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

The following discussion and analysis should be read in conjunction with the Company's Interim Consolidated Financial Statements and the related notes for the three months ended March 31, 2019 in Item 1. Financial Statements, other information in this report, and Item 8. Financial Statements and Supplementary Data of the Company's 2018 Annual Report on Form 10-K. Except where otherwise indicated, all financial information reflected herein is expressed in Canadian dollars.

For purposes of this report, all references herein to “CP”, “the Company”, “we”, “our” and “us” refer to CPRL, CPRL and its subsidiaries, CPRL and one or more of its subsidiaries, or one or more of CPRL's subsidiaries, as the context may require.

Available Information

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

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

Executive Summary

First Quarter of 2019 Results

During the first quarter of 2019, the Company experienced severe winter operating conditions and an increase in the frequency and severity of casualty incidents and derailments. As a result, the Company incurred significant costs for weather fighting, direct casualty costs, and higher operating costs. During this period and the subsequent network recovery the Company also experienced losses and deferrals of potential revenues.

- *Financial performance* - In the first quarter of 2019, CP reported Diluted earnings per share ("EPS") of $3.09, an increase of 28% as compared to the same period of 2018. Net income was $434 million in the first quarter of 2019, an increase of 25% as compared to the same period in 2018. These increases were primarily due to foreign exchange ("FX") translation gains on debt and lease liabilities in 2019. Adjusted diluted EPS, which excludes the FX translation gains on debt and lease liabilities, was $2.79 in the first quarter of 2019, an increase of 3% compared to the same period of 2018. This increase was primarily due to lower average outstanding shares due to the Company’s share repurchase program.

  CP reported an Operating ratio of 69.3% in the first quarter of 2019, a 180 basis point increase as compared to the same period of 2018. This increase was primarily due to increased operating expense associated with higher casualty costs and additional weather related costs caused by harsh winter operating conditions, partially offset by higher freight revenues mainly driven by higher rates.

  Adjusted diluted EPS is 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 6% in the first quarter of 2019 to $1,767 million from $1,662 million in the same period of 2018. This increase was driven primarily by higher rates and the favourable impact of the change in FX.

- *Operating performance* - CP's average train speed increased by 2% to 21.1 miles per hour due to completion of network infrastructure projects in 2018, partially offset by the impact of harsh winter operating conditions and network disruptions. Average train weight decreased by 1% to 8,868 tons and average train length decreased by 1% to 7,165 feet due to the implementation of CP's winter contingency plan resulting in shorter and lighter trains within the operating plan. These metrics are discussed further in Performance Indicators of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Performance Indicators

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

	For the three months ended March 31		
	2019	2018[(1)]	% Change
Operations Performance			
Gross ton-miles ("GTMs") (millions)	**64,854**	64,411	1
Train miles (thousands)	**7,823**	7,642	2
Average train weight – excluding local traffic (tons)	**8,868**	8,989	(1)
Average train length – excluding local traffic (feet)	**7,165**	7,229	(1)
Average terminal dwell (hours)	**7.9**	7.9	—
Average train speed (miles per hour, or "mph")	**21.1**	20.6	2
Fuel efficiency (U.S. gallons of locomotive fuel consumed / 1,000 GTMs)	**1.014**	0.984	3
Total Employees and Workforce			
Total employees (average)	**12,844**	12,173	6
Total employees (end of period)	**12,995**	12,328	5
Workforce (end of period)	**13,037**	12,398	5
Safety Indicators			
FRA personal injuries per 200,000 employee-hours	**1.97**	1.57	25
FRA train accidents per million train-miles	**1.62**	1.19	36

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

Operations Performance

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

Three months ended March 31, 2019 compared to the three months ended March 31, 2018

- A **GTM** is defined as the movement of one ton of train weight over one mile. GTMs are calculated by multiplying total train weight by the distance the train moved. Total train weight comprises the weight of the freight cars, their contents, and any inactive locomotives. An increase in GTMs indicates additional workload. GTMs increased by 1% in the first quarter of 2019 compared to the same period of 2018. This increase was primarily due to increased volumes of petroleum products, international intermodal, Potash, and Coal, as well as re-routing traffic due to the impact of harsh winter operating conditions and network disruptions. This increase was partially offset by decreased volumes of frac sand, U.S. grain, and crude.

- **Train miles** are defined as the sum of the distance moved by all trains operated on the network. Train miles increased by 2% in the first quarter of 2019 compared to the same period of 2018. This increase reflected the impact of a 1% increase in workload (GTMs) and an increase due to the impact of harsh winter conditions on operating plan productivity.

- **Average train weight** is defined as the average gross weight of CP trains, both loaded and empty. This excludes trains in short-haul service, work trains used to move CP's track equipment and materials, and the haulage of other railroads' trains on CP's network. Average train weight decreased by 1% in the first quarter of 2019 compared to the same period of 2018. This decrease was due to the implementation of CP's winter contingency plan resulting in shorter and lighter trains within the operating plan.

- **Average train length** is defined as the average total length of CP trains, both loaded and empty. This includes all cars and locomotives on the train and is calculated as the sum of each car or locomotive's length multiplied by the distance travelled, divided by train miles. Local trains are excluded from this measure. Average train length decreased by 1% in the first quarter of 2019 compared to the same period of 2018. This decrease was due to the implementation of CP's winter contingency plan resulting in shorter trains within the operating plan.

- **Average terminal dwell** is defined as the average time a freight car resides within terminal boundaries expressed in hours. The timing starts with a train arriving at the terminal, a customer releasing the car to the Company, or a car arriving at interchange from another railroad. The timing ends when the train leaves, a customer receives the car from CP, or the freight car is transferred to another railroad. Freight cars are excluded if they are being stored at the terminal or used in track repairs. Average terminal dwell was unchanged in the first quarter of 2019 compared to the same period of 2018.

- **Average train speed** is defined as a measure of the line-haul movement from origin to destination including terminal dwell hours. It is calculated by dividing the total train miles travelled by the total train hours operated. This calculation does not include delay time related to customers or foreign railroads and excludes the time and distance travelled by: i) trains used in or around CP's yards; ii) passenger trains; and iii) trains used for repairing track. Average train speed increased by 2% in the first quarter of 2019 compared to the same period of 2018. This increase in speed was due to completion of network infrastructure projects in 2018, partially offset by the impact of harsh winter operating conditions and network disruptions.

- **Fuel efficiency** is defined as U.S. gallons of locomotive fuel consumed per 1,000 GTMs. Fuel efficiency decreased by 3% in the first quarter of 2019 compared to the same period of 2018. This decrease in efficiency was primarily due to decreased train and locomotive productivity as a result of harsh winter conditions and network disruptions.

Total Employees and Workforce

An **employee** is defined as an individual currently engaged in full-time, part-time, or seasonal employment with CP. The average number of total employees increased by 6% in first quarter of 2019 compared to the same period of 2018. The total number of employees as at March 31, 2019 was 12,995, an increase of 667, or 5%, compared to 12,328 as at March 31, 2018.

Workforce is defined as total employees plus contractors and consultants. The total workforce as at March 31, 2019 was 13,037, an increase of 639, or 5%, compared to 12,398 as at March 31, 2018. The increases in the number of total employees and workforce is to accommodate current and anticipated volume growth.

Safety Indicators

Safety is a key priority and core strategy for CP's management, employees, and Board of Directors. The Company's two main safety indicators – personal injuries and train accidents – follow strict U.S. Federal Railroad Administration ("FRA") reporting guidelines.

The **FRA personal injuries per 200,000 employee-hours** frequency is the number of personal injuries multiplied by 200,000 and divided by total employee hours. Personal injuries are defined as injuries that require employees to lose time away from work, modify their normal duties or obtain medical treatment beyond minor first aid. FRA employee-hours are the total hours worked, excluding vacation and sick time, by all employees excluding contractors. The FRA personal injuries per 200,000 employee-hours frequency for CP was 1.97 in the first quarter of 2019, an increase from 1.57 in the same period of 2018.

The **FRA train accidents per million train-miles** frequency is the number of train accidents, multiplied by 1,000,000 and divided by total train miles. Train accidents included in this metric meet or exceed the FRA reporting threshold of U.S. $10,700 in damage. The FRA train accidents per million train-miles was 1.62 in the first quarter of 2019, an increase from 1.19 in the same period of 2018.

Financial Highlights

The following table presents selected financial data related to the Company's financial results as of, and for the first quarter ended March 31, 2019 and the comparative figures in 2018. The financial highlights should be read in conjunction with Item 1. Financial Statements and this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

	For the three months ended March 31	
(in millions, except per share data, percentages and ratios)	**2019**	2018
Financial Performance		
Revenues	**$ 1,767**	$ 1,662
Operating income	**543**	540
Net income	**434**	348
Adjusted income[(1)]	**392**	390
Basic EPS	**3.10**	2.41
Diluted EPS	**3.09**	2.41
Adjusted diluted EPS[(1)]	**2.79**	2.70
Dividends declared per share	**0.6500**	0.5625
Cash provided by operating activities	**413**	397
Free cash[(1)]	**193**	164
	As at March 31, 2019	As at December 31, 2018
Financial Position		
Total assets	**$ 21,910**	$ 21,254
Total long-term debt, including current portion	**8,923**	8,696
Shareholders' equity	**6,814**	6,636
	For the twelve months ended March 31	
	2019	2018
Financial Ratios		
Return on invested capital ("ROIC")[(1)]	**15.6%**	19.5%
Adjusted ROIC[(1)]	**15.9%**	14.6%
	For the three months ended March 31	
	2019	2018
Operating ratio[(2)]	**69.3%**	67.5%

(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.

Results of Operations

Three months ended March 31, 2019 compared to the three months ended March 31, 2018

Income

Operating income was $543 million in the first quarter of 2019, an increase of $3 million, or 1%, from $540 million in the same period of 2018. This increase was primarily due to:
- higher freight rates;
- lower fuel price; and
- the favourable impact of the change in FX of $19 million.

This increase was partially offset by:
- increased operating expense associated with higher casualty costs;
- increased weather related costs as a result of harsh winter operating conditions; and
- higher stock-based compensation driven primarily by an increase in the stock price.

Net income was $434 million in the first quarter of 2019, an increase of $86 million, or 25%, from $348 million in the same period of 2018. This increase was primarily due to FX translation gains on debt and lease liabilities compared to FX translation losses on debt in the same period of 2018 and higher operating income, partially offset by higher taxes primarily due to higher taxable income.

Adjusted income, defined and reconciled in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations, was $392 million in the first quarter of 2019, an increase of $2 million, or 1%, from $390 million in the same period of 2018. This increase was primarily due to higher operating income, partially offset by higher taxes primarily due to higher effective tax rates excluding discrete items.

Diluted Earnings per Share

Diluted EPS was $3.09 in the first quarter of 2019, an increase of $0.68, or 28%, from $2.41 in the same period of 2018. This increase was primarily due to higher Net income and the lower average number of outstanding shares due to the Company's share repurchase program.

Adjusted diluted EPS, defined and reconciled in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations, was $2.79 in the first quarter of 2019, an increase of $0.09, or 3%, from $2.70 in the same period of 2018. This increase was primarily due to the lower average number of outstanding shares due to the Company's share repurchase program.

Operating Ratio

The Operating ratio provides the percentage of revenues used to operate the railway. A lower percentage normally indicates higher efficiency in the operation of the railway. The Company's Operating ratio was 69.3% in the first quarter of 2019, a 180 basis point increase from 67.5% in the same period of 2018. This increase was primarily due to:

- increased operating expense associated with higher casualty costs;
- increased weather related costs as a result of harsh winter operating conditions; and
- a higher stock-based compensation driven primarily by an increase in the stock price;

This increase was partially offset by higher freight rates and lower fuel price.

Return on Invested Capital (ROIC)

ROIC is a measure of how productively the Company uses its long-term capital investments, representing critical indicators of good operating and investment decisions made by management, and is an important performance criteria in determining certain elements of the Company's long-term incentive plan. ROIC was 15.6% for the twelve months ended March 31, 2019, a 390 basis point decrease compared to 19.5% for the twelve months ended March 31, 2018. This decrease was due to:

- a higher invested capital base due to higher Retained earnings from Net income;
- higher Income tax expenses due to income tax recoveries from tax rate changes in the twelve months ended March 31, 2018; and
- the unfavourable impact of the change in FX translation on debt and lease liabilities.

This decrease was partially offset by higher operating income and higher Other components of net periodic benefit recoveries.

Adjusted ROIC was 15.9% for the twelve months ended March 31, 2019, a 130 basis point increase compared to 14.6% for the twelve months ended March 31, 2018. This increase was primarily due to higher Adjusted operating income and higher Other components of net periodic benefit recoveries. This was partially offset by the increase in adjusted average Shareholders' equity primarily due to higher Net income and higher tax expense due to higher taxable earnings. ROIC and Adjusted ROIC are defined and reconciled in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

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. In the first quarter of 2019, the impact of a stronger U.S. dollar resulted in an increase in total revenues of $44 million, an increase in total operating expenses of $25 million, and an increase in interest expense of $5 million from the same period in 2018.

On April 19, 2019, the noon buying rate certified for customs purposes by the U.S. Federal Reserve Bank of New York was U.S. $1.00 = $1.34 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. Averages 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)		**2019**		2018
For the three months ended March 31	**$**	**1.33**	$	1.27

Ending Exchange rates (Canadian/U.S. dollar)		**2019**		2018
Beginning of year - January 1	**$**	**1.36**	$	1.25
End of quarter - March 31	**$**	**1.34**	$	1.29

	For the three months ended March 31			
High/Low exchange rates (Canadian/U.S. dollar)		**2019**		2018
High	**$**	**1.36**	$	1.31
Low	**$**	**1.31**	$	1.23

In the first quarter of 2019, the impact of the weaker Canadian dollar relative to the U.S. dollar resulted in an increase in total revenues of $44 million, an increase in operating expenses of $25 million and an increase in net interest expense of $5 million from the same period in 2018.

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 months ended March 31, 2019 and the comparative periods in 2018.

Average Fuel Price (U.S. dollars per U.S. gallon)		**2019**		2018
For the three months ended - March 31	**$**	**2.40**	$	2.70

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

In the first quarter of 2019, the impact of fuel prices on earnings was $23 million. Lower fuel prices resulted in a decrease in total operating expenses of $19 million, and the timing of recoveries from CP's fuel cost adjustment program resulted in an increase in total revenues of $4 million from the same period in 2018.

Impact of Share Price on Earnings

Fluctuations in the Common Share price affect the Company's operating expenses because share-based liabilities are measured at fair value. The following tables indicate the opening and closing CP Common Share price on the Toronto Stock Exchange ("TSX") and the New York Stock Exchange ("NYSE") for the three months ended March 31, 2019 and the comparative periods in 2018.

TSX (in Canadian dollars)		**2019**		2018
Opening Common Share price, as at January 1	**$**	**242.24**	$	229.66
Ending Common Share price, as at March 31	**$**	**275.34**	$	227.20
Change in Common Share price for the three months ended March 31	**$**	**33.10**	$	(2.46)

NYSE (in U.S. dollars)		**2019**		2018
Opening Common Share price, as at January 1	**$**	**177.62**	$	182.76
Ending Common Share price, as at March 31	**$**	**206.03**	$	176.50
Change in Common Share price for the three months ended March 31	**$**	**28.41**	$	(6.26)

In the first quarter of 2019, the impact of the change in Common Share prices resulted in an increase in stock-based compensation expense of $13 million compared to a decrease of $2 million in the same period in 2018.

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

Operating Revenues

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

For the three months ended March 31	**2019**	2018	Total Change	% Change	FX Adjusted % Change[2]
Freight revenues (in millions)[1]	**$ 1,726**	$ 1,625	$ 101	6	3
Non-freight revenues (in millions)	**41**	37	4	11	11
Total revenues (in millions)	**$ 1,767**	$ 1,662	$ 105	6	4
Carloads (in thousands)	**635.6**	649.1	(13.5)	(2)	N/A
Revenue ton-miles (in millions)	**36,002**	36,355	(353)	(1)	N/A
Freight revenue per carload (in dollars)	**$ 2,716**	$ 2,503	$ 213	9	6
Freight revenue per revenue ton-mile (in cents)	**4.79**	4.47	0.32	7	4

(1) Freight revenues include fuel surcharge revenues of $107 million in 2019 and $101 million in 2018. 2019 and 2018 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 $1,726 million in the first quarter of 2019, an increase of $101 million, or 6%, from $1,625 million in the same period of 2018. This increase was primarily due to higher freight revenue per revenue ton-mile due to higher freight rates, the the favourable impact of the change in FX of $44 million, and higher volumes of petroleum products, Potash, and international intermodal. This was partially offset by lower volumes of frac sand, U.S. grain, and crude.

RTMs are defined as the movement of one revenue-producing ton of freight over a distance of one mile. RTMs measure the relative weight and distance of rail freight moved by the Company. RTMs for the first quarter of 2019 were 36,002 million, a decrease of 1% compared with 36,355 million in the same period of 2018. This decrease was mainly attributable to decreases in frac sand, U.S. grain, and crude. This decrease was partially offset by higher volumes of petroleum products, Potash, and international intermodal.

Non-freight revenues were $41 million in the first quarter of 2019, an increase of $4 million, or 11%, from $37 million in the same period of 2018. This increase was primarily due to higher logistical services revenue 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 include fuel surcharge revenues of $107 million in the first quarter of 2019, an increase of $6 million, or 6%, from $101 million in the same period in 2018. This increase was primarily due to the timing of recoveries from CP's fuel cost adjustment program, which represented $4 million of the change.

Lines of Business

Grain

For the three months ended March 31		**2019**		2018		Total Change	% Change	FX Adjusted % Change[(1)]
Freight revenues (in millions)	**$**	**380**	$	357	$	23	6	4
Carloads (in thousands)		**92.8**		97.7		(4.9)	(5)	N/A
Revenue ton-miles (in millions)		**8,352**		8,729		(377)	(4)	N/A
Freight revenue per carload (in dollars)	**$**	**4,089**	$	3,650	$	439	12	9
Freight revenue per revenue ton-mile (in cents)		**4.55**		4.09		0.46	11	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 $380 million in the first quarter of 2019, an increase of $23 million, or 6%, from $357 million in the same period of 2018. The increase was primarily driven by increased freight revenue per revenue ton-mile, and the favourable impact of the change in FX. This increase was partially offset by lower volumes of U.S. grain, primarily corn, to the Pacific Northwest. Freight revenue per revenue ton-mile increased due to higher freight rates, primarily for regulated Canadian grain.

Coal

For the three months ended March 31		**2019**		2018		Total Change	% Change	FX Adjusted % Change[(1)]
Freight revenues (in millions)	**$**	**158**	$	151	$	7	5	3
Carloads (in thousands)		**70.4**		72.8		(2.4)	(3)	N/A
Revenue ton-miles (in millions)		**5,232**		5,218		14	—	N/A
Freight revenue per carload (in dollars)	**$**	**2,237**	$	2,079	$	158	8	7
Freight revenue per revenue ton-mile (in cents)		**3.01**		2.90		0.11	4	3

(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 first quarter of 2019, an increase of $7 million, or 5%, from $151 million in the same period of 2018. This increase was primarily due to increased freight revenue per revenue ton-mile, and the favourable impact of the change in FX. Freight revenue per revenue ton-mile increased due to higher freight rates. RTMs increased more than carloads due to moving proportionately more Canadian coal, which has a longer length of haul.

Potash

For the three months ended March 31		**2019**		2018		Total Change	% Change	FX Adjusted % Change[(1)]
Freight revenues (in millions)	**$**	**114**	$	112	$	2	2	(2)
Carloads (in thousands)		**37.9**		37.3		0.6	2	N/A
Revenue ton-miles (in millions)		**4,573**		4,381		192	4	N/A
Freight revenue per carload (in dollars)	**$**	**2,996**	$	3,010	$	(14)	—	(3)
Freight revenue per revenue ton-mile (in cents)		**2.48**		2.56		(0.08)	(3)	(6)

(1) FX Adjusted % Change does not have any standardized meaning prescribed by GAAP and, therefore, is unlikely to be comparable to similar measures presented by other companies. FX Adjusted % 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 $114 million in the first quarter of 2019, an increase of $2 million, or 2%, from $112 million in the same period of 2018. This increase was primarily due to higher export potash volumes, and the favourable impact of the change in FX. Freight revenue per revenue ton-mile decreased due to moving proportionately more export volumes through the Port of Vancouver, which have a longer length of haul.

Fertilizers and Sulphur

For the three months ended March 31	2019	2018	Total Change	% Change	FX Adjusted % Change[1]
Freight revenues (in millions)	**$ 57**	$ 61	$ (4)	(7)	(8)
Carloads (in thousands)	**13.7**	14.9	(1.2)	(8)	N/A
Revenue ton-miles (in millions)	**902**	1,061	(159)	(15)	N/A
Freight revenue per carload (in dollars)	**$ 4,197**	$ 4,074	$ 123	3	—
Freight revenue per revenue ton-mile (in cents)	**6.38**	5.74	0.64	11	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.

Fertilizers and sulphur revenue was $57 million in the first quarter of 2019, a decrease of $4 million, or 7%, from $61 million in the same period of 2018. This decrease was primarily due to lower sulphur and wet fertilizer volumes. This decrease was partially offset by the favourable impact of the change in FX, and increased freight revenue per revenue ton-mile. Freight revenue per revenue ton-mile increased due to higher freight rates. RTMs decreased more than carloads due to moving proportionately less wet fertilizer to the U.S. Midwest, which has a longer length of haul.

Forest Products

For the three months ended March 31	2019	2018	Total Change	% Change	FX Adjusted % Change[1]
Freight revenues (in millions)	**$ 73**	$ 66	$ 7	11	7
Carloads (in thousands)	**17.1**	16.7	0.4	2	N/A
Revenue ton-miles (in millions)	**1,179**	1,122	57	5	N/A
Freight revenue per carload (in dollars)	**$ 4,288**	$ 3,937	$ 351	9	5
Freight revenue per revenue ton-mile (in cents)	**6.23**	5.84	0.39	7	3

(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 $73 million in the first quarter of 2019, an increase of $7 million, or 11%, from $66 million in the same period of 2018. This increase was due to higher volumes of newsprint, woodpulp, and lumber, the favourable impact of the change in FX, and increased freight revenue per ton-mile. Freight revenue per revenue ton-mile increased due to higher freight rates. RTMs increased more than carloads due to moving proportionately more newsprint and woodpulp to Chicago, which has a longer length of haul.

Energy, Chemicals and Plastics

For the three months ended March 31	2019	2018	Total Change	% Change	FX Adjusted % Change[1]
Freight revenues (in millions)	**$ 315**	$ 257	$ 58	23	18
Carloads (in thousands)	**78.8**	74.2	4.6	6	N/A
Revenue ton-miles (in millions)	**6,359**	6,157	202	3	N/A
Freight revenue per carload (in dollars)	**$ 3,998**	$ 3,468	$ 530	15	12
Freight revenue per revenue ton-mile (in cents)	**4.96**	4.18	0.78	19	15

(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.

Energy, chemicals and plastics revenue was $315 million in the first quarter of 2019, an increase of $58 million, or 23%, from $257 million in the same period of 2018. This increase was primarily due to increased freight revenue per revenue ton-mile, higher volumes of liquefied petroleum gas ("L.P.G."), fuel oil and diluents, and the favourable impact of the change in FX. This increase was partially offset by lower volumes of crude oil due to the Government of Alberta's production curtailments. Freight revenue per revenue ton-mile increased due to higher freight rates. Carloads increased more than RTMs due to moving proportionately less crude to Kansas City, which has a longer length of haul.

Metals, Minerals and Consumer Products

For the three months ended March 31		2019		2018		Total Change	% Change	FX Adjusted % Change[(1)]
Freight revenues (in millions)	**$**	**173**	$	183	$	(10)	(5)	(9)
Carloads (in thousands)		**53.5**		58.6		(5.1)	(9)	N/A
Revenue ton-miles (in millions)		**2,448**		2,924		(476)	(16)	N/A
Freight revenue per carload (in dollars)	**$**	**3,239**	$	3,126	$	113	4	(1)
Freight revenue per revenue ton-mile (in cents)		**7.07**		6.27		0.80	13	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.

Metals, minerals and consumer products revenue was $173 million in the first quarter of 2019, a decrease of $10 million, or 5%, from $183 million in the same period of 2018. This decrease was primarily due to moving lower volumes of frac sand. This decrease was partially offset by the favourable impact of the change in FX, and increased freight revenue per revenue ton-mile. Freight revenue per revenue ton-mile increased due to higher freight rates. RTMs decreased more than carloads due to increased volumes of short haul metallic ore.

Automotive

For the three months ended March 31		2019		2018		Total Change	% Change	FX Adjusted % Change[(1)]
Freight revenues (in millions)	**$**	**76**	$	71	$	5	7	3
Carloads (in thousands)		**25.1**		25.5		(0.4)	(2)	N/A
Revenue ton-miles (in millions)		**335**		305		30	10	N/A
Freight revenue per carload (in dollars)	**$**	**3,048**	$	2,792	$	256	9	4
Freight revenue per revenue ton-mile (in cents)		**22.84**		23.32		(0.48)	(2)	(6)

(1) FX Adjusted % Change does not have any standardized meaning prescribed by GAAP and, therefore, is unlikely to be comparable to similar measures presented by other companies. FX Adjusted % 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.

Automotive revenue was $76 million in the first quarter of 2019, an increase of $5 million, or 7%, from $71 million in the same period of 2018. This increase was primarily due to higher revenue ton-miles of trucks and automobiles, and the favourable impact of the change in FX. RTMs increased due to growth in long haul volumes from Vancouver to eastern Canada. Carloads decreased as a result of lower short haul volumes from Ontario to Illinois and Michigan due to an extended plant recalibration.

Intermodal

For the three months ended March 31		2019		2018		Total Change	% Change	FX Adjusted % Change[(1)]
Freight revenues (in millions)	**$**	**380**	$	367	$	13	4	2
Carloads (in thousands)		**246.3**		251.4		(5.1)	(2)	N/A
Revenue ton-miles (in millions)		**6,622**		6,458		164	3	N/A
Freight revenue per carload (in dollars)	**$**	**1,542**	$	1,458	$	84	6	4
Freight revenue per revenue ton-mile (in cents)		**5.74**		5.68		0.06	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.

Intermodal revenue was $380 million in the first quarter of 2019, an increase of $13 million, or 4%, from $367 million in the same period of 2018. This increase was primarily due to higher international volumes through the Port of Vancouver, the onboarding of a new domestic retail customer, and the favourable impact of the change in FX. RTMs increased while carloads decreased due to discontinuing expressway service, which had a shorter length of haul.

Operating Expenses

For the three months ended March 31 (in millions)	**2019**	2018	Total Change	% Change	FX Adjusted % Change[(1)]
Compensation and benefits	**$ 406**	$ 374	$ 32	9	7
Fuel	**209**	215	(6)	(3)	(7)
Materials	**57**	55	2	4	4
Equipment rents	**35**	33	2	6	—
Depreciation and amortization	**160**	170	(10)	(6)	(7)
Purchased services and other	**357**	275	82	30	27
Total operating expenses	**$ 1,224**	$ 1,122	$ 102	9	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.

Operating expenses were $1,224 million in the first quarter of 2019, an increase of $102 million, or 9%, from $1,122 million in the same period of 2018. This increase was primarily due to:

- increased operating expense associated with higher casualty costs;
- increased weather related costs as a result of harsh winter operating conditions;
- the unfavourable impact of the change in FX of $25 million; and
- higher stock-based compensation driven primarily by an increase in the stock price;

This increase was partially offset by lower fuel price and other reductions.

Compensation and Benefits

Compensation and benefits expense includes employee wages, salaries, fringe benefits, and stock-based compensation. Compensation and benefits expense was $406 million in the first quarter of 2019, an increase of $32 million, or 9%, from $374 million in the same period of 2018. This increase was primarily due to:

- higher stock-based compensation driven primarily by an increase in the stock price;
- harsher winter operating conditions;
- the unfavourable impact of change in FX of $6 million; and
- wage and benefit inflation.

This increase was partially offset by lower incentive compensation.

Fuel

Fuel expense consists mainly of fuel used by locomotives and includes provincial, state, and federal fuel taxes. Fuel expense was $209 million in the first quarter of 2019, a decrease of $6 million, or 3%, from $215 million in the same period of 2018. This decrease was primarily due to the favourable impact of $19 million from lower fuel prices.

This decrease was partially offset by a decrease in fuel efficiency of approximately 3% due to decreased train and locomotive productivity as a result of harsh winter operating conditions and network disruptions and the unfavourable impact of the change in FX of $9 million.

Materials

Materials expense includes the cost of material used for track, locomotive, freight car, and building maintenance and software sustainment. Materials expense was $57 million in the first quarter of 2019, an increase of $2 million, or 4%, from $55 million in the same period of 2018. This increase was due to increased locomotive units maintained and insourcing of 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 railroads for the use of CP’s equipment. Equipment rents expense was $35 million in the first quarter of 2019, an increase of $2 million, or 6%, from $33 million in the same period of 2018. This increase was primarily due to the unfavourable impact of the change in FX of $2 million and lower receipts for CP cars offline.

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 $160 million in the first quarter of 2019, a decrease of $10 million, or 6%, from $170 million in the same period of 2018. This decrease was primarily due to the impact of depreciation studies and other adjustments, partially offset by a higher depreciable asset base and the unfavourable impact of the change in FX of $2 million.

Purchased Services and Other

For the three months ended March 31 (in millions)		**2019**		2018	Total Change		% Change
Support and facilities	**$**	**71**	$	66	$	5	8
Track and operations		**75**		72		3	4
Intermodal		**56**		53		3	6
Equipment		**32**		34		(2)	(6)
Casualty		**69**		17		52	306
Property taxes		**36**		34		2	6
Other		**18**		1		17	1,700
Land sales		**—**		(2)		2	(100)
Total Purchased services and other	**$**	**357**	$	275	$	82	30

Purchased services and other expense encompasses a wide range of third-party costs, including expenses for joint facilities, personal injuries and damage, environmental remediation, property and other taxes, contractor and consulting fees, insurance, and gains on land sales. Purchased services and other expense was $357 million in the first quarter of 2019, an increase of $82 million, or 30%, from $275 million in the same period of 2018. This increase was primarily due to:

- higher expenses due to the increased number and severity of casualty incidents, which were the result of difficult weather operating conditions, reported in Casualty;
- a $10 million charge associated with a loss contingency, reported in Other;
- higher snow removal and other weather related costs reported in Track and operations and Intermodal;
- higher legal fees and vehicles repair costs reported in Support and facilities; and
- the unfavourable impact of the change in FX of $6 million.

This increase was partially offset by the decrease in costs for locomotive warranty service agreements, reported in Equipment and lower right of way maintenance costs due to focus on weather-related activities, reported in Track and operations.

Other Income Statement Items

Other (Income) Expense

Other (income) expense 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 income was $47 million in the first quarter of 2019, compared to an expense of $51 million in the same period of 2018, a change of $98 million, or 192%. This change was primarily due to FX translation gains on debt and lease liabilities of $45 million, compared to FX translation losses of $49 million on debt in the same period of 2018, discussed further in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Other Components of Net Periodic Benefit Recovery

Other components of net periodic recovery was $97 million in the first quarter of 2019, compared to $96 million in the same period of 2018, an increase of $1 million or 1%. This increase was primarily due to a decrease in the recognized net actuarial loss.

Net Interest Expense

Net interest expense includes interest on long-term debt and capital leases. Net interest expense was $114 million in the first quarter of 2019, a decrease of $1 million, or 1%, from $115 million in the same period of 2018. This decrease was primarily due to a net reduction in interest charges of $6 million as the result of a lower effective interest rate and lower average debt levels from debt refinancing in 2018 and 2019, partially offset by the unfavourable impact of the change in FX of $5 million.

Income Tax Expense

Income tax expense was $139 million in the first quarter of 2019, an increase of $17 million, or 14%, from $122 million in the same period of 2018. This increase was due to higher taxable earnings and a higher effective tax rate compared to the same period of 2018.

The effective tax rate in the first quarter of 2019, including discrete items, was 24.24% compared to 25.92% in the same period of 2018. The effective tax rate in the first quarter of 2019, excluding discrete items, was 25.75% compared to 24.75% in 2018. This increase was primarily due to increased taxable earnings and a higher proportion of the Company's income earned in higher tax rate jurisdictions.

The Company expects an annualized effective tax rate in 2019 of approximately 25.5% to 26%. The Company’s 2019 outlook for its annualized effective income tax rate is based on certain assumptions about events and developments that may or may not materialize or that may be offset entirely or partially by new events and developments. This is discussed further in Item 1A. Risk Factors of CP's 2018 Annual Report on Form 10-K.

Liquidity and Capital Resources

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

As at March 31, 2019, the Company had $352 million of Cash and cash equivalents, U.S. $1.0 billion available under its revolving credit facility, and up to $541 million available under its letter of credit facilities (December 31, 2018 - $61 million of Cash and cash equivalents, U.S. $1.0 billion available under its revolving credit facility, and up to $540 million available under its letter of credit facilities).

As at March 31, 2019, the Company's revolving credit facility was undrawn (December 31, 2018 - undrawn) and the Company did not draw from its revolving credit facility during the three months ended March 31, 2019. The revolving credit facility agreement requires the Company not to exceed a maximum debt to earnings before interest, tax, depreciation, and amortization ratio. As at March 31, 2019, the Company was in compliance with the threshold stipulated in this financial covenant.

The Company has a commercial paper program that enables it to issue commercial paper up to a maximum aggregate principal amount of U.S. $1.0 billion in the form of unsecured promissory notes. This commercial paper program is backed by the revolving credit facility. As at March 31, 2019, there were no commercial paper borrowings outstanding (December 31, 2018 - $nil).

As at March 31, 2019, under its bilateral letter of credit facility, the Company had letters of credit drawn of $59 million from a total available amount of $600 million. This compares to letters of credit drawn of $60 million from a total available amount of $600 million as at December 31, 2018. Under the bilateral letter of credit facility, the Company has the option to post collateral in the form of Cash or cash equivalents, equal at least to the face value of the letters of credit issued. As at March 31, 2019, the Company did not have any collateral posted on its bilateral letter of credit facility (December 31, 2018 - $nil).

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 $413 million in the first quarter of 2019, an increase of $16 million compared to $397 million in the same period of 2018. This increase was primarily due to an increase in receipts from customers in advance of performing service in the three months ended March 31, 2019, partially offset by a decrease in cash generating income, compared to the same period in 2018.

Investing Activities

Cash used in investing activities was $219 million in the first quarter of 2019, a decrease of $19 million compared to $238 million in the same period of 2018. This decrease was primarily due to lower capital additions during 2019, compared to the same period in 2018.

Free Cash

CP generated positive Free cash of $193 million in the first quarter of 2019, an increase of $29 million from $164 million in the same period of 2018. This increase was primarily due to a decrease in cash used in investing activities as a result of lower additions to properties and an increase in cash provided by operating activities compared to the same period in 2018.

Free cash is affected by seasonal fluctuations and by other factors including the size of the Company's additions to properties. Free cash is defined and reconciled in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Financing Activities

Cash provided by financing activities was $98 million in the first quarter of 2019, an increase of $475 million compared to cash used in financing activities of $377 million in the same period of 2018. This increase was primarily due to the issuance of the $400 million 10-year Notes in March 2019 and lower payments to buy back shares under the Company's share repurchase program in 2019 compared to the same period in 2018.

Credit Measures

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

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

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

As at March 31, 2019, CP's credit ratings from Standard & Poor's Rating Services ("Standard & Poor's") and Moody's Investor Service ("Moody's") remain unchanged from December 31, 2018.

Credit ratings as at March 31, 2019[(1)]

Long-term debt			Outlook
Standard & Poor's			
	Long-term corporate credit	**BBB+**	stable
	Senior secured debt	**A**	stable
	Senior unsecured debt	**BBB+**	stable
Moody's			
	Senior unsecured debt	**Baa1**	stable
Commercial paper program			
Standard & Poor's		**A-2**	N/A
Moody's		**P-2**	N/A

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

The Adjusted net debt to Adjusted earnings before interest, tax, depreciation and amortization ("EBITDA") ratio for the twelve months ended March 31, 2019 and March 31, 2018 was 2.6 and 2.7, respectively. This decrease was primarily due to an increase in Adjusted EBITDA as at March 31, 2019. Adjusted net debt to Adjusted EBITDA ratio is defined and reconciled in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations. Over the long term, CP targets an Adjusted net debt to Adjusted EBITDA ratio of 2.0 to 2.5.

Share Capital

At April 22, 2019, the latest practicable date, there were 139,824,714 Common Shares and no preferred shares issued and outstanding, which consists of 14,198 holders of record of the Company's Common Shares. In addition, CP has a Management Stock Option Incentive Plan ("MSOIP"), under which key officers and employees are granted options to purchase CP Common Shares. Each option granted can be exercised for one Common Share. At April 22, 2019, 1.7 million options were outstanding under the Company's MSOIP and stand-alone option agreements entered into with Mr. Keith Creel. There are 1.1 million options available to be issued by the Company's MSOIP in the future. CP has a Director's Stock Option Plan ("DSOP"), under which directors are granted options to purchase CP Common Shares. There are no outstanding options under the DSOP, which has 0.3 million options available to be issued in the future.

Non-GAAP Measures

The Company presents Non-GAAP measures including Free cash 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 and Adjusted diluted earnings per share 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, the FX impact of translating the Company's debt and lease liabilities, and certain items outside the control of management. These items may not be non-recurring. However, excluding these significant items from GAAP results allows for a consistent understanding of the Company's consolidated financial performance when performing a multi-period assessment including assessing the likelihood of future results. Accordingly, these Non-GAAP financial measures may provide insight to investors and other external users of the Company's consolidated financial information.

In the first quarter of 2019, there was one significant item included in Net income as follows:

- a non-cash gain of $45 million ($42 million after deferred tax) due to FX translation of debt and lease liabilities that favourably impacted Diluted EPS by 30 cents.

In 2018, there were two significant items included in Net income as follows:

- in the second quarter, a deferred tax recovery of $21 million due to reductions in the Missouri and Iowa state tax rates that favourably impacted Diluted EPS by 15 cents; and
- during the course of the year, a net non-cash loss of $168 million ($150 million after deferred tax) due to FX translation of debt as follows:
  - in the fourth quarter, a $113 million loss ($103 million after deferred tax) that unfavourably impacted Diluted EPS by 72 cents;
  - in the third quarter, a $38 million gain ($33 million after deferred tax) that favourably impacted Diluted EPS by 23 cents;
  - in the second quarter, a $44 million loss ($38 million after deferred tax) that unfavourably impacted Diluted EPS by 27 cents; and
  - in the first quarter, a $49 million loss ($42 million after deferred tax) that unfavourably impacted Diluted EPS by 29 cents.

In the nine months ended December 31, 2017, there were five significant items included in Net income as follows:

- in the second quarter, a charge on hedge roll and de-designation of $13 million ($10 million after deferred tax) that unfavourably impacted Diluted EPS by 7 cents;
- in the second quarter, an insurance recovery of a legal settlement of $10 million ($7 million after current tax) that favourably impacted Diluted EPS by 5 cents;
- a net deferred tax recovery of $541 million as a result of changes in income tax rates as follows:
  - in the fourth quarter, a deferred tax recovery of $527 million, primarily due to the U.S. tax reform, that favourably impacted Diluted EPS by $3.63;
  - in the third quarter, a deferred tax expense of $3 million as a result of the change in the Illinois state corporate income tax rate change that unfavourably impacted Diluted EPS by 2 cents;
  - in the second quarter, a deferred tax recovery of $17 million as a result of the change in the Saskatchewan provincial corporate income tax rate that favourably impacted Diluted EPS by 12 cents; and
- a net non-cash gain of $158 million ($138 million after deferred tax) due to FX translation of debt as follows:
  - in the fourth quarter, a $14 million loss ($12 million after deferred tax) that unfavourably impacted Diluted EPS by 8 cents;
  - in the third quarter, a $105 million gain ($91 million after deferred tax) that favourably impacted Diluted EPS by 62 cents; and
  - in the second quarter, a $67 million gain ($59 million after deferred tax) that favourably impacted Diluted EPS by 40 cents.

Reconciliation of GAAP Performance Measures to Non-GAAP Performance Measures

The following tables reconcile the most directly comparable measures presented in accordance with GAAP to the non-GAAP measures presented in Financial Highlights and discussed further in other sections of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations for the three months ended March 31, 2019 and 2018:

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

	For the three months ended March 31	
(in millions)	**2019**	2018
Net income as reported	**$ 434**	$ 348
Less significant items (pretax):		
Impact of FX translation on debt and lease liabilities	**45**	(49)
Add:		
Tax effect of adjustments[1]	**3**	(7)
Adjusted income	**$ 392**	$ 390

[1] The tax effect of adjustments was calculated as the pretax effect of the adjustments multiplied by the applicable tax rate for the above items of 6.45% for the three months ended March 31, 2019, and 13.43% for the three months ended March 31, 2018. The applicable tax rates reflect the taxable jurisdictions and nature, being on account of capital or income, of the significant items.

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

	For the three months ended March 31	
	2019	2018
Diluted earnings per share as reported	**$ 3.09**	$ 2.41
Less significant items (pretax):		
Impact of FX translation on debt and lease liabilities	**0.32**	(0.34)
Add:		
Tax effect of adjustments[1]	**0.02**	(0.05)
Adjusted diluted earnings per share	**$ 2.79**	$ 2.70

[1] The tax effect of adjustments was calculated as the pretax effect of the adjustments multiplied by the applicable tax rate for the above items of 6.45% for the three months ended March 31, 2019, and 13.43% for the three months ended March 31, 2018. The applicable tax rates reflect the taxable jurisdictions and nature, being on account of capital or income, of the significant items.

ROIC and Adjusted ROIC

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

Calculation of ROIC and Adjusted ROIC

(in millions, except for percentages)	For the twelve months ended March 31 **2019**	2018
Operating income as reported	**$ 2,834**	$ 2,455
Less:		
Other expense (income)	**76**	(99)
Other components of net periodic benefit recovery	**(385)**	(303)
Tax[(1)]	**764**	86
	$ 2,379	$ 2,771
Average of total shareholders' equity, long-term debt, long-term debt maturing within one year and short-term borrowing	**15,264**	14,222
ROIC	**15.6%**	19.5%

[(1)]Tax was calculated at the annualized effective tax rate of 24.31% and 2.99% for each of the above items for the twelve months ended March 31, 2019 and 2018, respectively.

(in millions, except for percentages)	For the twelve months ended March 31 **2019**	2018
Operating income as reported	**$ 2,834**	$ 2,455
Less:		
Other expense (income)	**76**	(99)
Other components of net periodic benefit recovery	**(385)**	(303)
Add significant items (pretax):		
Insurance recovery of legal settlement	**—**	(10)
Charge on hedge roll and de-designation	**—**	13
Impact of FX translation on debt and lease liabilities	**74**	(109)
Less:		
Tax[(1)]	**796**	716
	$ 2,421	$ 2,035
Average for the twelve months of total shareholders' equity, long-term debt, long-term debt maturing within one year and short-term borrowing	**15,264**	14,222
Add:		
Impact of periodic significant items net of tax on the above average	**(11)**	(269)
Adjusted average for the twelve months of total shareholders' equity, long-term debt, long-term debt maturing within one year and short-term borrowing	**15,253**	13,953
Adjusted ROIC	**15.9%**	14.6%

[(1)] Tax was calculated at the adjusted annualized effective tax rate of 24.76% and 26.02% for each of the above items for the twelve months ended March 31, 2019 and 2018, respectively.

Free Cash

Free cash is calculated as Cash provided by operating activities, less Cash used in investing activities, adjusted for changes in cash and cash equivalents balances resulting from FX fluctuations, and the cash settlement of hedges settled upon issuance of debt. Free cash is a measure that management considers to be an indicator of liquidity. Free cash is useful to investors and other external users of the consolidated financial statements as it assists with the evaluation of the Company's ability to generate cash from its operations without incurring additional external financing. The cash settlement of forward starting swaps that occurred in the second quarter of 2018 in conjunction with the issuance of long-term debt is not an indicator of CP's ongoing cash generating ability and therefore has been excluded from free cash. Positive Free cash indicates the amount of cash available for reinvestment in the business, or cash that can be returned to investors through dividends, stock repurchase programs, debt retirements or a combination of these. Conversely, negative Free cash indicates the amount of cash that must be raised from investors through new debt or equity issues, reduction in available cash balances or a combination of these. Free cash should be considered in addition to, rather than as a substitute for, Cash provided by operating activities. Free cash is presented in Financial Highlights and discussed further in Liquidity and Capital Resources of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Reconciliation of Cash Provided by Operating Activities to Free Cash

(in millions)	For the three months ended March 31 2019	2018
Cash provided by operating activities	**$ 413**	$ 397
Cash used in investing activities	**(219)**	(238)
Effect of foreign currency fluctuations on U.S. dollar-denominated cash and cash equivalents	**(1)**	5
Free cash	**$ 193**	$ 164

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 discussed in Operating Revenues of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

	For the three months ended March 31				
(in millions)	**Reported 2019**	Reported 2018	Variance due to FX	FX Adjusted 2018	FX Adjusted % Change
Freight revenues by line of business					
Grain	**$ 380**	$ 357	$ 10	$ 367	4
Coal	**158**	151	2	153	3
Potash	**114**	112	4	116	(2)
Fertilizers & sulphur	**57**	61	1	62	(8)
Forest products	**73**	66	2	68	7
Energy, chemicals & plastics	**315**	257	9	266	18
Metals, minerals & consumer products	**173**	183	8	191	(9)
Automotive	**76**	71	3	74	3
Intermodal	**380**	367	5	372	2
Freight revenues	**1,726**	1,625	44	1,669	3
Non-freight revenues	**41**	37	—	37	11
Total revenues	**$ 1,767**	$ 1,662	$ 44	$ 1,706	4

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

	For the three months ended March 31				
(in millions)	**Reported 2019**	Reported 2018	Variance due to FX	FX Adjusted 2018	FX Adjusted % Change
Compensation and benefits	**$ 406**	$ 374	$ 6	$ 380	7
Fuel	**209**	215	9	224	(7)
Materials	**57**	55	—	55	4
Equipment rents	**35**	33	2	35	—
Depreciation and amortization	**160**	170	2	172	(7)
Purchased services and other	**357**	275	6	281	27
Total operating expenses	**$ 1,224**	$ 1,122	$ 25	$ 1,147	7

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

EBIT is calculated as Net income before Net interest expense and Income tax expense. Adjusted EBIT excludes significant items reported in both Operating income and Other (income) expense. Adjusted EBITDA is calculated as Adjusted EBIT plus Other components of net periodic benefit recovery, operating lease expense and Depreciation and amortization.

	For the twelve months ended March 31	
(in millions)	**2019**	2018
Net income as reported	**$ 2,037**	$ 2,322
Add:		
Net interest expense	**452**	468
Income tax expense	**654**	67
EBIT	**3,143**	2,857
Less significant items (pretax):		
Insurance recovery of legal settlement	**—**	10
Charge on hedge roll and de-designation	**—**	(13)
Impact of FX translation on debt and lease liabilities	**(74)**	109
Adjusted EBIT	**3,217**	2,751
Less:		
Other components of net periodic benefit recovery	**385**	303
Operating lease expense	**(97)**	(98)
Depreciation and amortization	**(686)**	(665)
Adjusted EBITDA	**$ 3,615**	$ 3,211

Adjusted Net Debt to Adjusted EBITDA Ratio

Adjusted net debt is defined as Long-term debt, Long-term debt maturing within one year, and Short-term borrowing as reported on the Company's Consolidated Balance Sheets adjusted for pension plans deficit, operating leases liabilities recognized on the Company's Consolidated Balance Sheets, and Cash and cash equivalents. Adjusted net debt to Adjusted EBITDA ratio is calculated as Adjusted net debt divided by Adjusted EBITDA. The Adjusted net debt to Adjusted EBITDA ratio is a key credit measure used to assess the Company's financial capacity. The ratio provides information on the Company's ability to service its debt and other long-term obligations. Adjusted net debt to Adjusted EBITDA ratio is discussed further in Liquidity and Capital Resources of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Reconciliation of Long-term Debt to Adjusted Net Debt

(in millions)	**2019**	2018
Long-term debt including long-term debt maturing within one year as at March 31	**$ 8,923**	$ 8,357
Less:		
Pension plans in deficit[(1)]	**(265)**	(278)
Operating lease liabilities[(2)]	**(386)**	(276)
Cash and cash equivalents	**352**	125
Adjusted net debt as at March 31	**$ 9,222**	$ 8,786

[(1)] Pension plans deficit is the total funded status of the Pension plans in deficit only.
[(2)] Current period amount is as reported in compliance with GAAP following the adoption of Accounting Standards Update ("ASU") 2016-02 under the cumulative-effect adjustment transition approach, discussed further in Item 1. Financial Statements, Note 2 Accounting changes. The comparative period amount was calculated as the net present value of operating leases discounted by the Company's effective interest rate for the period presented.

Calculation of Adjusted Net Debt to Adjusted EBITDA Ratio

(in millions, except for ratios)	**2019**	2018
Adjusted net debt as at March 31	**$ 9,222**	$ 8,786
Adjusted EBITDA for the year ended March 31	**3,615**	3,211
Adjusted net debt to Adjusted EBITDA ratio	**2.6**	2.7

Off-Balance Sheet Arrangements

Guarantees

At March 31, 2019, the Company had residual value guarantees on operating lease commitments of $2 million (December 31, 2018 - $2 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. As at March 31, 2019, the fair value of these guarantees recognized as a liability was $19 million (December 31, 2018 - $10 million).

Contractual Commitments

The accompanying table indicates the Company's obligations and commitments to make future payments for contracts, such as debt, finance lease, and commercial arrangements, as at March 31, 2019.

Payments due by period (in millions)	Total	2019	2020 & 2021	2022 & 2023	2024 & beyond
Contractual commitments					
Interest on long-term debt and finance leases	**$ 11,747**	$ 304	$ 879	$ 749	$ 9,815
Long-term debt	**8,858**	487	441	984	6,946
Finance leases	**155**	4	11	115	25
Operating lease[1]	**444**	67	125	98	154
Supplier purchase	**686**	122	149	124	291
Other long-term liabilities[2]	**490**	42	105	102	241
Total contractual commitments	**$ 22,380**	$ 1,026	$ 1,710	$ 2,172	$ 17,472

(1) Residual value guarantees on certain leased equipment with a maximum exposure of $2 million are not included in the minimum payments shown above.

(2) 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 2019 to 2028. 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 2018 Annual Report on Form 10-K.

Certain Other Financial Commitments

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

Letters of Credit

Letters of credit are obtained mainly to provide security to third parties under the terms of various agreements. CP is liable for these contractual amounts in the case of non-performance under these agreements. Letters of credit are accommodated through a revolving credit facility and the Company's bilateral letter of credit facilities.

Capital Commitments

The Company remains committed to maintaining the current high level of quality of our capital assets in pursuing sustainable growth. As part of this commitment, CP has entered into contracts with suppliers to make various capital purchases related to track programs. Payments for these commitments are due in 2019 through 2032. These expenditures are expected to be financed by cash generated from operations or by issuing new debt.

The accompanying table indicates the Company's commitments to make future payments for letters of credit and capital expenditures as at March 31, 2019.

Payments due by period (in millions)	Total	2019	2020 & 2021	2022 & 2023	2024 & beyond
Certain other financial commitments					
Letters of credit	**$ 59**	$ 59	$ —	$ —	$ —
Capital commitments	**845**	569	94	66	116
Total certain other financial commitments	**$ 904**	$ 628	$ 94	$ 66	$ 116

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 2018 Annual Report on Form 10-K. There have not been any material changes to the Company's critical accounting estimates in the first three months of 2019.

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

Forward-Looking 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* and other relevant securities legislation. 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 guidance using Non-GAAP financial measures, the Company may not be able to provide a reconciliation to a GAAP measure, due to unknown variables and uncertainty related to future results. The purpose of 2019 revenues, operating expenses and net interest expense FX sensitivities is to assist readers in understanding our expected and targeted financial results, and this information may not be appropriate for other purpose.

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: 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; applicable laws, regulations and government policies; the availability and cost of labour, services and infrastructure; and the satisfaction by third parties of their obligations to the Company. 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 economic conditions render assumptions, although reasonable when made, subject to greater uncertainty.

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; general North American and global economic, 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; industry capacity; shifts in market demand; changes in commodity prices; uncertainty surrounding timing and volumes of commodities being shipped via CP; inflation; changes in laws, 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; uncertainties of investigations, proceedings or other types of claims and litigation; labour disputes; risks and liabilities arising from derailments; transportation of dangerous goods; timing of completion of capital and maintenance projects; currency and interest rate fluctuations; effects of changes in market conditions and discount rates on the financial position of pension plans and investments; trade restrictions or other changes to international trade arrangements; climate change; and 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. 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 2018 Annual Report on Form 10-K. Other risks are detailed from time to time in reports filed by CP with securities regulators in Canada and the United States.

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

There have been no material changes to market risk during the three months ended March 31, 2019 from the information provided in Item 7A. Quantitative and Qualitative Disclosure about Market Risk of CP's 2018 Annual Report on Form 10-K. Refer to information on foreign exchange risk and share price impact on stock-based compensation discussed below:

Foreign Exchange Risk

Although CP conducts business primarily in Canada, a significant portion of its revenues, expenses, assets, and liabilities including debt are denominated in U.S. dollars. The value of the Canadian dollar is affected by a number of domestic and international factors, including, without limitation, economic performance, and Canadian, U.S. and international monetary policies. Consequently, the Company's results are affected by fluctuations in the exchange rate between these currencies. On an annualized basis, a $0.01 weakening (or strengthening) of the Canadian dollar relative to the U.S. dollar positively (or negatively) impacts Total revenues by approximately $28 million, negatively (or positively) impacts Operating expenses by approximately $15 million, and negatively (or positively) impacts Net interest expense by approximately $3 million.

CP uses U.S. dollar-denominated debt to hedge its net investment in U.S. operations. As at March 31, 2019, the net investment in U.S. operations is less than the total U.S. denominated debt. Consequently, FX translation on the Company's undesignated debt and lease liabilities causes additional impacts on earnings in Other (income) expense. For further information on the net investment hedge, please refer to Item 8. Financial Statements and Supplementary Data, Note 18 Financial Instruments, in CP's 2018 Annual Report on Form 10-K.

To manage this exposure to fluctuations in exchange rates between Canadian and U.S. dollars, CP may sell or purchase U.S. dollar forwards at fixed rates in future periods. In addition, changes in the exchange rate between the Canadian dollar and other currencies (including the U.S. dollar) make the goods transported by the Company more or less competitive in the world marketplace and may in turn positively or negatively affect revenues.

Share Price Impact on Stock-Based Compensation

For every $1.00 change in share price, stock-based compensation expense has a corresponding change of approximately $0.4 million to $0.6 million based on information available at March 31, 2019. This excludes the impact of changes in share price relative to the S&P/TSX 60 Index, the S&P/TSX Capped Industrial Index, the S&P 1500 Road and Rail Index, and to Class I railways, which may trigger different performance share unit payouts. Share based compensation may also be impacted by non-market performance conditions.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

As of March 31, 2019, an evaluation was carried out under the supervision of and with the participation of CP's management, including its CEO and CFO, of the effectiveness of the design and operation of the Company's disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act. Based on that evaluation, the CEO and CFO concluded that these disclosure controls and procedures were effective as of March 31, 2019, to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is (i) recorded, processed, summarized and reported within the time periods specified by the SEC rules and forms and (ii) accumulated and communicated to the Company's management, including the CEO and CFO, as appropriate, to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

During the first quarter of 2019, 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.