

## Management's Discussion and Analysis

This Management's Discussion and Analysis (MD&A) dated July 25, 2016, relates to the consolidated financial position and results of operations of Canadian National Railway Company, together with its wholly-owned subsidiaries, collectively "CN" or the "Company," and should be read in conjunction with the Company's 2016 unaudited Interim Consolidated Financial Statements and Notes thereto. It should also be read in conjunction with the Company's 2015 audited Annual Consolidated Financial Statements and Notes thereto, and the 2015 Annual MD&A. All financial information reflected herein is expressed in Canadian dollars and prepared in accordance with United States generally accepted accounting principles (GAAP), unless otherwise noted.

CN's common shares are listed on the Toronto and New York stock exchanges. Additional information about CN filed with Canadian securities regulatory authorities and the United States Securities and Exchange Commission (SEC), including the Company's 2015 Annual Information Form and Form 40-F, may be found online at [www.sedar.com](http://www.sedar.com), [www.sec.gov](http://www.sec.gov), and on the Company's website at [www.cn.ca/regulatory-filings](http://www.cn.ca/regulatory-filings). The Company's Notice of Intention to Make a Normal Course Issuer Bid may be found online at [www.sedar.com](http://www.sedar.com) and [www.sec.gov](http://www.sec.gov). Copies of such documents may be obtained by contacting the Corporate Secretary's office.

### Business profile

CN is engaged in the rail and related transportation business. CN's network of approximately 20,000 route miles of track spans Canada and mid-America, uniquely connecting three coasts: the Atlantic, the Pacific and the Gulf of Mexico. CN's extensive network and efficient connections to all Class I railroads provide CN customers access to all three North American Free Trade Agreement (NAFTA) nations. A true backbone of the economy, CN handles over \$250 billion worth of goods annually and carries more than 300 million tons of cargo, serving exporters, importers, retailers, farmers and manufacturers.

CN's freight revenues are derived from seven commodity groups representing a diversified and balanced portfolio of goods transported between a wide range of origins and destinations. This product and geographic diversity better positions the Company to face economic fluctuations and enhances its potential for growth opportunities. For the six months ended June 30, 2016, no individual commodity group accounted for more than 24% of total revenues. From a geographic standpoint, 17% of revenues relate to United States (U.S.) domestic traffic, 35% transborder traffic, 18% Canadian domestic traffic and 30% overseas traffic. The Company is the originating carrier for approximately 85% of traffic moving along its network, which allows it both to capitalize on service advantages and build on opportunities to efficiently use assets.

### Strategy overview

A description of the Company's Strategy is provided in the section entitled *Strategy overview* of the Company's 2015 Annual MD&A.

#### 2016 second quarter highlights

- The Company attained a record second quarter operating ratio of 54.5%.
- The Company paid quarterly dividends of \$0.3750 per share, representing an increase of 20% when compared to 2015, amounting to \$291 million.
- The Company repurchased 7.2 million common shares, returning \$533 million to its shareholders.

#### 2016 business outlook and assumptions

In 2016, the Company sees growth in lumber and panels, finished vehicles and parts, as well as refined petroleum products, while shipments of commodities related to oil and gas development such as crude oil, frac sand and drilling pipe are expected to decrease relative to 2015. The Company sees unfavorable global demand-supply dynamics impacting coal shipments. A moderate decline in short-haul iron ore shipments and weaker international intermodal volumes are also expected.

Underpinning the 2016 business outlook, the Company now assumes that North American industrial production will be slightly negative. For the 2015/2016 crop year, the Canadian grain crop was in line with the five-year average and the U.S. grain crop was above the five-year average. The Company now assumes that the 2016/2017 grain crops in both Canada and the U.S. will be above their respective five-year averages.

The forward-looking statements discussed in this section and in other parts of this MD&A are subject to risks and uncertainties that could cause actual results or performance to differ materially from those expressed or implied in such statements and are based on certain factors and assumptions which the Company considers reasonable, about events, developments, prospects and opportunities that may not materialize or that may be offset entirely or partially by other events and developments. In addition to the assumptions and expectations discussed in this section, reference should be made to the section of this MD&A entitled *Forward-looking statements* for assumptions and risk factors affecting such statements.

### Forward-looking statements

Certain statements included in this MD&A are "forward-looking statements" within the meaning of the *United States Private Securities Litigation Reform Act of 1995* and under Canadian securities laws. By their nature, forward-looking statements involve risks, uncertainties and assumptions. The Company cautions that its assumptions may not materialize and that current economic conditions render such assumptions, although reasonable at the time they were made, subject to greater uncertainty. Forward-looking statements may be identified by the use of terminology such as "believes," "expects," "anticipates," "assumes," "outlook," "plans," "targets" or other similar words.

Forward-looking statements include, but are not limited to, those set forth in the table below, which also presents key assumptions used in determining these forward-looking statements. See also the section of this MD&A entitled *Strategy overview – 2016 business outlook and assumptions*.

Forward-looking statements	Key assumptions
Statements relating to revenue growth opportunities, including those referring to general economic and business conditions	<ul style="list-style-type: none"> <li>• North American and global economic growth</li> <li>• Long-term growth opportunities being less affected by current economic conditions</li> </ul>
Statements relating to the Company's ability to meet debt repayments and future obligations in the foreseeable future, including income tax payments, and capital spending	<ul style="list-style-type: none"> <li>• North American and global economic growth</li> <li>• Adequate credit ratios</li> <li>• Investment-grade credit ratings</li> <li>• Access to capital markets</li> <li>• Adequate cash generated from operations and other sources of financing</li> </ul>
Statements relating to pension contributions	<ul style="list-style-type: none"> <li>• Adequate cash generated from operations and other sources of financing</li> <li>• Adequate long-term return on investment on pension plan assets</li> <li>• Level of funding as determined by actuarial valuations, particularly influenced by discount rates for funding purposes</li> </ul>

Forward-looking statements are not guarantees of future performance and involve known and unknown risks, uncertainties and other factors which may cause the actual results or performance of the Company to be materially different from the outlook or any future results or performance implied by such statements. Accordingly, readers are advised not to place undue reliance on forward-looking statements. Important risk factors that could affect the forward-looking statements include, but are not limited to, the effects of general economic and business conditions; industry competition; inflation, currency and interest rate fluctuations; changes in fuel prices; legislative and/or regulatory developments; compliance with environmental laws and regulations; actions by regulators; security threats; reliance on technology; transportation of hazardous materials; various events which could disrupt operations, including natural events such as severe weather, droughts, floods and earthquakes; effects of climate change; labor negotiations and disruptions; environmental claims; uncertainties of investigations, proceedings or other types of claims and litigation; risks and liabilities arising from derailments; and other risks detailed from time to time in reports filed by CN with securities regulators in Canada and the U.S., including its Annual Information Form and Form 40-F. See the section entitled *Business risks* of this MD&A and the Company's 2015 Annual MD&A for a description of major risk factors.

Forward-looking statements reflect information as of the date on which they are made. CN assumes no obligation to update or revise forward-looking statements to reflect future events, changes in circumstances, or changes in beliefs, unless required by applicable securities laws. In the event CN does update any forward-looking statement, no inference should be made that CN will make additional updates with respect to that statement, related matters, or any other forward-looking statement.

## Financial highlights

<i>In millions, except percentage and per share data</i>	Three months ended June 30		Six months ended June 30	
	2016	2015	2016	2015
Revenues	\$ 2,842	\$ 3,125	\$ 5,806	\$ 6,223
Operating income	\$ 1,293	\$ 1,362	\$ 2,510	\$ 2,425
Net income	\$ 858	\$ 886	\$ 1,650	\$ 1,590
Adjusted net income <sup>(1)</sup>	\$ 865	\$ 928	\$ 1,657	\$ 1,632
Basic earnings per share	\$ 1.10	\$ 1.10	\$ 2.11	\$ 1.97
Adjusted basic earnings per share <sup>(1)</sup>	\$ 1.11	\$ 1.15	\$ 2.12	\$ 2.02
Diluted earnings per share	\$ 1.10	\$ 1.10	\$ 2.10	\$ 1.96
Adjusted diluted earnings per share <sup>(1)</sup>	\$ 1.11	\$ 1.15	\$ 2.11	\$ 2.01
Dividends declared per share	\$ 0.3750	\$ 0.3125	\$ 0.7500	\$ 0.6250
Total assets <sup>(2)</sup>	\$ 36,094	\$ 33,498	\$ 36,094	\$ 33,498
Total long-term liabilities <sup>(2)</sup>	\$ 18,555	\$ 16,446	\$ 18,555	\$ 16,446
Operating ratio	54.5%	56.4%	56.8%	61.0%
Free cash flow <sup>(3)</sup>	\$ 585	\$ 530	\$ 1,169	\$ 1,051

(1) See the section of this MD&A entitled *Adjusted performance measures* for an explanation of this non-GAAP measure.

(2) As a result of the retrospective adoption of new accounting standards in the fourth quarter of 2015, certain 2015 balances have been adjusted. See the section of the Company's 2015 Annual MD&A entitled *Recent accounting pronouncements* for additional information.

(3) See the section of this MD&A entitled *Liquidity and capital resources - Free cash flow* for an explanation of this non-GAAP measure.

## Second quarter and first half of 2016 compared to corresponding periods in 2015

Net income for the second quarter of 2016 was \$858 million, a decrease of \$28 million, or 3%, when compared to the same period in 2015, with diluted earnings per share remaining flat at \$1.10. The \$28 million decrease was mainly due to lower operating income and other income, and higher interest expense; net of the related income taxes. Net income for the six months ended June 30, 2016 was \$1,650 million, an increase of \$60 million, or 4%, when compared to the same period in 2015, with diluted earnings per share rising 7% to \$2.10. The \$60 million increase was mainly due to higher operating income net of the related income taxes, partly offset by an increase in interest expense.

Operating income for the quarter ended June 30, 2016 decreased by \$69 million, or 5%, to \$1,293 million. Operating income for the six months ended June 30, 2016 increased by \$85 million, or 4%, to \$2,510 million. The operating ratio, defined as operating expenses as a percentage of revenues, was 54.5% in 2016, compared to 56.4% in 2015, a 1.9-point improvement. The six-month operating ratio was 56.8% in 2016, compared to 61.0% in 2015, a 4.2-point improvement.

Revenues for the quarter ended June 30, 2016 decreased by \$283 million, or 9%, to \$2,842 million, and \$417 million, or 7%, to \$5,806 million for the first six months, mainly attributable to decreased shipments of energy-related commodities including crude oil, frac sand, drilling pipe and semi-finished steel products as a result of declining energy markets; reduced shipments of coal due to weaker North American and global demand; lower volumes of Canadian grain to North American and export markets due to lower available supply; and lower applicable fuel surcharge rates. These factors were partly offset by the positive translation impact of the weaker Canadian dollar on US dollar-denominated revenues; freight rate increases; as well as increased shipments of lumber and panels to U.S. markets, increased domestic retail intermodal shipments, and higher volumes of finished vehicle traffic in the first quarter.

Operating expenses for the quarter ended June 30, 2016 decreased by \$214 million, or 12%, to \$1,549 million, and \$502 million, or 13%, to \$3,296 million for the first six months, mainly due to lower costs resulting from decreased volumes of traffic, lower fuel prices, lower pension expense and cost-management initiatives, partly offset by the negative translation impact of a weaker Canadian dollar on US dollar-denominated expenses.

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### Non-GAAP measures

This MD&A makes reference to non-GAAP measures including adjusted net income, adjusted earnings per share, constant currency, free cash flow, and adjusted debt-to-adjusted EBITDA multiple, that do not have any standardized meaning prescribed by GAAP and therefore, may not be comparable to similar measures presented by other companies. From management's perspective, these non-GAAP measures are useful measures of performance and provide investors with supplementary information to assess the Company's results of operations and liquidity. These non-GAAP measures should not be considered in isolation or as a substitute for financial measures prepared in accordance with GAAP.

For further details of these non-GAAP measures, including a reconciliation to the most directly comparable GAAP financial measures, refer to the sections entitled *Adjusted performance measures*, *Constant currency* and *Liquidity and capital resources*.

### Adjusted performance measures

Management believes that adjusted net income and adjusted earnings per share are useful measures of performance that can facilitate period-to-period comparisons, as they exclude items that do not necessarily arise as part of the normal day-to-day operations of the Company and could distort the analysis of trends in business performance. The exclusion of such items in adjusted net income and adjusted earnings per share does not, however, imply that such items are necessarily non-recurring. These adjusted measures do not have any standardized meaning prescribed by GAAP and therefore, may not be comparable to similar measures presented by other companies.

For the three and six months ended June 30, 2016, the Company reported adjusted net income of \$865 million, or \$1.11 per diluted share, and \$1,657 million, or \$2.11 per diluted share, respectively. The adjusted figures for the three and six months ended June 30, 2016 exclude a deferred income tax expense of \$7 million (\$0.01 per diluted share) resulting from the enactment of a higher provincial corporate income tax rate.

For the three and six months ended June 30, 2015, the Company reported adjusted net income of \$928 million, or \$1.15 per diluted share, and \$1,632 million, or \$2.01 per diluted share, respectively. The adjusted figures for the three and six months ended June 30, 2015 exclude a deferred income tax expense of \$42 million (\$0.05 per diluted share) resulting from the enactment of a higher provincial corporate income tax rate.

The following table provides a reconciliation of net income and earnings per share, as reported for the three and six months ended June 30, 2016 and 2015, to the adjusted performance measures presented herein:

<i>In millions, except per share data</i>	Three months ended June 30		Six months ended June 30	
	2016	2015	2016	2015
Net income as reported	\$ 858	\$ 886	\$ 1,650	\$ 1,590
<i>Adjustment: Income tax expense</i>	7	42	7	42
<b><i>Adjusted net income</i></b>	<b>\$ 865</b>	<b>\$ 928</b>	<b>\$ 1,657</b>	<b>\$ 1,632</b>
Basic earnings per share as reported	\$ 1.10	\$ 1.10	\$ 2.11	\$ 1.97
<i>Impact of adjustment, per share</i>	0.01	0.05	0.01	0.05
<b><i>Adjusted basic earnings per share</i></b>	<b>\$ 1.11</b>	<b>\$ 1.15</b>	<b>\$ 2.12</b>	<b>\$ 2.02</b>
Diluted earnings per share as reported	\$ 1.10	\$ 1.10	\$ 2.10	\$ 1.96
<i>Impact of adjustment, per share</i>	0.01	0.05	0.01	0.05
<b><i>Adjusted diluted earnings per share</i></b>	<b>\$ 1.11</b>	<b>\$ 1.15</b>	<b>\$ 2.11</b>	<b>\$ 2.01</b>

### Constant currency

Financial results at constant currency allow 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. Measures at constant currency are considered non-GAAP measures and do not have any standardized meaning prescribed by GAAP and therefore, may not be comparable to similar measures presented by other companies. Financial results at constant currency are obtained by translating the current period results denominated in US dollars at the foreign exchange rates of the comparable period of the prior year. The average foreign exchange rates were \$1.29 and \$1.33 per US\$1.00, respectively, for the three and six months ended June 30, 2016, and \$1.23 per US\$1.00, for both the three and six months ended June 30, 2015.

On a constant currency basis, the Company's net income for the three and six months ended June 30, 2016 would have been lower by \$23 million (\$0.03 per diluted share) and \$80 million (\$0.10 per diluted share), respectively.

## Revenues

<i>In millions, unless otherwise indicated</i>	Three months ended June 30				Six months ended June 30			
	2016	2015	% Change	% Change at constant currency	2016	2015	% Change	% Change at constant currency
Rail freight revenues	\$ 2,646	\$ 2,927	(10%)	(12%)	\$ 5,491	\$ 5,907	(7%)	(11%)
Other revenues	196	198	(1%)	(4%)	315	316	-	(4%)
<b>Total revenues</b>	<b>\$ 2,842</b>	<b>\$ 3,125</b>	<b>(9%)</b>	<b>(12%)</b>	<b>\$ 5,806</b>	<b>\$ 6,223</b>	<b>(7%)</b>	<b>(11%)</b>
<b>Rail freight revenues</b>								
Petroleum and chemicals	\$ 492	\$ 586	(16%)	(19%)	\$ 1,070	\$ 1,229	(13%)	(17%)
Metals and minerals	292	351	(17%)	(19%)	602	728	(17%)	(22%)
Forest products	439	424	4%	-	901	842	7%	1%
Coal	95	148	(36%)	(38%)	188	307	(39%)	(42%)
Grain and fertilizers	432	489	(12%)	(14%)	954	1,024	(7%)	(11%)
Intermodal	697	728	(4%)	(6%)	1,390	1,417	(2%)	(5%)
Automotive	199	201	(1%)	(4%)	386	360	7%	1%
<b>Total rail freight revenues</b>	<b>\$ 2,646</b>	<b>\$ 2,927</b>	<b>(10%)</b>	<b>(12%)</b>	<b>\$ 5,491</b>	<b>\$ 5,907</b>	<b>(7%)</b>	<b>(11%)</b>
Revenue ton miles (RTMs) ( <i>millions</i> )	49,717	55,713	(11%)	(11%)	101,973	112,842	(10%)	(10%)
Rail freight revenue/RTM ( <i>cents</i> )	5.32	5.25	1%	(1%)	5.38	5.23	3%	(2%)

Revenues for the quarter ended June 30, 2016 totaled \$2,842 million compared to \$3,125 million in the same period in 2015, a decrease of \$283 million, or 9%. Revenues for the first half of 2016 were \$5,806 million, a decrease of \$417 million, or 7%, when compared to the same period in 2015. The decreases were mainly attributable to decreased shipments of energy-related commodities including crude oil, frac sand, drilling pipe and semi-finished steel products as a result of declining energy markets; reduced shipments of coal due to weaker North American and global demand; lower volumes of Canadian grain to North American and export markets due to lower available supply; and lower applicable fuel surcharge rates. These factors were partly offset by the positive translation impact of the weaker Canadian dollar on US dollar-denominated revenues; freight rate increases; as well as increased shipments of lumber and panels to U.S. markets, increased domestic retail intermodal shipments, and higher volumes of finished vehicle traffic in the first quarter.

Fuel surcharge revenues decreased by \$92 million in the second quarter and \$230 million in the first half of 2016 when compared to the same periods in 2015 as a result of lower applicable fuel surcharge rates.

Revenue ton miles (RTMs), measuring the relative weight and distance of rail freight transported by the Company, declined by 11% in the second quarter and 10% in the first half of 2016 relative to the same periods in 2015.

Rail freight revenue per RTM, a measurement of yield defined as revenue earned on the movement of a ton of freight over one mile, increased by 1% in the second quarter and 3% in the first half of 2016, when compared to the same periods in 2015, driven by the positive translation impact of the weaker Canadian dollar and freight rate increases, partly offset by a significant increase in the average length of haul and lower applicable fuel surcharge rates.

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### Petroleum and chemicals

	Three months ended June 30				Six months ended June 30			
	2016	2015	% Change	% Change at constant currency	2016	2015	% Change	% Change at constant currency
Revenues ( <i>millions</i> )	\$ 492	\$ 586	(16%)	(19%)	\$ 1,070	\$ 1,229	(13%)	(17%)
RTMs ( <i>millions</i> )	9,575	12,425	(23%)	(23%)	20,881	26,042	(20%)	(20%)
Revenue/RTM ( <i>cents</i> )	5.14	4.72	9%	5%	5.12	4.72	8%	3%

Revenues for this commodity group decreased by \$94 million, or 16%, in the second quarter and \$159 million, or 13%, in the first half of 2016 when compared to the same periods in 2015. The decreases were mainly due to lower shipments of crude oil due to increased pipeline capacity and the effects of the Alberta wildfires in the second quarter of 2016, which also adversely impacted volumes of sulfur; as well as lower applicable fuel surcharge rates. These factors were partly offset by the positive translation impact of a weaker Canadian dollar; higher volumes of refined petroleum products including gasoline and diesel, and propane; as well as freight rate increases.

Revenue per RTM increased by 9% in the second quarter and 8% in the first half of 2016 when compared to the same periods in 2015, mainly due to a significant decrease in the average length of haul, the positive translation impact of a weaker Canadian dollar and freight rate increases, partly offset by lower applicable fuel surcharge rates.

### Metals and minerals

	Three months ended June 30				Six months ended June 30			
	2016	2015	% Change	% Change at constant currency	2016	2015	% Change	% Change at constant currency
Revenues ( <i>millions</i> )	\$ 292	\$ 351	(17%)	(19%)	\$ 602	\$ 728	(17%)	(22%)
RTMs ( <i>millions</i> )	4,751	5,430	(13%)	(13%)	9,454	11,141	(15%)	(15%)
Revenue/RTM ( <i>cents</i> )	6.15	6.46	(5%)	(8%)	6.37	6.53	(2%)	(8%)

Revenues for this commodity group decreased by \$59 million, or 17%, in the second quarter and \$126 million, or 17%, in the first half of 2016 when compared to the same periods in 2015. The decreases were mainly due to decreased shipments of energy-related commodities including frac sand, drilling pipe, and semi-finished steel products as a result of declining energy markets; and lower applicable fuel surcharge rates. These factors were partly offset by the positive translation impact of a weaker Canadian dollar.

Revenue per RTM decreased by 5% in the second quarter and 2% in the first half of 2016 when compared to the same periods in 2015, mainly due to a significant increase in the average length of haul and lower applicable fuel surcharge rates, offset by the positive translation impact of a weaker Canadian dollar.

### Forest products

	Three months ended June 30				Six months ended June 30			
	2016	2015	% Change	% Change at constant currency	2016	2015	% Change	% Change at constant currency
Revenues ( <i>millions</i> )	\$ 439	\$ 424	4%	-	\$ 901	\$ 842	7%	1%
RTMs ( <i>millions</i> )	7,807	7,605	3%	3%	15,736	14,847	6%	6%
Revenue/RTM ( <i>cents</i> )	5.62	5.58	1%	(3%)	5.73	5.67	1%	(5%)

Revenues for this commodity group increased by \$15 million, or 4%, in the second quarter and \$59 million, or 7%, in the first half of 2016 when compared to the same periods in 2015. The increases were mainly due to the positive translation impact of a weaker Canadian dollar; increased shipments of lumber and panels to the U.S. due to an improved U.S. housing market; and freight rate increases. These factors were partly offset by lower applicable fuel surcharge rates and decreased shipments of paper products amidst weak market conditions.

Revenue per RTM increased by 1% in both the second quarter and first half of 2016 when compared to the same periods in 2015, mainly due to the positive translation impact of a weaker Canadian dollar and freight rate increases, offset by lower applicable fuel surcharge rates and an increase in the average length of haul.

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### Coal

	Three months ended June 30				Six months ended June 30			
	2016	2015	% Change	% Change at constant currency	2016	2015	% Change	% Change at constant currency
Revenues ( <i>millions</i> )	\$ 95	\$ 148	(36%)	(38%)	\$ 188	\$ 307	(39%)	(42%)
RTMs ( <i>millions</i> )	2,686	3,916	(31%)	(31%)	4,934	8,126	(39%)	(39%)
Revenue/RTM ( <i>cents</i> )	3.54	3.78	(6%)	(9%)	3.81	3.78	1%	(4%)

Revenues for this commodity group decreased by \$53 million, or 36%, in the second quarter and \$119 million, or 39%, in the first half of 2016 when compared to the same periods in 2015. The decreases were mainly due to lower volumes of thermal coal to U.S. coal-fired utilities, and continued global oversupply impacting export shipments of thermal coal via the U.S. Gulf Coast and metallurgical coal via west coast ports; as well as lower applicable fuel surcharge rates. These factors were partly offset by the positive translation impact of a weaker Canadian dollar and freight rate increases.

Revenue per RTM decreased by 6% in the second quarter and increased by 1% in the first half of 2016 when compared to the same periods in 2015. The decrease in the second quarter was mainly due to lower applicable fuel surcharge rates, partly offset by the positive translation impact of a weaker Canadian dollar and freight rate increases. The increase in the first half was mainly due to a significant decrease in the average length of haul, the positive translation impact of a weaker Canadian dollar and freight rate increases, partly offset by lower applicable fuel surcharge rates.

### Grain and fertilizers

	Three months ended June 30				Six months ended June 30			
	2016	2015	% Change	% Change at constant currency	2016	2015	% Change	% Change at constant currency
Revenues ( <i>millions</i> )	\$ 432	\$ 489	(12%)	(14%)	\$ 954	\$ 1,024	(7%)	(11%)
RTMs ( <i>millions</i> )	10,353	11,783	(12%)	(12%)	22,883	24,727	(7%)	(7%)
Revenue/RTM ( <i>cents</i> )	4.17	4.15	-	(2%)	4.17	4.14	1%	(3%)

Revenues for this commodity group decreased by \$57 million, or 12%, in the second quarter and \$70 million, or 7%, in the first half of 2016 when compared to the same periods in 2015. The decreases were mainly due to lower volumes of Canadian wheat to North American and export markets, lower export volumes of barley and lentils, decreased volumes of oats to U.S. markets, and reduced volumes of U.S. corn and soybean meal exports via the Gulf of Mexico mainly in the first quarter; as well as lower applicable fuel surcharge rates. These factors were partly offset by the positive translation impact of a weaker Canadian dollar; increased volumes of Canadian canola meal and oil, and increased offshore exports of Canadian canola and soybeans mainly in the first quarter; as well as freight rate increases.

Revenue per RTM remained flat in the second quarter and increased by 1% in the first half of 2016 when compared to the same periods in 2015, mainly due to the positive translation impact of a weaker Canadian dollar and freight rate increases, almost entirely offset by lower applicable fuel surcharge rates.

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### Intermodal

	Three months ended June 30				Six months ended June 30			
	2016	2015	% Change	% Change at constant currency	2016	2015	% Change	% Change at constant currency
Revenues ( <i>millions</i> )	\$ 697	\$ 728	(4%)	(6%)	\$ 1,390	\$ 1,417	(2%)	(5%)
RTMs ( <i>millions</i> )	13,519	13,493	-	-	26,182	26,086	-	-
Revenue/RTM ( <i>cents</i> )	5.16	5.40	(4%)	(6%)	5.31	5.43	(2%)	(5%)

Revenues for this commodity group decreased by \$31 million, or 4%, in the second quarter and \$27 million, or 2%, in the first half of 2016 when compared to the same periods in 2015. The decreases were mainly due to lower applicable fuel surcharge rates and decreased international volumes via the Port of Vancouver. These factors were partly offset by the positive translation impact of a weaker Canadian dollar; increased international volumes via the Port of Halifax, and higher domestic retail volumes in the industrial and consumer products segments; as well as freight rate increases.

Revenue per RTM decreased by 4% in the second quarter and 2% in the first half of 2016 when compared to the same periods in 2015, mainly due to lower applicable fuel surcharge rates and an increase in the average length of haul, partly offset by the positive translation impact of a weaker Canadian dollar and freight rate increases.

### Automotive

	Three months ended June 30				Six months ended June 30			
	2016	2015	% Change	% Change at constant currency	2016	2015	% Change	% Change at constant currency
Revenues ( <i>millions</i> )	\$ 199	\$ 201	(1%)	(4%)	\$ 386	\$ 360	7%	1%
RTMs ( <i>millions</i> )	1,026	1,061	(3%)	(3%)	1,903	1,873	2%	2%
Revenue/RTM ( <i>cents</i> )	19.40	18.94	2%	(1%)	20.28	19.22	6%	-

Revenues for this commodity group decreased by \$2 million, or 1%, in the second quarter and increased by \$26 million, or 7%, in the first half of 2016 when compared to the same periods in 2015. The decrease in the second quarter was mainly due to lower applicable fuel surcharge rates, partly offset by the positive translation impact of a weaker Canadian dollar and freight rate increases. The increase in the first half was mainly due to higher volumes of domestic finished vehicle and parts traffic, and increased finished vehicle imports via the Port of Halifax mainly in the first quarter; the positive translation impact of a weaker Canadian dollar; and freight rate increases, partly offset by lower applicable fuel surcharge rates.

Revenue per RTM increased by 2% in the second quarter and 6% in the first half of 2016 when compared to the same periods in 2015, mainly due to a decrease in the average length of haul, the positive translation impact of a weaker Canadian dollar and freight rate increases, partly offset by lower applicable fuel surcharge rates.

### Other revenues

	Three months ended June 30				Six months ended June 30			
	2016	2015	% Change	% Change at constant currency	2016	2015	% Change	% Change at constant currency
Revenues ( <i>millions</i> )	\$ 196	\$ 198	(1%)	(4%)	\$ 315	\$ 316	-	(4%)

Other revenues are largely derived from non-rail services that support CN's rail business including vessels and docks, warehousing and distribution, automotive logistic services, freight forwarding and transportation management; as well as other revenues including commuter train revenues.

Other revenues decreased by \$2 million, or 1%, in the second quarter and \$1 million, remaining flat, in the first half of 2016 when compared to the same periods in 2015, mainly due to lower revenues from freight forwarding and vessels, partly offset by the positive translation impact of a weaker Canadian dollar and higher revenues from automotive logistic services.

## Operating expenses

Operating expenses for the second quarter of 2016 amounted to \$1,549 million compared to \$1,763 million in the same quarter of 2015. Operating expenses for the first half of 2016 amounted to \$3,296 million compared to \$3,798 million in the same period of 2015. The decreases of \$214 million, or 12%, and \$502 million, or 13%, respectively, in the second quarter and the first half of 2016 were mainly due to lower costs resulting from decreased volumes of traffic, lower fuel prices, lower pension expense and cost-management initiatives, partly offset by the negative translation impact of a weaker Canadian dollar on US dollar-denominated expenses.

<i>In millions</i>	Three months ended June 30				Six months ended June 30			
	2016	2015	% Change	% Change at constant currency	2016	2015	% Change	% Change at constant currency
Labor and fringe benefits	\$ 469	\$ 542	13%	15%	\$ 1,059	\$ 1,210	12%	16%
Purchased services and material	377	434	13%	15%	785	891	12%	15%
Fuel	243	327	26%	29%	478	688	31%	35%
Depreciation and amortization	296	285	(4%)	(2%)	603	581	(4%)	(1%)
Equipment rents	92	83	(11%)	(6%)	187	177	(6%)	1%
Casualty and other	72	92	22%	25%	184	251	27%	31%
<b>Total operating expenses</b>	<b>\$ 1,549</b>	<b>\$ 1,763</b>	<b>12%</b>	<b>15%</b>	<b>\$ 3,296</b>	<b>\$ 3,798</b>	<b>13%</b>	<b>17%</b>

### Labor and fringe benefits

Labor and fringe benefits expense decreased by \$73 million, or 13%, in the second quarter of 2016 and \$151 million, or 12%, in the first half of 2016 when compared to the same periods in 2015. The decreases were primarily a result of a lower average headcount due to lower volumes of traffic and increased productivity, and lower pension expense, partly offset by higher incentive-based compensation expense and the negative translation impact of the weaker Canadian dollar.

### Purchased services and material

Purchased services and material expense decreased by \$57 million, or 13%, in the second quarter of 2016 and \$106 million, or 12%, in the first half of 2016 when compared to the same periods in 2015. The decreases were mainly due to lower repairs and maintenance costs resulting from lower volumes of traffic and cost-management initiatives, as well as favorable winter conditions in the first quarter, and lower accident costs, partly offset by the negative translation impact of the weaker Canadian dollar.

### Fuel

Fuel expense decreased by \$84 million, or 26%, in the second quarter of 2016 and \$210 million, or 31%, in the first half of 2016 when compared to the same periods in 2015. The decreases were primarily due to lower fuel prices and lower volumes of traffic, partly offset by the negative translation impact of the weaker Canadian dollar.

### Depreciation and amortization

Depreciation and amortization expense increased by \$11 million, or 4%, in the second quarter of 2016 and \$22 million, or 4%, in the first half of 2016 when compared to the same periods in 2015. The increases were mainly due to net capital additions and the negative translation impact of the weaker Canadian dollar, partly offset by the favorable impact of depreciation studies.

### Equipment rents

Equipment rents expense increased by \$9 million, or 11%, in the second quarter of 2016 and \$10 million, or 6%, in the first half of 2016 when compared to the same periods in 2015. The increases were primarily due to lower rental income from the use of the Company's locomotives and cars, and the negative translation impact of the weaker Canadian dollar, partly offset by lower rental and car hire expense.

### Casualty and other

Casualty and other expense decreased by \$20 million, or 22%, in the second quarter of 2016 and \$67 million, or 27%, in the first half of 2016 when compared to the same periods in 2015. The decreases were mainly due to lower accident costs partly offset by the negative translation impact of the weaker Canadian dollar.

## Management's Discussion and Analysis

### Other income and expenses

#### Interest expense

Interest expense was \$116 million and \$239 million for the three and six months ended June 30, 2016, respectively, compared to \$105 million and \$209 million, respectively, for the same periods in 2015. The increases were mainly due to the negative translation impact of the weaker Canadian dollar on US dollar-denominated interest expense and a higher level of debt.

#### Other income (loss)

In the second quarter and first half of 2016, the Company recorded other loss of \$1 million and other income of \$4 million, respectively, compared to other income of \$16 million and \$20 million, respectively, in the same periods in 2015, due to lower gains on disposal of land.

#### Income tax expense

The Company recorded income tax expense of \$318 million and \$625 million for the three and six months ended June 30, 2016, respectively, compared to \$387 million and \$646 million, respectively, for the same periods in 2015.

Included in the 2016 figures was a deferred income tax expense of \$7 million resulting from the enactment of a higher provincial corporate income tax rate, which was recorded in the second quarter.

Included in the 2015 figures was a deferred income tax expense of \$42 million resulting from the enactment of a higher provincial corporate income tax rate, which was recorded in the second quarter.

The effective tax rates for the three and six months ended June 30, 2016 were 27.0% and 27.5%, respectively, and 30.4% and 28.9%, respectively, for the same periods in 2015. Excluding the net deferred income tax expense of \$7 million in 2016 and \$42 million in 2015, the effective tax rates for the three and six months ended June 30, 2016 were 26.4% and 27.2%, respectively, and 27.1% and 27.0%, respectively, for the same periods in 2015.

### Summary of quarterly financial data

<i>In millions, except per share data</i>	2016 Quarters			2015 Quarters			2014 Quarters		
	Second <sup>(1)</sup>	First	Fourth	Third	Second <sup>(2)</sup>	First	Fourth	Third	
Revenues	\$ 2,842	\$ 2,964	\$ 3,166	\$ 3,222	\$ 3,125	\$ 3,098	\$ 3,207	\$ 3,118	
Operating income	\$ 1,293	\$ 1,217	\$ 1,354	\$ 1,487	\$ 1,362	\$ 1,063	\$ 1,260	\$ 1,286	
Net income	\$ 858	\$ 792	\$ 941	\$ 1,007	\$ 886	\$ 704	\$ 844	\$ 853	
Basic earnings per share	\$ 1.10	\$ 1.01	\$ 1.19	\$ 1.26	\$ 1.10	\$ 0.87	\$ 1.04	\$ 1.04	
Diluted earnings per share	\$ 1.10	\$ 1.00	\$ 1.18	\$ 1.26	\$ 1.10	\$ 0.86	\$ 1.03	\$ 1.04	
Adjusted diluted earnings per share <sup>(3)</sup>	\$ 1.11	\$ 1.00	\$ 1.18	\$ 1.26	\$ 1.15	\$ 0.86	\$ 1.03	\$ 1.04	
Dividends per share	\$ 0.3750	\$ 0.3750	\$ 0.3125	\$ 0.3125	\$ 0.3125	\$ 0.3125	\$ 0.2500	\$ 0.2500	

(1) Included in net income in the second quarter of 2016 was an income tax expense of \$7 million that resulted from the enactment of a higher corporate income tax rate.

(2) Included in net income in the second quarter of 2015 was an income tax expense of \$42 million that resulted from the enactment of a higher corporate income tax rate.

(3) See the section of this MD&A entitled *Adjusted performance measures* for an explanation of this non-GAAP measure.

Revenues generated by the Company during the year are influenced by seasonal weather conditions, general economic conditions, cyclical demand for rail transportation, and competitive forces in the transportation marketplace (see the section entitled *Business risks* of the Company's 2015 Annual MD&A). Operating expenses reflect the impact of freight volumes, seasonal weather conditions, labor costs, fuel prices, and the Company's productivity initiatives. Fluctuations in the Canadian dollar relative to the US dollar have also affected the conversion of the Company's US dollar-denominated revenues and expenses and resulted in fluctuations in net income in the rolling eight quarters presented above.

### Liquidity and capital resources

An analysis of the Company's liquidity and capital resources is provided in the section entitled *Liquidity and capital resources* of the Company's 2015 Annual MD&A. There were no significant changes during the first half of 2016, except as noted below.

As at June 30, 2016 and December 31, 2015, the Company had Cash and cash equivalents of \$160 million and \$153 million, respectively; Restricted cash and cash equivalents of \$510 million and \$523 million, respectively; and a working capital deficit of \$604 million and \$845 million, respectively. The working capital deficit decreased by \$241 million in the first half of 2016 primarily as a result of a decrease in Current portion of long-term debt. The cash and cash equivalents pledged as collateral for a minimum term of one month pursuant to the Company's bilateral letter of credit facilities are recorded as Restricted cash and cash equivalents. There are currently no specific requirements relating to working capital other than in the normal course of business as discussed herein.

The Company expects cash from operations and its various sources of financing to be sufficient to meet its ongoing obligations. The Company is not aware of any trends or expected fluctuations in its liquidity that would impact its ongoing operations or financial condition as at the date of this MD&A.

#### Available financing sources

##### ***Shelf prospectus and registration statement***

On February 23, 2016, under its current shelf prospectus and registration statement, the Company issued US\$500 million (\$686 million) 2.75% Notes due 2026 in the U.S. capital markets, which resulted in net proceeds of \$677 million. The Company has remaining capacity available of \$5,314 million under its current shelf prospectus and registration statement. Access to the Canadian and U.S. capital markets under the shelf prospectus and registration statement is dependent on market conditions.

##### ***Revolving credit facility***

On March 11, 2016, the Company's revolving credit facility agreement was amended, which increased the credit facility from \$800 million to \$1.3 billion, effective May 5, 2016. The increase in capacity provides the Company with additional financial flexibility. The amended credit facility of \$1.3 billion consists of a tranche for \$420 million maturing on May 5, 2019 and a tranche for \$880 million maturing on May 5, 2021. The accordion feature, which provides for an additional \$500 million subject to the consent of individual lenders, remains unchanged. As at June 30, 2016 and December 31, 2015, the Company had no outstanding borrowings under its revolving credit facility and there were no draws during the six months ended June 30, 2016.

##### ***Commercial paper***

The Company's commercial paper programs are backstopped by the Company's revolving credit facility agreement, which was amended March 11, 2016. During the second quarter of 2016, the maximum aggregate principal amount of commercial paper that could be issued increased from \$800 million to \$1.3 billion, or the US dollar equivalent on a combined basis. As at June 30, 2016 and December 31, 2015, the Company had total commercial paper borrowings of US\$600 million (\$775 million) and US\$331 million (\$458 million), respectively, presented in Current portion of long-term debt on the Consolidated Balance Sheets.

##### ***Accounts receivable securitization program***

As at June 30, 2016 and December 31, 2015, the Company had no proceeds received under the accounts receivable securitization program, which provides the Company with access to up to \$450 million of proceeds.

##### ***Bilateral letter of credit facilities***

As at June 30, 2016, the Company had letters of credit drawn of \$532 million (\$551 million as at December 31, 2015) from a total committed amount of \$567 million (\$575 million as at December 31, 2015) by the various banks. As at June 30, 2016, cash and cash equivalents of \$510 million (\$523 million as at December 31, 2015) were pledged as collateral and recorded as Restricted cash and cash equivalents on the Consolidated Balance Sheets.

Additional information relating to these financing sources is provided in the section entitled *Liquidity and capital resources – Available financing sources* of the Company's 2015 Annual MD&A as well as *Note 5 - Financing activities* to the Company's unaudited Interim Consolidated Financial Statements.

#### Credit ratings

The Company's long-term debt and commercial paper credit ratings remain unchanged from those described in the section entitled *Liquidity and capital resources – Credit ratings* of the Company's 2015 Annual MD&A.

## Management's Discussion and Analysis

### Cash flows

<i>In millions</i>	Three months ended June 30			Six months ended June 30		
	2016	2015	Variance	2016	2015	Variance
Net cash provided by operating activities	\$ 1,271	\$ 1,203	\$ 68	\$ 2,336	\$ 2,195	\$ 141
Net cash used in investing activities	(674)	(662)	(12)	(1,154)	(1,143)	(11)
Net cash used in financing activities	(628)	(633)	5	(1,182)	(1,022)	(160)
Effect of foreign exchange fluctuations on						
US dollar-denominated cash and cash equivalents	3	-	3	7	4	3
<i>Net increase (decrease) in cash and cash equivalents</i>	<b>(28)</b>	<b>(92)</b>	<b>64</b>	<b>7</b>	<b>34</b>	<b>(27)</b>
Cash and cash equivalents, beginning of period	188	178	10	153	52	101
<i>Cash and cash equivalents, end of period</i>	<b>\$ 160</b>	<b>\$ 86</b>	<b>\$ 74</b>	<b>\$ 160</b>	<b>\$ 86</b>	<b>\$ 74</b>

### Operating activities

Net cash provided by operating activities increased by \$68 million in the second quarter of 2016 when compared to the same period in 2015, mainly due to favorable changes in working capital. Net cash provided by operating activities increased by \$141 million in the first half of 2016 when compared to the same period in 2015, due to improvements in cash earnings, partly offset by unfavorable changes in working capital.

### Pension contributions

The Company's contributions to its various defined benefit pension plans are made in accordance with the applicable legislation in Canada and the U.S. and such contributions follow minimum and maximum thresholds as determined by actuarial valuations.

Actuarial valuations are generally required on an annual basis for all Canadian plans, or when deemed appropriate by the Office of the Superintendent of Financial Institutions (OSFI). Actuarial valuations are also required annually for the Company's U.S. qualified pension plans. For accounting purposes, the funded status is calculated under GAAP. For funding purposes, the funded status of the Company's Canadian registered defined benefit pension plans is calculated under going concern and solvency scenarios as prescribed under federal pension legislation and is subject to guidance issued by the Canadian Institute of Actuaries and OSFI. The federal pension legislation requires funding deficits to be paid over a number of years. Alternatively, a letter of credit can be subscribed to fulfill solvency deficit payments.

The Company's most recently filed actuarial valuations for funding purposes for its Canadian registered defined benefit pension plans conducted as at December 31, 2015 indicated a funding excess on a going concern basis of approximately \$2.2 billion and a funding excess on a solvency basis of approximately \$0.3 billion calculated using the three-year average of the plans' hypothetical wind-up ratio.

Pension contributions for the six months ended June 30, 2016 and 2015 of \$88 million and \$92 million, respectively, primarily represent contributions to the CN Pension Plan, for the current service cost as determined under the Company's current actuarial valuations for funding purposes. In 2016, the Company expects to make total cash contributions of approximately \$130 million for all of the Company's pension plans.

Adverse changes to the assumptions used to calculate the Company's funding status, particularly the discount rate, as well as changes to existing federal pension legislation could significantly impact to the Company's future pension contributions.

Additional information relating to the pension plans is provided in *Note 12 – Pensions and other postretirement benefits* to the Company's 2015 Annual Consolidated Financial Statements.

### Income tax payments

Net income tax payments decreased by \$16 million in the first six months of 2016 when compared to the same period in 2015, mainly due to lower tax installments for the 2016 fiscal year. For the 2016 fiscal year, the Company's net income tax payments are expected to be approximately \$800 million.

## Management's Discussion and Analysis

### Investing activities

Net cash used in investing activities increased by \$12 million in the second quarter of 2016 and \$11 million first half of 2016 when compared to the same periods in 2015, mainly as a result of higher property additions.

### Property additions

<i>In millions</i>	Three months ended June 30		Six months ended June 30	
	2016	2015	2016	2015
Track and roadway	\$ 560	\$ 533	\$ 838	\$ 770
Rolling stock	43	60	164	234
Buildings	13	12	21	19
Information technology	22	38	42	65
Other	32	16	74	39
<b>Property additions <sup>(1)</sup></b>	<b>\$ 670</b>	<b>\$ 659</b>	<b>\$ 1,139</b>	<b>\$ 1,127</b>

(1) Includes \$64 million and \$110 million associated with the U.S. federal government legislative Positive Train Control implementation in the three and six months ended June 30, 2016, respectively, (\$25 million and \$41 million in the three and six months ended June 30, 2015, respectively).

### Capital expenditure program

The Company reduced its budget for capital spending from approximately \$2.9 billion to approximately \$2.75 billion in the first quarter of 2016 as a result of updated foreign exchange assumptions. The details of the Company's 2016 capital program are provided in the section entitled *Liquidity and capital resources – Cash flows* of the Company's 2015 Annual MD&A.

### Financing activities

Net cash used in financing activities decreased by \$5 million in the second quarter of 2016 when compared to the same period in 2015, driven by a net issuance of commercial paper, partly offset by the repayment of notes and debt related to capital leases, and higher repurchases of common shares and dividend payments. Net cash used in financing activities increased by \$160 million in the first half of 2016 when compared to the same period in 2015, driven by the repayment of notes and debt related to capital leases, higher repurchases of common shares and dividend payments, and a lower net issuance of commercial paper, partly offset by the issuance of notes.

### Debt financing activities

Debt financing activities in the first half of 2016 included the following:

- On February 23, 2016, issuance of US\$500 million (\$686 million) 2.75% Notes due 2026 in the U.S. capital markets, which resulted in net proceeds of \$677 million;
- On June 1, 2016, repayment of US\$250 million (\$328 million) 5.80% Notes due 2016 upon maturity;
- Repayment of debt related to capital leases of \$59 million in the second quarter and \$170 million in the first half; and
- Net issuance of commercial paper of \$622 million in the second quarter and \$322 million in the first half.

Debt financing activities in the first half of 2015 included a net issuance of commercial paper of \$69 million in the second quarter and \$379 million in the first half, and repayment of debt related to capital leases of \$56 million in the first half.

Additional information relating to the Company's outstanding debt securities is provided in *Note 10 – Long-term debt* to the Company's 2015 Annual Consolidated Financial Statements.

## Management's Discussion and Analysis

### Share repurchase programs

The Company may repurchase shares pursuant to a Normal Course Issuer Bid (NCIB) at prevailing market prices plus brokerage fees, or such other prices as may be permitted by the Toronto Stock Exchange. Under its current NCIB, the Company may repurchase up to 33.0 million common shares between October 30, 2015 and October 29, 2016. As at June 30, 2016, the Company had repurchased 20.4 million common shares for \$1,463 million under its current program.

The following table provides the information related to the share repurchase programs for the three and six months ended June 30, 2016 and 2015:

<i>In millions, except per share data</i>	Three months ended June 30		Six months ended June 30	
	2016	2015	2016	2015
Number of common shares repurchased <sup>(1)</sup>	7.2	5.3	14.6	10.7
Weighted-average price per share <sup>(2)</sup>	\$ 73.80	\$ 77.14	\$ 72.20	\$ 78.17
Amount of repurchase <sup>(3)</sup>	\$ 533	\$ 404	\$ 1,053	\$ 833

(1) Includes repurchases of common shares in the first and second quarters of 2016 and the first quarter 2015 pursuant to private agreements between the Company and arm's length third-party sellers.

(2) Includes brokerage fees where applicable.

(3) Includes settlements in subsequent periods.

### Share Trusts

The Company's Employee Benefit Plan Trusts ("Share Trusts") purchase common shares on the open market, which are used to deliver common shares under the Share Units Plan. For the six months ended June 30, 2016, the Share Trusts disbursed 0.3 million common shares, which had a historical cost of \$23 million, representing a weighted-average price per share of \$73.31, for settlement under the Share Units Plan. For the three and six months ended June 30, 2015, the Share Trusts purchased 0.6 million common shares for \$44 million at a weighted-average price per share of \$74.39, including brokerage fees.

### Dividends paid

The Company paid quarterly dividends of \$0.3750 per share amounting to \$291 million and \$584 million in the second quarter and first half of 2016, respectively, compared to \$250 million and \$502 million, at the rate of \$0.3125 per share, for the same periods in 2015.

### Contractual obligations

In the normal course of business, the Company incurs contractual obligations. The following table sets forth the Company's contractual obligations for the following items as at June 30, 2016:

<i>In millions</i>	Total	2016	2017	2018	2019	2020	2021 & thereafter
Debt obligations <sup>(1)</sup>	\$ 9,984	\$ 1,162	\$ 637	\$ 670	\$ 704	\$ -	\$ 6,811
Interest on debt obligations <sup>(2)</sup>	6,526	217	429	395	347	327	4,811
Capital lease obligations <sup>(3)</sup>	442	60	177	16	16	22	151
Operating lease obligations	649	100	114	111	82	56	186
Purchase obligations <sup>(4)</sup>	1,056	647	237	42	35	30	65
Other long-term liabilities <sup>(5)</sup>	731	32	65	47	42	59	486
<b>Total contractual obligations</b>	<b>\$ 19,388</b>	<b>\$ 2,218</b>	<b>\$ 1,659</b>	<b>\$ 1,281</b>	<b>\$ 1,226</b>	<b>\$ 494</b>	<b>\$ 12,510</b>

(1) Presented net of unamortized discounts and debt issuance costs and excludes capital lease obligations.

(2) Interest payments on floating rate notes are calculated based on the three-month London Interbank Offered Rate effective as at June 30, 2016.

(3) Includes \$338 million of minimum lease payments and \$104 million of imputed interest at rates ranging from 0.7% to 7.3%.

(4) Includes commitments for railroad ties, rail, locomotives and other equipment and services, and outstanding information technology service contracts and licenses.

(5) Includes expected payments for workers' compensation, postretirement benefits other than pensions, net unrecognized tax benefits, environmental liabilities and pension obligations that have been classified as contractual settlement agreements.

## Management's Discussion and Analysis

### Free cash flow

Management believes that free cash flow is a useful measure of performance as it demonstrates the Company's ability to generate cash for debt obligations and for discretionary uses such as payment of dividends, share repurchases, and strategic opportunities. The Company defines its free cash flow measure as the difference between net cash provided by operating activities and net cash used in investing activities; adjusted for changes in restricted cash and cash equivalents and the impact of major acquisitions, if any. Free cash flow does not have any standardized meaning prescribed by GAAP and therefore, may not be comparable to similar measures presented by other companies.

The following table provides a reconciliation of net cash provided by operating activities as reported for the three and six months ended June 30, 2016 and 2015, to free cash flow:

<i>In millions</i>	Three months ended June 30		Six months ended June 30	
	2016	2015	2016	2015
Net cash provided by operating activities	\$ 1,271	\$ 1,203	\$ 2,336	\$ 2,195
Net cash used in investing activities	(674)	(662)	(1,154)	(1,143)
<i>Net cash provided before financing activities</i>	597	541	1,182	1,052
<i>Adjustment: Change in restricted cash and cash equivalents</i>	(12)	(11)	(13)	(1)
<b>Free cash flow</b>	<b>\$ 585</b>	<b>\$ 530</b>	<b>\$ 1,169</b>	<b>\$ 1,051</b>

### Adjusted debt-to-adjusted EBITDA multiple

Management believes that the adjusted debt-to-adjusted earnings before interest, income taxes, depreciation and amortization (EBITDA) multiple is a useful credit measure because it reflects the Company's ability to service its debt. The Company calculates the adjusted debt-to-adjusted EBITDA multiple as adjusted debt divided by adjusted EBITDA. These measures do not have any standardized meaning prescribed by GAAP and therefore, may not be comparable to similar measures presented by other companies.

The following table provides a reconciliation of debt and net income to the adjusted measures presented below, which have been used to calculate the adjusted debt-to-adjusted EBITDA multiple:

<i>In millions, unless otherwise indicated</i>	<i>As at and for the twelve months ended June 30,</i>		2016	2015
Debt <sup>(1)</sup>		\$	10,322	\$ 9,308
<i>Adjustment: Present value of operating lease commitments <sup>(2)</sup></i>			561	647
<b>Adjusted debt</b>		<b>\$</b>	<b>10,883</b>	<b>\$ 9,955</b>
Net income		\$	3,598	\$ 3,287
Interest expense			469	397
Income tax expense			1,315	1,318
Depreciation and amortization			1,180	1,118
<b>EBITDA</b>			<b>6,562</b>	<b>6,120</b>
<i>Adjustments:</i>				
Other income			(31)	(31)
Deemed interest on operating leases			27	30
<b>Adjusted EBITDA</b>		<b>\$</b>	<b>6,558</b>	<b>\$ 6,119</b>
<b>Adjusted debt-to-adjusted EBITDA multiple (times)</b>			<b>1.66</b>	<b>1.63</b>

(1) As a result of the retrospective adoption of a new accounting standard in the fourth quarter of 2015, the prior period debt balance has been adjusted. There was no impact to the related financial ratio. See the section of the Company's 2015 Annual MD&A entitled *Recent accounting pronouncements* for additional information.

(2) The operating lease commitments have been discounted using the Company's implicit interest rate for each of the periods presented.

The increase in the Company's adjusted debt-to-adjusted EBITDA multiple at June 30, 2016, as compared to the same period in 2015, was mainly due to an increased debt level as at June 30, 2016, resulting from the net issuance of debt and a weaker Canadian-to-US dollar foreign exchange rate, partly offset by a higher net income earned during the twelve months ended June 30, 2016, as compared to the twelve months ended June 30, 2015.

All forward-looking statements discussed in this section are subject to risks and uncertainties and are based on assumptions about events and developments that may not materialize or that may be offset entirely or partially by other events and developments. See the section of this MD&A entitled *Forward-looking statements* for a discussion of assumptions and risk factors affecting such forward-looking statements.

## Management's Discussion and Analysis

### Off balance sheet arrangements

#### Guarantees and indemnifications

In the normal course of business, the Company, including certain of its subsidiaries, enters into agreements that may involve providing guarantees or indemnifications to third parties and others, which may extend beyond the term of the agreements. These include, but are not limited to, residual value guarantees on operating leases, standby letters of credit, surety and other bonds, and indemnifications that are customary for the type of transaction or for the railway business. As at June 30, 2016, the Company has not recorded a liability with respect to guarantees and indemnifications. Additional information relating to guarantees and indemnifications is provided in *Note 9 – Major commitments and contingencies* to the Company's unaudited Interim Consolidated Financial Statements.

### Outstanding share data

As at July 25, 2016, the Company had 771.6 million common shares and 6.4 million stock options outstanding.

### Financial instruments

#### Risk management

In the normal course of business, the Company is exposed to various financial risks from its use of financial instruments, such as credit risk, liquidity risk, and market risks such as foreign currency risk, interest rate risk and commodity price risk. A description of these risks and how the Company manages them, is provided in the section entitled *Financial instruments* of the Company's 2015 Annual MD&A.

#### Foreign currency risk

The estimated annual impact on net income of a year-over-year one-cent change in the Canadian dollar relative to the US dollar is approximately \$30 million.

#### Derivative financial instruments

As at June 30, 2016, the Company had outstanding foreign exchange forward contracts with a notional value of US\$967 million (US\$361 million as at December 31, 2015). For the three and six months ended June 30, 2016, the Company recorded a loss of \$2 million and \$47 million, respectively, related to foreign exchange forward contracts, compared to a loss of \$7 million and a gain of \$29 million, respectively, for the same periods in 2015. These gains and losses were largely offset by the re-measurement of US dollar-denominated monetary assets and liabilities recorded in Other income.

As at June 30, 2016, Other current assets included an unrealized gain of \$6 million (\$4 million as at December 31, 2015) and Accounts payable and other included an unrealized loss of \$21 million (\$2 million as at December 31, 2015), related to the fair value of outstanding foreign exchange forward contracts.

#### Fair value of financial instruments

As at June 30, 2016, the Company's investments had a carrying amount of \$64 million (\$69 million as at December 31, 2015) and a fair value of \$207 million (\$220 million as at December 31, 2015). As at June 30, 2016, the Company's debt had a carrying amount of \$10,322 million (\$10,427 million as at December 31, 2015) and a fair value of \$12,077 million (\$11,720 million as at December 31, 2015).

Additional information relating to financial instruments is provided in *Note 10 – Financial instruments* to the Company's unaudited Interim Consolidated Financial Statements.

## Management's Discussion and Analysis

### Recent accounting pronouncements

The following recent Accounting Standards Updates (ASUs) issued by the Financial Accounting Standards Board (FASB) were adopted by the Company during the current period:

Standard	Description	Impact
<b>ASU 2016-09 Compensation – Stock Compensation</b>	Simplifies several aspects of the accounting for share-based payments, including the income tax consequences, classification of awards as either equity or liabilities, and classification in the Statement of Cash Flows. The new guidance includes multiple amendments with differing application methods.	The Company adopted this standard during the second quarter of 2016 with an effective date of January 1, 2016. The adoption of this standard did not have a significant impact on the Consolidated Financial Statements of the Company.

The following recent ASUs issued by FASB have an effective date after June 30, 2016 and have not been adopted by the Company:

Standard	Description	Impact	Effective date <sup>(1)</sup>
<b>ASU 2016-13 Financial Instruments – Credit Losses</b>	Requires financial assets measured at amortized cost to be presented at the net amount expected to be collected. The amendments replace the current incurred loss impairment methodology with one that reflects expected credit losses and considers a broader range of reasonable and supportable information to determine the expected credit loss estimates.	The Company is evaluating the effects that the adoption of the ASU will have on its Consolidated Financial Statements, if any; however, no significant impact is expected.	December 15, 2019. Early adoption is permitted.
<b>ASU 2016-02 Leases</b>	Requires the recognition of lease assets and lease liabilities on the Balance Sheet by lessees for most leases. The accounting treatment applied by a lessor is largely unchanged. Lessees and lessors are required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach.	The Company is evaluating the effects that the adoption of the ASU will have on its Consolidated Financial Statements.	December 15, 2018. Early adoption is permitted.
<b>ASU 2016-01 Financial Instruments – Overall</b>	Addresses certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. The amendments require equity investments (except those accounted for under the equity method of accounting or those resulting in consolidation) to be measured at fair value with changes in fair value recognized in net income. The new guidance can be applied by means of a cumulative effect adjustment to the Balance Sheet at the beginning of the year of adoption.	The adoption of the ASU will not have a significant impact on the Company's Consolidated Financial Statements.	December 15, 2017.
<b>ASU 2014-09 Revenue from Contracts with Customers</b>	Establishes principles for reporting the nature, amount, timing and uncertainty of revenues and cash flows arising from an entity's contracts with customers. The basis of the new standard is that an entity recognizes revenue to represent the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The new guidance can be applied using a retrospective or the cumulative effect transition method.	The Company is evaluating the effects that the adoption of the ASU will have on its Consolidated Financial Statements, if any; however, no significant impact is expected.	December 15, 2017. Early adoption is permitted.

(1) Effective for annual and interim reporting periods beginning after the stated date.

### Critical accounting estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates, judgments and assumptions that affect the reported amounts of revenues, expenses, assets and liabilities, and the disclosure of contingent assets and liabilities at the date of the financial statements. On an ongoing basis, management reviews its estimates based upon available information. Actual results could differ from these estimates. The Company's policies for income taxes, depreciation, pensions and other postretirement benefits, personal injury and other claims and environmental matters, require management's more significant judgments and estimates in the preparation of the Company's Consolidated Financial Statements and, as such, are considered to be critical. Reference is made to the section entitled *Critical accounting estimates* of the Company's 2015 Annual MD&A for a detailed description of the Company's critical accounting estimates. There have not been any material changes to these estimates, except as noted below for pensions and other postretirement benefits.

#### Adoption of the spot rate approach

In the first quarter of 2016, the Company adopted the spot rate approach to measure current service cost and interest cost for all defined benefit pension and other postretirement benefit plans on a prospective basis as a change in accounting estimate. In prior periods, these costs were determined using the discount rate used to measure the projected benefit obligation at the beginning of the period.

The spot rate approach enhances the precision to which current service cost and interest cost are measured by increasing the correlation between projected cash flows and spot discount rates corresponding to their maturity. Under the spot rate approach, individual spot discount rates along the same yield curve used in the determination of the projected benefit obligation are applied to the relevant projected cash flows at the relevant maturity. More specifically, current service cost is measured using the projected cash flows related to benefits expected to be accrued in the following year by active members of a plan and interest cost is measured using the projected cash flows making up the projected benefit obligation multiplied by the corresponding spot discount rate at each maturity. Use of the spot rate approach does not affect the measurement of the projected benefit obligation.

Based on bond yields prevailing at December 31, 2015, the single equivalent discount rates to determine current service cost and interest cost under the spot rate approach in 2016 are 4.24% and 3.27%, respectively, compared to 3.99%, for both costs, under the approach applied in prior periods. For the three and six months ended June 30, 2016, the adoption of the spot rate approach increased net periodic benefit income by approximately \$35 million and \$65 million, respectively, compared to the approach applied in prior periods.

Management discusses the development and selection of the Company's critical accounting policies, including the underlying estimates and assumptions, with the Audit Committee of the Company's Board of Directors. The Audit Committee has reviewed the Company's related disclosures.

### Business risks

In the normal course of business, the Company is exposed to various business risks and uncertainties that can have an effect on the Company's results of operations, financial position, or liquidity. While some exposures may be reduced by the Company's risk management strategies, many risks are driven by external factors beyond the Company's control or are of a nature which cannot be eliminated.

Reference is made to the section entitled *Business risks* of the Company's 2015 Annual MD&A for a detailed description of such key areas of business risks and uncertainties with respect to: Competition, Environmental matters, Personal injury and other claims, Labor negotiations, Regulation, Transportation of hazardous materials, Economic conditions, Pension funding volatility, Reliance on technology, Trade restrictions, Terrorism and international conflicts, Customer credit risk, Liquidity, Supplier concentration, Availability of qualified personnel, Fuel costs, Foreign exchange, Interest rate, Transportation network disruptions, and Weather and climate change, which is incorporated herein by reference. Additional risks and uncertainties not currently known to management or that may currently not be considered material by management, could nevertheless also have an adverse effect on the Company's business.

There have been no material changes to the risks described in the Company's 2015 Annual MD&A. The following is an update on labor negotiations and regulatory matters.

#### Labor negotiations

As at June 30, 2016, CN employed a total of 15,258 employees in Canada, of which 10,989, or 72%, were unionized employees; and 6,904 employees in the U.S., of which 5,453, or 79% were unionized employees. The Company's relationships with its unionized workforce are governed by, amongst other items, collective agreements which are negotiated from time to time. Disputes relating to the renewal of collective agreements could potentially result in strikes, slowdowns and loss of business. Future labor agreements or renegotiated agreements could increase labor and fringe benefits expenses. There can be no assurance that the Company will be able to renew and have

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its collective agreements ratified without any strikes or lockouts or that the resolution of these collective bargaining negotiations will not have a material adverse effect on the Company's results of operations or financial position.

### **Canadian workforce**

On March 23, 2016, the Company served notice to commence bargaining for the renewal of the collective agreements with the Teamsters Canada Rail Conference governing approximately 2,500 train conductors and yard coordinators, which expired on July 22, 2016. On June 29, 2016, the Company filed a notice of dispute seeking conciliation assistance. On July 14, 2016, the Minister of Labour appointed two conciliation officers to assist the parties with their negotiations.

The Company's collective agreements remain in effect until the bargaining process outlined under the *Canada Labour Code* has been exhausted.

### **U.S. workforce**

As of July 25, 2016, all collective agreements covering non-operating craft employees and six of sixteen collective agreements covering operating craft employees are under renegotiation.

Where negotiations are ongoing, the terms and conditions of existing collective bargaining agreements continue to apply until new agreements are reached or the processes of the *Railway Labor Act* have been exhausted.

## **Regulation**

### **Economic regulation – Canada**

On June 25, 2014, the Government of Canada launched a statutory review of the Canada Transportation Act. The review concluded on December 21, 2015 when a report was submitted to the Federal Minister of Transport by the Chair of the review panel. The report was tabled in Parliament on February 25, 2016 by the Federal Minister of Transport. It is unclear what actions will be taken by the Government after it has considered the findings of the report and consulted with interested groups, and the potential impact on CN, if any.

On June 15, 2016, the Government of Canada announced that the provisions introduced by Bill C-30, notably with respect to extended interswitching distances and minimum volumes of grain to be moved, which were set to expire on August 1, 2016, had been extended until August 2017.

On June 18, 2016, the liability and compensation regime for rail under the *Safe and Accountable Rail Act* came into force. Under the regime, railway companies are strictly liable for damages resulting from accidents involving crude oil and are required to maintain minimum liability insurance coverage in respect of losses incurred as a result of a railway accident involving crude oil. The Act also creates a fund, capitalized through levies payable by crude oil shippers, to compensate for losses exceeding the railway company's minimum insurance level. CN has provided the Canadian Transportation Agency with submissions respecting the adequacy of its insurance coverage and has started collecting the levy on crude shipments.

### **Economic regulation – U.S.**

On March 28, 2016, the Surface Transportation Board issued a Notice of Proposed Rulemaking to revoke previously granted exemptions of five commodities from regulatory oversight: (1) crushed or broken stone, (2) hydraulic cement, (3) coke produced from coal, (4) primary iron or steel products, and (5) iron or steel scrap, wastes or tailings.

On April 29, 2016, the U.S. Court of Appeals for the District of Columbia Circuit ruled that the *Passenger Rail Investment and Improvement Act of 2008 (PRIIA)* violates the due process rights of freight railroads, and consequently, that the performance standards jointly promulgated by Amtrak and the Federal Railroad Administration (FRA) pursuant to PRIIA are unconstitutional. The case will likely be appealed to the U.S. Supreme Court later this year.

### **Safety regulation – Canada**

On April 28, 2016, Transport Canada issued a Protective Direction under which railways are required to provide municipalities and first responders with data on dangerous goods to improve emergency planning, risk assessment, and training.

On June 1, 2016, the Minister of Transport proposed amendments to the *Transportation of Dangerous Goods Act* to improve reporting requirements by carriers respecting shipments of dangerous goods to enhance public safety and improve local emergency response.

On June 18, 2016, Transport Canada proposed Locomotive Emissions Regulations under the *Railway Safety Act* to limit air pollution and align Canadian standards with U.S. regulations.

### **Safety regulation – U.S.**

On March 15, 2016, the FRA issued a Notice of Proposed Rulemaking establishing a requirement for a minimum of two crewmembers on most train movements, with the second crewmember needing to be physically located on the train, except in certain circumstances. The FRA will consider possible scenarios for use of a one person crew, but some element of a safety assessment will be involved with each scenario.

## Management's Discussion and Analysis

On July 13, 2016, in coordination with the FRA, the Pipeline and Hazardous Materials Safety Administration announced proposed regulations for oil spill response plans and information sharing for high-hazard flammable trains to improve oil spill response readiness and mitigate effects of oil-related rail incidents.

### ***Positive Train Control***

The Company filed its annual progress report with the FRA on March 31, 2016. In addition to the annual progress report, the FRA is now requesting that railroads submit a quarterly progress report, the first of which is due on July 31, 2016.

No assurance can be given that these and any other current or future regulatory or legislative initiatives by the Canadian and U.S. federal governments and agencies will not materially adversely affect the Company's results of operations or its competitive and financial position.

### **Trade restrictions**

On October 12, 2015, the Softwood Lumber Agreement (SLA) between Canada and the U.S. expired. The SLA included a clause that prevents the U.S. from launching any trade action against Canadian producers for one year after the expiration date of the SLA. It is unlikely that a new agreement will be renegotiated before the moratorium period ends. After the moratorium period ends, there is a risk that Canadian softwood lumber shipments to the U.S. may be impacted by future trade disputes.

There can be no assurance that any trade action taken by the Canadian and U.S. federal governments and agencies will not have a material adverse effect on the volume of rail shipments and/or revenues from commodities carried by the Company, and thus materially and negatively impact earnings and/or cash flow.

## Controls and procedures

The Company's Chief Executive Officer and its Chief Financial Officer, after evaluating the effectiveness of the Company's disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) as of June 30, 2016, have concluded that the Company's disclosure controls and procedures were effective.

During the second quarter ended June 30, 2016, there was no change in the Company's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.