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, 2021 in Item 1. Financial Statements, other information in this report, and Item 8. Financial Statements and Supplementary Data of the Company's 2020 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 Canadian Pacific Railway Limited ("CPRL"), CPRL and its subsidiaries, CPRL and one or more of its subsidiaries, or one or more of CPRL's subsidiaries, as the context may require.

Available Information

CP makes available on or through its website www.cpr.ca free of charge, its annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and all amendments to those reports as soon as reasonably practicable after such reports are filed with or furnished to the Securities and Exchange Commission (“SEC”). 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 2021 Results

- *Financial performance* - In the third quarter of 2021, CP reported Diluted earnings per share ("EPS") of $0.70, a decrease of 20% compared to the same period of 2020 and Net income of $472 million in the third quarter of 2021, a decrease of 21% compared to the same period of 2020. These decreases were primarily due to acquisition-related costs associated with the pending Kansas City Southern ("KCS") transaction and a foreign exchange ("FX") translation loss on debt and lease liabilities compared to an FX translation gain in the same period of 2020, partially offset by higher freight revenue.

  Adjusted diluted EPS was $0.88 in the third quarter of 2021, an increase of 7% compared to the same period of 2020. Adjusted income was $592 million in the third quarter of 2021, an increase of 6% compared to the same period of 2020. These increases were primarily due to higher freight revenue per RTM, partially offset by lower freight volumes as measured by RTMs.

  CP reported an Operating ratio of 60.2% in the third quarter of 2021, a 200 basis point increase compared to the same period of 2020. This increase was primarily due to the impact of lower freight volumes as measured by RTMs, the unfavourable impact of higher fuel prices net of recoveries, the acquisition-related costs associated with the pending KCS transaction, and higher depreciation and amortization, partially offset by higher freight revenue per RTM and lower stock-based compensation expense. Adjusted operating ratio was 59.4%, a 120 basis point increase compared to the same period of 2020. This increase was primarily due to the same factors discussed above for the increase in Operating ratio, except that Adjusted operating ratio excludes the acquisition-related costs associated with the pending KCS transaction.

  Adjusted diluted EPS, Adjusted income and Adjusted Operating ratio are defined and reconciled in Non-GAAP Measures and discussed further in Results of Operations of this Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations.

- *Total revenues* - Total revenues increased by 4% in the third quarter of 2021 to $1,942 million compared to the same period of 2020. This increase was primarily due to higher freight revenue per RTM, partially offset by lower volumes as measured by RTMs.

- *Operating performance* - CP's average train weight increased by 1% to 9,973 tons and average train length increased by 3% to 8,285 feet, compared to the same period in 2020. These increases were a result of improvements in operating plan efficiency and continued improvements in bulk train efficiency due to moving longer and heavier Grain trains, in each case compared to the same period in 2020. 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 March 21, 2021, CP announced that it entered into an Agreement and Plan of Merger (the "Original Merger Agreement") with KCS, under which CP agreed to acquire KCS in a stock and cash transaction representing an enterprise value of approximately U.S. $29 billion, based on the CP closing price on March 19, 2021, including the assumption of U.S.

$3.8 billion of outstanding KCS debt. On May 21, 2021, KCS terminated the Original Merger Agreement in order to enter into a merger agreement with Canadian National Railway ("CN") (the "CN Merger Agreement"). As a result, and under the terms of the Original Merger Agreement, KCS concurrently paid a merger termination fee of $845 million (U.S. $700 million) to the Company.

On August 10, 2021, CP submitted a proposal to acquire KCS in a stock and cash transaction representing an enterprise value of approximately U.S. $31 billion, based on the CP closing price on August 9, 2021, which includes the assumption of U.S. $3.8 billion of outstanding KCS debt. The terms of the proposal were very similar in nearly every respect to those in the Original Merger Agreement, except for an increase in the share exchange ratio from 2.445 to 2.884. Following the Surface Transportation Board's ("STB") decision on August 31, 2021 to refuse CN and KCS's joint motion for voting trust approval in respect of the CN Merger Agreement, and after renewed negotiations with CP, KCS's Board of Directors deemed CP's proposal a "Company Superior Proposal", as defined in the CN Merger Agreement, and terminated the CN Merger Agreement.

On September 15, 2021, upon KCS's termination of the CN Merger Agreement, the Company entered into an Agreement and Plan of Merger (the "Merger Agreement") with KCS. Pursuant to the terms of the CN Merger Agreement, KCS paid a merger termination fee of U.S. $700 million and refunded the CP merger termination fee of U.S. $700 million to CN (together, the "CN merger termination fees"). In connection with the Merger Agreement, the Company remitted $1,773 million (U.S. $1,400 million) to KCS on September 15, 2021 in connection with KCS's payment of the CN merger termination fees.

The transaction will be completed in two steps. First, upon approval of the transaction by the shareholders of both the Company and KCS, Mexican regulatory approvals, and satisfaction or waiver of customary closing conditions, the shares of KCS will be deposited into a voting trust subject to a voting trust agreement, pending final approval of the acquisition of control by the STB. Approval to use the voting trust has been received from the STB and CP currently expects to close the transaction into the voting trust in the first quarter of 2022. KCS's management and Board of Directors will continue to steward KCS while it is in trust, pursuing its independent business plan and growth strategies. Under the Merger Agreement, common stockholders of KCS will receive 2.884 (the "Exchange Ratio") of the Company's Common Shares and U.S. $90 in cash for each KCS common stock held. Preferred stockholders of KCS will receive U.S. $37.50 in cash for each KCS preferred stock held. Immediately after the KCS transaction closes into the voting trust, former KCS stockholders are expected to own approximately 28 percent of the Company's Common Shares. The second step of the transaction will occur after control approval from the STB and other applicable regulatory authorities is obtained. The STB's review of the transaction while KCS is in the voting trust is expected to be completed in the second half of 2022.

Upon obtaining control approval from the STB and any other remaining approvals of regulatory authorities, if applicable, the two companies will be combined. Mr. Creel will serve as the Chief Executive Officer of the combined company. The combined entity will be named Canadian Pacific Kansas City ("CPKC"). Calgary, Alberta will be the global headquarters of CPKC, and Kansas City, Missouri will be designated as the U.S. headquarters. The Mexico headquarters will remain in Mexico City and Monterrey. CP's current U.S. headquarters in Minneapolis-St. Paul, Minnesota will remain an important base of operations. Four KCS Directors may join CP's expanded Board at the appropriate time, bringing their experience and expertise in overseeing KCS's multinational operations.

The transaction will combine the two railroads to create the first rail network connecting the U.S., Mexico, and Canada and will deliver dramatically expanded market reach for customers served by CP and KCS, provide new competitive transportation service options, and support North American economic growth.

The new single-line routes made possible by the transaction are expected to shift trucks off crowded U.S. highways, lowering emissions and reducing the need for public investments in road and highway bridge repairs. On average, rail is three to four times more fuel efficient than trucking, and one train can keep more than 300 trucks off public roads and produce 75% less greenhouse gas emissions. The synergies created by this combination are expected to take tens of thousands of trucks off North American highways annually. Additionally, the combined company would maintain both CP and KCS's pledges to improve fuel efficiency and lower emissions in-line with the Paris Agreement to support a more sustainable North American supply chain.

Specific risk factors related to the pending KCS transaction are included in Item 1A. Risk Factors of this Quarterly Report on Form 10-Q.

- Building on CP's climate change commitment announced last year, on July 26, 2021, CP published its first comprehensive Climate Strategy, outlining the Company's approach to drive innovative climate action and a measured response to emerging climate-related risks impacting the rail sector. The Climate Strategy outlines CP's objectives across strategic pillars, which include establishing a clear understanding of climate-related risks and opportunities; reducing greenhouse gas emissions, and adapting CP operations to the physical risks of climate change. To guide implementation of the Climate Strategy, CP has established two science-based emissions reduction targets that address 100% of CP's Scope 1 and Scope 2 emissions, and more than half of Scope 3 emissions:
  - CP commits to reducing Scope 1, 2 and 3 greenhouse gas ("GHG") emissions intensity of its locomotives by in excess of 38% by 2030. Locomotive operations represent CP's largest source of emissions.
  - To support decarbonization across all operations, CP also commits to reducing absolute Scope 1 and Scope 2 GHG emissions from non-locomotive operations by in excess of 27% by 2030.

- In the third quarter of 2021, CP’s Pandemic Team continued to proactively monitor guidance and orders from governments, public health authorities, and regulatory agencies. Utilizing that guidance while implementing CP protocols and safety measures, the Company safely reintegrated its employees into the workplace where permissible. The Company maintained preventative measures that serve to minimize the risk of exposure to COVID-19, including physical distancing measures, restricting employee business travel, strengthening clean workplace and face covering practices, reinforcing socially responsible sick leave recommendations, limiting visitor and third-party access to Company facilities, and continuously reevaluating our efforts with safety as a top priority.

  Additional information concerning the impact COVID-19 may have to our future business and results of operations is provided in Part I, Item 1A. Risk Factors of the Company's 2020 Annual Report on Form 10-K.

Prior Developments

- On April 21, 2021, the five-for-one Share Split of the issued and outstanding Common Shares was approved at the Annual and Special Meeting of Shareholders. On May 13, 2021, the Company’s shareholders of record as of May 5, 2021 received four additional Common Shares for every Common Share held. Ex-distribution trading in the Company’s Common Shares on a split-adjusted basis commenced on May 14, 2021. Proportional adjustments were also made to outstanding awards under the Company's stock-based compensation plans in order to reflect the share split. All outstanding Common Shares, stock-based compensation awards, and per share amounts herein have been retrospectively adjusted to reflect the share split.

- On April 21, 2021, at the Company's Annual and Special Meeting of Shareholders, conducted virtually, all 11 director nominees were elected.

- On March 31, 2021, CP completed the installation of the solar energy farm at its Calgary headquarters. This sustainability-driven project is one of the largest private solar farms in Alberta and is expected to generate more power than consumed annually by the main headquarters building.

- On March 30, 2021, CP and the Illinois State Toll Highway Authority closed their transaction regarding western access at O’Hare Airport and at Bensenville Yard, CP’s principal rail facility in Chicago, Illinois. The transaction allows for the construction of a new tollway to the west side of O’Hare Airport while protecting CP’s ability to serve its customers moving freight through the critical Chicago gateway.

- On March 21, 2021, CP's Board of Directors and President and CEO Keith Creel agreed on certain contract amendments to Mr. Creel's incentive compensation that are intended to see him lead the Company until at least early 2026.

- On March 9, 2021, CP announced that it will employ Ballard's hydrogen fuel cell modules in CP's pioneering Hydrogen Locomotive Program. Through its Hydrogen Locomotive Program, CP plans to develop North America’s first hydrogen-powered line-haul freight locomotive by retrofitting a diesel-powered locomotive with Ballard hydrogen fuel cells. This purchase from Ballard further demonstrates the Company's commitment to action on climate change and developing the next generation locomotive – one that produces zero emissions.

2021 Outlook

As a result of diminished expectations for the 2021-2022 Canadian grain crop and ongoing supply chain challenges, CP has updated its 2021 outlook. CP now expects volumes, as measured in RTMs, to grow by low single-digits year-over-year. In spite of the revised volume expectations, CP continues to expect double digit growth in Adjusted diluted EPS based on Adjusted diluted EPS of $3.53 in 2020. CP’s revised guidance continues to assume a decrease in Other components of net periodic benefit recovery by approximately $40 million versus 2020, an effective tax rate of approximately 24.6 percent and capital expenditure of $1.55 billion.

Although CP has provided a forward-looking Non-GAAP measure (Adjusted diluted EPS), management is unable to reconcile, without unreasonable efforts, the forward-looking Adjusted diluted EPS to 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 recent years, CP has recognized acquisition-related costs (including legal, consulting, and financing fees and fair value gain or loss on FX forward contracts and interest rate hedges), the merger termination payment received, changes in income tax rates and a change to an uncertain tax item. These or other similar, large unforeseen transactions affect diluted EPS but may be excluded from CP's Adjusted diluted EPS. Additionally, the U.S.-to-Canadian 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 excludes the FX impact of translating the Company's debt and lease liabilities from Adjusted diluted EPS. Please see Forward-Looking Statements in this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations for further discussion.

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		
	2021	2020[(1)]	% Change	**2021**	2020[(1)]	% Change
Operations Performance						
Gross ton-miles ("GTMs") (millions)	**64,665**	65,997	(2)	**207,347**	200,383	3
Train miles (thousands)	**6,999**	7,247	(3)	**22,406**	22,479	—
Average train weight - excluding local traffic (tons)	**9,973**	9,857	1	**9,953**	9,644	3
Average train length - excluding local traffic (feet)	**8,285**	8,082	3	**8,192**	7,831	5
Average terminal dwell (hours)	**7.2**	6.7	7	**7.1**	6.5	9
Average train speed (miles per hour, or "mph")	**21.7**	22.5	(4)	**21.4**	22.1	(3)
Locomotive productivity (GTMs / operating horsepower)	**203**	207	(2)	**204**	207	(1)
Fuel efficiency (U.S. gallons of locomotive fuel consumed / 1,000 GTMs)	**0.907**	0.926	(2)	**0.928**	0.940	(1)
Total Employees and Workforce						
Total employees (average)	**12,485**	12,156	3	**12,411**	12,214	2
Total employees (end of period)	**12,262**	12,166	1	**12,262**	12,166	1
Workforce (end of period)	**12,301**	12,185	1	**12,301**	12,185	1
Safety Indicators[(1)]						
FRA personal injuries per 200,000 employee-hours	**0.97**	1.03	(6)	**0.97**	1.11	(13)
FRA train accidents per million train-miles	**1.54**	1.13	36	**1.09**	1.05	4

(1) Federal Railroad Administration ("FRA") personal injuries per 200,000 employee-hours for the three and nine months ended September 30, 2020, previously reported as 1.06 and 1.13, were restated to 1.03 and 1.11, respectively in this report. FRA train accidents per million train-miles for the nine months ended September 30, 2020, previously reported as 1.06, was restated to 1.05 in this report. These restatements reflect new information available within specified periods stipulated by the FRA but that exceed the Company's financial reporting timeline.

For key measures of the Company's revenue performance, refer to Results of Operations, Operating Revenues of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Operations Performance

These key measures are used by management as comparisons to historical operating results and in the planning process to facilitate decisions that continue to drive further productivity improvements in the Company's operations. Results of these key measures reflect how effective CP's management is at controlling costs and executing the Company's operating plan and strategy. Continued monitoring of these key measures ensures that the Company can take appropriate actions to ensure the delivery of superior service and be able to grow its business at low incremental cost.

Three months ended September 30, 2021 compared to the three months ended September 30, 2020

- 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 decreased by 2% in the third quarter of 2021 compared to the same period of 2020. This decrease was mainly attributable to lower volumes of Grain and Potash. This decrease was partially offset by higher volumes of Energy, chemicals and plastics, Metals, minerals and consumer products, and Intermodal.

- **Train miles** are defined as the sum of the distance moved by all trains operated on the network. Train miles provide a measure of the productive utilization of our network. A smaller increase in train miles relative to increases in volumes, as measured by RTMs, and/or workload, as measured by GTMs, indicate improved train productivity. Train miles decreased by 3% in the third quarter of 2021 compared to the same period of 2020. This decrease reflects the impact of a 2% decrease in workload (GTMs) as well as a 1% increase in average train weights.

- **Average train weight** is defined as the average gross weight of CP trains, both loaded and empty. This excludes trains in short-haul service, work trains used to move CP's track equipment and materials, and the haulage of other railways' trains on CP's network. An increase in average train weight indicates improved asset utilization and may also be the result of moving heavier commodities. Average train weight increased by 1% in the third quarter of 2021 compared to the same period of 2020. This increase was a result of improvements in operating plan efficiency and continued improvements in bulk train efficiency due to moving longer and heavier Grain trains. Improvements for Grain trains were driven by the High Efficiency Product ("HEP") train model, which is an 8,500-foot train model that features the new high-capacity grain hopper cars and increased grain carrying capacity. This increase was partially offset by lower volumes of heavier bulk commodities.

- **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. This excludes trains in short-haul service, work trains used to move CP's track equipment and materials, and the haulage of other railways' trains on CP's network. An increase in average train length indicates improved asset utilization. Average train length increased by 3% in the third quarter of 2021 compared to the same period of 2020. This increase was a result of improvements in operating plan efficiency and continued improvements in bulk train efficiency due to moving longer Grain trains. Improvements for Grain trains were driven by the 8,500-foot HEP train model.

- **Average terminal dwell** is defined as the average time a freight car resides within terminal boundaries expressed in hours. The timing starts with a train arriving at the terminal, a customer releasing the car to the Company, or a car arriving at interchange from another railway. The timing ends when the train leaves, a customer receives the car from CP, or the freight car is transferred to another railway. Freight cars are excluded if they are being stored at the terminal or used in track repairs. A decrease in average terminal dwell indicates improved terminal performance resulting in faster cycle times and improved railcar utilization. Average terminal dwell increased by 7% in the third quarter of 2021 compared to the same period of 2020, as a result of the impact of the B.C. wildfires.

- **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. An increase in average train speed indicates improved on-time performance resulting in improved asset utilization. Average train speed decreased by 4% in the third quarter of 2021 compared to the same period of 2020, as a result of the impact of the B.C. wildfires.

- **Locomotive productivity** is defined as the daily average GTMs divided by daily average operating horsepower. Operating horsepower excludes units offline, tied up or in storage, or in use on other railways, and includes foreign units online. An increase in locomotive productivity indicates more efficient locomotive utilization and may also be the result of moving heavier commodities. Locomotive productivity decreased by 2% in the third quarter of 2021 compared to the same period of 2020, as a result of moving higher volumes of merchandise and Intermodal, which are lighter than bulk commodities.

- **Fuel efficiency** is defined as U.S. gallons of locomotive fuel consumed per 1,000 GTMs. Fuel consumed includes gallons from freight, yard and commuter service but excludes fuel used in capital projects and other non-freight activities. An improvement in fuel efficiency indicates operational cost savings and CP's commitment to corporate sustainability through a reduction of greenhouse gas emissions intensity. Fuel efficiency improved by 2% in the third quarter of 2021 compared to the same period of 2020. This increase in efficiency was due to running longer and heavier trains as a result of improvements in the operating plan.

Nine months ended September 30, 2021 compared to the nine months ended September 30, 2020

- **GTMs** increased by 3% for the first nine months of 2021 compared to the same period of 2020. This increase was primarily attributable to higher volumes of Metals, minerals and consumer products, Energy, chemicals and plastics, Coal and Automotive. This increase was partially offset by lower volumes of Potash and Grain.

- **Train miles** were flat for the first nine months of 2021 compared to the same period of 2020. This reflected the impact of a 3% increase in workload (GTMs), offset by a 3% increase in average train weights.

- **Average train weight** increased by 3% for the first nine months of 2021 compared to the same period of 2020. This increase was a result of improvements in operating plan efficiency and continued improvements in bulk train efficiency due to moving longer and heavier Grain trains. Improvements for Grain trains were driven by the 8500-foot HEP train model. This increase was partially offset by lower volumes of heavier bulk commodities.

- **Average train length** increased by 5% for the first nine months of 2021 from the same period of 2020. This increase was primarily due to improvements in operating plan efficiency and continued improvements in bulk train efficiency due to moving longer Grain trains. Improvements for Grain trains were driven by the 8,500-foot HEP train model.

- **Average terminal dwell** increased by 9% in the first nine months of 2021 compared to the same period of 2020. This unfavourable increase was driven primarily by increased network activity in response to demand recovery from the impact of the COVID-19 pandemic in the prior year as well as the impact of the B.C. wildfires.

- **Average train speed** decreased by 3% in the first nine months of 2021 compared to the same period of 2020. This decrease was driven primarily by harsh winter operating conditions in the first quarter of 2021 as well as the impact of the B.C. wildfires.

- **Locomotive productivity** decreased by 1% in the first nine months of 2021 compared to the same period of 2020, as a result of moving higher volumes of merchandise and Intermodal, which are lighter than bulk commodities.

- **Fuel efficiency** improved by 1% in the first nine months of 2021 compared to the same period of 2020. This increase in efficiency was due to running longer and heavier trains as a result of improvements in the operating plan.

Total Employees and Workforce

An **employee** is defined as an individual currently engaged in full-time, part-time, or seasonal employment with CP while **workforce** is defined as total employees plus contractors and consultants. The Company monitors employment and workforce levels in order to efficiently meet service and strategic requirements. The number of employees is a key driver to total compensation and benefits costs.

The average number of total employees increased by 3% and 2% for the three and nine months ended September 30, 2021, respectively, compared to the same periods of 2020. The total number of employees as at September 30, 2021 was 12,262, an increase of 96, or 1%, compared to 12,166 as at September 30, 2020. The total workforce as at September 30, 2021 was 12,301, an increase of 116, or 1%, compared to 12,185 as at September 30, 2020. The increases in the total employees and workforce were driven by furloughs in the prior year associated with the economic downturn caused by COVID-19.

Safety Indicators

Safety is a key priority and core strategy for CP's management, employees, and Board of Directors. Personal injuries and train accidents are indicators of the effectiveness of the Company's safety systems, and are used by management to evaluate and, as necessary, alter the Company's safety systems, procedures, and protocols. Each measure follows U.S. FRA reporting guidelines, which can result in restatement after initial publication to reflect new information available within specified periods stipulated by the FRA but that exceed the Company's financial reporting timeline.

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 0.97 in the third quarter of 2021, a decrease from 1.03 in the same period of 2020. For the first nine months of 2021, the FRA personal injury rate per 200,000 employee-hours for CP was 0.97, a decrease from 1.11 in the same period of 2020.

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. $11,200 in 2021 and U.S. $10,700 in damage for 2020. The FRA train accidents per million train-miles was 1.54 in the third quarter of 2021, an increase from 1.13 in the same period of 2020. For the first nine months of 2021, the FRA train accidents per million train-miles was 1.09, an increase from 1.05 in the same period of 2020.

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, 2021 and the comparative figures in 2020. The financial highlights should be read in conjunction with Item 1. Financial Statements and this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

	For the three months ended September 30		For the nine months ended September 30	
(in millions, except per share data, percentages and ratios)	**2021**	2020	**2021**	2020
Financial Performance and Liquidity				
Total revenues	**$ 1,942**	$ 1,863	**$ 5,955**	$ 5,698
Operating income	**774**	779	**2,374**	2,383
Adjusted operating income[1]	**789**	779	**2,521**	2,383
Net income	**472**	598	**2,320**	1,642
Adjusted income[1]	**592**	560	**1,881**	1,720
Basic EPS	**0.71**	0.88	**3.48**	2.42
Diluted EPS	**0.70**	0.88	**3.46**	2.41
Adjusted diluted EPS[1]	**0.88**	0.82	**2.81**	2.52
Dividends declared per share	**0.190**	0.190	**0.570**	0.522
Cash provided by operating activities	**548**	493	**3,084**	1,817
Cash used in investing activities	**(2,129)**	(483)	**(2,820)**	(1,313)
Cash provided by (used in) financing activities	**902**	(100)	**(194)**	(466)
Free cash[1]	**203**	6	**1,245**	497
Financial Position	**As at September 30, 2021**		As at December 31, 2020	
Total assets	**$ 26,445**		$ 23,640	
Total long-term debt, including current portion	**9,968**		9,771	
Total shareholders' equity	**9,468**		7,319	
	For the three months ended September 30		**For the nine months ended September 30**	
Financial Ratios	**2021**	2020	**2021**	2020
Operating ratio[2]	**60.2%**	58.2%	**60.1%**	58.2%
Adjusted operating ratio[1]	**59.4%**	58.2%	**57.7%**	58.2%
	For the twelve months ended September 30			
	2021		2020	
Return on average shareholders' equity[3]	**36.6%**		31.2%	
Adjusted return on invested capital ("Adjusted ROIC")[1]	**15.9%**		16.2%	
Long-term debt to Net income ratio[4]	**3.2**		4.2	
Adjusted net debt to adjusted EBITDA ratio[1]	**2.4**		2.5	

(1) These measures have no standardized meanings prescribed by accounting principles generally accepted in the United States of America ("GAAP") and, therefore, may not be comparable to similar measures presented by other companies. These measures are defined and reconciled in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

(2) Operating ratio is defined as operating expenses divided by revenues, further discussed in Results of Operations of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

(3) Return on average shareholders' equity is defined as Net income divided by average shareholders' equity, averaged between the beginning and ending balance over a rolling 12-month period, further discussed in Results of Operations of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

(4) Long-term debt to Net income ratio is defined as long-term debt, including long-term debt maturing within one year, divided by Net income, further discussed in Liquidity and Capital Resources of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Results of Operations

Three months ended September 30, 2021 compared to the three months ended September 30, 2020

Income

Operating income was $774 million in the third quarter of 2021, a decrease of $5 million, or 1%, from $779 million in the same period of 2020. This decrease was primarily due to:
- lower freight volumes as measured by RTMs;
- the unfavourable impact of the change in FX of $26 million;
- acquisition-related costs of $15 million associated with the pending KCS transaction that were recognized in Purchased services and other;
- higher depreciation and amortization of $11 million (excluding FX); and
- increased training costs driven by recovery from the economic downturn caused by COVID-19 in the prior year.

This decrease was partially offset by higher freight rates and lower stock-based compensation of $30 million primarily driven by the impact of changes in share price.

Adjusted operating income, defined and reconciled in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations, was $789 million in the third quarter of 2021, an increase of $10 million, or 1%, from $779 million in the same period of 2020. This increase was primarily due to higher freight rates and lower stock-based compensation of $30 million primarily driven by the impact of changes in share price.

This increase was partially offset by;
- lower freight volumes as measured by RTMs;
- the unfavourable impact of the change in FX of $26 million;
- higher depreciation and amortization of $11 million (excluding FX); and
- increased training costs driven by recovery from the economic downturn caused by COVID-19 in the prior year.

Net income was $472 million in the third quarter of 2021, a decrease of $126 million, or 21%, from $598 million in the same period of 2020. This decrease was primarily due to acquisition-related costs of $83 million associated with the pending KCS transaction that were recognized in Other expense (income) and an FX translation loss of $46 million on debt and lease liabilities compared to an FX translation gain of $40 million in the same period of 2020.

This decrease was partially offset by lower income tax expense due to lower taxable earnings.

Adjusted income, defined and reconciled in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations, was $592 million in the third quarter of 2021, an increase of $32 million, or 6%, from $560 million in the same period of 2020. This increase was primarily due to higher Adjusted operating income.

Diluted Earnings per Share

Diluted EPS was $0.70 in the third quarter of 2021, a decrease of $0.18, or 20%, from $0.88 in the same period of 2020. This decrease was due to lower Net income, partially offset by lower average number of outstanding shares due to share repurchases under 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 $0.88 in the third quarter of 2021, an increase of $0.06, or 7%, from $0.82 in the same period of 2020. This increase was due to higher Adjusted income and lower average number of outstanding shares due to share repurchases under 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 60.2% in the third quarter of 2021, a 200 basis point increase from 58.2% in the same period of 2020. This increase was primarily due to:
- lower freight volumes as measured by RTMs;
- the unfavourable impact of higher fuel prices net of recoveries;
- acquisition-related costs associated with the pending KCS transaction that were recognized in Purchased services and other;
- higher depreciation and amortization; and
- increased training costs driven by recovery from the economic downturn caused by COVID-19 in the prior year.

This increase was partially offset by higher freight rates and lower stock-based compensation primarily driven by the impact of changes in share price.

Adjusted operating ratio, defined and reconciled in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations, was 59.4% in the third quarter of 2021, a 120 basis point increase from the same period of 2020. This increase was primarily due to the same factors discussed above for the increase in Operating ratio, except that Adjusted operating ratio excludes the acquisition-related costs associated with the pending KCS transaction that were recognized in Purchased services and other.

Return on Average Shareholders' Equity and Adjusted Return on Invested Capital

Return on average shareholders' equity and Adjusted ROIC are measures used by management to determine how productively the Company uses its long-term capital investments, representing critical indicators of good operating and investment decisions. Adjusted ROIC is also an important performance criteria in determining certain elements of the Company's long-term incentive plan.

Return on average shareholders' equity was 36.6% for the twelve months ended September 30, 2021, a 540 basis point increase compared to 31.2% for the twelve months ended September 30, 2020, primarily due to higher Net income. This increase was partially offset by higher average shareholders' equity due to accumulated Net income, partially offset by the impact of the Company's share repurchase program.

Adjusted ROIC was 15.9% for the twelve months ended September 30, 2021, a 30 basis point decrease compared to 16.2% for the twelve months ended September 30, 2020. This decrease was primarily due to higher average shareholders' equity driven by accumulated Adjusted income, partially offset by lower shares due to the Company's share repurchase program, and higher average long-term debt. This decease was partially offset by higher Adjusted operating income. Adjusted ROIC is a Non-GAAP measure, which is defined and reconciled from Return on average shareholders' equity, the most comparable measure calculated in accordance with GAAP, 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, 2021 compared to the nine months ended September 30, 2020

Income

Operating income was $2,374 million in the first nine months of 2021, a decrease of $9 million, from $2,383 million in the same period of 2020. This decrease was primarily due to:

- acquisition-related costs of $147 million associated with the pending KCS transaction that were recognized in Purchased services and other;
- the unfavourable impact of the change in FX of $98 million;
- the unfavourable impact of higher fuel prices net of recoveries of $37 million;
- higher depreciation and amortization of $35 million (excluding FX);
- cost inflation; and
- higher defined benefit pension current service cost of $23 million.

This decrease was partially offset by:

- higher freight volumes as measured by RTMs and higher freight rates;
- a gain on the exchange of property and construction easements in Chicago of $50 million and gains on sale of land in British Columbia of $16 million; and
- the efficiencies generated from improved operating performance and asset utilization.

Adjusted operating income, defined and reconciled in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations, was $2,521 million in the first nine months of 2021, an increase of $138 million, or 6%, from $2,383 million in the same period of 2020. This increase was primarily due to:

- higher freight volumes as measured by RTMs and higher freight rates;
- a gain on the exchange of property and construction easements in Chicago of $50 million and gains on sale of land in British Columbia of $16 million; and
- the efficiencies generated from improved operating performance and asset utilization.

This increase was partially offset by:

- the unfavourable impact of the change in FX of $98 million;
- the unfavourable impact of higher fuel prices net of recoveries of $37 million;
- higher depreciation and amortization of $35 million (excluding FX);
- cost inflation; and
- higher defined benefit pension current service cost of $23 million.

Net income was $2,320 million in the first nine months of 2021, an increase of $678 million, or 41%, from $1,642 million in the same period of 2020. This increase was primarily due to the $845 million merger termination payment received in connection with KCS's termination of the Original Merger Agreement and an FX translation gain of $39 million on debt and lease liabilities compared to an FX loss of $89 million in the same period of 2020, partially offset by acquisition-related costs of $295 million associated with the pending KCS transaction that were recognized in Other expense (income).

Adjusted income was $1,881 million in the first nine months of 2021, an increase of $161 million, or 9%, from $1,720 million in the same period of 2020. This increase was primarily due to higher Adjusted operating income and higher other components of net periodic benefits recovery, partially offset by higher income tax expense due to higher taxable earnings.

Diluted Earnings per Share

Diluted EPS was $3.46 in the first nine months of 2021, an increase of $1.05, or 44%, from $2.41 in the same period of 2020. This increase was due to higher Net income and lower average number of outstanding shares due to share repurchases under the Company's share repurchase program.

Adjusted diluted EPS was $2.81 in the first nine months of 2021, an increase of $0.29, or 12%, from $2.52 in the same period of 2020. This increase was due to higher Adjusted income and lower average number of outstanding shares due to share repurchases under the Company's share repurchase program.

Operating Ratio

The Company's Operating ratio was 60.1% in the first nine months of 2021, a 190 basis point increase from 58.2% in the same period of 2020. This increase was primarily due to:

- acquisition-related costs associated with the pending KCS transaction that were recognized in Purchased services and other;
- the unfavourable impact of higher fuel prices net of recoveries;
- higher depreciation and amortization; and
- cost inflation.

This increase was partially offset by higher freight rates and a gain on the exchange of property and construction easements in Chicago and gains on sale of land in British Columbia.

Adjusted operating ratio, which excludes the acquisition-related costs associated with the pending KCS transaction that were recognized in Purchased services and other, was 57.7% in the first nine months of 2021, a 50 basis point improvement from 58.2% in the same period of 2020. This improvement was primarily due to higher freight rates and a gain on the exchange of property and construction easements in Chicago and gains on sale of land in British Columbia.

This improvement was partially offset by:

- the unfavourable impact of higher fuel prices net of recoveries;
- higher depreciation and amortization;and
- cost inflation.

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.

On October 15, 2021, the noon buying rate certified for customs purposes by the U.S. Federal Reserve Bank of New York was U.S. $1.00 = $1.24 Canadian dollar.

The following tables set forth, for the periods indicated, the average exchange rate between the Canadian dollar and the U.S. dollar expressed in the Canadian dollar equivalent of one U.S. dollar, the high and low exchange rates and period end exchange rates for the periods indicated. Average for year-end periods are calculated by using the exchange rates on the last day of each full month during the relevant period. These rates are based on the noon buying rate certified for customs purposes by the U.S. Federal Reserve Bank of New York set forth in the H.10 statistical release of the Federal Reserve Board.

Average exchange rates (Canadian/U.S. dollar)	**2021**	2020
For the three months ended - September 30	**$ 1.26**	$ 1.33
For the nine months ended - September 30	**$ 1.25**	$ 1.35

Ending exchange rates (Canadian/U.S. dollar)	**2021**	2020
Beginning of year - January 1	**$ 1.28**	$ 1.30
Beginning of quarter - July 1	**$ 1.24**	$ 1.36
End of quarter - September 30	**$ 1.27**	$ 1.33

	For the three months ended September 30		**For the nine months ended September 30**	
High/Low exchange rates (Canadian/U.S. dollar)	**2021**	2020	**2021**	2020
High	**$ 1.29**	$ 1.36	**$ 1.29**	$ 1.45
Low	**$ 1.23**	$ 1.30	**$ 1.20**	$ 1.30

In the third quarter of 2021, the impact of a weaker U.S. dollar resulted in a decrease in total revenues of $50 million, a decrease in total operating expenses of $24 million, and a decrease in interest expense of $5 million from the same period of 2020. In the first nine months of 2021, the impact of a weaker U.S. dollar resulted in a decrease in total revenues of $196 million, a decrease in total operating expenses of $98 million, and a decrease in interest expense of $24 million from the same period of 2020.

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, 2021 and the comparative periods of 2020.

Average Fuel Price (U.S. dollars per U.S. gallon)	**2021**	2020
For the three months ended - September 30	**$ 2.70**	$ 1.72
For the nine months ended - September 30	**$ 2.59**	$ 1.90

The impact of fuel prices 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 2021, the favourable impact of fuel prices on Operating income was $15 million. Higher fuel prices and increased carbon tax recoveries, partially offset by the unfavourable impact of the timing of recoveries from CP's fuel cost adjustment program resulted in an increase in Total revenues of $89 million. Higher fuel prices resulted in an increase in Total operating expenses of $74 million from the same period of 2020.

In the first nine months of 2021, the unfavourable impact of fuel prices on Operating income was $37 million. Higher fuel prices resulted in an increase in Total operating expenses of $149 million. Higher fuel prices and increased carbon tax recoveries, partially offset by the unfavourable impact of the timing of recoveries from CP's fuel cost adjustment program resulted in an increase in Total revenues of $112 million from the same period of 2020.

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 Company's Common Shares are listed on the Toronto Stock Exchange ("TSX") and the New York Stock Exchange ("NYSE") with ticker symbol "CP". The following tables indicate the opening and closing Common Share price on the TSX and the NYSE for the three and nine months ended September 30, 2021 and the comparative periods in 2020.

TSX (in Canadian dollars)	**2021**	2020
Opening Common Share price, as at January 1	**$ 88.31**	$ 66.21
Ending Common Share price, as at June 30	**$ 95.32**	$ 69.06
Ending Common Share price, as at September 30	**$ 82.71**	$ 81.01
Change in Common Share price for the three months ended September 30	**$ (12.61)**	$ 11.95
Change in Common Share price for the nine months ended September 30	**$ (5.60)**	$ 14.80

NYSE (in U.S. dollars)	2021	2020
Opening Common Share price, as at January 1	**$ 69.34**	$ 50.99
Ending Common Share price, as at June 30	**$ 76.91**	$ 51.07
Ending Common Share price, as at September 30	**$ 65.07**	$ 60.89
Change in Common Share price for the three months ended September 30	**$ (11.84)**	$ 9.82
Change in Common Share price for the nine months ended September 30	**$ (4.27)**	$ 9.90

In the third quarter of 2021, the impact of the change in Common Share prices resulted in a decrease in stock-based compensation expense of $27 million compared to an increase of $32 million in the same period of 2020.

In the first nine months of 2021, the impact of the change in Common Share prices resulted in a decrease in stock-based compensation expense of $10 million compared to an increase of $35 million in the same period of 2020.

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

Operating Revenues

The Company's revenues are primarily derived from transporting freight. 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 revenue is generated from leasing of certain assets; other arrangements, including contracts with passenger service operators and logistical services; and switching fees.

For the three months ended September 30	2021	2020	Total Change	% Change	FX Adjusted % Change[(2)]
Freight revenues (in millions)[(1)]	**$ 1,896**	$ 1,821	$ 75	4	7
Non-freight revenues (in millions)	**46**	42	4	10	10
Total revenues (in millions)	**$ 1,942**	$ 1,863	$ 79	4	7
Carloads (in thousands)	**665.0**	659.0	6.0	1	N/A
Revenue ton-miles (in millions)	**35,391**	36,690	(1,299)	(4)	N/A
Freight revenue per carload (in dollars)	**$ 2,851**	$ 2,763	$ 88	3	6
Freight revenue per revenue ton-mile (in cents)	**5.36**	4.96	0.40	8	11

(1) Freight revenues include fuel surcharge revenues of $148 million in 2021 and $55 million in 2020. Fuel surcharge revenues include recoveries of carbon taxes, levies, and obligations 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 % Change is defined and reconciled in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Freight revenues were $1,896 million in the third quarter of 2021, an increase of $75 million, or 4%, from $1,821 million in the same period of 2020. This increase was primarily due to increased freight revenue per RTM, partially offset by lower volumes as measured by RTMs.

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 2021 were 35,391 million, a decrease of 1,299 million, or 4%, from 36,690 million in the same period of 2020. This decrease was mainly attributable to lower volumes of Grain and Potash. This decrease was partially offset by higher volumes of Energy, chemicals and plastics, Metals, minerals and consumer products, and Intermodal.

Freight revenue per RTM is defined as freight revenue per revenue-producing ton of freight over a distance of one mile. This is an indicator of yield. Freight revenue per RTM was 5.36 cents in the third quarter of 2021, an increase of 0.40 cents, or 8%, from 4.96 cents in the same period of 2020. This increase was primarily due to higher fuel surcharge revenue as a result of higher fuel prices of $89 million and higher freight rates. This increase was partially offset by the unfavourable impact of the change in FX of $50 million.

Carloads are defined as revenue-generating shipments of containers and freight cars. Carloads were 665.0 thousand in the third quarter of 2021, an increase of 6.0 thousand, or 1%, from 659.0 thousand in the same period of 2020. This increase was primarily due to higher volumes of Intermodal, Energy, chemicals and plastics, Coal, and Metals, minerals and consumer products. This increase was partially offset by lower volumes of Grain, Automotive, and Potash.

Freight revenue per carload is defined as freight revenue per revenue-generating shipment of containers or freight cars. This is an indicator of yield. Freight revenue per carload was $2,851 in the third quarter of 2021, an increase of $88, or 3%, from $2,763 in the same period of 2020. This increase was primarily due to higher fuel surcharge revenue as a result of higher fuel prices of $89 million and higher freight rates, partially offset by the unfavourable impact of the change in FX of $50 million.

Non-freight revenues were $46 million in the third quarter of 2021, an increase of $4 million, or 10%, from $42 million in the same period of 2020. This increase was primarily due to revenue recognized for construction easements in Chicago of $5 million, higher revenue from passenger service operators, and higher leasing revenue, partially offset by lower revenue from logistical services and switching fees.

For the nine months ended September 30		**2021**		2020		Total Change	% Change	FX Adjusted % Change[(2)]
Freight revenues (in millions)[(1)]	**$**	**5,822**	$	5,573	$	249	4	8
Non-freight revenues (in millions)		**133**		125		8	6	7
Total revenues (in millions)	**$**	**5,955**	$	5,698	$	257	5	8
Carloads (in thousands)		**2,079.9**		1,980.6		99.3	5	N/A
Revenue ton-miles (in millions)		**113,725**		111,635		2,090	2	N/A
Freight revenue per carload (in dollars)	**$**	**2,799**	$	2,814	$	(15)	(1)	3
Freight revenue per revenue ton-mile (in cents)		**5.12**		4.99		0.13	3	6

(1) Freight revenues include fuel surcharge revenues of $366 million in 2021 and $237 million in 2020. 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 % Change is defined and reconciled in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Freight revenues were $5,822 million in the first nine months of 2021, an increase of $249 million, or 4%, from $5,573 million in the same period of 2020. This increase was primarily due to increased freight revenue per RTM and higher volumes as measured by RTMs.

RTMs for the first nine months of 2021 were 113,725 million, an increase of 2,090 million, or 2% from 111,635 million in the same period of 2020. This increase was mainly attributable to higher volumes of Metals, minerals and consumer products, Energy, chemicals and plastics, Coal, and Automotive. This increase was partially offset by lower volumes of Potash and Grain.

Freight revenue per RTM was 5.12 cents in the first nine months of 2021, an increase of 0.13 cents, or 3%, from 4.99 cents in the same period in 2020. This increase was primarily due to higher fuel surcharge revenue as a result of higher fuel prices of $112 million, moving higher volumes of Automotive, which has a higher freight revenue per RTM compared to the corporate average, and higher freight rates. This increase was partially offset by the unfavourable impact of the change in FX of $195 million.

Carloads were 2,079.9 thousand in the first nine months of 2021, an increase of 99.3 thousand, or 5%, from 1,980.6 thousand in the same period of 2020. This increase was primarily due to higher volumes of Intermodal, Coal, Metals, minerals, and consumer products, and Automotive. This increase was partially offset by lower volumes Grain and Potash.

Freight revenue per carload was $2,799 in the first nine months of 2021, a decrease of $15, or 1%, from $2,814 in the same period of 2020. This decrease was primarily due the unfavourable impact of the change in FX of $195 million. This decrease was partially offset by higher fuel surcharge revenue as a result of higher fuel prices of $112 million and higher freight rates.

Non-freight revenues were $133 million in the first nine months of 2021, an increase of $8 million, or 6%, from $125 million in the same period of 2020. This increase was primarily due to revenue recognized for construction easements in Chicago of $9 million, higher leasing revenues, and higher revenue from passenger service operators, partially offset by lower revenue from logistical services and switching fees.

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 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 included fuel surcharge revenues of $148 million in the third quarter of 2021, an increase of $93 million, or 169%, from $55 million in the same period of 2020. This increase was primarily due to higher fuel prices, increased carbon tax recoveries, and higher volumes. This increase was partially offset by the unfavourable timing of recoveries from CP's fuel cost adjustment program and the unfavourable impact of the change in FX.

In the first nine months of 2021, fuel surcharge revenues were $366 million, an increase of $129 million, or 54%, from $237 million in the same period of 2020. This increase was primarily due to higher fuel prices, higher volumes, and increased carbon tax recoveries. This increase was partially offset by the unfavourable timing of recoveries from CP's fuel cost adjustment program and the unfavourable impact of the change in FX.

Lines of Business

Grain

For the three months ended September 30		**2021**		2020		Total Change	% Change	FX Adjusted % Change[1]
Freight revenues (in millions)	**$**	**352**	$	457	$	(105)	(23)	(21)
Carloads (in thousands)		**89.0**		124.5		(35.5)	(29)	N/A
Revenue ton-miles (in millions)		**7,715**		10,549		(2,834)	(27)	N/A
Freight revenue per carload (in dollars)	**$**	**3,955**	$	3,671	$	284	8	10
Freight revenue per revenue ton-mile (in cents)		**4.56**		4.33		0.23	5	8

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

Grain revenue was $352 million in the third quarter of 2021, a decrease of $105 million, or 23%, from $457 million in the same period of 2020. This decrease was primarily due to lower volumes of Canadian grain to Vancouver and eastern Canada as a result of drought conditions, lower volumes of U.S. soybeans and corn to the U.S. Pacific Northwest and Midwest, and the unfavourable impact of the change in FX. This decrease was partially offset by increased freight revenue per RTM. Freight revenue per RTM increased due to higher freight rates and higher fuel surcharge revenue as a result of higher fuel prices. Carloads decreased more than RTMs due to moving lower volumes of U.S. corn and soybeans to the U.S. Midwest, which has a shorter length of haul.

For the nine months ended September 30		**2021**		2020		Total Change	% Change	FX Adjusted % Change[1]
Freight revenues (in millions)	**$**	**1,244**	$	1,321	$	(77)	(6)	(3)
Carloads (in thousands)		**323.8**		343.5		(19.7)	(6)	N/A
Revenue ton-miles (in millions)		**28,564**		29,734		(1,170)	(4)	N/A
Freight revenue per carload (in dollars)	**$**	**3,842**	$	3,846	$	(4)	—	3
Freight revenue per revenue ton-mile (in cents)		**4.36**		4.44		(0.08)	(2)	1

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

Grain revenue was $1,244 million in the first nine months of 2021, a decrease of $77 million, or 6%, from $1,321 million in the same period of 2020. This decrease was primarily due to lower volumes of Canadian grain to Vancouver and eastern Canada as a result of drought conditions and decreased freight revenue per RTM. This decrease was partially offset by moving higher volumes of U.S. corn and wheat to the U.S. Pacific Northwest, higher freight rates, and higher fuel surcharge revenue as a result of higher fuel prices. Freight revenue per RTM decreased due to the unfavourable impact of the change in FX. Carloads decreased more than RTMs due to moving higher volumes of U.S. corn and wheat to the U.S. Pacific Northwest, which has a longer length of haul.

Coal

For the three months ended September 30		**2021**		2020		Total Change	% Change	FX Adjusted % Change[1]
Freight revenues (in millions)	**$**	**158**	$	130	$	28	22	22
Carloads (in thousands)		**73.4**		63.5		9.9	16	N/A
Revenue ton-miles (in millions)		**4,334**		4,437		(103)	(2)	N/A
Freight revenue per carload (in dollars)	**$**	**2,153**	$	2,047	$	106	5	6
Freight revenue per revenue ton-mile (in cents)		**3.65**		2.93		0.72	25	25

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

Coal revenue was $158 million in the third quarter of 2021, an increase of $28 million, or 22%, from $130 million in the same period of 2020. This increase was primarily due to increased freight revenue per RTM, higher volumes of Canadian coal to Kamloops, B.C., and higher volumes of U.S. coal. This increase was partially offset by lower volumes of Canadian coal to

Vancouver and impacts of the B.C. wildfires. Freight revenue per RTM increased due to higher fuel surcharge revenue as a result of higher fuel prices. Carloads increased while RTMs decreased due to moving lower volumes of Canadian coal to Vancouver, which has a longer length of haul, and higher volumes of Canadian coal to Kamloops, B.C., which has a shorter length of haul.

For the nine months ended September 30		**2021**		2020		Total Change	% Change	FX Adjusted % Change[(1)]
Freight revenues (in millions)	**$**	**491**	$	411	$	80	19	21
Carloads (in thousands)		**224.2**		186.7		37.5	20	N/A
Revenue ton-miles (in millions)		**14,451**		13,209		1,242	9	N/A
Freight revenue per carload (in dollars)	**$**	**2,190**	$	2,201	$	(11)	—	—
Freight revenue per revenue ton-mile (in cents)		**3.40**		3.11		0.29	9	10

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

Coal revenue was $491 million in the first nine months of 2021, an increase of $80 million, or 19%, from $411 million in the same period of 2020. This increase was primarily due to higher volumes of Canadian coal, driven by prior year supply chain challenges at both the mines and the ports, and increased freight revenue per RTM. This increase was partially offset by the unfavourable impact of the change in FX. Freight revenue per RTM increased due to higher fuel surcharge revenue as a result of higher fuel prices. Carloads increased more than RTMs due to moving lower volumes of Canadian coal to Vancouver, which has a longer length of haul, and higher volumes of Canadian coal to Kamloops B.C., which has a shorter length of haul.

Potash

For the three months ended September 30		**2021**		2020		Total Change	% Change	FX Adjusted % Change[(1)]
Freight revenues (in millions)	**$**	**113**	$	132	$	(19)	(14)	(12)
Carloads (in thousands)		**35.8**		43.6		(7.8)	(18)	N/A
Revenue ton-miles (in millions)		**3,941**		5,036		(1,095)	(22)	N/A
Freight revenue per carload (in dollars)	**$**	**3,156**	$	3,028	$	128	4	7
Freight revenue per revenue ton-mile (in cents)		**2.87**		2.62		0.25	10	12

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

Potash revenue was $113 million in the third quarter of 2021, a decrease of $19 million, or 14%, from $132 million in the same period of 2020. This decrease was primarily due to lower volumes of export potash to Vancouver as a result of the B.C. wildfires, lower volumes of domestic potash as a result of mine closures, and the unfavourable impact of the change in FX. This decrease was partially offset by increased freight revenue per RTM. Freight revenue per RTM increased due to higher fuel surcharge revenue as a result of higher fuel prices and higher freight rates. RTMs decreased more than carloads due to moving lower volumes of export potash, which has a longer length of haul.

For the nine months ended September 30		**2021**		2020		Total Change	% Change	FX Adjusted % Change[(1)]
Freight revenues (in millions)	**$**	**348**	$	390	$	(42)	(11)	(7)
Carloads (in thousands)		**114.8**		127.0		(12.2)	(10)	N/A
Revenue ton-miles (in millions)		**12,705**		14,664		(1,959)	(13)	N/A
Freight revenue per carload (in dollars)	**$**	**3,031**	$	3,071	$	(40)	(1)	2
Freight revenue per revenue ton-mile (in cents)		**2.74**		2.66		0.08	3	7

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

Potash revenue was $348 million in the first nine months of 2021, a decrease of $42 million, or 11%, from $390 million in the same period of 2020. This decrease was primarily due to lower volumes of export potash to Vancouver and the U.S. Pacific Northwest as a result of construction at the Port of Vancouver and the Port of Portland, and the unfavourable impact of the change in FX. This decrease was partially offset by increased freight revenue per RTM. Freight revenue per RTM increased due to higher fuel surcharge revenue as a result of higher fuel prices and higher freight rates. RTMs decreased more than carloads as a result of moving lower volumes of export potash, which has a longer length of haul.

Fertilizers and Sulphur

For the three months ended September 30		**2021**		2020		Total Change	% Change	FX Adjusted % Change[(1)]
Freight revenues (in millions)	**$**	**72**	$	65	$	7	11	16
Carloads (in thousands)		**15.1**		13.9		1.2	9	N/A
Revenue ton-miles (in millions)		**1,141**		1,059		82	8	N/A
Freight revenue per carload (in dollars)	**$**	**4,768**	$	4,676	$	92	2	7
Freight revenue per revenue ton-mile (in cents)		**6.31**		6.14		0.17	3	8

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

Fertilizers and sulphur revenue was $72 million in the third quarter of 2021, an increase of $7 million, or 11%, from $65 million in the same period of 2020. This increase was primarily due to higher volumes of wet fertilizer and sulphur from western Canada to the U.S. Midwest and increased freight revenue per RTM. This increase was partially offset by the unfavourable impact of the change in FX. Freight revenue per RTM increased due to higher fuel surcharge revenue as a result of higher fuel prices and higher freight rates.

For the nine months ended September 30		**2021**		2020		Total Change	% Change	FX Adjusted % Change[(1)]
Freight revenues (in millions)	**$**	**227**	$	212	$	15	7	14
Carloads (in thousands)		**48.4**		45.7		2.7	6	N/A
Revenue ton-miles (in millions)		**3,673**		3,387		286	8	N/A
Freight revenue per carload (in dollars)	**$**	**4,690**	$	4,639	$	51	1	7
Freight revenue per revenue ton-mile (in cents)		**6.18**		6.26		(0.08)	(1)	5

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Fertilizers and sulphur revenue was $227 million in the first nine months of 2021, an increase of $15 million, or 7%, from $212 million in the same period of 2020. This increase was primarily due to higher volumes of wet and dry fertilizer, higher freight rates, and higher fuel surcharge revenue as a result of higher fuel prices. This increase was partially offset by decreased freight revenue per RTM. Freight revenue per RTM decreased due to the unfavourable impact of the change in FX. RTMs increased more than carloads due to moving higher volumes of wet fertilizers from western Canada to the U.S. Midwest, which has a longer length of haul.

Forest Products

For the three months ended September 30		**2021**		2020		Total Change	% Change	FX Adjusted % Change[(1)]
Freight revenues (in millions)	**$**	**89**	$	85	$	4	5	10
Carloads (in thousands)		**18.7**		17.9		0.8	4	N/A
Revenue ton-miles (in millions)		**1,419**		1,463		(44)	(3)	N/A
Freight revenue per carload (in dollars)	**$**	**4,759**	$	4,749	$	10	—	5
Freight revenue per revenue ton-mile (in cents)		**6.27**		5.81		0.46	8	13

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

Forest products revenue was $89 million in the third quarter of 2021, an increase of $4 million, or 5%, from $85 million in the same period of 2020. This increase was primarily due to increased freight revenue per RTM. This increase was partially offset by the unfavourable impact of the change in FX and lower volumes of lumber. Freight revenue per RTM increased due to higher fuel surcharge revenue as a result of higher fuel prices and higher freight rates. Carloads increased while RTMs decreased due to moving lower volumes of lumber, which has a longer length of haul, and higher volumes of paperboard, which has a shorter length of haul.

For the nine months ended September 30		2021		2020		Total Change	% Change	FX Adjusted % Change(1)
Freight revenues (in millions)	$	**259**	$	244	$	15	6	13
Carloads (in thousands)		**55.1**		53.5		1.6	3	N/A
Revenue ton-miles (in millions)		**4,290**		4,059		231	6	N/A
Freight revenue per carload (in dollars)	$	**4,701**	$	4,561	$	140	3	10
Freight revenue per revenue ton-mile (in cents)		**6.04**		6.01		0.03	—	7

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Forest products revenue was $259 million in the first nine months of 2021, an increase of $15 million, or 6%, from $244 million in the same period of 2020. This increase was primarily due to higher volumes of lumber, higher freight rates, and higher fuel surcharge revenue as a result of higher fuel prices. This increase was partially offset by the unfavourable impact of the change in FX. RTMs increased more than carloads due to moving higher volumes of lumber, which has a longer length of haul.

Energy, Chemicals and Plastics

For the three months ended September 30		2021		2020		Total Change	% Change	FX Adjusted % Change(1)
Freight revenues (in millions)	$	**392**	$	321	$	71	22	27
Carloads (in thousands)		**78.2**		63.6		14.6	23	N/A
Revenue ton-miles (in millions)		**6,330**		4,620		1,710	37	N/A
Freight revenue per carload (in dollars)	$	**5,013**	$	5,047	$	(34)	(1)	3
Freight revenue per revenue ton-mile (in cents)		**6.19**		6.95		(0.76)	(11)	(7)

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Energy, chemicals and plastics revenue was $392 million in the third quarter of 2021, an increase of $71 million, or 22%, from $321 million in the same period of 2020. This increase was primarily due to higher volumes of crude and petroleum products as a result of demand recovery from the impact of the COVID-19 pandemic in the prior year, higher fuel surcharge revenue as a result of higher fuel prices, and higher freight rates. This increase was partially offset by decreased freight revenue per RTM. Freight revenue per RTM decreased primarily due to moving proportionately higher volumes of crude to Kansas City, which has a longer length of haul, and the unfavourable impact of the change in FX.

For the nine months ended September 30		2021		2020		Total Change	% Change	FX Adjusted % Change(1)
Freight revenues (in millions)	$	**1,149**	$	1,153	$	(4)	—	4
Carloads (in thousands)		**241.5**		228.2		13.3	6	N/A
Revenue ton-miles (in millions)		**19,328**		17,981		1,347	7	N/A
Freight revenue per carload (in dollars)	$	**4,758**	$	5,053	$	(295)	(6)	(2)
Freight revenue per revenue ton-mile (in cents)		**5.94**		6.41		(0.47)	(7)	(3)

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Energy, chemicals and plastics revenue was $1,149 million in the first nine months of 2021, a decrease of $4 million, from $1,153 million in the same period of 2020. This decrease was primarily due to decreased freight revenue per RTM and lower volumes of crude to Chicago. This decrease was partially offset by higher volumes of liquefied petroleum gas ("LPG") and other petroleum products as a result of demand recovery from the impact of the COVID-19 pandemic in the prior year, higher fuel surcharge revenue as a result of higher fuel prices, and higher freight rates. Freight revenue per RTM decreased primarily due to the unfavourable impact of the change in FX and higher volumes of crude to Kansas City, which has a longer length of haul.

Metals, Minerals and Consumer Products

For the three months ended September 30	2021	2020	Total Change	% Change	FX Adjusted % Change(1)
Freight revenues (in millions)	**$ 196**	$ 152	$ 44	29	35
Carloads (in thousands)	**60.4**	50.8	9.6	19	N/A
Revenue ton-miles (in millions)	**2,992**	2,303	689	30	N/A
Freight revenue per carload (in dollars)	**$ 3,245**	$ 2,992	$ 253	8	14
Freight revenue per revenue ton-mile (in cents)	**6.55**	6.60	(0.05)	(1)	4

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Metals, minerals and consumer products revenue was $196 million in the third quarter of 2021, an increase of $44 million, or 29%, from $152 million in the same period of 2020. This increase was primarily due to higher volumes of frac sand and steel, higher fuel surcharge revenue as a result of higher fuel prices, and higher freight rates. This increase was partially offset by decreased freight revenue per RTM. Freight revenue per RTM decreased due to the unfavourable impact of the change in FX. RTMs increased more than carloads due to moving proportionately higher volumes of frac sand, which has a longer length of haul.

For the nine months ended September 30	2021	2020	Total Change	% Change	FX Adjusted % Change(1)
Freight revenues (in millions)	**$ 535**	$ 474	$ 61	13	20
Carloads (in thousands)	**177.2**	154.1	23.1	15	N/A
Revenue ton-miles (in millions)	**8,328**	6,951	1,377	20	N/A
Freight revenue per carload (in dollars)	**$ 3,019**	$ 3,076	$ (57)	(2)	4
Freight revenue per revenue ton-mile (in cents)	**6.42**	6.82	(0.40)	(6)	—

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Metals, minerals and consumer products revenue was $535 million in the first nine months of 2021, an increase of $61 million, or 13%, from $474 million in the same period of 2020. This increase was primarily due to higher volumes of steel and frac sand, higher fuel surcharge revenue as a result of higher fuel prices, and higher freight rates. This increase was partially offset by decreased freight revenue per RTM. Freight revenue per RTM decreased due to the unfavourable impact of the change in FX. RTMs increased more than carloads due to moving proportionately higher volumes of frac sand, which has a longer length of haul.

Automotive

For the three months ended September 30	2021	2020	Total Change	% Change	FX Adjusted % Change(1)
Freight revenues (in millions)	**$ 83**	$ 94	$ (11)	(12)	(8)
Carloads (in thousands)	**23.3**	31.2	(7.9)	(25)	N/A
Revenue ton-miles (in millions)	**403**	390	13	3	N/A
Freight revenue per carload (in dollars)	**$ 3,562**	$ 3,013	$ 549	18	23
Freight revenue per revenue ton-mile (in cents)	**20.60**	24.10	(3.50)	(15)	(11)

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Automotive revenue was $83 million in the third quarter of 2021, a decrease of $11 million, or 12%, from $94 million in the same period of 2020. This decrease was primarily due to decreased freight revenue per RTM. This decrease was partially offset by higher fuel surcharge revenue as a result of higher fuel prices, higher volumes as a result of onboarding a customer moving from Vancouver to eastern Canada, and higher freight rates. Freight revenue per RTM decreased due to moving proportionately higher volumes from Vancouver to eastern Canada, which has a longer length of haul, and the unfavourable impact of the change in FX. RTMs increased while carloads decreased due to moving lower volumes from eastern Canada to the eastern U.S., which has a shorter length of haul, as a result of the global semiconductor chip shortage causing manufacturing plant shutdowns across North America.

For the nine months ended September 30		2021		2020		Total Change	% Change	FX Adjusted % Change[(1)]
Freight revenues (in millions)	$	**289**	$	215	$	74	34	42
Carloads (in thousands)		**85.4**		71.3		14.1	20	N/A
Revenue ton-miles (in millions)		**1,378**		846		532	63	N/A
Freight revenue per carload (in dollars)	$	**3,384**	$	3,015	$	369	12	19
Freight revenue per revenue ton-mile (in cents)		**20.97**		25.41		(4.44)	(17)	(13)

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Automotive revenue was $289 million in the first nine months of 2021, an increase of $74 million, or 34%, from $215 million in the same period of 2020. This increase was primarily due to higher volumes as a result of onboarding customers moving to and from Vancouver, prior year manufacturing plant shutdowns across North America as a result of the COVID-19 pandemic, higher freight rates, and higher fuel surcharge revenue as a result of higher fuel prices. This increase was partially offset by decreased freight revenue per RTM. Freight revenue per RTM decreased due to moving proportionately higher volumes from Vancouver to eastern Canada, which has a longer length of haul, and the unfavourable impact of the change in FX.

Intermodal

For the three months ended September 30		2021		2020		Total Change	% Change	FX Adjusted % Change[(1)]
Freight revenues (in millions)	$	**441**	$	385	$	56	15	16
Carloads (in thousands)		**271.1**		250.0		21.1	8	N/A
Revenue ton-miles (in millions)		**7,116**		6,833		283	4	N/A
Freight revenue per carload (in dollars)	$	**1,627**	$	1,540	$	87	6	7
Freight revenue per revenue ton-mile (in cents)		**6.20**		5.63		0.57	10	12

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Intermodal revenue was $441 million in the third quarter of 2021, an increase of $56 million, or 15%, from $385 million in the same period of 2020. This increase was primarily due to increased freight revenue per RTM and higher international intermodal volumes driven by the onboarding of new customers. This increase was partially offset by the unfavourable impact of the change in FX. Freight revenue per RTM increased due to higher fuel surcharge revenue as a result of higher fuel prices and higher freight rates. Carloads increased more than RTMs due to moving lower volumes of international intermodal to and from the Port of Vancouver, which has a longer length of haul.

For the nine months ended September 30		2021		2020		Total Change	% Change	FX Adjusted % Change[(1)]
Freight revenues (in millions)	$	**1,280**	$	1,153	$	127	11	13
Carloads (in thousands)		**809.5**		770.6		38.9	5	N/A
Revenue ton-miles (in millions)		**21,008**		20,804		204	1	N/A
Freight revenue per carload (in dollars)	$	**1,581**	$	1,496	$	85	6	8
Freight revenue per revenue ton-mile (in cents)		**6.09**		5.54		0.55	10	12

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Intermodal revenue was $1,280 million in the first nine months of 2021, an increase of $127 million, or 11%, from $1,153 million in the same period of 2020. This increase was primarily due to increased freight revenue per RTM and higher domestic retail and wholesale intermodal volumes. This increase was partially offset by the unfavourable impact of the change in FX. Freight revenue per RTM increased due to higher fuel surcharge revenue as a result of higher fuel prices and higher freight rates. Carloads increased more than RTMs due to moving lower volumes of international intermodal to and from the Port of Vancouver, which has a longer length of haul.

Operating Expenses

For the three months ended September 30 (in millions of Canadian dollars)	2021	2020	Total Change	% Change	FX Adjusted % Change(1)
Compensation and benefits	**$ 381**	$ 382	$ (1)	—	2
Fuel	**199**	140	59	42	49
Materials	**51**	53	(2)	(4)	(4)
Equipment rents	**31**	39	(8)	(21)	(16)
Depreciation and amortization	**203**	195	8	4	6
Purchased services and other	**303**	275	28	10	13
Total operating expenses	**$ 1,168**	$ 1,084	$ 84	8	10

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Operating expenses were $1,168 million in the third quarter of 2021, an increase of $84 million, or 8%, from $1,084 million in the same period of 2020. This increase was primarily due to:

- the unfavourable impact of higher fuel prices of $74 million;
- acquisition-related costs of $15 million associated with the pending KCS transaction that were recognized in Purchased services and other;
- higher depreciation and amortization of $11 million (excluding FX);
- increased training costs driven by recovery from the economic downturn caused by COVID-19 in the prior year;
- increased costs due to the wildfire response in British Columbia;
- higher defined benefit pension current service cost of $7 million; and
- cost inflation.

This increase was partially offset by decreased stock-based compensation of $30 million primarily driven by the impact of changes in share price and the favourable impact of the change in FX of $24 million.

For the nine months ended September 30 (in millions of Canadian dollars)	2021	2020	Total Change	% Change	FX Adjusted % Change(1)
Compensation and benefits	**$ 1,165**	$ 1,127	$ 38	3	6
Fuel	**623**	483	140	29	36
Materials	**164**	162	2	1	3
Equipment rents	**92**	108	(16)	(15)	(9)
Depreciation and amortization	**605**	582	23	4	6
Purchased services and other	**932**	853	79	9	13
Total operating expenses	**$ 3,581**	$ 3,315	$ 266	8	11

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Operating expenses were $3,581 million in the first nine months of 2021, an increase of $266 million, or 8%, from $3,315 million in the same period of 2020. This increase was primarily due to:

- the unfavourable impact of higher fuel prices of $149 million;
- acquisition-related costs of $147 million associated with the pending KCS transaction that were recognized in Purchased services and other;
- increased variable expenses from higher volumes;
- higher depreciation and amortization of $35 million (excluding FX);
- cost inflation;
- higher defined benefit pension current service cost of $23 million; and
- increased training costs driven by recovery from the economic downturn caused by COVID-19 in the prior year.

This increase was partially offset by:

- the favourable impact of the change in FX of $98 million;
- a gain on the exchange of property and construction easements in Chicago of $50 million and gains on sale of land in British Columbia of $16 million; and
- the efficiencies generated from improved operating performance and asset utilization.

Compensation and Benefits

Compensation and benefits expense includes employee wages, salaries, fringe benefits, and stock-based compensation. Compensation and benefits expense was $381 million in the third quarter of 2021, a decrease of $1 million from $382 million in the same period of 2020. This decrease was primarily due to lower stock-based compensation of $30 million primarily driven by the impact of changes in share price and the favourable impact of the change in FX of $7 million.

This decrease was partially offset by:
- increased training costs driven by recovery from the economic downturn caused by COVID-19 in the prior year;
- the impact of wage and benefit inflation;
- higher defined benefit pension current service cost of $7 million; and
- higher health and welfare costs due to higher usage as a result of the recovery from the impact of the COVID-19 pandemic from the prior year.

Compensation and benefits expense was $1,165 million in the first nine months of 2021, an increase of $38 million, or 3%, from $1,127 million in the same period of 2020. This increase was primarily due to:
- the impact of wage and benefit inflation;
- higher defined benefit pension current service cost of $23 million;
- higher volume variable expenses as a result of an increase in workload as measured by GTMs;
- increased training costs driven by recovery from the economic downturn caused by COVID-19 in the prior year; and
- increased health and welfare costs due to higher usage as a result of the recovery from the impact of the COVID-19 pandemic from the prior year.

This increase was partially offset by:
- lower stock-based compensation of $35 million primarily driven by the impact of changes in share price;
- the favourable impact of the change in FX of $24 million; and
- labour efficiencies generated from improved operating performance and asset utilization.

Fuel

Fuel expense consists mainly of fuel used by locomotives and includes provincial, state, and federal fuel taxes. Fuel expense was $199 million in the third quarter of 2021, an increase of $59 million, or 42%, from $140 million in the same period of 2020. This increase was primarily due to the unfavourable impact of higher fuel prices of $74 million.

This increase was partially offset by:
- the favourable impact of the change in FX of $6 million;
- a decrease in workload, as measured by GTMs; and
- an increase in fuel efficiency of 2% from improvements in the operating plan resulting in running longer and heavier trains.

Fuel expense was $623 million in the first nine months of 2021, an increase of $140 million, or 29%, from $483 million in the same period of 2020. This increase was primarily due to the unfavourable impact of higher fuel prices of $149 million and an increase in workload, as measured by GTMs.

This increase was partially offset by the favourable impact of the change in FX of $25 million and an increase in fuel efficiency of 1% from improvements in the operating plan resulting in running longer and heavier trains.

Materials

Materials expense includes the cost of materials used for the maintenance of track, locomotives, freight cars, and buildings, as well as software sustainment. Materials expense was $51 million in the third quarter of 2021, a decrease of $2 million, or 4%, from $53 million in the same period of 2020. This decrease was primarily due to reduced track and locomotive maintenance, partially offset by increased fuel prices and cost inflation.

Materials expense was $164 million in the first nine months of 2021, an increase of $2 million, or 1%, from $162 million in the same period of 2020. This increase was primarily due to the unfavorable impact of higher fuel prices, increased locomotive maintenance and cost inflation, partially offset by the favourable impact of the change in FX of $3 million and reduced track and freight car maintenance.

Equipment Rents

Equipment rents expense includes the cost associated with using other railways' freight cars, intermodal equipment, and locomotives, net of rental income received from other railways for the use of CP's equipment. Equipment rents expense was $31 million in the third quarter of 2021, a decrease of $8 million, or 21%, from $39 million in the same period of 2020. This decrease was primarily due to:

- price incentives received on intermodal cars;
- higher receipts for CP freight cars used by other railways;
- efficiencies in usage of pooled freight cars by CP; and
- the favourable impact of the change in FX of $2 million.

This decrease was partially offset by greater usage of pooled freight cars.

Equipment rents expense was $92 million in the first nine months of 2021, a decrease of $16 million, or 15%, from $108 million in the same period of 2020. This decrease was primarily due to:

- efficiencies in usage of pooled freight cars by CP;
- price incentives received on intermodal cars;
- the favourable impact of the change in FX of $7 million; and
- higher receipts for CP freight cars used by other railways.

This decrease was partially offset by greater usage of pooled freight cars.

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 $203 million in the third quarter of 2021, an increase of $8 million, or 4%, from $195 million in the same period of 2020. This increase was primarily due to a higher depreciable asset base, partially offset by the favourable impact of the change in FX of $3 million.

Depreciation and amortization expense was $605 million in the first nine months of 2021, an increase of $23 million, or 4%, from $582 million in the same period of 2020. This increase was primarily due to a higher depreciable asset base, partially offset by the favourable impact of the change in FX of $12 million.

Purchased Services and Other

For the three months ended September 30 (in millions of Canadian dollars)	**2021**	2020	Total Change	% Change
Support and facilities	**$ 80**	$ 68	$ 12	18
Track and operations	**66**	65	1	2
Intermodal	**50**	51	(1)	(2)
Equipment	**26**	27	(1)	(4)
Casualty	**42**	31	11	35
Property taxes	**30**	28	2	7
Other	**17**	5	12	240
Land sales	**(8)**	—	(8)	—
Total Purchased services and other	**$ 303**	$ 275	$ 28	10

Purchased services and other expense encompasses a wide range of third-party costs, including expenses for joint facilities, personal injuries and damage claims, environmental remediation, property taxes, contractor and consulting fees, insurance, and gains on land sales. Purchased services and other expense was $303 million in the third quarter of 2021, an increase of $28 million from $275 million in the same period of 2020. This increase was primarily due to:

- the acquisition-related expenses of $15 million related to the pending KCS transaction, reported in Other;
- higher expenses of $11 million primarily due to the third party claims reported in Casualty;
- expenses due to the wildfire response in British Columbia, reported in Support and Facilities, and Track and operations; and
- cost inflation.

This increase was partially offset by:

- a gain on sale of land in British Columbia of $7 million;
- the favourable impact of the change in FX of $6 million; and
- lower variable expenses from lower volumes, reported in Intermodal and Track and operations.

For the nine months ended September 30 (in millions of Canadian dollars)		2021		2020		Total Change	% Change
Support and facilities	$	**214**	$	198	$	16	8
Track and operations		**204**		210		(6)	(3)
Intermodal		**154**		154		—	—
Equipment		**80**		85		(5)	(6)
Casualty		**101**		100		1	1
Property taxes		**98**		95		3	3
Other		**148**		15		133	887
Land sales		**(67)**		(4)		(63)	1,575
Total Purchased services and other	$	**932**	$	853	$	79	9

Purchased services and other expense was $932 million in the first nine months of 2021, an increase of $79 million, or 9%, from $853 million in the same period of 2020. This increase was primarily due to:

- the acquisition-related expenses of $147 million related to the pending KCS transaction, reported in Other;
- cost inflation;
- expenses due to the wildfire response in British Columbia, reported in Support and facilities, and Track and operations; and
- higher variable expenses from higher volumes, reported in Intermodal, Track and operations, and Equipment;

This increase was partially offset by:

- a gain on the exchange of property and construction easements in Chicago of $50 million and gains on sale of land in British Columbia of $16 million;
- the favourable impact of the change in FX of $27 million;
- a $16 million legal claim recovery, reported in Other; and
- a $7 million arbitration settlement, reported in Track and operations.

Other Income Statement Items

Other Expense (Income)

Other expense (income) consists of gains and losses from the change in FX on debt and lease liabilities and working capital, costs related to financing, shareholder costs, equity income, and other non-operating expenditures. Other expense was $124 million in the third quarter of 2021, a change of $160 million, or 444%, compared to other income of $36 million in the same period of 2020. This change was primarily due to an FX translation loss on U.S. dollar-denominated debt and lease liabilities of $46 million, compared to an FX translation gain of $40 million in the same period of 2020, as well as acquisition-related expenses of $83 million which include losses on interest rate hedges of $111 million, gains on FX hedges of $30 million, and bridge facility fees of $2 million. This was partially offset by FX gains on cash and working capital of $7 million, compared to FX losses of $2 million in the same period of 2020.

Other expense was $253 million in the first nine months of 2021, an increase of $164 million, or 184%, from $89 million in the same period of 2020. This increase is primarily due to acquisition-related expenses of $295 million which include losses on interest rate hedges of $261 million, bridge facility and backstop revolver fees of $47 million, and gains on FX hedges of $13 million. This increase is partially offset by an FX translation gain on U.S. dollar-denominated debt and lease liabilities of $39 million, compared to an FX translation loss of $89 million in the same period of 2020.

FX translation gains and losses on debt and lease liabilities are discussed further in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Merger Termination Fee

On May 21, 2021, KCS terminated the Original Merger Agreement with CP to enter into a definitive agreement with CN. At the same time and in accordance with the terms of the Original Merger Agreement, KCS paid CP a termination fee of $845 million (U.S. $700 million). This amount is reported as "Merger termination fee" in the Company's Interim Consolidated Statements of Income for the first nine months of 2021. No similar items were received in the same period of 2020.

Other Components of Net Periodic Benefit Recovery

Other components of net periodic benefit recovery is related to the Company's pension and other post-retirement and post-employment benefit plans. It includes interest cost on benefit obligations, expected return on fund assets, recognized net actuarial losses, and amortization of prior service costs. Other components of net periodic benefit recovery was $95 million in the third quarter of 2021, an increase of $9 million or 10%, compared to $86 million in the same period of 2020. This increase was primarily due to a decrease in the interest cost on the benefit obligation of $14 million and an increase in expected return on fund assets of $4 million, partially offset by an increase in recognized net actuarial losses of $8 million.

Other components of net periodic benefit recovery was $286 million in the first nine months of 2021, an increase of $29 million or 11%, compared to $257 million in the same period of 2020. This increase was primarily due to a decrease in the interest cost on the benefit obligation of $42 million and an increase in expected return on fund assets of $11 million, partially offset by an increase in recognized net actuarial losses of $23 million.

Net Interest Expense

Net interest expense includes interest on long-term debt and finance leases. Net interest expense was $104 million in the third quarter of 2021, a decrease of $10 million, or 9%, from $114 million in the same period of 2020. This decrease was primarily due to:

- the favourable impact of the change in FX rates of $5 million;
- a decrease in debt levels of $3 million; and
- a reduction in interest related to long-term debt of $2 million as the result of a lower effective interest rate.

Net interest expense was $315 million in the first nine months of 2021, a decrease of $31 million, or 9%, from $346 million in the same period of 2020. This decrease was primarily due to:

- the favourable impact of the change in FX rates of $24 million;
- a reduction in interest related to long-term debt of $8 million as the result of a lower effective interest rate; and
- higher interest income of $4 million.

This was partially offset by the unfavourable impact of an increase in debt levels of $4 million.

Income Tax Expense

Income tax expense was $169 million in the third quarter of 2021, a decrease of $20 million, or 11%, from $189 million in the same period of 2020. The decrease was primarily due to tax recoveries on acquisition-related costs associated with the pending KCS transaction and a lower effective tax rate.

Income tax expense was $617 million in the first nine months of 2021, an increase of $54 million, or 10%, from $563 million in the same period of 2020. The increase was primarily a result of higher taxable earnings due to the $845 million (U.S. $700 million) merger termination payment received in connection with KCS's termination of the Original Merger Agreement, partially offset by acquisition-related costs associated with the pending KCS transaction and a lower effective tax rate.

The effective tax rate in the third quarter of 2021, including discrete items, was 26.36% compared to 23.97% in the same period of 2020. The effective tax rate in the first nine months of 2021, including discrete items, was 21.00% compared to 25.52% in the same period of 2020. The effective tax rate in the third quarter and first nine months of 2021, excluding discrete items, was 24.60% compared to 25.00% for the same periods in 2020. The decrease in the effective tax rates, excluding discrete items, was primarily due to the decrease in Alberta's corporate tax rate and a lower North Dakota tax rate.

The Company expects an annualized effective tax rate in 2021 of 24.60%. The Company’s 2021 outlook for its 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 2020 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. Additionally, CP believes that its existing sources of liquidity, including the new 364-day bridge facility described below, along with anticipated long-term financing will be sufficient to fund the pending KCS transaction. 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 commercial paper program, its bilateral letter of credit facilities, its term credit facility, and its revolving credit facility.

On June 21, 2021, the Company filed a new base shelf prospectus in each province of Canada and a registration statement with the SEC to issue up to U.S. $8.5 billion in debt securities in the Canadian and U.S. capital markets over 25 months from the filing date. The Company had previously entered into forward starting floating-to-fixed interest rate swap agreements totalling a notional U.S. $2.4 billion and interest rate bond locks totalling a notional $600 million to fix benchmark rates on future debt issuances in 2021.

During the third quarter of 2021, the Company obtained commitments for a new 364-day senior unsecured facility (the "bridge facility") in the amount of U.S. $8.5 billion to bridge debt financing required to fund a portion of the cash component of the pending KCS transaction. Based on the Exchange Ratio, the Company plans to issue approximately 262 million new Common Shares to fund the share consideration portion of the pending KCS transaction. The Exchange Ratio is fixed and will not be adjusted for fluctuations in the market price of the Company's Common Shares or KCS common stock between the date of the Merger Agreement and closing of the pending KCS transaction.

As at September 30, 2021, the Company had $210 million of Cash and cash equivalents compared to $147 million at December 31, 2020.

As at September 30, 2021, the Company's revolving credit facility was undrawn, unchanged from December 31, 2020 from a total available amount of U.S. $1.3 billion. Effective April 9, 2021, the Company amended its revolving credit facility to modify certain provisions relating to the calculation of the financial covenant ratio in its revolving credit facility. In addition, effective September 24, 2021, the Company entered into an amendment to extend the two-year tranche and the five-year tranche of its revolving credit facility to September 27, 2023 and September 27, 2026, respectively. Effective September 29, 2021, the Company entered into a further amendment to its revolving credit facility in order to provide financial covenant flexibility for the anticipated acquisition financing pertaining to the pending KCS transaction, which is in place for a two-year period from the date the transaction closes. Effective September 15, 2021, the Company entered into a U.S. $500 million unsecured non-revolving term credit facility with an initial maturity date of March 15, 2022. As at September 30, 2021, the unsecured non-revolving term credit facility was fully drawn. The credit facility agreements require the Company to maintain a financial covenant. As at September 30, 2021, the Company was in compliance with all terms and conditions of the credit facility arrangements and satisfied the financial covenants.

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, 2021, there was U.S. $565 million commercial paper borrowings outstanding, compared to U.S. $644 million as at December 31, 2020.

As at September 30, 2021, under its bilateral letter of credit facilities, the Company had letters of credit drawn of $59 million from a total available amount of $300 million, compared to $59 million from a total available amount of $300 million as at December 31, 2020. Under the bilateral letter of credit facilities, 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 letter of credit issued. As at September 30, 2021 and December 31, 2020, the Company did not have any collateral posted on its bilateral letter of credit facilities.

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 $548 million in the third quarter of 2021, an increase of $55 million, or 11%, compared to $493 million in the same period of 2020. This increase was primarily due to a favourable change in working capital.

Cash provided by operating activities was $3,084 million in the first nine months of 2021, an increase of $1,267 million, or 70%, compared to $1,817 million in the same period of 2020. This increase was primarily due to a favourable change in working capital driven by acquisition-related payables as well as higher cash generating income as a result of the $845 million merger termination payment received from KCS in the second quarter of 2021.

Investing Activities

Cash used in investing activities was $2,129 million in the third quarter of 2021, an increase of $1,646 million, or 341%, compared to $483 million in the same period of 2020. Cash used in investing activities was $2,820 million in the first nine months of 2021, an increase of $1,507 million, or 115%, compared to $1,313 million in the same period of 2020. These increases were primarily due to the cash payment made to KCS in the third quarter of 2021, partially offset by lower capital spending compared to the same period of 2020.

Free Cash

CP generated positive Free cash of $203 million in the third quarter of 2021, an increase of $197 million, or 3,283%, from $6 million in the same period of 2020. For the first nine months of 2021, CP generated positive Free cash of $1,245 million, an increase of $748 million, or 151%, from $497 million in the same period of 2020. These increases were primarily due to an increase in cash provided by operating activities as well as lower capital additions and higher proceeds from the sale of properties during 2021 compared to the same period of 2020.

Free cash is affected by seasonal fluctuations and by other factors including the size of the Company's capital programs. 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 provided by financing activities was $902 million in the third quarter of 2021, a change of $1,002 million, or 1,002%, compared to cash used in financing activities of $100 million in the same period of 2020. This change was primarily due to an increase in short-term borrowings, including commercial paper and the term loan, and a pause on payments to buy back shares under the Company's share repurchase program due to the pending KCS transaction during the three months ended September 30, 2021. This was partially offset by higher debt repayments including the repayment of U.S. $250 million 9.450% debentures in the three months ended September 30, 2021.

Cash used in financing activities was $194 million in the first nine months of 2021, a decrease of $272 million, or 58%, compared to $466 million in the same period of 2020. This decrease was primarily due to a pause on payments to buy back shares under the Company's share repurchase program due to the pending KCS transaction, an increase in short-term borrowings, and lower repayments of commercial paper during the nine months ended September 30, 2021. This was partially offset by the issuances of U.S. $500 million 2.050% notes due March 5, 2030 and $300 million 3.050% notes due March 9, 2050 during the first nine months of 2020, higher debt repayments including the repayment of U.S. $250 million 9.450% debentures at maturity, acquisition-related financing fees, and an increase in dividends paid during the nine months ended September 30, 2021.

Credit Measures

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

A strong 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, 2021, CP's credit ratings from Standard & Poor's Rating Services ("Standard & Poor's") remain unchanged from December 31, 2020. During the first quarter of 2021, Moody's Investor Service ("Moody's") downgraded CP's credit rating to Baa2 from Baa1 due to the announcement of the pending KCS transaction.

Credit ratings as at September 30, 2021[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	**Baa2**	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.

Financial Ratios

The Long-term debt to Net income ratio for the twelve months ended September 30, 2021 and September 30, 2020 was 3.2 and 4.2, respectively. This decrease was primarily due to a higher Net income, partially offset by higher debt balance for the twelve months ended September 30, 2021.

The Adjusted net debt to Adjusted earnings before interest, tax, depreciation and amortization ("EBITDA") ratio for the twelve months ended September 30, 2021 and September 30, 2020 was 2.4 and 2.5, respectively. The decrease as at September 30, 2021 was primarily due to an increase in Adjusted EBITDA, partially offset by a higher Adjusted net debt as of September 30, 2020. The Adjusted net debt to Adjusted EBITDA ratio is a Non-GAAP measure, which is defined and reconciled from the Long-term debt to Net income ratio, the most comparable measure calculated in accordance with GAAP, 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. The pending KCS transaction and the anticipated issuance of debt securities in connection with the pending transaction is expected to temporarily increase the Adjusted net debt to Adjusted EBITDA ratio to approximately 3.9 in 2021. CP plans to repay a portion of the financing in connection with the pending KCS transaction as well as maturing long-term debt, and expects to return back to its target range approximately 24 months after the pending KCS transaction closes into the voting trust.

Although CP has provided a target Non-GAAP measure (Adjusted net debt to Adjusted EBITDA ratio), management is unable to reconcile, without unreasonable efforts, the target Adjusted net debt to Adjusted EBITDA ratio to the most comparable GAAP measure (Long-term debt to Net income ratio), due to unknown variables and uncertainty related to future results. These unknown variables may include unpredictable transactions of significant value. In recent years, CP has recognized acquisition-related costs (including legal, consulting, and financing fees and fair value gain or loss on FX forward contracts and interest rate hedges), the merger termination payment received, changes in income tax rates, and a change to an uncertain tax item. These or other similar, large unforeseen transactions affect Net income but may be excluded from CP's Adjusted EBITDA. Additionally, the U.S.-to-Canada dollar exchange rate is unpredictable and can have a significant impact on CP's reported results but may be excluded from CP's Adjusted EBITDA. In particular, CP excludes the FX impact of translating the Company's debt and lease liabilities, interest and taxes from Adjusted EBITDA. Please see Forward-Looking Statements in this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations for further discussion.

Supplemental Guarantor Financial Information

Canadian Pacific Railway Company ("CPRC"), a 100%-owned subsidiary of CPRL, is the issuer of certain securities which are fully and unconditionally guaranteed by CPRL on an unsecured basis. The other subsidiaries of CPRC do not guarantee the securities and are referred to below as the "Non-Guarantor Subsidiaries". The following is a description of the terms and conditions of the guarantees with respect to securities for which CPRC is the issuer and CPRL provides a full and unconditional guarantee.

As at September 30, 2021, CPRC had $7,135 million principal amount of debt securities outstanding due through 2115, and $44 million in perpetual 4% consolidated debenture stock, for all of which CPRL is the guarantor.

CPRL fully and unconditionally guarantees the payment of the principal (and premium, if any) and interest on the debt securities and consolidated debenture stock issued by CPRC, any sinking fund or analogous payments payable with respect to such securities, and any additional amounts payable when they become due, whether at maturity or otherwise. The guarantee is CPRL's unsubordinated and unsecured obligation and ranks equally with all of CPRL's other unsecured, unsubordinated obligations.

CPRL will be released and relieved of its obligations under the guarantees after obligations to the holders are satisfied in accordance with the terms of the respective instruments.

Pursuant to Rule 13-01 of the SEC's Regulation S-X, the Company provides summarized financial and non-financial information of CPRC in lieu of providing separate financial statements of CPRC.

More information on the securities under this guarantee structure can be found in Exhibit 22.1 List of Issuers and Guarantor Subsidiaries of this quarterly report.

Summarized Financial Information

The following tables present summarized financial information for CPRC (Subsidiary Issuer) and CPRL (Parent Guarantor) on a combined basis after elimination of (i) intercompany transactions and balances among CPRC and CPRL; (ii) equity in earnings from and investments in the Non-Guarantor Subsidiaries; and (iii) intercompany dividend income.

Statements of Income

	CPRC (Subsidiary Issuer) and CPRL (Parent Guarantor)	
(in millions of Canadian dollars)	**For the nine months ended September 30, 2021**	For the year ended December 31, 2020
Total revenues	**$ 4,435**	$ 5,797
Total operating expenses	**2,800**	3,263
Operating income[(1)]	**1,635**	2,534
Less: Other[(2)]	**(539)**	127
Income before income tax expense	**2,174**	2,407
Net income	**$ 1,716**	$ 1,792

(1) Includes net lease costs incurred from non-guarantor subsidiaries for the nine months ended September 30, 2021 and for the year ended December 31, 2020 of $329 million and $435 million, respectively.

(2) Includes Other expense (income), Merger termination fee, Other components of net periodic benefit recovery, and Net interest expense.

Balance Sheets

	CPRC (Subsidiary Issuer) and CPRL (Parent Guarantor)	
(in millions of Canadian dollars)	**As at September 30, 2021**	As at December 31, 2020
Assets		
Current assets	**$ 1,079**	$ 907
Properties	**11,279**	10,865
Other non-current assets	**3,203**	1,151
Liabilities		
Current liabilities	**$ 3,312**	$ 2,290
Long-term debt	**8,032**	8,585
Other non-current liabilities	**3,129**	2,981

Excluded from the Income Statements and Balance Sheets above are the following significant intercompany transactions and balances that CPRC and CPRL have with the Non-Guarantor Subsidiaries:

Cash Transactions with Non-Guarantor Subsidiaries

	CPRC (Subsidiary Issuer) and CPRL (Parent Guarantor)	
(in millions of Canadian dollars)	**For the nine months ended September 30, 2021**	For the year ended December 31, 2020
Dividend income from non-guarantor subsidiaries	**$ 292**	$ 163
Capital contributions to non-guarantor subsidiaries	**(134)**	—
Redemption of shares by non-guarantor subsidiaries	**1,370**	198

Balances with Non-Guarantor Subsidiaries

(in millions of Canadian dollars)	CPRC (Subsidiary Issuer) and CPRL (Parent Guarantor) As at September 30, 2021	As at December 31, 2020
Assets		
Accounts receivable, intercompany	**$ 193**	$ 327
Short-term advances to affiliates	**61**	20
Long-term advances to affiliates	**10**	9
Liabilities		
Accounts payable, intercompany	**$ 183**	$ 179
Short-term advances from affiliates	**2,587**	3,658
Long-term advances from affiliates	**82**	82

Share Capital

At October 19, 2021, the latest practicable date, there were 666,964,525 Common Shares and no preferred shares issued and outstanding, which consists of 13,737 holders of record of the Common Shares. In addition, CP has a Management Stock Option Incentive Plan ("MSOIP"), under which key officers and employees are granted options to purchase the Common Shares. Options issued prior to the share split described in the Executive Summary now each provide rights over five shares. For consistency, all number of options presented herein are shown on the basis of the number of shares subject to the options. At October 19, 2021, 7,479,714 options were outstanding under the MSOIP and stand-alone option agreements entered into with Mr. Keith Creel. There are 3,319,041 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 Common Shares. There are no outstanding options under the DSOP, which has 1,700,000 options available to be issued in the future.

Non-GAAP Measures

The Company presents Non-GAAP measures 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.

Non-GAAP Performance Measures

The Company uses adjusted earnings results including 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, acquisition-related costs (including legal, consulting, and financing fees and fair value gain or loss on FX forward contracts and interest rate hedges), the merger termination payment received, the FX impact of translating the Company's debt and lease liabilities (including borrowings under the credit facility), discrete tax items, changes in income tax rates, changes to an uncertain tax item, 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 2021, there were three significant items included in Net income as follows:

- acquisition-related costs of $442 million in connection with the pending KCS transaction ($343 million after current taxes of $94 million and deferred taxes of $5 million), including an expense of $147 million recognized in Purchased services and other and $295 million recognized in Other expense (income), that unfavourably impacted Diluted EPS by 51 cents as follows:
  - in the third quarter, acquisition-related costs of $98 million ($80 million after current tax recovery of $61 million net of deferred tax expense of $43 million), including an expense of $15 million recognized in Purchased services and other and $83 million recognized in Other expense (income), that unfavourably impacted Diluted EPS by 12 cents;
  - in the second quarter, acquisition-related costs of $308 million ($236 million after current taxes of $25 million and deferred taxes of $47 million), including an expense of $99 million recognized in Purchased services and other and $209 million recognized in Other expense (income), that unfavourably impacted Diluted EPS by 35 cents; and
  - in the first quarter, acquisition-related costs of $36 million ($27 million after current taxes of $8 million and deferred taxes of $1 million), including an expense of $33 million recognized in Purchased services and other and $3 million recognized in Other expense (income), that unfavourably impacted Diluted EPS by 4 cents.
- merger termination payment received of $845 million ($748 million after current taxes) in connection with KCS's termination of the Original Merger Agreement dated March 21, 2021 effective May 21, 2021, that favourably impacted Diluted EPS by $1.11; and
- a non-cash gain of $39 million ($34 million after deferred tax) due to FX translation of debt and lease liabilities that favourably impacted Diluted EPS by 5 cents as follows:
  - In the third quarter, a $46 million loss ($40 million after deferred tax) that unfavourably impacted Diluted EPS by 6 cents; and
  - in the second quarter, a $52 million gain ($45 million after deferred tax) that favourably impacted Diluted EPS by 7 cents; and
  - in the first quarter, a $33 million gain ($29 million after deferred tax) that favourably impacted Diluted EPS by 4 cents.

In 2020, there were two significant items included in Net income as follows:

- in the fourth quarter, a deferred tax recovery of $29 million due to a change relating to a tax return filing election for the state of North Dakota that favourably impacted Diluted EPS by 5 cents; and
- during the course of the year, a net non-cash gain of $14 million ($12 million after deferred tax) due to FX translation of debt and lease liabilities that favourably impacted Diluted EPS by 2 cents as follows:
  - in the fourth quarter, a $103 million gain ($90 million after deferred tax) that favourably impacted Diluted EPS by 13 cents;
  - in the third quarter, a $40 million gain ($38 million after deferred tax) that favourably impacted Diluted EPS by 6 cents;
  - in the second quarter, an $86 million gain ($82 million after deferred tax) that favourably impacted Diluted EPS by 12 cents; and
  - in the first quarter, a $215 million loss ($198 million after deferred tax) that unfavourably impacted Diluted EPS by 28 cents.

In the three months ended December 31, 2019, there were two significant items included in Net income as follows:

- a deferred tax expense of $24 million as a result of a provision for an uncertain tax item of a prior period that unfavourably impacted Diluted EPS by 3 cents; and
- a $37 million non-cash gain ($32 million after deferred tax) due to FX translation of debt that favourably impacted Diluted EPS by 4 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:

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

	For the three months ended September 30		For the nine months ended September 30		For the twelve months ended December 31
(in millions of Canadian dollars)	**2021**	2020	**2021**	2020	2020
Net income as reported	**$ 472**	$ 598	**$ 2,320**	$ 1,642	$ 2,444
Less significant items (pre-tax):					
Acquisition-related costs	**(98)**	—	**(442)**	—	—
Merger termination fee	**—**	—	**845**	—	—
Impact of FX translation (loss) gain on debt and lease liabilities	**(46)**	40	**39**	(89)	14
Add:					
Tax effect of adjustments[(1)]	**(24)**	2	**3**	(11)	2
Income tax rate changes	**—**	—	**—**	—	(29)
Adjusted income	**$ 592**	$ 560	**$ 1,881**	$ 1,720	$ 2,403

(1) The tax effect of adjustments was calculated as the pre-tax effect of the adjustments multiplied by the applicable tax rate for the above items of 16.88% and 0.68% for the three and nine months ended September 30, 2021, respectively, 4.82% and 12.15% for the three and nine months ended September 30, 2020, respectively, and 13.58% for the twelve months ended December 31, 2020. 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 number of Common 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		For the twelve months ended December 31
	2021	2020	**2021**	2020	2020
Diluted earnings per share as reported	**$ 0.70**	$ 0.88	**$ 3.46**	$ 2.41	$ 3.59
Less significant items (pre-tax):					
Acquisition-related costs	**(0.15)**	—	**(0.66)**	—	—
Merger termination fee	**—**	—	**1.26**	—	—
Impact of FX translation (loss) gain on debt and lease liabilities	**(0.07)**	0.06	**0.06**	(0.13)	0.02
Add:					
Tax effect of adjustments[(1)]	**(0.04)**	—	**0.01**	(0.02)	—
Income tax rate changes	**—**	—	**—**	—	(0.04)
Adjusted diluted earnings per share	**$ 0.88**	$ 0.82	**$ 2.81**	$ 2.52	$ 3.53

(1) The tax effect of adjustments was calculated as the pre-tax effect of the adjustments multiplied by the applicable tax rate for the above items of 16.88% and 0.68% for the three and nine months ended September 30, 2021, respectively, 4.82% and 12.15% for the three and nine months ended September 30, 2020, respectively, and 13.58% for the twelve months ended December 31, 2020. The applicable tax rates reflect the taxable jurisdictions and nature, being on account of capital or income, of the significant items.

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

	For the three months ended September 30		For the nine months ended September 30	
(in millions of Canadian dollars)	**2021**	2020	**2021**	2020
Operating income as reported	**$ 774**	$ 779	**$ 2,374**	$ 2,383
Less significant item:				
Acquisition-related costs	**(15)**	—	**(147)**	—
Adjusted operating income	**$ 789**	$ 779	**$ 2,521**	$ 2,383

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	
	2021	2020	**2021**	2020
Operating ratio as reported	**60.2 %**	58.2 %	**60.1 %**	58.2 %
Less significant item:				
Acquisition-related costs	**0.8 %**	— %	**2.4 %**	— %
Adjusted operating ratio	**59.4 %**	58.2 %	**57.7 %**	58.2 %

Adjusted ROIC

Adjusted ROIC is calculated as Adjusted return divided by Adjusted average invested capital. Adjusted return is defined as Net income adjusted for interest expense, tax effected at the Company’s adjusted annualized effective tax rate, and significant items in the Company’s Consolidated Financial Statements, tax effected at the applicable tax rate. Adjusted average invested capital is defined as the sum of total Shareholders' equity, Long-term debt, and Long-term debt maturing within one year, as presented in the Company's Consolidated Financial Statements, each averaged between the beginning and ending balance over a rolling 12-month period, adjusted for the impact of significant items, tax effected at the applicable tax rate, on closing balances as part of this average. Adjusted ROIC excludes significant items reported in the Company's Consolidated Financial Statements, as these significant items are not considered indicative of future financial trends either by nature or amount, and excludes interest expense, net of tax, to incorporate returns on the Company’s overall capitalization. Adjusted ROIC is a performance measure that measures 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. Adjusted ROIC, which is reconciled below from Return on average shareholders' equity, the most comparable measure calculated in accordance with GAAP, is also 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 Return on average shareholders' equity

	For the twelve months ended September 30	
(in millions of Canadian dollars, except for percentages)	**2021**	2020
Net income as reported	**$ 3,122**	$ 2,306
Average shareholders' equity	**$ 8,524**	$ 7,397
Return on average shareholders' equity	**36.6 %**	31.2 %

Reconciliation of Net income to Adjusted return

(in millions of Canadian dollars)	For the twelve months ended September 30 2021	2020
Net income as reported	**$ 3,122**	$ 2,306
Add:		
Net interest expense	**427**	458
Tax on interest(1)	**(104)**	(114)
Significant items (pre-tax):		
Acquisition-related costs	**442**	—
Merger termination fee	**(845)**	—
Impact of FX translation (gain) loss on debt and lease liabilities	**(142)**	52
Tax on significant items(2)	**16**	(6)
Income tax rate changes	**(29)**	—
Provision for uncertain tax item	**—**	24
Adjusted return	**$ 2,887**	$ 2,720

(1) Tax was calculated at the adjusted annualized effective tax rate of 24.34% and 24.67% for the twelve months ended September 30, 2021 and 2020, respectively.
(2) Tax was calculated as the pre-tax effect of the adjustments multiplied by the applicable tax rate for the above items of 2.57% and 11.22% for the twelve months ended September 30, 2021 and 2020, respectively. The applicable tax rates reflect the taxable jurisdictions and nature, being on account of capital or income, of the significant items.

Reconciliation of Average shareholders' equity to Adjusted average invested capital

(in millions of Canadian dollars)	For the twelve months ended September 30 2021	2020
Average shareholders' equity	**$ 8,524**	$ 7,397
Average Long-term debt, including long-term debt maturing within one year	**9,877**	9,385
	$ 18,401	$ 16,782
Less:		
Significant items (pre-tax):		
Acquisition-related costs	**(221)**	—
Merger termination fee	**423**	—
Tax on significant items(1)	**—**	—
Income tax rate changes	**15**	—
Provision for uncertain tax item	**—**	(12)
Adjusted average invested capital	**$ 18,184**	$ 16,794

(1) Tax was calculated at the pre-tax effect of the adjustment multiplied by the applicable tax rate of 0.51% for the twelve months ended September 30, 2021. The applicable tax rate reflects the taxable jurisdiction and nature, being on account of capital or income, of the significant item.

Calculation of Adjusted ROIC

(in millions of Canadian dollars, except for percentages)	For the twelve months ended September 30 2021	2020
Adjusted return	**$ 2,887**	$ 2,720
Adjusted average invested capital	**$ 18,184**	$ 16,794
Adjusted ROIC	**15.9 %**	16.2 %

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, the acquisition-related transaction costs paid in cash, the merger termination payment received and the payment to KCS related to the pending KCS transaction, and the acquisition of Central Maine & Québec Railway ("CMQ"). Free cash is a measure that management considers to be a valuable indicator of liquidity. Free cash is useful to investors and other external users of the Company's Consolidated Financial Statements as it assists with the evaluation of the Company's ability to generate cash to satisfy debt obligations and discretionary activities such as dividends, share repurchase programs, and other strategic opportunities. The acquisition-related transaction costs paid in cash and the merger termination payment received related to the pending KCS transaction are not indicative of operating trends and have been excluded from Free cash. The payment to KCS and the acquisition of CMQ are not indicative of investment trends and have also been excluded from Free cash. 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 of Canadian dollars)	For the three months ended September 30		For the nine months ended September 30	
	2021	2020	**2021**	2020
Cash provided by operating activities	**$ 548**	$ 493	**$ 3,084**	$ 1,817
Cash used in investing activities	**(2,129)**	(483)	**(2,820)**	(1,313)
Effect of foreign currency fluctuations on U.S. dollar-denominated cash and cash equivalents	**10**	(4)	**6**	12
Less:				
Acquisition-related costs	**(1)**	—	**(47)**	—
Merger termination fee	**—**	—	**845**	—
Payment to Kansas City Southern	**(1,773)**	—	**(1,773)**	—
Investment in Central Maine and Québec Railway	**—**	—	**—**	19
Free cash	**$ 203**	$ 6	**$ 1,245**	$ 497

Foreign Exchange Adjusted % Change

FX adjusted % change 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 % changes in revenues are further used in calculating FX adjusted % change in freight revenue per carload and RTM. These items are presented in Operating Revenues of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

	For the three months ended September 30				
(in millions of Canadian dollars)	**Reported 2021**	Reported 2020	Variance due to FX	FX Adjusted 2020	FX Adjusted % Change
Freight revenues by line of business					
Grain	**$ 352**	$ 457	$ (11)	$ 446	(21)
Coal	**158**	130	(1)	129	22
Potash	**113**	132	(3)	129	(12)
Fertilizers and sulphur	**72**	65	(3)	62	16
Forest products	**89**	85	(4)	81	10
Energy, chemicals and plastics	**392**	321	(12)	309	27
Metals, minerals and consumer products	**196**	152	(7)	145	35
Automotive	**83**	94	(4)	90	(8)
Intermodal	**441**	385	(5)	380	16
Freight revenues	**1,896**	1,821	(50)	1,771	7
Non-freight revenues	**46**	42	—	42	10
Total revenues	**$ 1,942**	$ 1,863	$ (50)	$ 1,813	7

(in millions of Canadian dollars)	For the nine months ended September 30 **Reported 2021**	Reported 2020	Variance due to FX	FX Adjusted 2020	FX Adjusted % Change
Freight revenues by line of business					
Grain	**$ 1,244**	$ 1,321	$ (41)	$ 1,280	(3)
Coal	**491**	411	(4)	407	21
Potash	**348**	390	(14)	376	(7)
Fertilizers and sulphur	**227**	212	(12)	200	14
Forest products	**259**	244	(15)	229	13
Energy, chemicals and plastics	**1,149**	1,153	(47)	1,106	4
Metals, minerals and consumer products	**535**	474	(27)	447	20
Automotive	**289**	215	(12)	203	42
Intermodal	**1,280**	1,153	(23)	1,130	13
Freight revenues	**5,822**	5,573	(195)	5,378	8
Non-freight revenues	**133**	125	(1)	124	7
Total revenues	**$ 5,955**	$ 5,698	$ (196)	$ 5,502	8

FX adjusted % changes in operating expenses are presented in Operating Expenses of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

(in millions of Canadian dollars)	For the three months ended September 30 **Reported 2021**	Reported 2020	Variance due to FX	FX Adjusted 2020	FX Adjusted % Change
Compensation and benefits	**$ 381**	$ 382	$ (7)	$ 375	2
Fuel	**199**	140	(6)	134	49
Materials	**51**	53	—	53	(4)
Equipment rents	**31**	39	(2)	37	(16)
Depreciation and amortization	**203**	195	(3)	192	6
Purchased services and other	**303**	275	(6)	269	13
Total operating expenses	**$ 1,168**	$ 1,084	$ (24)	$ 1,060	10

(in millions of Canadian dollars)	For the nine months ended September 30 **Reported 2021**	Reported 2020	Variance due to FX	FX Adjusted 2020	FX Adjusted % Change
Compensation and benefits	**$ 1,165**	$ 1,127	$ (24)	$ 1,103	6
Fuel	**623**	483	(25)	458	36
Materials	**164**	162	(3)	159	3
Equipment rents	**92**	108	(7)	101	(9)
Depreciation and amortization	**605**	582	(12)	570	6
Purchased services and other	**932**	853	(27)	826	13
Total operating expenses	**$ 3,581**	$ 3,315	$ (98)	$ 3,217	11

Adjusted Net Debt to Adjusted EBITDA Ratio

Adjusted net debt to Adjusted earnings before interest, tax, depreciation and amortization ("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. The Adjusted net debt to Adjusted EBITDA ratio, which is reconciled below from the Long-term debt to Net income ratio, the most comparable measure calculated in accordance with GAAP, is also 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 Long-term Debt to Net Income Ratio

(in millions of Canadian dollars, except for ratios)		2021		2020
Long-term debt including long-term debt maturing within one year as at September 30	**$**	**9,968**	$	9,786
Net income for the twelve months ended September 30	**$**	**3,122**	$	2,306
Long-term debt to Net income ratio		**3.2**		4.2

Reconciliation of Long-term Debt to Adjusted Net Debt

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, operating lease liabilities recognized on the Company's Consolidated Balance Sheets, and Cash and cash equivalents.

(in millions of Canadian dollars)		2021		2020
Long-term debt including long-term debt maturing within one year as at September 30	**$**	**9,968**	$	9,786
Add:				
Pension plans deficit[(1)]		**323**		287
Operating lease liabilities		**274**		325
Less:				
Cash and cash equivalents		**210**		183
Adjusted net debt as at September 30	**$**	**10,355**	$	10,215

[(1)] Pension plans deficit is the total funded status of the Pension plans in deficit only.

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

Earnings before interest and tax ("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 expense (income). Adjusted EBITDA is calculated as Adjusted EBIT plus operating lease expense and Depreciation and amortization, less Other components of net periodic benefit recovery.

	For the twelve months ended September 30			
(in millions of Canadian dollars)		2021		2020
Net income as reported	**$**	**3,122**	$	2,306
Add:				
Net interest expense		**427**		458
Income tax expense		**812**		795
EBIT		**4,361**		3,559
Less significant items (pre-tax):				
Acquisition-related costs		**(442)**		—
Merger termination fee		**845**		—
Impact of FX translation gain (loss) on debt and lease liabilities		**142**		(52)
Adjusted EBIT		**3,816**		3,611
Add:				
Operating lease expense		**71**		79
Depreciation and amortization		**802**		760
Less:				
Other components of net periodic benefit recovery		**371**		344
Adjusted EBITDA	**$**	**4,318**	$	4,106

Calculation of Adjusted Net Debt to Adjusted EBITDA Ratio

(in millions of Canadian dollars, except for ratios)	**2021**	2020
Adjusted net debt as at September 30	**$ 10,355**	$ 10,215
Adjusted EBITDA for the twelve months ended September 30	**$ 4,318**	$ 4,106
Adjusted net debt to Adjusted EBITDA ratio	**2.4**	2.5

Off-Balance Sheet Arrangements

Guarantees

As at September 30, 2021, the Company had residual value guarantees on operating lease commitments of $1 million. 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 of these guarantees. All or a portion of amounts paid under certain guarantees could be recoverable from other parties or through insurance. The Company accrues for all guarantees that it expects to pay. As at September 30, 2021, these accruals amounted to $18 million (December 31, 2020 - $18 million).

Contractual Commitments

The following table indicates the Company's obligations and commitments to make future payments for contracts such as debt, leases, and commercial arrangements as at September 30, 2021.

Payments due by period (in millions of Canadian dollars)	**Total**	2021	2022 & 2023	2024 & 2025	Thereafter
Contractual commitments					
Interest on long-term debt and finance leases	**$ 10,516**	$ 63	$ 763	$ 692	$ 8,998
Long-term debt	**9,909**	728	1,583	975	6,623
Finance leases	**143**	2	112	15	14
Operating leases	**305**	12	121	80	92
Supplier purchases	**1,688**	208	1,195	97	188
Other long-term liabilities(1)	**457**	16	102	99	240
Total contractual commitments	**$ 23,018**	$ 1,029	$ 3,876	$ 1,958	$ 16,155

(1) Includes expected cash payments for environmental remediation, post-retirement benefits, workers' compensation benefits, long-term disability benefits, pension benefit payments for the Company's non-registered supplemental pension plan, and certain other long-term liabilities. Projected payments for post-retirement benefits, workers' compensation benefits, and long-term disability benefits include the anticipated payments for years 2021 to 2030. 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 2020 Annual Report on Form 10-K.

Certain Other Financial Commitments

In addition to the financial commitments mentioned previously in Off-Balance Sheet Arrangements and those mentioned above, 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 primarily to track and rolling stock programs. Payments for these commitments are due in 2021 through 2032. These expenditures are expected to be financed by cash generated from operations or by issuing new debt.

The following table outlines the Company’s commitments to make future payments for letters of credit and capital expenditures as at September 30, 2021:

Payments due by period (in millions of Canadian dollars)	Total	2021	2022 & 2023	2024 & 2025	Thereafter
Certain other financial commitments					
Letters of credit	**$ 59**	$ 46	$ 13	$ —	$ —
Capital commitments	**495**	83	308	46	58
Total certain other financial commitments	**$ 554**	$ 129	$ 321	$ 46	$ 58

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 2020 Annual Report on Form 10-K.

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

Forward-Looking Statements

This Management's Discussion and Analysis of Financial Condition and Results of Operations 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*, Section 21E of the United States Exchange Act, as amended and Section 27A of the United States Securities Act of 1933, as amended and forward-looking information within the meaning of other relevant securities legislation, including applicable securities laws in Canada (collectively referred to herein as "forward-looking statements"). Forward-looking statements typically include 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 forecasts or targets using Non-GAAP financial measures, the Company may not be able to provide a reconciliation to a GAAP measure without unreasonable efforts, due to unknown variables and uncertainty related to future results. This Management's Discussion and Analysis of Financial Condition and Results of Operations and Quarterly Report on Form 10-Q includes forward-looking statements relating, but not limited to, statements concerning 2021 volume as measured in revenue ton-miles, Adjusted diluted EPS, capital program investments, the U.S.-to-Canadian dollar exchange rate and expected impacts resulting from changes therein, annualized effective tax rate, other components of net periodic benefit recovery, and the expected outcome of litigation against the Company, the purpose of which is to assist readers in understanding our expected and targeted financial results, and this information may not be appropriate for other purposes.

The forward-looking statements contained in this Management’s Discussion and Analysis of Financial Condition and Results of Operations and Quarterly Report on Form 10-Q are based on current expectations, estimates, projections and assumptions, having regard to the Company's experience and its perception of historical trends, and includes, but is not limited to, expectations, estimates, projections and assumptions relating to: changes in business strategies; North American and global economic growth; commodity demand growth; sustainable industrial and agricultural production; commodity prices and interest rates; foreign exchange rates (as specified herein); effective tax rates (as specified herein); performance of our assets and equipment; sufficiency of our budgeted capital expenditures in carrying out our business plan; geopolitical conditions; applicable laws, regulations and government policies; the availability and cost of labour, services and infrastructure; the satisfaction by third parties of their obligations to the Company; the anticipated impacts of the COVID-19 pandemic on the Company’s business, operating results, cash flows and/or financial condition; and plans to reduce GHG emissions. Although the Company believes the expectations, estimates, projections and assumptions reflected in the forward-looking statements presented herein are reasonable as of the date hereof, there can be no assurance that they will prove to be correct. Current conditions, economic and otherwise, render assumptions, although reasonable when made, subject to greater uncertainty.

Specifically with respect to GHG emissions, we can provide no assurance that CP's plans to reduce GHG emissions per our commitments and aspirations will be viable or successful. The primary risks associated with achieving these commitments could include but are not limited to (a) future investments in and the availability of carbon emissions-reduction tools and technologies, (b) CP’s ability to work with governments and third parties to mitigate the impacts of climate change, (c) domestic and international economic conditions, including exchange rates, (d) the effects of competition and regulation, (e) uncertainties in the financial markets, (f) capital spending, (g) actions of vendors, (h) the willingness of customers to acquire our services, (i) cost of network expansion, maintenance and retrofits, and (j) physical impact of climate change on our business. The commitments are subject to the successful implementation of the actions and plans outlined in the Climate Strategy as well as the accuracy of the assumptions in the science-based methodology used to calculate these targets.

Undue reliance should not be placed on forward-looking statements as actual results may differ materially from those expressed or implied by forward-looking statements. By their nature, forward-looking statements involve numerous inherent risks and uncertainties that could cause actual results to differ materially from the forward-looking statements, including but not limited to the following factors: changes in business strategies and strategic opportunities; general Canadian, U.S., Mexican and global social, economic, political, credit and business conditions; risks associated with agricultural production such as weather conditions and insect populations; the availability and price of energy commodities; the effects of competition and pricing pressures, including competition from other rail carriers, trucking companies and maritime shippers in Canada, the U.S. and Mexico; North American and global economic growth; industry capacity; shifts in market demand; changes in commodity prices and commodity demand; uncertainty surrounding timing and volumes of commodities being shipped via CP; inflation; geopolitical instability; changes in laws, regulations and government policies, including regulation of rates; changes in taxes and tax rates; potential increases in maintenance and operating costs; changes in fuel prices; disruption in fuel supplies; uncertainties of investigations, proceedings or other types of claims and litigation; compliance with environmental regulations; labour disputes; changes in labour costs and labour difficulties; risks and liabilities arising from derailments; transportation of dangerous goods; timing of completion of capital and maintenance projects; sufficiency of budgeted capital expenditures in carrying out business plans; services and infrastructure; the satisfaction by third parties of their obligations; currency and interest rate fluctuations; exchange rates; effects of changes in market conditions and discount rates on the financial position of pension plans and investments; trade restrictions or other changes to international trade arrangements; the effects of current and future multinational trade agreements on the level of trade among Canada, the U.S. and Mexico; climate change and the market and regulatory responses to climate change; ability to achieve commitments and aspirations relating to reducing GHG emissions and other climate-related objectives; anticipated in-service dates; success of hedging activities; operational performance and reliability; customer, shareholder, regulatory and other stakeholder approvals and support; regulatory and legislative decisions and actions; the adverse impact of any termination or revocation by the Mexican government of Kansas City Southern de México, S.A. de C.V.'s Concession; public opinion; various events that could disrupt operations, including severe weather, such as droughts, floods, avalanches and earthquakes, and cybersecurity attacks, as well as security threats and governmental response to them, and technological changes; acts of terrorism, war or other acts of violence or crime or risk of such activities; insurance coverage limitations; material adverse changes in economic and industry conditions, including the availability of short and long-term financing; the pandemic created by the outbreak of COVID-19 and its variants, and resulting effects on economic conditions, the demand environment for logistics requirements and energy prices, restrictions imposed by public health authorities or governments, fiscal and monetary policy responses by governments and financial institutions, and disruptions to global supply chains; the timing and completion of the pending KCS transaction, including receipt of regulatory and shareholder approvals and the satisfaction of other conditions precedent; interloper risk to the pending KCS transaction; the realization of anticipated benefits and synergies of the transaction and the timing thereof; the success of integration plans for KCS; the focus of management time and attention on the pending KCS transaction and other disruptions arising from the transaction; estimated future dividends; financial strength and flexibility; debt and equity market conditions, including the ability to access capital markets on favourable terms or at all; cost of debt and equity capital; potential changes in CP's share price which may negatively impact the value of consideration offered to KCS stockholders; and the ability of the management of CP, its subsidiaries and affiliates to execute key priorities, including those in connection with the pending KCS transaction. The foregoing list of factors is not exhaustive. There are more specific factors that could cause actual results to differ materially from those described in the forward-looking statements contained in this Management's Discussion and Analysis of Financial Condition and Results of Operations and Quarterly Report on Form 10-Q. These more specific factors are identified and discussed in Item 1A. Risk Factors of CP's 2020 Annual Report on Form 10-K. Additionally, specific risk factors related to pending KCS transaction are included in Item 1A. Risk Factors of this Quarterly Report on Form 10-Q. Other risks are detailed from time to time in reports filed by CP with securities regulators in Canada and the United States.

The forward-looking statements contained in this Management's Discussion and Analysis of Financial Condition and Results of Operations and Quarterly Report on Form 10-Q are made as of the date hereof. Except as required by law, CP undertakes no obligation to update publicly or otherwise revise any forward-looking statements, or the foregoing assumptions and risks affecting such forward-looking statements, whether as a result of new information, future events or otherwise.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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 (2020 - approximately $30 million), negatively (or positively) impacts Operating expenses by approximately $14 million (2020 - approximately $15 million), and negatively (or positively) impacts Net interest expense by approximately $3 million (2020 - approximately $3 million).

CP uses U.S. dollar-denominated long-term debt to hedge its net investment in U.S. operations. As at September 30, 2021, the net investment in U.S. operations is less than the total U.S. dollar-denominated long-term debt. Consequently, FX translation on the Company's undesignated debt and lease liabilities causes additional impacts on earnings in Other expense (income). For further information on the net investment hedge, please refer to Financial Statements, Note 17 Financial instruments of CP's 2020 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

Based on information available at September 30, 2021, for every $1.00 change in share price, stock-based compensation expense has a corresponding change of approximately $2.4 million to $2.7 million (2020 - approximately $2.0 million to $2.8 million). This excludes the impact of changes in share price relative to the S&P/TSX 60 Index and to Class I railways which may trigger different performance share unit payouts. Stock-based compensation may also be impacted by non-market performance conditions.

Additional information concerning stock-based compensation is included in Item 1. Financial Statements, Note 15 Stock-based compensation.

Interest Rate Risk

Debt financing forms part of the Company's capital structure. The debt agreements entered into expose CP to increased interest costs on future fixed debt instruments and existing variable rate debt instruments, should market rates increase. As at September 30, 2021, a hypothetical one percentage point change in interest rates on the Company's floating rate debt obligations outstanding is not material. In addition, the present value of the Company's assets and liabilities will also vary with interest rate changes. To manage interest rate exposure, CP may enter into forward rate agreements such as treasury rate locks or bond locks that lock in rates for a future date, thereby protecting against interest rate increases. CP may also enter into swap agreements whereby one party agrees to pay a fixed rate of interest while the other party pays a floating rate. Contingent on the direction of interest rates, the Company may incur higher costs depending on the contracted rate.

The fair value of the Company's fixed rate debt may fluctuate with changes in market interest rates. A hypothetical one percentage point decrease in interest rates as of September 30, 2021 would result in an increase of approximately $1.3 billion to the fair value of the Company's debt as at September 30, 2021 (2020 - approximately $1.5 billion). Fair values of CP's fixed rate debt are estimated by considering the impact of the hypothetical interest rates on quoted market prices and current borrowing rates, but do not consider other factors that could impact actual results.

As at September 30, 2021, the Company had forward starting swap and bond lock agreements totalling a notional U.S. $2.4 billion and $600 million, respectively, to fix the benchmark rate on cash flows associated with forecasted issuances of long-term notes (2020 - $nil). A hypothetical one basis point change in interest rates as of September 30, 2021 would result in a change in unrealized gains or losses of approximately $6 million.

Information concerning market risks is supplemented in Item 1. Financial Statements, Note 12 Financial instruments.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

As of September 30, 2021, 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, 2021, 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 2021, 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.

PART II

ITEM 1A. RISK FACTORS

There have been no material changes to the risk factors from the information provided in Item 1A. Risk Factors of CP's 2020 Annual Report on Form 10-K, with the exception of those discussed below.

Risks Related to the Pending Kansas City Southern Transaction

There is no assurance when or if the transaction will be completed. Completion of the transaction is subject to the satisfaction or waiver of a number of conditions as set forth in the Merger Agreement, including certain regulatory approvals and other customary closing conditions. There can be no assurance that the conditions to completion of the transaction will be satisfied or waived or that other events will not intervene to delay or result in the failure to close the transaction such as interloper risk to the pending KCS transaction. In addition, each of the Company and KCS may unilaterally terminate the Merger Agreement under certain circumstances set forth in the Merger Agreement, and the Company and KCS may agree at any time to terminate the Merger Agreement. If the Company were to terminate the Merger Agreement under certain circumstances, we could incur significant costs (including, without limitation, the payment of a U.S. $1 billion regulatory termination fee).

The announcement and pendency of the transaction could have an adverse effect on the Company’s businesses, results of operations, financial condition, cash flows or the market value of the Company’s common stock and debt securities. The announcement and pendency of the transaction could disrupt the Company’s businesses, and uncertainty about the effect of the transaction may have an adverse effect on the Company or the combined company following the transaction. The attention of the Company’s management may be directed towards the completion of the transaction including obtaining regulatory approvals and other transaction-related considerations and may be diverted from the day-to-day business operations of the Company and matters related to the transaction may require commitments of time and resources that could otherwise have been devoted to other opportunities that might have been beneficial to the Company. Additionally, the Merger Agreement requires the Company to obtain KCS’s consent prior to taking certain specified actions while the transaction is pending. These restrictions may prevent the Company and KCS from pursuing otherwise attractive business opportunities prior to the consummation of the transaction. Further, the transaction may give rise to potential liabilities, including as a result of pending and future shareholder lawsuits relating to the transaction. In addition, the Company has incurred, and expects to incur additional, material non-recurring expenses in connection with the transaction and consummation of the transactions contemplated by the Merger Agreement. Any of these matters could adversely affect the businesses of, or harm the results of operations, financial condition or cash flows of the Company and the market value of the Company’s common stock.

The Company may be unable to integrate KCS successfully, and the Company may not experience the growth being sought from the transaction. The Company and KCS have operated and, until the receipt of final approval from the STB, will continue to operate, independently. Coordinating certain aspects of the operations and personnel of the Company with KCS after the consummation of the transaction will involve complex operational, technological and personnel-related challenges, which may be made more difficult in light of the COVID-19 pandemic. This process will be time-consuming and expensive, may disrupt the businesses of either or both of the companies and may reduce the growth opportunities sought from the transaction.

Consummation of the transaction will result in the Company incurring substantial indebtedness, which may pose risks and/or intensify existing risks. In connection with the transaction, the Company expects to incur approximately U.S. $12.3 billion of additional indebtedness relative to debt balances outstanding as at September 30, 2021, as a result of obtaining financing to complete the transaction and refinancing of debt assumed in the transaction as required. In addition, in connection with the transaction, the existing indebtedness of KCS is expected to remain outstanding to the extent the transaction closes into the voting trust.

The foregoing indebtedness, as well as any additional indebtedness we may incur, could have the effect, among other things, of reducing our liquidity and may limit our flexibility in responding to other business opportunities and increasing our vulnerability to adverse economic and industry conditions.

Our ability to make payments of principal and interest on our indebtedness depends upon our future performance, which will be subject to general economic, financial and business conditions, sufficient cash flow from KCS during the period in which it is in the voting trust (if closing of the transaction occurs), the implementation of the integration with KCS (if closing of the transaction occurs and the STB approves our assuming control of KCS) and other factors affecting our operations, many of which are beyond our control.

Our increased indebtedness could also reduce funds available for working capital, capital expenditures, acquisitions and other general corporate purposes and may create competitive disadvantages relative to other companies with lower debt levels. If we complete the transaction of KCS and obtain control of KCS but we do not achieve the expected benefits and cost savings from the transaction, or if the financial performance of the combined company does not meet current expectations, then our ability to service our indebtedness may be adversely impacted.

The agreements that will govern the indebtedness that would be incurred in connection with the transaction, if it is consummated, may contain various affirmative and negative covenants that may, subject to certain customary exceptions, restrict our ability to, among other things, create liens over our property, change our line of business and/or merge or consolidate with any other person or sell or convey certain of our assets to another person. In addition, some of the agreements that will govern our new debt financings may contain financial covenants that will require us to maintain certain financial ratios. Various risks, uncertainties and events beyond our control could affect our ability to comply with these covenants and failure to comply with them could result in an event of default, which, if not cured or waived, could accelerate our repayment obligations. Under these circumstances, we may not have sufficient funds or other resources to satisfy all of our obligations.

Moreover, we may be required to raise substantial additional financing to fund working capital, capital expenditures, acquisitions or other general corporate requirements. Our ability to arrange additional financing or refinancing will depend on, among other factors, our financial position and performance, as well as prevailing market conditions and other factors beyond our control. There can be no assurance that we will be able to obtain additional financing or refinancing on terms acceptable to us or at all.