capital ("ROIC") ⁽²⁾	19.4%		15.9%	
Adjusted ROIC ⁽²⁾	15.7%		14.7%	
	For the three months ended September 30		For the nine months ended September 30	
	2018	2017	2018	2017
Operating ratio ⁽¹⁾⁽³⁾	58.3%	61.0%	63.1%	62.1%
Adjusted operating ratio ⁽¹⁾⁽²⁾	58.3%	61.0%	63.1%	63.1%

⁽¹⁾ 2017 comparative period figures have 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 September 30, 2018 compared to the three months ended September 30, 2017

Income

Operating income was \$790 million in the third quarter of 2018, an increase of \$168 million, or 27%, from \$622 million in the same period of 2017. This increase was primarily due to:

- higher volumes;
- favourable impact of the change in FX of \$15 million; and
- the efficiencies generated from improved operating performance and asset utilization.

This increase was partially offset by higher stock-based compensation driven primarily by an increase in the stock price and higher depreciation expense due to a higher asset base.

Net income was \$622 million in the third quarter of 2018, an increase of \$112 million, or 22%, from \$510 million in the same period of 2017. This increase was primarily due to the higher operating income and higher income from other components of net periodic benefit recoveries. This increase was partially offset by a lower gain from FX translation on U.S. dollar-denominated debt and higher taxes due to higher taxable income.

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 \$589 million in the third quarter of 2018, an increase of \$167 million, or 40%, from \$422 million in the same period of 2017. This increase was primarily due to higher operating income and higher income from other components of net periodic benefit recoveries. This was partially offset by higher taxes due to higher taxable earnings.

Diluted Earnings per Share

Diluted earnings per share was \$4.35 in the third quarter of 2018, an increase of \$0.85, or 24%, from \$3.50 in the same period of 2017. 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 \$4.12 in the third quarter of 2018, an increase of \$1.22, or 42%, from \$2.90 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 58.3% in the third quarter of 2018, a 270 basis point improvement from 61.0% in the same period of 2017. This improvement was primarily due to higher volumes and efficiencies generated from improved operating performance and asset utilization. This was partially offset by higher fuel prices and higher stock-based compensation driven primarily by an increase in the stock price.

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 19.4% for the twelve months ended September 30, 2018, a 350 basis point increase compared to 15.9% for the twelve months ended September 30, 2017. This increase was due to lower Income tax expense due to income tax rate changes, higher Operating income, and higher Other components of net periodic benefit recoveries. This increase was partially offset by a higher invested capital base due to higher Retained earnings from Net income and the unfavourable change in FX translation on U.S. dollar-denominated debt.

Adjusted ROIC was 15.7% for the twelve months ended September 30, 2018, a 100 basis point increase compared to 14.7% for the twelve months ended September 30, 2017. This increase was primarily due to a higher Adjusted operating income and higher Other components of net periodic benefit recoveries. This is partially offset by the increase in adjusted average Shareholders' equity primarily due to higher Net income and higher tax expense due to higher taxable earnings. 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, 2018 compared to the nine months ended September 30, 2017

Income

Operating income was \$1,957 million in the first nine months of 2018, an increase of \$120 million, or 7%, from \$1,837 million in the same period of 2017. This increase was primarily due to higher volumes and efficiencies generated from improved operating performance and asset utilization.

This increase was partially offset by:

- a management transition recovery of \$51 million associated with Mr. E. Hunter Harrison's retirement as CEO of CP in 2017;
- cost inflation;
- higher depreciation expense due to a higher asset base;
- higher stock-based compensation driven primarily by an increase in the stock price;
- the unfavourable impact of the change in FX of \$17 million;
- harsher winter operating conditions in the first quarter of 2018; and
- higher incentive compensation.

Adjusted operating income was \$1,957 million in the first nine months of 2018, an increase of \$171 million, or 10%, from \$1,786 million in the first nine months of 2017. This increase reflects the same factors discussed above, except that Adjusted operating income in 2017 excluded the management transition recovery of \$51 million.

Net income was \$1,406 million in the first nine months of 2018, a decrease of \$15 million, or 1%, from \$1,421 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 higher income taxes due to higher taxable income. This was partially offset by higher operating income and higher income from other components of net periodic benefit recoveries.

Adjusted income was \$1,432 million in the first nine months of 2018, an increase of \$235 million, or 20%, from \$1,197 million in the same period of 2017. This increase was primarily due to higher operating income and income from other components of net periodic benefits recoveries. This was partially offset by higher income taxes due to higher taxable earnings.

Diluted Earnings per Share

Diluted earnings per share was \$9.78 in the first nine months of 2018, an increase of \$0.08, or 1%, from \$9.70 in the same period of 2017. This increase was primarily due to the lower average outstanding shares due to the Company's share repurchase program, partially offset by lower Net income.

Adjusted diluted EPS was \$9.97 in the first nine months of 2018, an increase of \$1.80, or 22%, from \$8.17 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 Company's Operating ratio was 63.1% in the first nine months of 2018, a 100 basis point increase from 62.1% in the same period of 2017. This increase was primarily due to:

- the unfavourable impact of higher fuel prices;
- a management transition recovery of \$51 million associated with Mr. E. Hunter Harrison's retirement as CEO of CP in 2017;
- cost inflation;
- higher depreciation expense due to a higher asset base;
- higher stock-based compensation driven primarily by an increase in the stock price;
- harsher winter operating conditions in the first quarter; and
- incentive compensation.

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

Adjusted operating ratio was 63.1% in the first nine months of 2018, unchanged from the same period of 2017. This reflects the same factors discussed above except that Adjusted operating ratio for 2017 excludes the impact of the management transition recovery of 100 basis points.

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, 2018 and the comparative periods in 2017.

Average exchange rates (Canadian/U.S. dollar)	2018	2017
For the three months ended - September 30	\$ 1.31	\$ 1.25
For the nine months ended - September 30	\$ 1.29	\$ 1.31

Exchange rates (Canadian/U.S. dollar)	2018	2017
Beginning of year - January 1	\$ 1.25	\$ 1.34
Beginning of quarter - July 1	\$ 1.32	\$ 1.30
End of quarter - September 30	\$ 1.29	\$ 1.25

In the third quarter of 2018, the impact of a stronger U.S. dollar resulted in an increase in total revenues of \$33 million, an increase in total operating expenses of \$18 million, and an increase in interest expense of \$5 million from the same period in 2017.

In the first nine months of 2018, the impact of a weaker U.S. dollar resulted in a decrease in total revenues of \$39 million, a decrease in total operating expenses of \$22 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 an impact on earnings due to the timing of recoveries from CP's fuel cost adjustment program. The following table indicates the average fuel price for the three and nine months ended September 30, 2018 and the comparative periods in 2017.

Average Fuel Price (U.S. dollars per U.S. gallon)	2018	2017
For the three months ended - September 30	\$ 2.69	\$ 2.08
For the nine months ended - September 30	\$ 2.72	\$ 2.07

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 third quarter of 2018, the impact of higher fuel prices resulted in an increase in total revenues of \$68 million and an increase in total operating expenses of \$59 million from the same period in 2017.

In the first nine months of 2018, the impact of higher fuel prices resulted in an increase in total revenues of \$160 million and an increase in total operating expenses of \$163 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 and nine months ended September 30, 2018 and the comparative periods 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 June 30	\$ 240.92	\$ 208.65
Ending Common Share Price, as at September 30	\$ 273.23	\$ 209.58
Change in Common Share Price for the three months ended September 30	\$ 32.31	\$ 0.93
Change in Common Share Price for the nine months ended September 30	\$ 43.57	\$ 18.02

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 June 30	\$	183.02	\$	160.81
Ending Common Share Price, as at September 30	\$	211.94	\$	168.03
Change in Common Share Price for the three months ended September 30	\$	28.92	\$	7.22
Change in Common Share Price for the nine months ended September 30	\$	29.18	\$	25.26

In the third quarter of 2018, the impact of the change in Common Share prices resulted in an increase in stock-based compensation expense of \$15 million compared to an increase of \$2 million in the same period in 2017.

In the first nine months of 2018, the impact of the change in Common Share prices resulted in an increase in stock-based compensation expense of \$17 million compared to an increase of \$10 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 are generated from leasing of certain assets, switching fees, contracts with passenger service operators, and logistical management services.

For the three months ended September 30	2018	2017	Total Change	% Change	FX Adjusted % Change ⁽²⁾
Freight revenues (in millions) ⁽¹⁾	\$ 1,854	\$ 1,547	\$ 307	20	17
Non-freight revenues (in millions)	44	48	(4)	(8)	(10)
Total revenues (in millions)	\$ 1,898	\$ 1,595	\$ 303	19	17
Carloads (in thousands) ⁽³⁾	702.0	666.4	35.6	5	N/A
Revenue ton-miles (in millions)	39,664	35,170	4,494	13	N/A
Freight revenue per carload (in dollars)	\$ 2,640	\$ 2,321	\$ 319	14	11
Freight revenue per revenue ton-mile (in cents)	4.67	4.40	0.27	6	4

⁽¹⁾ Freight revenues include fuel surcharge revenues of \$137 million in 2018 and \$52 million in 2017. 2018 and 2017 fuel surcharge revenues include carbon taxes, levies, and obligations recovered under cap-and-trade programs.

⁽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 \$1,854 million in the third quarter of 2018, an increase of \$307 million, or 20%, from \$1,547 million in the same period of 2017. This increase was primarily due to higher volumes, as measured by RTMs, of crude, Intermodal, and Potash, the favourable impact of higher fuel surcharge revenue as a result of higher fuel prices of \$68 million, and the favourable impact of the change in FX of \$32 million. This was partially offset by lower volumes of Coal and frac sand.
- **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 2018 were 39,664 million, an increase of 13% compared with 35,170 million in the same period of 2017. This increase was primarily due to increases in crude, Intermodal, and Potash, partially offset by decreases in Coal and frac sand.
- **Non-freight revenues** were \$44 million in the third quarter of 2018, a decrease of \$4 million, or 8%, from \$48 million in the same period of 2017. This decrease was primarily due to a recovery of prior costs following the expiration of a passenger service contract in 2017.

For the nine months ended September 30	2018	2017	Total Change	% Change	FX Adjusted % Change ⁽²⁾
Freight revenues (in millions) ⁽¹⁾	\$ 5,188	\$ 4,708	\$ 480	10	11
Non-freight revenues (in millions)	122	133	(11)	(8)	(8)
Total revenues (in millions)	\$ 5,310	\$ 4,841	\$ 469	10	11
Carloads (in thousands) ⁽³⁾	2,029.9	1,955.2	74.7	4	N/A
Revenue ton-miles (in millions)	113,584	105,381	8,203	8	N/A
Freight revenue per carload (in dollars)	\$ 2,556	\$ 2,408	\$ 148	6	7
Freight revenue per revenue ton-mile (in cents)	4.57	4.47	0.10	2	3

⁽¹⁾ Freight revenues include fuel surcharge revenues of \$351 million in 2018 and \$164 million in 2017. 2018 and 2017 fuel surcharge revenues include carbon taxes, levies, and obligations recovered under cap-and-trade programs.

⁽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 \$5,188 million in the first nine months of 2018, an increase of \$480 million, or 10%, from \$4,708 million in the same period of 2017. This increase was primarily due to higher volumes, as measured by RTMs, of crude, Intermodal, and Potash, and the favourable impact of higher fuel surcharge revenue as a result of higher fuel prices of \$160 million. This was partially offset by the unfavourable impact of the change in FX of \$39 million and lower volumes of Coal and Grain.
- **RTMs** for the first nine months of 2018 were 113,584 million, an increase of 8% compared with 105,381 million in the same period of 2017. This increase was primarily due to increases in crude, Intermodal, and Potash, partially offset by decreases in Coal and Grain.
- **Non-freight revenues** were \$122 million in the first nine months of 2018, a decrease of \$11 million, or 8%, from \$133 million in the same period of 2017. This decrease was primarily due to a recovery of prior costs and 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 \$137 million in the third quarter of 2018, an increase of \$85 million, or 163%, from \$52 million in the same period in 2017. This increase was primarily due to higher fuel prices, which represented \$68 million of the change. In the first nine months of 2018, fuel surcharge revenues were \$351 million, an increase of \$187 million, or 114%, from \$164 million in the same period of 2017. This increase was primarily due to higher fuel prices, which represented \$160 million of the change.

Lines of Business

Grain

For the three months ended September 30	2018	2017	Total Change	% Change	FX Adjusted % Change
Freight revenues (in millions)	\$ 384	\$ 351	\$ 33	9	7
Carloads (in thousands)	107.4	108.0	(0.6)	(1)	N/A
Revenue ton-miles (in millions)	9,009	8,627	382	4	N/A
Freight revenue per carload (in dollars)	\$ 3,565	\$ 3,251	\$ 314	10	7
Freight revenue per revenue ton-mile (in cents)	4.25	4.07	0.18	4	2

Grain revenue was \$384 million in the third quarter of 2018, an increase of \$33 million, or 9%, from \$351 million in the same period of 2017. The increase in revenue was primarily due to higher volumes of regulated Canadian grain to Vancouver, the favourable impact of the change in FX, higher fuel surcharge revenue as a result of higher fuel prices, and higher regulated grain pricing. This increase was partially offset by a decrease in US grain volumes to the Pacific Northwest. RTMs increased while carloads decreased due to moving proportionately more regulated Canadian grain, which has a longer length of haul.

For the nine months ended September 30	2018	2017	Total Change	% Change	FX Adjusted % Change
Freight revenues (in millions)	\$ 1,113	\$ 1,107	\$ 6	1	1
Carloads (in thousands)	314.5	325.6	(11.1)	(3)	N/A
Revenue ton-miles (in millions)	26,698	27,274	(576)	(2)	N/A
Freight revenue per carload (in dollars)	\$ 3,536	\$ 3,402	\$ 134	4	5
Freight revenue per revenue ton-mile (in cents)	4.17	4.06	0.11	3	3

Grain revenue was \$1,113 million in the first nine months of 2018, an increase of \$6 million, or 1%, from \$1,107 million in the same period of 2017. The increase in revenue was primarily due to higher freight rates and higher fuel surcharge revenue as a result of higher fuel prices. This increase was partially offset by lower volumes of regulated Canadian grain due to harsher winter operating conditions in the first quarter, lower volumes of U.S. wheat primarily to the U.S. Pacific North West, and the unfavourable impact of the change in FX.

Coal

For the three months ended September 30	2018	2017	Total Change	% Change	FX Adjusted % Change
Freight revenues (in millions)	\$ 171	\$ 165	\$ 6	4	4
Carloads (in thousands)	76.8	81.3	(4.5)	(6)	N/A
Revenue ton-miles (in millions)	5,764	6,009	(245)	(4)	N/A
Freight revenue per carload (in dollars)	\$ 2,234	\$ 2,021	\$ 213	11	9
Freight revenue per revenue ton-mile (in cents)	2.98	2.73	0.25	9	9

Coal revenue was \$171 million in the third quarter of 2018, an increase of \$6 million, or 4%, from \$165 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 the favourable impact of the change in FX, partially offset by lower volumes of Canadian coal due to supply chain issues. RTMs decreased less than carloads due to moving proportionately more volumes of long haul Canadian coal to Thunder Bay.

For the nine months ended September 30	2018	2017	Total Change	% Change	FX Adjusted % Change
Freight revenues (in millions)	\$ 486	\$ 478	\$ 8	2	2
Carloads (in thousands)	226.7	233.3	(6.6)	(3)	N/A
Revenue ton-miles (in millions)	16,657	17,230	(573)	(3)	N/A
Freight revenue per carload (in dollars)	\$ 2,145	\$ 2,047	\$ 98	5	3
Freight revenue per revenue ton-mile (in cents)	2.92	2.77	0.15	5	5

Coal revenue was \$486 million in the first nine months of 2018, an increase of \$8 million, or 2%, from \$478 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 freight revenue per revenue ton-mile. This was partially offset by lower volumes of Canadian export coal and the unfavourable impact of the change in FX. Freight revenue per revenue ton-mile increased due to higher freight rates.

Potash

For the three months ended September 30	2018	2017	Total Change	% Change	FX Adjusted % Change
Freight revenues (in millions)	\$ 130	\$ 103	\$ 27	26	24
Carloads (in thousands)	42.3	34.6	7.7	22	N/A
Revenue ton-miles (in millions)	4,944	4,083	861	21	N/A
Freight revenue per carload (in dollars)	\$ 3,089	\$ 2,978	\$ 111	4	1
Freight revenue per revenue ton-mile (in cents)	2.64	2.53	0.11	4	2

Potash revenue was \$130 million in the third quarter of 2018, an increase of \$27 million, or 26%, from \$103 million in the same period of 2017. This increase was primarily due to higher export potash volumes, higher fuel surcharge revenue as a result of higher fuel prices, and the favourable impact of the change in FX.

For the nine months ended September 30	2018	2017	Total Change	% Change	FX Adjusted % Change
Freight revenues (in millions)	\$ 358	\$ 310	\$ 48	15	17
Carloads (in thousands)	117.4	102.9	14.5	14	N/A
Revenue ton-miles (in millions)	13,750	11,919	1,831	15	N/A
Freight revenue per carload (in dollars)	\$ 3,052	\$ 3,013	\$ 39	1	2
Freight revenue per revenue ton-mile (in cents)	2.61	2.60	0.01	—	1

Potash revenue was \$358 million in the first nine months of 2018, an increase of \$48 million, or 15%, from \$310 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. RTMs increased more than carloads due to moving proportionately more export potash to Vancouver, which has a longer length of haul.

Fertilizers and Sulphur

For the three months ended September 30	2018	2017	Total Change	% Change	FX Adjusted % Change
Freight revenues (in millions)	\$ 55	\$ 52	\$ 3	6	2
Carloads (in thousands)	13.8	13.8	—	—	N/A
Revenue ton-miles (in millions)	935	864	71	8	N/A
Freight revenue per carload (in dollars)	\$ 3,957	\$ 3,814	\$ 143	4	1
Freight revenue per revenue ton-mile (in cents)	5.87	6.08	(0.21)	(3)	(6)

Fertilizers and sulphur revenue was \$55 million in the third quarter of 2018, an increase of \$3 million, or 6%, from \$52 million in the same period of 2017. This increase was primarily due to increased dry fertilizer and sulphur volumes, higher fuel surcharge revenue as a result of higher fuel prices, and the favourable impact of the change in FX. This increase was partially offset by decreased volumes of wet fertilizer and a decrease in freight revenue per revenue ton-mile. Freight revenue per revenue ton-mile decreased due to moving proportionately less wet fertilizer, which has higher freight rates, and more sulphur volumes from Canada to the U.S., which have a longer length of haul.

For the nine months ended September 30	2018	2017	Total Change	% Change	FX Adjusted % Change
Freight revenues (in millions)	\$ 171	\$ 181	\$ (10)	(6)	(4)
Carloads (in thousands)	41.9	43.2	(1.3)	(3)	N/A
Revenue ton-miles (in millions)	2,902	2,837	65	2	N/A
Freight revenue per carload (in dollars)	\$ 4,084	\$ 4,198	\$ (114)	(3)	(1)
Freight revenue per revenue ton-mile (in cents)	5.90	6.39	(0.49)	(8)	(6)

Fertilizers and sulphur revenue was \$171 million in the first nine months of 2018, a decrease of \$10 million, or 6%, from \$181 million in the same period of 2017. This decrease was primarily due to lower freight revenue per revenue ton-mile and the unfavourable impact of the change in FX, partially offset by higher fuel surcharge revenue as a result of higher fuel prices. Freight revenue per revenue ton-mile decreased due to moving proportionately less wet fertilizer, which has higher freight rates, and more sulphur volumes from Canada to the U.S., which have a longer length of haul.

Forest Products

For the three months ended September 30	2018	2017	Total Change	% Change	FX Adjusted % Change
Freight revenues (in millions)	\$ 76	\$ 67	\$ 9	13	12
Carloads (in thousands)	17.9	17.2	0.7	4	N/A
Revenue ton-miles (in millions)	1,263	1,157	106	9	N/A
Freight revenue per carload (in dollars)	\$ 4,240	\$ 3,870	\$ 370	10	6
Freight revenue per revenue ton-mile (in cents)	6.01	5.78	0.23	4	1

Forest products revenue was \$76 million in the third quarter of 2018, an increase of \$9 million, or 13%, from \$67 million in the same period of 2017. This increase was due to higher volumes of lumber, higher fuel surcharge revenue as a result of higher fuel prices,

and the favourable impact of the change in FX. RTMs increased more than carloads due to increased volumes of lumber, which have a longer length of haul.

For the nine months ended September 30	2018	2017	Total Change	% Change	FX Adjusted % Change
Freight revenues (in millions)	\$ 211	\$ 202	\$ 9	4	6
Carloads (in thousands)	51.5	49.8	1.7	3	N/A
Revenue ton-miles (in millions)	3,596	3,390	206	6	N/A
Freight revenue per carload (in dollars)	\$ 4,107	\$ 4,056	\$ 51	1	3
Freight revenue per revenue ton-mile (in cents)	5.88	5.96	(0.08)	(1)	—

Forest products revenue was \$211 million in the first nine months of 2018, an increase of \$9 million, or 4%, from \$202 million in the same period of 2017. This increase was due to higher volumes of pulp and paper products and higher fuel surcharge revenue as a result of higher fuel prices, partially offset by a decrease in freight revenue per revenue ton-mile and the unfavourable impact of the change in FX. RTMs increased more than carloads due to increased volumes of longer haul wood pulp from Eastern Canada to the U.S.

Energy, Chemicals and Plastics

For the three months ended September 30	2018	2017	Total Change	% Change	FX Adjusted % Change
Freight revenues (in millions)	\$ 339	\$ 208	\$ 131	63	58
Carloads (in thousands)	89.1	64.7	24.4	38	N/A
Revenue ton-miles (in millions)	7,485	4,992	2,493	50	N/A
Freight revenue per carload (in dollars)	\$ 3,806	\$ 3,227	\$ 579	18	15
Freight revenue per revenue ton-mile (in cents)	4.53	4.18	0.35	8	5

Energy, chemicals and plastics revenue was \$339 million in the third quarter of 2018, an increase of \$131 million, or 63%, from \$208 million in the same period of 2017. This increase was primarily due to higher volumes of crude, liquefied petroleum gas ("L.P.G.") and fuel oil, higher fuel surcharge revenue as a result of higher fuel prices, and the favourable impact of the change in FX. RTMs increased more than carloads due to moving proportionately more crude, which has a longer length of haul.

For the nine months ended September 30	2018	2017	Total Change	% Change	FX Adjusted % Change
Freight revenues (in millions)	\$ 874	\$ 651	\$ 223	34	36
Carloads (in thousands)	242.4	194.0	48.4	25	N/A
Revenue ton-miles (in millions)	20,047	15,302	4,745	31	N/A
Freight revenue per carload (in dollars)	\$ 3,606	\$ 3,357	\$ 249	7	9
Freight revenue per revenue ton-mile (in cents)	4.36	4.26	0.10	2	4

Energy, chemicals and plastics revenue was \$874 million in the first nine months of 2018, an increase of \$223 million, or 34%, from \$651 million in the same period of 2017. This increase was primarily due to higher volumes of crude and L.P.G., and higher fuel surcharge revenue as a result of higher fuel prices, partially offset by the unfavourable impact of the change in FX. RTMs increased more than carloads due to moving proportionately more crude, which has a longer length of haul.

Metals, Minerals and Consumer Products

For the three months ended September 30	2018	2017	Total Change	% Change	FX Adjusted % Change
Freight revenues (in millions)	\$ 208	\$ 192	\$ 16	8	5
Carloads (in thousands)	65.0	68.2	(3.2)	(5)	N/A
Revenue ton-miles (in millions)	2,979	3,030	(51)	(2)	N/A
Freight revenue per carload (in dollars)	\$ 3,206	\$ 2,806	\$ 400	14	11
Freight revenue per revenue ton-mile (in cents)	7.00	6.32	0.68	11	7

Metals, minerals and consumer products revenue was \$208 million in the third quarter of 2018, an increase of \$16 million, or 8%, from \$192 million in the same period of 2017. This increase was primarily due to higher fuel surcharge revenue as a result of higher

fuel prices, the favourable impact of the change in FX, and higher steel volumes. This increase was partially offset by lower volumes of frac sand. RTMs decreased less than carloads due to increased volumes of longer haul steel traffic.

For the nine months ended September 30	2018	2017	Total Change	% Change	FX Adjusted % Change
Freight revenues (in millions)	\$ 595	\$ 552	\$ 43	8	9
Carloads (in thousands)	189.6	191.1	(1.5)	(1)	N/A
Revenue ton-miles (in millions)	9,067	8,512	555	7	N/A
Freight revenue per carload (in dollars)	\$ 3,140	\$ 2,888	\$ 252	9	10
Freight revenue per revenue ton-mile (in cents)	6.57	6.49	0.08	1	2

Metals, minerals and consumer products revenue was \$595 million in the first nine months of 2018, an increase of \$43 million, or 8%, from \$552 million in the same period of 2017. This increase was primarily due to higher frac sand and steel volumes and higher fuel surcharge revenue as a result of higher fuel prices, partially offset by the unfavourable impact of the change in FX. RTMs increased while carloads decreased due to a decrease in volumes of short haul copper ore traffic.

Automotive

For the three months ended September 30	2018	2017	Total Change	% Change	FX Adjusted % Change
Freight revenues (in millions)	\$ 85	\$ 68	\$ 17	25	20
Carloads (in thousands)	27.4	25.0	2.4	10	N/A
Revenue ton-miles (in millions)	343	316	27	9	N/A
Freight revenue per carload (in dollars)	\$ 3,102	\$ 2,737	\$ 365	13	9
Freight revenue per revenue ton-mile (in cents)	24.76	21.62	3.14	15	11

Automotive revenue was \$85 million in the third quarter of 2018, an increase of \$17 million, or 25%, from \$68 million in the same period of 2017. This increase was primarily due to higher volumes of automobiles and machinery, higher fuel surcharge revenue as a result of higher fuel prices, higher freight revenue per revenue ton-mile, and the favourable impact of the change in FX. This increase was partially offset by moving fewer trucks. Carloads increased more than RTMs due to moving proportionately more trucks with a shorter length of haul. Freight revenue per revenue ton-mile increased due to higher freight rates.

For the nine months ended September 30	2018	2017	Total Change	% Change	FX Adjusted % Change
Freight revenues (in millions)	\$ 247	\$ 223	\$ 24	11	13
Carloads (in thousands)	83.0	79.9	3.1	4	N/A
Revenue ton-miles (in millions)	1,047	1,016	31	3	N/A
Freight revenue per carload (in dollars)	\$ 2,970	\$ 2,788	\$ 182	7	8
Freight revenue per revenue ton-mile (in cents)	23.56	21.92	1.64	7	9

Automotive revenue was \$247 million in the first nine months of 2018, an increase of \$24 million, or 11%, from \$223 million in the same period of 2017. This increase was primarily due to higher volumes of trucks and machinery, higher fuel surcharge revenue as a result of higher fuel prices, and higher freight revenue per revenue ton-mile. This increase was partially offset by the unfavourable impact of the change in FX. Freight revenue per revenue ton-mile increased due to higher freight rates.

Intermodal

For the three months ended September 30	2018	2017	Total Change	% Change	FX Adjusted % Change
Freight revenues (in millions)	\$ 406	\$ 341	\$ 65	19	18
Carloads (in thousands)	262.3	253.6	8.7	3	N/A
Revenue ton-miles (in millions)	6,942	6,092	850	14	N/A
Freight revenue per carload (in dollars)	\$ 1,545	\$ 1,343	\$ 202	15	14
Freight revenue per revenue ton-mile (in cents)	5.84	5.59	0.25	4	3

Intermodal revenue was \$406 million in the third quarter of 2018, an increase of \$65 million, or 19%, from \$341 million in the same period of 2017. This increase was primarily due to higher international volumes through the Port of Vancouver, higher wholesale domestic volumes, higher fuel surcharge revenue as a result of higher fuel prices, and the favourable impact of the change in FX.

RTMs increased more than carloads due to moving proportionately more wholesale domestic intermodal volumes, which have a longer length of haul, and an increased length of haul for international intermodal volume moving through the Port of Vancouver.

For the nine months ended September 30	2018	2017	Total Change	% Change	FX Adjusted % Change
Freight revenues (in millions)	\$ 1,133	\$ 1,004	\$ 129	13	13
Carloads (in thousands)	762.9	735.4	27.5	4	N/A
Revenue ton-miles (in millions)	19,820	17,901	1,919	11	N/A
Freight revenue per carload (in dollars)	\$ 1,485	\$ 1,364	\$ 121	9	9
Freight revenue per revenue ton-mile (in cents)	5.72	5.61	0.11	2	3

Intermodal revenue was \$1,133 million in the first nine months of 2018, an increase of \$129 million, or 13%, from \$1,004 million in the same period of 2017. This increase was primarily due to higher international volumes through the Port of Vancouver, higher wholesale domestic volumes, as well as higher fuel surcharge revenue as a result of higher fuel prices. This 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 have a longer length of haul, and an increased length of haul for international intermodal volume moving through the Port of Vancouver.

Operating Expenses

For the three months ended September 30 (in millions)	2018	2017	Total Change	% Change	FX Adjusted % Change ⁽²⁾
Compensation and benefits ⁽¹⁾	\$ 365	\$ 324	\$ 41	13	11
Fuel	226	150	76	51	46
Materials	47	45	2	4	4
Equipment rents	33	35	(2)	(6)	(11)
Depreciation and amortization	174	162	12	7	6
Purchased services and other	263	257	6	2	—
Total operating expenses⁽¹⁾	\$ 1,108	\$ 973	\$ 135	14	12

⁽¹⁾ 2017 comparative period figures have 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 \$1,108 million in the third quarter of 2018, an increase of \$135 million, or 14%, from \$973 million in the same period of 2017. This increase was primarily due to:

- the unfavourable impact of increases in fuel price of \$59 million;
- higher volume variable expenses;
- the unfavourable impact of the change in FX of \$18 million;
- higher stock-based compensation driven primarily by an increase in the stock price;
- higher depreciation expense due to a higher asset base;
- cost inflation; and
- higher incentive compensation.

This increase was partially offset by the efficiencies generated from improved operating performance and asset utilization.

For the nine months ended September 30 (in millions)	2018	2017	Total Change	% Change	FX Adjusted % Change ⁽²⁾
Compensation and benefits ⁽¹⁾	\$ 1,090	\$ 969	\$ 121	12	13
Fuel	671	480	191	40	42
Materials	155	142	13	9	10
Equipment rents	99	108	(9)	(8)	(7)
Depreciation and amortization	516	493	23	5	5
Purchased services and other	822	812	10	1	2
Total operating expenses⁽¹⁾	\$ 3,353	\$ 3,004	\$ 349	12	12

⁽¹⁾ 2017 comparative period figures have 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 \$3,353 million in the first nine months of 2018, an increase of \$349 million, or 12%, from \$3,004 million in the same period of 2017. This increase was primarily due to:

- the unfavourable impact of increases in fuel price of \$163 million;
- higher volume variable expenses;
- a management transition recovery of \$51 million associated with Mr. E. Hunter Harrison's retirement as CEO of CP in 2017;
- cost inflation;
- higher depreciation expense due to a higher asset base;
- higher stock-based compensation driven primarily by an increase in the stock price;
- harsher winter operating conditions; and
- higher incentive compensation.

This increase was partially offset by the favourable impact of the efficiencies generated from improved operating performance and asset utilization and the favourable change in FX of \$22 million.

Compensation and Benefits

Compensation and benefits expense includes employee wages, salaries, fringe benefits, and stock-based compensation. Compensation and benefits expense was \$365 million in the third quarter of 2018, an increase of \$41 million, or 13%, from \$324 million in the same period of 2017. This increase was primarily due to:

- higher volume variable expenses as a result of an increase in workload as measured by GTMs;
- higher stock-based compensation driven primarily by an increase in the stock price;
- higher incentive compensation;
- cost inflation; and
- the unfavourable impact of change in FX.

This increase was partially offset by the benefit of operational efficiencies.

Compensation and benefits expense was \$1,090 million in the first nine months of 2018, an increase of \$121 million, or 12%, from \$969 million in the same period of 2017. This increase was primarily due to:

- a management transition recovery of \$51 million associated with Mr. E. Hunter Harrison's retirement as CEO of CP in 2017;
- higher volume variable expenses as a result of an increase in workload as measured by GTMs;
- cost inflation;
- higher stock-based compensation driven primarily by an increase in the stock price; 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 \$226 million in the third quarter of 2018, an increase of \$76 million, or 51%, from \$150 million in the same period of 2017. This increase was primarily due to:

- the unfavourable impact of \$59 million from higher fuel prices;
- an increase in workload, as measured by GTMs; and
- the unfavourable impact of the change in FX of \$5 million

This increase was partially offset by improvements in fuel efficiency of approximately 3%.

Fuel expense was \$671 million in the first nine months of 2018, an increase of \$191 million, or 40%, from \$480 million in the same period of 2017. This increase was primarily due to:

- the unfavourable impact of \$163 million from higher fuel prices;
- an increase in workload, as measured by GTMs; and
- a 2017 fuel tax recovery related to prior periods of \$8 million.

This increase was partially offset by improvements in fuel efficiency of approximately 3% and the favourable impact of the change in FX of \$6 million.

Materials

Materials expense includes the cost of material used for track, locomotive, freight car, and building maintenance and software sustainment. Materials expense was \$47 million in the third quarter of 2018, an increase of \$2 million, or 4%, from \$45 million in the same period of 2017. This increase was primarily due to higher materials consumed on locomotive maintenance and higher non-locomotive fuel costs. This increase was partially offset by lower freight car repairs.

Materials expense was \$155 million in the first nine months of 2018, an increase of \$13 million, or 9%, from \$142 million in the same period of 2017. This increase was primarily due to higher materials consumed on locomotive maintenance and servicing and higher non-locomotive fuel costs.

Equipment Rents

Equipment rents expense includes the cost associated with using other railroads' freight cars, intermodal equipment, and locomotives, net of rental income received from other railroads for the use of CP's equipment. Equipment rents expense was \$33 million in the third quarter of 2018, a decrease of \$2 million, or 6%, from \$35 million in the same period of 2017. Equipment rents expense was \$99 million in the first nine months of 2018, a decrease of \$9 million, or 8%, from \$108 million in the same period of 2017. This decrease was primarily due to the purchase or return of leased freight cars reducing rental expense and a decrease in Intermodal container rents.

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 \$174 million in the third quarter of 2018, an increase of \$12 million, or 7%, from \$162 million in the same period of 2017. This increase was primarily due to a higher depreciable asset base and the unfavourable impact of the change in FX of \$2 million.

Depreciation and amortization expense was \$516 million in the first nine months of 2018, an increase of \$23 million, or 5%, from \$493 million in the same period of 2017. This 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

For the three months ended September 30 (in millions)	2018	2017	Total Change	% Change
Support and facilities	\$ 62	\$ 65	\$ (3)	(5)
Track and operations	60	58	2	3
Intermodal	56	49	7	14
Equipment	36	35	1	3
Casualty	23	20	3	15
Property taxes	28	31	(3)	(10)
Other	2	1	1	100
Land sales	(4)	(2)	(2)	100
Total Purchased services and other	\$ 263	\$ 257	\$ 6	2

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 \$263 million in the third quarter of 2018, an increase of \$6 million, or 2%, from \$257 million in the same period of 2017. This increase was primarily due to:

- higher intermodal expenses related to pickup and delivery, reported in Intermodal;
- higher rolling stock repair and wreck service costs, reported in Casualty;
- the unfavourable impact of the change in FX of \$5 million; and
- the increase in locomotive maintenance due to increased volumes, reported in Equipment.

This increase was partially offset by:

- the decrease in costs for locomotive warranty service agreements, reported in Equipment;
- lower property taxes due to an adjustment of property tax rates;
- higher land sales in 2018 compared to 2017;
- lower event and sponsorship costs, reported in Support and facilities; and
- lower locomotive engine overhaul expenses, due to the capital nature of overhaul activities in 2018, reported in Equipment.

For the nine months ended September 30 (in millions)	2018	2017	Total Change	% Change
Support and facilities	\$ 193	\$ 201	\$ (8)	(4)
Track and operations	206	193	13	7
Intermodal	163	144	19	13
Equipment	110	120	(10)	(8)
Casualty	57	55	2	4
Property taxes	95	95	—	—
Other	4	9	(5)	(56)
Land sales	(6)	(5)	(1)	20
Total Purchased services and other	\$ 822	\$ 812	\$ 10	1

Purchased services and other expense was \$822 million in the first nine months of 2018, an increase of \$10 million, or 1%, from \$812 million in the same period of 2017. This increase was primarily due to:

- higher intermodal expenses related to pickup and delivery, reported in Intermodal;
- higher bad debt expenses, reported in Other;
- higher rolling stock repair and wreck service costs, reported in Casualty;
- weather related impacts including higher snow removal, reported in Track and operations and Intermodal; and
- costs related to labour negotiations in the second quarter of 2018, reported in Track and operations.

This increase was partially offset by:

- lower locomotive engine overhaul expenses, due to the capital nature of overhaul activities in 2018, reported in Equipment;
- the favourable impact of the change in FX of \$7 million;
- charges related to assets held for sale in 2017, reported in Other; and
- lower event and sponsorship costs, reported in Support and facilities.

Other Income Statement Items

Other (Income) Expense

Other (income) expense 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 was \$47 million in the third quarter of 2018, compared to \$105 million in the same period of 2017, a decrease of \$58 million, or 55%. This decrease was primarily due to a lower gain on FX translation of U.S. dollar-denominated debt of \$67 million, partially offset by higher equity income, compared to the same period of 2017.

Other expense was \$56 million in the first nine months of 2018, compared to other income of \$194 million in the same period of 2017, a change of \$250 million, or 129%. This change was primarily due to the unfavourable impact of FX translation of \$55 million on U.S. dollar-denominated debt in the first nine months of 2018, compared to the favourable impact of FX translation of \$200 million in the same period of 2017 and a \$10 million insurance recovery of legal costs in 2017. This change was partially offset by a \$13 million charge on the settlement and roll of forward starting swaps in 2017. 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 Components of Net Periodic Benefit Recovery

Other components of net periodic benefit was a recovery of \$96 million in the third quarter of 2018, compared to a recovery of \$68 million in the same period of 2017, a change of \$28 million or 41%. Other components of net periodic benefit was a recovery of \$287 million in the first nine months of 2018, compared to a recovery of \$203 million in the same period of 2017, a change of \$84 million or 41%. These changes were 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 \$112 million in the third quarter of 2018, a decrease of \$3 million, or 3%, from \$115 million in the same period of 2017. This decrease was primarily due to a net reduction in interest charges of \$6 million as a result of a lower effective interest rate and lower debt levels from debt refinancing in the second quarter of 2018 as well as higher capitalized interest. This was partially offset by the unfavourable impact of the change in FX of \$5 million.

Net interest expense was \$339 million in the first nine months of 2018, a decrease of \$18 million, or 5%, from \$357 million in the same period of 2017. This decrease was primarily due to a net reduction in interest charges of \$8 million as a result of a lower effective interest rate and lower debt levels from debt refinancing in 2018, the favourable impact of the change in FX of \$4 million, and higher capitalized interest.

Income Tax Expense

Income tax expense was \$199 million in the third quarter of 2018, an increase of \$29 million, or 17%, from \$170 million in the same period of 2017. This increase was due to higher taxable earnings, partially offset by a lower effective tax rate.

Income tax expense was \$443 million in the first nine months of 2018, a decrease of \$13 million, or 3%, from \$456 million in the same period of 2017. This decrease was primarily due to a lower effective tax rate.

During the nine months ended September 30, 2018, the Iowa and Missouri state corporate tax rate decreases were enacted and resulted in a \$21 million deferred tax recovery on the revaluation of deferred income tax balances as at January 1, 2018.

The effective tax rate in the third quarter of 2018, including discrete items, was 24.23% compared to 24.95% in the same period of 2017. The effective tax rate in the first nine months of 2018, including discrete items, was 23.95% compared to 24.28% in the same period of 2017. The effective tax rate in the third quarter and first nine months 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 September 30, 2018, the Company had \$150 million of Cash and cash equivalents, U.S. \$1.0 billion available under its revolving credit facility, and up to \$544 million available under its letter of credit facilities (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 letter of credit facilities).

Effective June 8, 2018, the Company canceled the U.S. \$1.0 billion one-year plus one-year portion of the revolving credit facility and extended the maturity date on the U.S. \$1.0 billion five-year portion to June 28, 2023. As at September 30, 2018, the Company's revolving credit facility was undrawn (December 31, 2017 - undrawn) and the Company did not draw from its revolving credit facility during the three and nine months ended September 30, 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 September 30, 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. This commercial paper program is backed by the revolving credit facility. As at September 30, 2018, total commercial paper borrowings were \$nil (December 31, 2017 - \$nil).

As at September 30, 2018, under its bilateral letter of credit facility, the Company had letters of credit drawn of \$56 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 letter 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 September 30, 2018, the Company did not have any collateral posted on its bilateral letter 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 \$673 million in the third quarter of 2018, an increase of \$146 million compared to \$527 million in the same period of 2017. This increase was primarily due to higher cash generating income in the three months ended September 30, 2018 compared to the same period in 2017.

Cash provided by operating activities was \$1,781 million in the first nine months of 2018, an increase of \$332 million compared to \$1,449 million in the same period of 2017. This increase was primarily due to higher cash generating income and a favourable change in working capital in the nine months ended September 30, 2018, compared to the same period in 2017.

Investing Activities

Cash used in investing activities was \$423 million in the third quarter of 2018, an increase of \$117 million compared to \$306 million in the same period of 2017. Cash used in investing activities was \$1,069 million in the first nine months of 2018, an increase of \$208 million compared to \$861 million in the same period of 2017. These increases were primarily due to higher capital additions during 2018, compared to the same periods in 2017.

Free Cash

CP generated positive Free cash of \$245 million in the third quarter of 2018, an increase of \$31 million from \$214 million in the same period of 2017. For the first nine months of 2018, CP generated positive Free cash of \$740 million, an increase of \$165 million from \$575 million in the same period of 2017. These increases were primarily due to an increase in cash provided by operating activities in the three and nine months ended September 30, 2018, compared to the same periods of 2017, partially offset by an increase in cash used in investing activities as a result of higher additions to properties, compared to 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 \$146 million in the third quarter of 2018, a decrease of \$164 million compared to cash used in financing activities of \$310 million in the same period of 2017. This decrease was primarily due to payments to buy back shares under the Company's share repurchase program in the third quarter of 2017, partially offset by the net repayment of commercial paper in the third quarter of 2018.

Cash used in financing activities was \$904 million in the first nine months of 2018, an increase of \$307 million compared to \$597 million in the same period of 2017. This increase was primarily due to the principal repayments of the U.S. \$275 million and \$375 million notes during the second quarter of 2018 and higher payments to buy back shares under the Company's share repurchase program in 2018 compared to the same period of 2017. This increase was partially offset by the issuance of the U.S. \$500 million notes in the second quarter of 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 September 30, 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 September 30, 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
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 September 30, 2018 and September 30, 2017 was 2.5 and 2.7, respectively. This decrease was primarily due to an increase in EBITDA as at September 30, 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 October 16, 2018, the latest practicable date, there were 142,601,634 Common Shares and no preferred shares issued and outstanding, which consists of 14,318 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 October 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 1.3 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 including 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 nine months of 2018, there were two significant items included in Net income as follows:

- in the second quarter, a deferred tax recovery of \$21 million due to reductions in the Missouri and Iowa state tax rates that favourably impacted Diluted EPS by 15 cents; and
- during the course of the year, a net non-cash loss of \$55 million (\$47 million after deferred tax) due to FX translation of the Company's U.S dollar-denominated debt as follows:
 - in the third quarter, a \$38 million gain (\$33 million after deferred tax) that favourably impacted Diluted EPS by 23 cents;
 - in the second quarter, a \$44 million loss (\$38 million after deferred tax) that unfavourably impacted Diluted EPS by 27 cents; and
 - in the first quarter, a \$49 million loss (\$42 million after deferred tax) 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 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 three months ended December 31, 2016, there was one significant item included in Net income as follows:

- a net non-cash loss of \$74 million (\$64 million after deferred tax) due to FX translation of the Company's U.S. dollar-denominated debt as follows that unfavourably impacted Diluted EPS by 43 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 and nine months ended September 30, 2018 and 2017:

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

(in millions)	For the three months ended September 30		For the nine months ended September 30	
	2018	2017	2018	2017
Net income as reported	\$ 622	\$ 510	\$ 1,406	\$ 1,421
Less significant items (pretax):				
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	38	105	(55)	200
Add:				
Tax effect of adjustments ⁽¹⁾	5	14	(8)	38
Income tax rate change	—	3	(21)	(14)
Adjusted income	\$ 589	\$ 422	\$ 1,432	\$ 1,197

⁽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% for the three and nine months ended September 30, 2018, and 13.28% and 15.16% for the three and nine months ended September 30, 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 September 30		For the nine months ended September 30	
	2018	2017	2018	2017
Diluted earnings per share as reported	\$ 4.35	\$ 3.50	\$ 9.78	\$ 9.70
Less significant items (pretax):				
Insurance recovery of legal settlement	—	—	—	0.07
Charge on hedge roll and de-designation	—	—	—	(0.09)
Management transition recovery	—	—	—	0.35
Impact of FX translation on U.S. dollar-denominated debt	0.27	0.72	(0.38)	1.36
Add:				
Tax effect of adjustments ⁽¹⁾	0.04	0.10	(0.04)	0.26
Income tax rate change	—	0.02	(0.15)	(0.10)
Adjusted diluted earnings per share	\$ 4.12	\$ 2.90	\$ 9.97	\$ 8.17

⁽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% for the three and nine months ended September 30, 2018, and 13.28% and 15.16% for the three and nine months ended September 30, 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.

(in millions)	For the three months ended September 30		For the nine months ended September 30	
	2018	2017	2018	2017
Operating income as reported⁽¹⁾	\$ 790	\$ 622	\$ 1,957	\$ 1,837
Less significant item:				
Management transition recovery	—	—	—	51
Adjusted operating income⁽¹⁾	\$ 790	\$ 622	\$ 1,957	\$ 1,786

⁽¹⁾2017 comparative period figures have 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 September 30		For the nine months ended September 30	
	2018	2017	2018	2017
Operating ratio as reported⁽¹⁾	58.3%	61.0%	63.1%	62.1%
Less significant item:				
Management transition recovery	—%	—%	—%	(1.0)%
Adjusted operating ratio⁽¹⁾	58.3%	61.0%	63.1%	63.1%

⁽¹⁾2017 comparative period figures have 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) expense and Other components of net periodic benefit recovery, tax effected at the Company's annualized effective tax rate, 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, Other (income) expense, and Other components of net periodic benefit recovery 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 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 September 30	
	2018	2017
Operating income as reported⁽¹⁾	\$ 2,639	\$ 2,514
Less:		
Other expense (income)	72	(120)
Other components of net periodic benefit recovery ⁽¹⁾	(358)	(243)
Tax ⁽²⁾	95	716
	\$ 2,830	\$ 2,161
Average of total shareholders' equity, long-term debt, long-term debt maturing within one year and short-term borrowing	14,556	13,623
ROIC	19.4%	15.9%

⁽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 3.24% and 24.89% for each of the above items for the twelve months ended September 30, 2018 and 2017, respectively.

**For the twelve months
ended September 30**

(in millions, except for percentages)

	2018	2017
Operating income as reported⁽¹⁾	\$ 2,639	\$ 2,514
Less significant item:		
Management transition recovery	—	51
Adjusted operating income	2,639	2,463
Less:		
Other expense (income)	72	(120)
Other components of net periodic benefit recovery ⁽¹⁾	(358)	(243)
Add significant items (pretax):		
Insurance recovery of legal settlement	—	(10)
Charge on hedge roll and de-designation	—	13
Impact of FX translation on U.S. dollar-denominated debt	69	(126)
Less:		
Tax ⁽²⁾	752	708
	\$ 2,242	\$ 1,995
Average for the twelve months of total shareholders' equity, long-term debt, long-term debt maturing within one year and short-term borrowing	14,556	13,623
Add:		
Impact of periodic significant items net of tax on the above average	(274)	(31)
Adjusted average for the twelve months of total shareholders' equity, long-term debt, long-term debt maturing within one year and short-term borrowing	14,282	13,592
Adjusted ROIC⁽³⁾	15.7%	14.7%

⁽¹⁾ 2017 comparative period figures have 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 25.12% and 26.18% for each of the above items for the twelve months ended September 30, 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, and the cash settlement of hedges settled upon issuance of debt. 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. The cash settlement of forward starting swaps that occurred in the second quarter of 2018 in conjunction with the issuance of long-term debt is not an indicator of CP's ongoing cash generating ability and therefore has been excluded from free cash. 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

(in millions)	For the three months ended September 30		For the nine months ended September 30	
	2018	2017	2018	2017
Cash provided by operating activities	\$ 673	\$ 527	\$ 1,781	\$ 1,449
Cash used in investing activities	(423)	(306)	(1,069)	(861)
Effect of foreign currency fluctuations on U.S. dollar-denominated cash and cash equivalents	(5)	(7)	4	(13)
Settlement of forward starting swaps on debt issuance	—	—	24	—
Free cash	\$ 245	\$ 214	\$ 740	\$ 575

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.

(in millions)	For the three months ended September 30				
	Reported 2018	Reported 2017	Variance due to FX	FX Adjusted 2017	FX Adjusted % Change
Freight revenues	\$ 1,854	\$ 1,547	\$ 32	\$ 1,579	17
Non-freight revenues	44	48	1	49	(10)
Total revenues	1,898	1,595	33	1,628	17
Compensation and benefits ⁽¹⁾	365	324	4	328	11
Fuel	226	150	5	155	46
Materials	47	45	—	45	4
Equipment rents	33	35	2	37	(11)
Depreciation and amortization	174	162	2	164	6
Purchased services and other	263	257	5	262	—
Total operating expenses⁽¹⁾	1,108	973	18	991	12
Operating income⁽¹⁾	\$ 790	\$ 622	\$ 15	\$ 637	24

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

(in millions)	For the nine months ended September 30				
	Reported 2018	Reported 2017	Variance due to FX	FX Adjusted 2017	FX Adjusted % Change
Freight revenues	\$ 5,188	\$ 4,708	\$ (39)	\$ 4,669	11
Non-freight revenues	122	133	—	133	(8)
Total revenues	5,310	4,841	(39)	4,802	11
Compensation and benefits ⁽¹⁾	1,090	969	(5)	964	13
Fuel	671	480	(6)	474	42
Materials	155	142	(1)	141	10
Equipment rents	99	108	(1)	107	(7)
Depreciation and amortization	516	493	(2)	491	5
Purchased services and other	822	812	(7)	805	2
Total operating expenses⁽¹⁾	3,353	3,004	(22)	2,982	12
Operating income⁽¹⁾	\$ 1,957	\$ 1,837	\$ (17)	\$ 1,820	8

⁽¹⁾ 2017 comparative period figures have 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 both Operating income and Other (income) expense. Adjusted EBITDA is calculated as Adjusted EBIT plus net periodic pension and other benefit costs other than current service costs, operating lease expense and Depreciation and amortization.

(in millions)	For the twelve months ended September 30	
	2018	2017
Net income as reported	\$ 2,390	\$ 1,805
Add:		
Net interest expense	455	473
Income tax expense	80	599
EBIT	2,925	2,877
Less significant items (pretax):		
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	(69)	126
Adjusted EBIT	2,994	2,703
Less:		
Other components of net periodic benefit recovery	358	243
Operating lease expense	(87)	(107)
Depreciation and amortization	(684)	(655)
Adjusted EBITDA	\$ 3,407	\$ 3,222

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 September 30	\$ 8,286	\$ 8,133
Less:		
Pension plans in deficit ⁽¹⁾	(276)	(266)
Net present value of operating leases ⁽²⁾	(261)	(284)
Cash and cash equivalents	150	142
Adjusted net debt as at September 30	\$ 8,673	\$ 8,541

⁽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 September 30	\$ 8,673	\$ 8,541
Adjusted EBITDA for the year ended September 30	3,407	3,222
Adjusted net debt to Adjusted EBITDA ratio	2.5	2.7

Off-Balance Sheet Arrangements

Guarantees

At September 30, 2018, the Company had residual value guarantees on operating lease commitments of \$1 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 September 30, 2018, the fair value of these guarantees recognized as a liability was \$11 million, compared to fair value of \$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 September 30, 2018.

Payments due by period (in millions)	Total	2018	2019 & 2020	2021 & 2022	2023 & beyond
Contractual commitments					
Interest on long-term debt and capital leases	\$ 11,503	\$ 82	\$ 853	\$ 776	\$ 9,792
Long-term debt	8,224	7	540	840	6,837
Capital leases	153	1	10	111	31
Operating lease ⁽¹⁾	332	21	125	74	112
Supplier purchase	1,355	199	656	141	359
Other long-term liabilities ⁽²⁾	697	258	101	101	237
Total contractual commitments	\$ 22,264	\$ 568	\$ 2,285	\$ 2,043	\$ 17,368

⁽¹⁾ Residual value guarantees on certain leased equipment with a maximum exposure of \$1 million are not included in the minimum payments shown above.

⁽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, long-term disability benefits, and the non-registered supplemental pension plan 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 Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations of the Company's 2017 Annual Report on Form 10-K.

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. 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 September 30, 2018.

Payments due by period (in millions)	Total	2018	2019 & 2020	2021 & 2022	2023 & beyond
Certain other financial commitments					
Letters of credit	\$ 56	\$ 56	\$ —	\$ —	\$ —
Capital commitments	723	185	291	81	166
Total certain other financial commitments	\$ 779	\$ 241	\$ 291	\$ 81	\$ 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 Form 10-K. There have not been any material changes to the Company's critical accounting estimates in the first nine 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 2018 full-year guidance which includes an effective tax rate in the range of 24.5 to 25 percent, capital expenditures of \$1.6 billion, and adjusted EPS growth in excess of 20 percent as well as financial targets for 2018 through 2020 and related key assumptions, and 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. The purpose of our expected 2018 adjusted diluted EPS is to assist readers in understanding our expected and targeted financial results, and this information may not be appropriate for other purposes. 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: anticipated land sales in 2018, 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 and nine months ended September 30, 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 relative to the U.S. 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 September 30, 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) expense. 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 September 30, 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 September 30, 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 September 30, 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 third 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.