

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 Interim Consolidated Financial Statements and related notes for the three months ended March 31, 2016 in Item 1. Financial Statements, and other information in this report. 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"). Also, filings made pursuant to Section 16 of the Securities Exchange Act of 1934 ("Exchange Act") with the SEC by our executive officers, directors and other reporting persons with respect to the Company's Common Shares are made available free of charge, through our website. Our website also contains charters for each of the committees of our Board of Directors, 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 an Exhibit to this report.

Executive Summary

First Quarter 2016 Results

- *Financial performance* – In the first quarter of 2016, CP reported Diluted EPS of \$3.51 while Adjusted diluted EPS was \$2.50, 83% and 11% improvements compared to the Diluted EPS of \$1.92 and Adjusted diluted EPS of \$2.26, respectively, for the same period in 2015. CP's commitment to operational efficiency produced an operating ratio of 58.9%, a 430 basis point improvement. 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.
- *Operating performance* – CP's continued focus on asset utilization and network investments resulted in significant improvements to CP's key operating metrics. CP's network train speed increased by 21% to 23.5 miles per hour, terminal dwell improved by 22% to 6.9 hours and fuel efficiency improved by 9% to 0.998 U.S. gallons of locomotive fuel consumed per 1,000 gross ton-miles ("GTMs"). These metrics are discussed further in Performance Indicators of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Recent Developments

On April 20, 2016, CP announced that it intends to implement a new normal course issuer bid to repurchase, for cancellation, up to 6.91 million of its Common Shares, subject to Toronto Stock Exchange acceptance.

Also on April 20, 2016, CP announced an increase to the Company's quarterly dividend to \$0.5000 per share from \$0.3500 per share payable on July 25, 2016 to shareholders of record on June 24, 2016.

Changes to Executive Officers

On April 20, 2016, the Company announced that Mr. Robert Johnson was appointed Executive Vice-President, Operations.

Performance Indicators

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

For the three months ended March 31	2016 ⁽¹⁾	2015 ⁽¹⁾	% Change
Operations Performance			
Freight gross ton-miles ("GTMs") (millions)	61,913	65,355	(5)
Revenue ton-miles ("RTMs") (millions)	34,335	36,063	(5)
Train miles (thousands)	7,854	8,540	(8)
Average train weight – excluding local traffic (tons)	8,498	8,183	4
Average train length – excluding local traffic (feet)	7,108	6,773	5
Average terminal dwell (hours)	6.9	8.9	(22)
Average train speed (mph)	23.5	19.5	21
Fuel efficiency (U.S. gallons of locomotive fuel consumed /1,000 GTMs)	0.998	1.048	(5)
Total employees (average)	12,434	14,364	(13)
Total employees (end of period)	12,443	14,259	(13)
Workforce (end of period)	12,508	14,342	(13)
Safety Indicators			
FRA personal injuries per 200,000 employee-hours	1.45	2.09	(31)
FRA train accidents per million train miles	0.81	1.48	(45)

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

Operations Performance

GTMs are defined as the movement of total train weight over a distance of one mile. Total train weight comprises the weight of the freight cars, their contents, and any inactive locomotives. An increase in GTMs indicates additional workload. GTMs for the first quarter of 2016 were 61,913 million, a 5% decrease compared with 65,355 million in the same period of 2015. This decline was primarily due to a drop in volumes in the Crude, Coal, and Metals, minerals and consumer products lines of business.

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 2016 were 34,335 million, a decrease of 1,728 million or 5% compared with 36,063 million in the same period of 2015. This decrease was primarily due to lower volumes in the U.S. Grain, Crude and other energy related products and Potash lines of business. This decrease in RTMs was partially offset by increased shipments of Canadian grain.

Train miles for the first quarter of 2016 decreased by 686 thousand miles or 8% compared to the same period of 2015, reflecting continuous improvements in operating efficiency from longer, heavier trains.

The average train weight is defined as the average gross weight of CP trains, both loaded and empty. This excludes trains in short-haul service, work trains used to move CP's track equipment and materials, and the haulage of other railways' trains on CP's network. Average train weight increased in the first quarter of 2016 by 315 tons, or 4%, from the same period of 2015.

The average train length is defined as the sum of each car length multiplied by the distance travelled, divided by train miles. Local trains are excluded from this measure. Average train length increased in the first quarter of 2016 by 335 feet, or 5%, from the same period of 2015.

Both average train weight and length in the first quarter of 2016 benefited from improvements in operating plan efficiency.

The average terminal dwell is defined as the average time a freight car resides within terminal boundaries expressed in hours. The timing starts with a train arriving in the terminal, a customer releasing the car to the Company, or a car arriving at interchange from another railway. The timing ends when the train leaves, a customer receives the car from CP, or the freight car is transferred to another railway. Freight cars are excluded if they are being stored at the terminal or used in track repairs. Average terminal dwell decreased by 22% to 6.9 hours in the first quarter of 2016 from 8.9 hours in the same period of 2015. This favourable decrease was primarily due to continued improvements in yard operating performance.

The average train speed is defined as a measure of the line-haul movement from origin to destination including terminal dwell hours. It is calculated by dividing the total train miles travelled by the total train hours operated. This calculation does not include delay time related to customer or foreign railways and excludes the time and distance travelled by: i) trains used in or around CP's yards; ii) passenger trains; and iii) trains used for repairing track. Average train speed was 23.5 miles per hour in the first quarter of 2016, an increase of 21%, from 19.5 miles per hour in the same period of 2015. This favourable increase was primarily due to improved train design and operating plan execution.

Fuel efficiency improved by 5% in the first quarter of 2016 compared to the same period of 2015. Improvements in fuel efficiency were a result of increased locomotive productivity, operational fluidity, and execution of the Company's fuel conservation strategies.

An employee is defined by the Company as an individual currently engaged in full-time or part-time employment with CP. Employees could be engaged in full-time, part-time or seasonal capacity. The average number of total employees for the first quarter of 2016 was 12,434, a decrease of 1,930, or 13%, compared with the same period of 2015. The total number of employees as at March 31, 2016 was 12,443, a decrease of 13% compared with 14,259 as at March 31, 2015. The Company's workforce is defined as employees, plus contractors and consultants. The Company's total workforce as at March 31, 2016 was 12,508, a decrease of 1,834, or 13%, compared with 14,342 as at March 31, 2015. This reduction was primarily due to lower workload, strong operational performance and natural attrition.

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 injury rate per 200,000 employee-hours 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 injury rate per 200,000 employee-hours for CP was 1.45 in the first quarter of 2016, down from 2.09 in the same period of 2015. The FRA train accidents per million train miles was 0.81 in the first quarter of 2016, a decrease from 1.48 in the same period of 2015.

Financial Highlights

For the three months ended March 31

(in millions, except per share data, percentages and ratios)	2016	2015
Financial Performance		
Revenues	\$ 1,591	\$ 1,665
Operating income	653	612
Net income	540	320
Adjusted income ⁽¹⁾	384	375
Basic earnings per share	3.53	1.94
Diluted earnings per share	3.51	1.92
Adjusted diluted earnings per share ⁽¹⁾	2.50	2.26
Dividends declared per share	0.3500	0.3500
Financial Position		
Total assets ⁽²⁾⁽³⁾	\$ 19,349	\$ 19,637
Total long-term obligations ⁽²⁾⁽³⁾⁽⁴⁾	8,508	9,012
Shareholders' equity ⁽³⁾	5,290	4,796
Cash provided by operating activities	218	555
Free cash ⁽¹⁾	(71)	312
Financial Ratios		
Return on invested capital ("ROIC") ⁽¹⁾	14.8%	14.6%
Adjusted ROIC ⁽¹⁾	15.2%	15.2%
Operating ratio ⁽⁵⁾	58.9%	63.2%

⁽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⁾ 2015 comparative period figures have been restated for retrospective adoption of Accounting Standards Update ("ASU") 2015-17.

⁽³⁾ 2015 information is as at December 31, 2015.

⁽⁴⁾ Excludes deferred income taxes: \$3,422 million and \$3,391 million; and other non-financial deferred liabilities of \$963 million and \$991 million at March 31, 2016 and 2015 respectively.

⁽⁵⁾ Operating ratio is defined as operating expenses divided by revenues.

Results of Operations

Income

Operating income was \$653 million in the first quarter of 2016, an increase of \$41 million, or 7%, from \$612 million in the same period of 2015. This increase was primarily due to:

- the favourable impact of the change in foreign exchange ("FX") of \$54 million;
- efficiencies generated from improved operating performance and asset utilization;
- higher pension income of \$33 million;
- lower casualty expense of \$16 million; and
- lower share-based compensation expense of \$14 million.

This increase was partially offset by lower traffic volume and higher wage and benefit inflation of 3%.

Net income was \$540 million in the first quarter of 2016, an increase of \$220 million, or 69%, from \$320 million in the same period of 2015. This increase was primarily due to higher operating income and the favourable impact of FX translation on U.S. dollar-denominated debt, partially offset by higher interest expense on new debt issued in 2015 and an increase in Income tax expense due to higher taxable earnings.

Adjusted income, defined and reconciled in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations, was \$384 million in the first quarter of 2016, an increase of \$9 million, or 2%, from \$375 million in the same period of 2015. This increase was due to the same factors discussed above for the increase in Net income except that Adjusted income excluded the impact of FX translation on U.S. dollar-denominated debt.

Diluted Earnings per Share

Diluted earnings per share was \$3.51 in the first quarter of 2016, an increase of \$1.59, or 83% from \$1.92 in the same period of 2015. 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 \$2.50 in the first quarter of 2016, an increase of \$0.24, or 11%, from \$2.26 in the same period of 2015. These increases were primarily due to higher Net income and Adjusted income, respectively, and lower average outstanding shares due to the Company's share repurchase program.

Operating Ratio

The Operating ratio provides the percentage of revenues used to operate the railway. A lower percentage normally indicates higher efficiency in the operation of the railway. The Company's Operating ratio was 58.9% in the first quarter of 2016, a 430 basis point improvement from 63.2% in the same period of 2015. This improvement was primarily due to efficiencies generated from improved operating performance and asset utilization, higher pension income and lower casualty expense.

This improvement was offset by lower traffic volumes and wage and benefit inflation.

Return on Invested Capital

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 14.8% for the twelve months ended March 31, 2016, a 20 basis point increase compared to 14.6% for the twelve months ended March 31, 2015. This increase was due to higher income and lower total shareholders' equity, primarily due to the Company's share repurchase program. Adjusted ROIC was 15.2% for the twelve months ended March 31, 2016, and was unchanged compared to the twelve months ended March 31, 2015. 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 2016, the impact of a stronger U.S. dollar resulted in an increase in total revenues of \$108 million, an increase in total operating expenses of \$54 million and an increase in interest expense of \$7 million from the same period in 2015.

Canadian to U.S. dollar		
Average exchange rates		
	2016	2015
For the three months ended – March 31	\$ 1.37	\$ 1.24

Canadian to U.S. dollar			
Exchange rates	2016		2015
Beginning of quarter – January 1	\$	1.38	\$ 1.16
End of quarter – March 31	\$	1.30	\$ 1.27

Impact of Fuel Price on Earnings

Fluctuations in fuel prices affect the Company's results because fuel expense constitutes a significant portion of CP's operating costs. As fuel prices fluctuate, there will be a timing impact on earnings. In the first quarter of 2016, the impact of lower fuel prices resulted in a decrease in total revenues of \$82 million and a decrease in total operating expenses of \$67 million from the same period in 2015.

Average Fuel Price			
(U.S. dollars per U.S. gallon)	2016		2015
For the three months ended – March 31	\$	1.48	\$ 2.32

Impact of Share Price on Earnings

CP Common Share Price			
Toronto Stock Exchange (in Canadian dollars)	2016		2015
Opening Common Share Price, as at January 1	\$	176.73	\$ 223.75
Ending Common Share Price, as at March 31	\$	172.55	\$ 231.90
Change in Common Share Price	\$	(4.18)	\$ 8.15

Common Share Price			
New York Stock Exchange (in U.S. dollars)	2016		2015
Opening Common Share Price, as at January 1	\$	127.60	\$ 192.69
Ending Common Share Price, as at March 31	\$	132.69	\$ 182.70
Change in Common Share Price	\$	5.09	\$ (9.99)

Fluctuations in the Common Share price affect the Company's operating expenses because share-based liabilities are fair valued. In the first quarter of 2016, the impact of the change in Common Share price resulted in a decrease in stock-based compensation expense of \$2 million compared to an increase of \$7 million in the same period in 2015.

Operating Revenues

For the three months ended March 31	2016	2015	% Change	2016 vs. 2015	
				Total Change	FX Impact ⁽²⁾
Freight revenues (in millions) ⁽¹⁾	\$ 1,548	\$ 1,630	(5)	\$ (82)	\$ 107
Non-freight revenues (in millions)	43	35	23	8	1
Total revenues (in millions)	\$ 1,591	\$ 1,665	(4)	\$ (74)	\$ 108
Carloads (in thousands)	614	642	(4)	(28)	N/A
Revenue ton-miles (in millions)	34,335	36,063	(5)	(1,728)	N/A
Freight revenue per carload (dollars)	\$ 2,520	\$ 2,541	(1)	\$ (21)	N/A
Freight revenue per revenue ton-miles (cents)	4.51	4.52	—	(0.01)	N/A

⁽¹⁾ Freight revenues include fuel surcharge revenues of \$22 million in 2016, and \$104 million in 2015.

⁽²⁾ FX impact is a component of the Total Change.

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

Freight Revenues

Freight revenues were \$1,548 million in the first quarter of 2016, a decrease of \$82 million, or 5% from \$1,630 million in the same period of 2015. This decrease was primarily due to the impact of lower fuel prices on fuel surcharge revenue of \$82 million and an overall decline in traffic volumes. This decrease was partially offset by a favourable impact of the change in FX of \$107 million.

Non-freight Revenues

Non-freight revenues were \$43 million in the first quarter of 2016, an increase of \$8 million, or 23% from \$35 million in the same period of 2015. This increase was primarily due to higher transload revenues following the acquisition of Steelcare Inc. in the third quarter of 2015, leasing and switching revenues. The favourable impact of the change in FX accounted for \$1 million of the increase.

Lines of Business

Canadian Grain

For the three months ended March 31	2016 vs. 2015				
	2016	2015	% Change	Total Change	FX Impact ⁽¹⁾
Freight revenues (in millions)	\$ 254	\$ 256	(1)	\$ (2)	\$ 8
Carloads (in thousands)	66	61	8	5	N/A
Revenue ton-miles (in millions)	6,941	6,405	8	536	N/A
Freight revenue per carload (dollars)	\$ 3,861	\$ 4,214	(8)	\$ (353)	N/A
Freight revenue per revenue ton-mile (cents)	3.66	3.99	(8)	(0.33)	N/A

⁽¹⁾FX impact is a component of the Total Change.

Canadian grain revenue was \$254 million in the first quarter of 2016, a decrease of \$2 million, or 1% from \$256 million in the same period of 2015. This decrease was primarily due to lower freight rates that reflect the decrease in the Maximum Revenue Entitlement for Canadian regulated grain in crop year 2015/2016 and lower fuel surcharge revenue on non-regulated grain shipments. The decreases were largely offset by increased volume, particularly export volumes through Port of Vancouver, and the favourable impact of the change in FX.

U.S. Grain

For the three months ended March 31	2016 vs. 2015				
	2016	2015	% Change	Total Change	FX Impact ⁽¹⁾
Freight revenues (in millions)	\$ 113	\$ 137	(18)	\$ (24)	\$ 17
Carloads (in thousands)	34	40	(15)	(6)	N/A
Revenue ton-miles (in millions)	2,314	2,944	(21)	(630)	N/A
Freight revenue per carload (dollars)	\$ 3,272	\$ 3,408	(4)	\$ (136)	N/A
Freight revenue per revenue ton-mile (cents)	4.89	4.66	5	0.23	N/A

⁽¹⁾FX impact is a component of the Total Change.

U.S. grain revenue was \$113 million in the first quarter of 2016, a decrease of \$24 million, or 18% from \$137 million in the same period of 2015. The decrease was primarily due to lower volume, particularly for long-haul export traffic, and lower fuel surcharge revenue. The favourable impact of the change in FX partially offset these decreases.

Coal

For the three months ended March 31	2016 vs. 2015				
	2016	2015	% Change	Total Change	FX Impact ⁽¹⁾
Freight revenues (in millions)	\$ 145	\$ 160	(9)	\$ (15)	\$ 3
Carloads (in thousands)	72	82	(12)	(10)	N/A
Revenue ton-miles (in millions)	5,348	5,704	(6)	(356)	N/A
Freight revenue per carload (dollars)	\$ 2,001	\$ 1,939	3	\$ 62	N/A
Freight revenue per revenue ton-mile (cents)	2.70	2.80	(4)	(0.10)	N/A

⁽¹⁾FX impact is a component of the Total Change.

Coal revenue was \$145 million in the first quarter of 2016, a decrease of \$15 million, or 9% from \$160 million in the same period of 2015. This decrease was primarily due to lower fuel surcharge revenue and lower volumes of short-haul thermal coal to U.S. domestic customers. The favourable impact of the change in FX partially offset these revenue decreases.

Potash

For the three months ended March 31	2016 vs. 2015				
	2016	2015	% Change	Total Change	FX Impact ⁽¹⁾
Freight revenues (in millions)	\$ 82	\$ 93	(12)	\$ (11)	\$ 6
Carloads (in thousands)	27	31	(13)	(4)	N/A
Revenue ton-miles (in millions)	3,185	3,675	(13)	(490)	N/A
Freight revenue per carload (dollars)	\$ 3,064	\$ 3,028	1	\$ 36	N/A
Freight revenue per revenue ton-mile (cents)	2.58	2.54	2	0.04	N/A

⁽¹⁾ FX impact is a component of the Total Change.

Potash revenue was \$82 million in the first quarter of 2016, a decrease of \$11 million, or 12% from \$93 million in the same period of 2015. This decrease was primarily due to lower export Potash volume and lower fuel surcharge revenue. These decreases were partially offset by the favourable impact of the change in FX.

Fertilizers and Sulphur

For the three months ended March 31	2016 vs. 2015				
	2016	2015	% Change	Total Change	FX Impact ⁽¹⁾
Freight revenues (in millions)	\$ 81	\$ 71	14	\$ 10	\$ 5
Carloads (in thousands)	16	17	(6)	(1)	N/A
Revenue ton-miles (in millions)	1,167	1,115	5	52	N/A
Freight revenue per carload (dollars)	\$ 4,993	\$ 4,268	17	\$ 725	N/A
Freight revenue per revenue ton-mile (cents)	6.93	6.40	8	0.53	N/A

⁽¹⁾ FX impact is a component of the Total Change.

Fertilizers and sulphur revenue was \$81 million in the first quarter of 2016, an increase of \$10 million, or 14% from \$71 million in the same period of 2015. This increase was primarily due to the favourable impact of the change in FX, higher freight rates and a shift in mix of traffic to more fertilizers, which generally has higher freight rates than sulphur. Lower fuel surcharge revenue was a partial offset.

Forest Products

For the three months ended March 31	2016 vs. 2015				
	2016	2015	% Change	Total Change	FX Impact ⁽¹⁾
Freight revenues (in millions)	\$ 71	\$ 57	25	\$ 14	\$ 5
Carloads (in thousands)	17	15	13	2	N/A
Revenue ton-miles (in millions)	1,157	1,019	14	138	N/A
Freight revenue per carload (dollars)	\$ 4,216	\$ 3,857	9	\$ 359	N/A
Freight revenue per revenue ton-mile (cents)	6.17	5.64	9	0.53	N/A

⁽¹⁾ FX impact is a component of the Total Change.

Forest products revenue was \$71 million in the first quarter of 2016, an increase of \$14 million, or 25% from \$57 million in the same period of 2015. This increase was due to increased volume, the favourable impact of the change in FX and higher freight rates. Lower fuel surcharge revenue was a partial offset.

Chemicals and Plastics

2016 vs. 2015

For the three months ended March 31	2016	2015	% Change	Total Change	FX Impact ⁽¹⁾
Freight revenues (in millions)	\$ 194	\$ 178	9	\$ 16	\$ 18
Carloads (in thousands)	54	51	6	3	N/A
Revenue ton-miles (in millions)	3,662	3,570	3	92	N/A
Freight revenue per carload (dollars)	\$ 3,605	\$ 3,500	3	\$ 105	N/A
Freight revenue per revenue ton-mile (cents)	5.30	4.99	6	0.31	N/A

⁽¹⁾ FX impact is a component of the Total Change.

Chemicals and plastics revenue was \$194 million in the first quarter of 2016, an increase of \$16 million, or 9% from \$178 million in the same period of 2015. This increase was primarily due to the favourable impact of the change in FX and an increase in volume, partially offset by lower fuel surcharge revenue.

Crude

2016 vs. 2015

For the three months ended March 31	2016	2015	% Change	Total Change	FX Impact ⁽¹⁾
Freight revenues (in millions)	\$ 71	\$ 98	(28)	\$ (27)	\$ 11
Carloads (in thousands)	17	22	(23)	(5)	N/A
Revenue ton-miles (in millions)	2,460	3,032	(19)	(572)	N/A
Freight revenue per carload (dollars)	\$ 4,227	\$ 4,500	(6)	\$ (273)	N/A
Freight revenue per revenue ton-mile (cents)	2.89	3.24	(11)	(0.35)	N/A

⁽¹⁾ FX impact is a component of the Total Change.

Crude revenue was \$71 million in the first quarter of 2016, a decrease of \$27 million, or 28% from \$98 million in the same period of 2015. This decrease was primarily due to a decline in volume as a result of the fall in crude oil prices, traffic mix changes that lowered the average freight rate, and lower fuel surcharge revenue. These decreases were partially offset by the favourable impact of the change in FX.

Metals, Minerals and Consumer Products

2016 vs. 2015

For the three months ended March 31	2016	2015	% Change	Total Change	FX Impact ⁽¹⁾
Freight revenues (in millions)	\$ 133	\$ 159	(16)	\$ (26)	\$ 16
Carloads (in thousands)	45	55	(18)	(10)	N/A
Revenue ton-miles (in millions)	1,807	2,283	(21)	(476)	N/A
Freight revenue per carload (dollars)	\$ 2,977	\$ 2,878	3	\$ 99	N/A
Freight revenue per revenue ton-mile (cents)	7.38	6.94	6	0.44	N/A

⁽¹⁾ FX impact is a component of the Total Change.

Metals, minerals and consumer products revenue was \$133 million in the first quarter of 2016, a decrease of \$26 million, or 16% from \$159 million in the same period of 2015. This decrease was primarily due to declines in the volume of frac sand and other aggregates traffic, and reduced fuel surcharge revenue, partially offset by the favourable impact of the change in FX.

Automotive

2016 vs. 2015

For the three months ended March 31	2016	2015	% Change	Total Change	FX Impact ⁽¹⁾
Freight revenues (in millions)	\$ 91	\$ 82	11	\$ 9	\$ 8
Carloads (in thousands)	33	30	10	3	N/A
Revenue ton-miles (in millions)	417	419	—	(2)	N/A
Freight revenue per carload (dollars)	\$ 2,754	\$ 2,692	2	\$ 62	N/A
Freight revenue per revenue ton-mile (cents)	21.75	19.49	12	2.26	N/A

⁽¹⁾ FX impact is a component of the Total Change.

Automotive revenue was \$91 million in the first quarter of 2016, an increase of \$9 million, or 11% from \$82 million in the same period of 2015. This increase was primarily due to the favourable impact of the change in FX and an increase in higher rated short-haul traffic, partially offset by lower fuel surcharge revenue.

Domestic Intermodal

2016 vs. 2015

For the three months ended March 31	2016	2015	% Change	Total Change	FX Impact ⁽¹⁾
Freight revenues (in millions)	\$ 171	\$ 194	(12)	\$ (23)	\$ 3
Carloads (in thousands)	98	103	(5)	(5)	N/A
Revenue ton-miles (in millions)	2,847	3,024	(6)	(177)	N/A
Freight revenue per carload (dollars)	\$ 1,736	\$ 1,894	(8)	\$ (158)	N/A
Freight revenue per revenue ton-mile (cents)	5.99	6.43	(7)	(0.44)	N/A

⁽¹⁾ FX impact is a component of the Total Change.

Domestic intermodal revenue was \$171 million in the first quarter of 2016, a decrease of \$23 million, or 12% from \$194 million in the same period of 2015. This decrease was primarily due to lower fuel surcharge revenue and a decrease in volume, partially offset by the favourable impact of the change in FX.

International Intermodal

2016 vs. 2015

For the three months ended March 31	2016	2015	% Change	Total Change	FX Impact ⁽¹⁾
Freight revenues (in millions)	\$ 142	\$ 145	(2)	\$ (3)	\$ 7
Carloads (in thousands)	135	135	—	—	N/A
Revenue ton-miles (in millions)	3,030	2,873	5	157	N/A
Freight revenue per carload (dollars)	\$ 1,049	\$ 1,070	(2)	\$ (21)	N/A
Freight revenue per revenue ton-mile (cents)	4.68	5.03	(7)	(0.35)	N/A

⁽¹⁾ FX impact is a component of the Total Change.

International intermodal revenue was \$142 million in the first quarter of 2016, a decrease of \$3 million, or 2% from \$145 million in the same period of 2015. This decrease was primarily due to lower fuel surcharge revenue and traffic mix changes that lowered the average freight rate, partially offset by the favourable impact of the change in FX.

Operating Expenses

2016 vs. 2015

For the three months ended March 31 (in millions)	2016	2015	% Change	Total Change	FX Impact ⁽¹⁾
Compensation and benefits	\$ 329	\$ 378	(13)	\$ (49)	\$ 12
Fuel	125	195	(36)	(70)	17
Materials	56	52	8	4	3
Equipment rents	45	42	7	3	3
Depreciation and amortization	162	146	11	16	4
Purchased services and other	221	240	(8)	(19)	15
Total operating expenses	\$ 938	\$ 1,053	(11)	\$ (115)	\$ 54

⁽¹⁾ FX impact is a component of the Total Change.

Operating expenses were \$938 million in the first quarter of 2016, a decrease of \$115 million, or 11%, from \$1,053 million in the same period of 2015. This decrease was primarily due to:

- the favourable impact of \$67 million from lower fuel prices;
- efficiencies generated from improved operating performance and asset utilization;
- higher pension income of \$33 million;
- lower volume variable expenses;
- lower casualty expense of \$16 million; and
- lower stock-based compensation of \$14 million.

This decrease was partially offset by the unfavourable impact of the change in FX of \$54 million and the impact of wage and benefit inflation of approximately 3%.

Compensation and Benefits

Compensation and benefits expense includes employee wages, salaries, fringe benefits and stock-based compensation. Compensation and benefits expense was \$329 million in the first quarter of 2016, a decrease of \$49 million, or 13%, from \$378 million in the same period of 2015. This decrease was primarily due to:

- higher pension income of \$33 million;
- fewer employees; and
- lower stock-based compensation of \$14 million primarily driven by the change in stock price and fewer share-based liability units.

This decrease was partially offset by the unfavourable impact of the change in FX of \$12 million and the impact of wage and benefit inflation of approximately 3%.

Fuel

Fuel expense consists mainly of fuel used by locomotives and includes provincial, state and federal fuel taxes. Fuel expense was \$125 million in the first quarter of 2016, a decrease of \$70 million, or 36%, from \$195 million in the same period of 2015. This decrease was primarily due to:

- the favourable impact of \$67 million from lower fuel prices;
- a reduction in workload, as measured by GTMs; and
- improvements in fuel efficiency, of approximately 5%, as a result of increased locomotive productivity, operational fluidity and the advancement of the Company's fuel conservation strategies.

This decrease was partially offset by the unfavourable impact of the change in FX of \$17 million.

Materials

Materials expense includes the cost of material used for track, locomotive, freight car and building maintenance and software sustainment. Materials expense was \$56 million in the first quarter of 2016, an increase of \$4 million or 8%, from \$52 million in the same period of 2015. This increase was primarily due to the unfavourable impact of the change in FX of \$3 million.

Equipment Rents

Equipment rents expense includes the cost associated with using other railways freight cars, intermodal equipment, and locomotives, net of rental income received from other railways for the use of CP's equipment. Equipment rents expense was \$45 million in the

first quarter of 2016, an increase of \$3 million or 7% from \$42 million in the same period of 2015. This increase was primarily due to a return of subleased locomotives and freight cars reducing rental income by \$3 million, and the unfavourable impact of the change in FX of \$3 million. This increase was largely offset by the purchase or return of leased freight cars and intermodal equipment reducing rental expenses by \$5 million.

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 \$162 million in the first quarter of 2016, an increase of \$16 million, or 11%, from \$146 million in the same period of 2015. This increase was primarily due to a higher depreciable asset base and the unfavourable impact of the change in FX of \$4 million.

Purchased Services and Other

For the three months ended March 31 (in millions)	2016 vs. 2015			
	2016	2015 ⁽¹⁾	% Change	Total change
Support and facilities	\$ 84	\$ 82	2	\$ 2
Track and operations	56	62	(10)	(6)
Intermodal	44	46	(4)	(2)
Equipment	44	51	(14)	(7)
Casualty	20	33	(39)	(13)
Property taxes	30	26	15	4
Other	(4)	—	100	(4)
Land sales	(53)	(60)	(12)	7
Total Purchased services and other	\$ 221	\$ 240	(8)	\$ (19)

⁽¹⁾ Certain comparative figures have been reclassified within Purchased services and other to conform with 2016 presentation: previously Property taxes were included in Support and facilities, Track and operations and Other.

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 \$221 million in the first quarter of 2016, a decrease of \$19 million, or 8% from \$240 million in the same period of 2015. This decrease was primarily due to:

- lower casualty expenses as a result of lower personal injuries and lower incident costs, reported in Casualty;
- lower third-party freight car and locomotive maintenance costs, reported in Equipment;
- lower crew travel and accommodations costs, reported in Track and operations;
- lower contractor services cost, reported in Support and facilities; and
- lower intermodal expenses related to pickup and delivery service, reported in Intermodal.

This decrease was partially offset by the unfavourable impact of the change in FX of \$15 million and lower land sales of \$7 million.

In March 2016, the Company completed the sale of CP's Arbutus Corridor to the City of Vancouver for gross proceeds of \$55 million and a gain on sale of \$50 million. The agreement allows the Company to share in future proceeds on the eventual development and/or sale of certain parcels of the Arbutus Corridor. In the first quarter of 2015, the Company recorded a gain of \$31 million following the sale of a building after resolution of legal proceedings and the Company sold various sections of land in eastern Canada for transit purposes.

Other Income Statement Items

Other Income and Charges

Other income and charges consists of gains and losses from the change in FX on long-term debt and working capital, various costs related to financing activities, shareholder costs, equity income and other non-operating expenditures. Other income and charges was a gain of \$181 million in the first quarter of 2016, compared to an expense of \$73 million in the same period of 2015, a change of \$254 million, or 348%. This change was primarily due to a favourable impact of FX translation of \$181 million on U.S. dollar-denominated debt, compared to an unfavourable FX impact of \$64 million in the same period of 2015, discussed further in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Net Interest Expense

Net interest expense includes interest on long-term debt and capital leases. Net interest expense was \$124 million in the first quarter of 2016, an increase of \$39 million, or 46%, from \$85 million in the same period of 2015. This increase was primarily due to an additional \$33 million of interest on new debt issued in 2015 and the unfavourable impact of the change in FX of \$7 million.

Income Tax Expense

Income tax expense was \$170 million in the first quarter of 2016, an increase of \$36 million, or 27%, from \$134 million in the same period of 2015. This increase was due to higher taxable earnings in 2016.

The estimated 2016 annualized effective tax rate for the first quarter of 2016 excluding discrete items (FX translation of on U.S. dollar denominated debt) was 27.5%, unchanged compared to the same period of 2015.

The effective tax rate in the first quarter of 2016, including discrete items was 23.9%, compared with 29.5% for 2015. The lower effective tax rate, compared to the prior period of 2015, was due to the tax expense related to FX translation gains on U.S. dollar-denominated debt in the first quarter of 2016 versus the tax recovery related to FX translation losses on U.S. dollar-denominated debt in the first quarter of 2015. Both the tax expense in 2016 and the tax recovery in 2015 were taxed at significantly lower rates than the estimated 2015 annualized effective tax rate of 27.5%.

The Company expects an annualized effective tax rate in 2016 of approximately 27.25%. The Company's 2016 outlook for its normalized 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 other events and developments, discussed further in Item 1A. Risk Factors of CP's 2015 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 letters of credit, and its revolving credit facility. As at March 31, 2016, the Company had \$571 million of Cash and cash equivalents and, under its bilateral letters of credit facilities, the Company had letters of credit drawn of \$371 million from a total available amount of \$600 million. As at March 31, 2016, the Company's U.S. \$2 billion revolving credit facility, which includes a U.S. \$1 billion five-year portion and U.S. \$1 billion one-year plus one-year term-out portion, was undrawn. 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 \$218 million in the first quarter of 2016 compared to \$555 million in the same period of 2015, a decrease of \$337 million. The decrease in Cash provided by operating activities is primarily due to an unfavourable change in working capital as a result of higher income taxes paid and an increase in interest payments resulting from debt issued in 2015. These decreases are partially offset by higher cash generating income in the first quarter of 2016 compared to the first quarter of 2015.

Investing Activities

Cash used in investing activities was \$218 million in the first quarter of 2016, an increase of \$27 million from \$191 million in the same period of 2015.

The increase is due to higher additions to properties ("capital programs") in the first quarter of 2016. The increase, primarily in track and roadway investments, reflects CP's strategy of reinvesting in the plant, enhancing throughput and capacity, and optimizing existing assets. During the first quarter of 2015, there was also a repayment of a loan for \$20 million made in 2013 pursuant to a court order to a corporation owned by a court appointed trustee recorded in Other investing activities.

The increase in proceeds from the sale of properties and other assets were primarily due to proceeds of \$55 million for the Arbutus Corridor and the sale of other assets for proceeds of \$5 million in the first quarter of 2016, compared to proceeds of \$39 million following the sale of a building to an arm's length third party, following resolution of legal proceedings, and proceeds of \$13 million for the sale of other assets in the first quarter of 2015.

For 2016, CP expects to invest approximately \$1.1 billion in its capital programs, which will be financed with cash generated from operations and leverages the considerable network upgrade and improvement investments that have been made over the last several years. Approximately 75% of planned capital programs are for track and roadway, including approximately \$44 million for PTC. Approximately 10% is expected to be allocated to rolling stock assets, including locomotive improvements and the continued

acquisition of freight cars previously held under operating leases. Between 5% and 10% is expected to be allocated to information services, and between 5% and 10% is expected to be allocated to buildings and other.

Financing Activities

Cash used in financing activities was \$62 million in the first quarter of 2016, a decrease of \$350 million from \$412 million in the same period of 2015. This decrease was largely due to the purchase of CP common shares for \$529 million and net repayment of commercial paper of \$593 million, partially offset by the issuance of long-term debt for total net proceeds of U.S. \$694 million (\$873 million) during the first quarter of 2015. At issuance, the Company also settled a notional U.S. \$700 million floating-to-fixed interest rate swap agreements ("forward starting swaps") for a payment of U.S. \$50 million (\$63 million) that is discussed further in Item 1. Financial Statements, Note 9 Financial instruments. In addition, repayment of long-term debt decreased by \$47 million to \$11 million and dividend payments decreased by \$4 million to \$54 million in the first quarter of 2016 as the Company's share repurchase program decreased shares outstanding.

The Company has available, as sources of financing, up to U.S. \$2 billion under its revolving credit facility and up to \$229 million under its bilateral letter of credit facilities. Under the bilateral letter of credit facilities, the Company has the option to post collateral in the form of Cash or cash equivalents, equal at least to the face value of the letter of credit issued. Collateral provided may include highly liquid investments purchased three months or less from maturity and is stated at cost, which approximates market value. As at March 31, 2016, the Company had posted \$350 million in collateral on the bilateral letter of credit facilities (March 31, 2015 - \$nil). The Company can largely withdraw this collateral during any month. As at March 31, 2016, the revolving credit facility was undrawn and the Company did not draw from its revolving credit facility during the three months ended March 31, 2016. 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, 2016, the Company was in compliance with the threshold stipulated in this financial covenant.

Interest Coverage Ratio

At March 31, 2016, the Company's interest coverage ratio was 6.1, compared with 8.2 at March 31, 2015. This decrease was primarily due to an increase in Net interest expense of \$136 million based on the twelve month period ended March 31, 2016, compared to the same period of 2015, partially offset by a year over year improvement in Earnings before interest and taxes ("EBIT").

Excluding significant items from EBIT, Adjusted interest coverage ratio was 6.2 at March 31, 2016, compared with 8.5 at March 31, 2015. This decrease was primarily due to an increase in Net interest expense, partially offset by a year over year improvement in adjusted EBIT. Interest coverage ratio, Adjusted interest coverage ratio, EBIT, Adjusted EBIT, and significant items are defined and reconciled in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

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, 2016, CP's credit ratings from Standard & Poor's Rating Services ("Standard & Poor's"), Moody's Investor Service ("Moody's"), and Dominion Bond Rating Service Limited ("DBRS") remain unchanged from December 31, 2015.

The Company's goal is to maintain a degree of continuity and predictability for investors by meeting a minimum threshold. The Adjusted net debt to Adjusted earnings before interest, tax, depreciation and amortization ("EBITDA") ratio for the twelve months ended March 31, 2016 and 2015 was 2.6 and 2.3, respectively. This increase was due to additional debt issued during the 2015 fiscal year, partially offset by the improved Adjusted income for the twelve months ended March 31, 2016. Adjusted net debt to Adjusted EBITDA ratio and Adjusted income are defined and reconciled in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Free Cash

CP generated negative Free cash of \$71 million in the first quarter of 2016, a decrease of \$383 million from positive Free cash of \$312 million in the same period of 2015. The decrease was primarily due to a decrease in cash provided by operating activities and an increase in capital additions. Free cash is defined and reconciled in the Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Free cash is affected by seasonal fluctuations and by other factors including the size of the Company's capital programs. Capital additions were \$278 million in the first quarter of 2016, \$15 million higher than in the same period of 2015. The 2016 capital programs are discussed further above in Investing Activities.

Share Capital

At April 18, 2016, the latest practicable date, there were 153,059,426 Common Shares and no preferred shares issued and outstanding, which consists of 15,222 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 shares. Each option granted can be exercised for one Common Share. At April 18, 2016, 2.7 million options were outstanding under the Company's MSOIP and stand-alone option agreements entered into with Mr. E. Hunter Harrison and Mr. Keith E. Creel. There are 1.5 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 shares. There are no outstanding options under the DSOP, which has 0.3 million options available to be issued in the future.

Non-GAAP Measures

The Company presents non-GAAP measures and cash flow information to provide a basis for evaluating underlying earnings and liquidity trends in the Company's business that can be compared with the results of operations in prior periods. In addition, these non-GAAP measures facilitate a multi-period assessment of long-term profitability allowing management and other external users of the Company's consolidated financial information to compare profitability on a long-term basis, including assessing future profitability, with that of the Company's peers.

These non-GAAP measures have no standardized meaning and are not defined by GAAP and, therefore, may not be comparable to similar measures presented by other companies. The presentation of these non-GAAP measures is not intended to be considered in isolation from, as a substitute for, or as superior to, the financial information presented in accordance with GAAP.

Adjusted Performance Measures

The Company uses Adjusted income 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 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 2016, there was one significant item included in Net income as follows:

- in the first quarter, a non-cash gain of \$181 million (\$156 million after tax) due to FX translation of the Company's U.S. dollar-denominated debt.

In 2015, there were four significant items included in Net income as follows:

- in the third quarter, a \$68 million gain (\$42 million after tax) related to the sale of D&H South;
- in the third quarter, a \$47 million charge (\$35 million after tax) related to the early redemption premium on notes;
- in the second quarter, an income tax expense of \$23 million as a result of the change in the Alberta provincial corporate income tax rate; and
- during the course of the year, a net non-cash loss of \$297 million (\$257 million after tax) due to FX translation of the Company's U.S. dollar-denominated debt as follows:
 - in the fourth quarter, a \$115 million loss (\$100 million after tax);
 - in the third quarter, a \$128 million loss (\$111 million after tax);
 - in the second quarter, a \$10 million gain (\$9 million after tax); and
 - in the first quarter, a \$64 million loss (\$55 million after tax).

In 2014, there was one significant item included in Net income as follows:

- in the fourth quarter, a \$12 million net non-cash loss (\$9 million after tax) due to FX translation on the Company's U.S. dollar-denominated debt.

Reconciliation of Non-GAAP Performance Measures to GAAP Performance Measures

The following tables reconcile 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 to the most directly comparable measures presented in accordance with GAAP for the three months ended March 31, 2016 and 2015:

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

Net income (in millions)	For the three months ended March 31	
	2016	2015
Adjusted income	\$ 384	\$ 375
Add significant items, net of tax:		
Impact of FX translation on U.S. dollar-denominated debt	156	(55)
Net income as reported	\$ 540	\$ 320

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.

Diluted earnings per share	For the three months ended March 31	
	2016	2015
Adjusted diluted earnings per share	\$ 2.50	\$ 2.26
Add significant items:		
Impact of FX translation on U.S. dollar-denominated debt	1.01	(0.34)
Diluted earnings per share as reported	\$ 3.51	\$ 1.92

ROIC and Adjusted ROIC

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

Calculation of ROIC and Adjusted ROIC

(in millions, except for percentages)	2016	2015
Operating income for the twelve months ended March 31	\$ 2,729	\$ 2,528
Less:		
Other income and charges	81	92
Tax ⁽¹⁾	760	685
	\$ 1,888	\$ 1,751
Average for the twelve months of total shareholders' equity, long-term debt, long-term debt maturing within one year and short-term borrowing	\$ 12,786	\$ 11,962
ROIC	14.8%	14.6%

⁽¹⁾ Tax was calculated at the annualized effective tax rate for each of the above items for the periods presented.

(in millions, except for percentages)	2016		2015	
Operating income for the twelve months ended March 31	\$	2,729	\$	2,528
Less significant items:				
Gain on sale of D&H South	\$	68	\$	—
Adjusted operating income for the twelve months ended March 31	\$	2,661	\$	2,528
Less:				
Other income and charges		81		92
Add significant items:				
Impact of FX translation on U.S. dollar-denominated debt		52		76
Early redemption premium on notes		47		—
Less: tax ⁽¹⁾		735		696
	\$	1,944	\$	1,816
Average for the twelve months of total shareholders' equity, long-term debt, long-term debt maturing within one year and short-term borrowing	\$	12,786	\$	11,962
Adjusted ROIC		15.2%		15.2%

⁽¹⁾ Tax was calculated at the annualized effective tax rate for each of the above items for the periods presented.

Free Cash

Free cash is calculated as Cash provided by operating activities, less Cash used in investing activities and Dividends paid, adjusted for changes in cash and cash equivalents balances resulting from FX fluctuations. Free cash is a measure that management considers to be an indicator of liquidity. Free cash is useful to investors and other external users of the consolidated financial information as it assists with the evaluation of the Company's ability to generate cash from its operations without incurring additional external financing. Positive Free cash indicates the amount of cash available for reinvestment in the business, or cash that can be returned to investors through increased 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	
	2016	2015
Cash provided by operating activities	\$ 218	\$ 555
Cash used in investing activities	(218)	(191)
Dividends paid	(54)	(58)
Effect of foreign currency fluctuations on U.S. dollar-denominated cash and cash equivalents	(17)	6
Free cash	\$ (71)	\$ 312

Interest Coverage Ratio

Interest coverage ratio is measured, on a rolling twelve-month basis, as EBIT divided by Net interest expense. Interest coverage ratio is an indicator of liquidity used in assessing the Company's debt servicing capabilities. This ratio provides useful information on how the Company's debt servicing capabilities have changed, period over period and in comparison to the Company's peers. Additionally, investors, analysts, and lenders may use this measure to assess the Company's debt servicing capabilities. Interest coverage 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.

Adjusted interest coverage ratio is calculated as Adjusted EBIT divided by Net interest expense. By excluding significant items which affect EBIT, Adjusted interest coverage ratio assists management in comparing the Company's performance over various reporting periods on a consistent basis. Adjusted interest coverage 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.

Calculation of Interest Coverage Ratio and Adjusted Interest Coverage Ratio

(in millions, except for ratios)	For the twelve months ended March 31	
	2016	2015
EBIT	\$ 2,648	\$ 2,436
Adjusted EBIT	\$ 2,679	\$ 2,512
Net interest expense	\$ 433	\$ 297
Interest coverage ratio	6.1	8.2
Adjusted interest coverage ratio	6.2	8.5

EBIT is calculated as Operating income, less Other income and charges. Adjusted EBIT excludes significant items reported in Operating income and Other income and charges. These are components of the calculations of Interest coverage ratio and Adjusted interest coverage ratio.

Earnings before interest and tax (in millions)	For the twelve months ended March 31	
	2016	2015
Adjusted EBIT	\$ 2,679	\$ 2,512
Add Significant items:		
Gain on sale of D&H South	68	—
Impact of foreign exchange translation on U.S. dollar-denominated debt	(52)	(76)
Early redemption premium on notes	(47)	—
EBIT	2,648	2,436
Less:		
Net interest expense	433	297
Income tax expense	643	597
Net income as reported	\$ 1,572	\$ 1,542

Adjusted Net Debt to Adjusted EBITDA Ratio

Adjusted net debt is defined as Long-term debt, Long-term debt maturing within one year and Short-term borrowing as reported on the Company's Consolidated Balance Sheets adjusted for pension plans deficit, the net present value of operating leases, which is discounted by the Company's effective interest rate for each of the periods presented, and Cash and cash equivalents. Adjusted EBITDA is calculated as Adjusted EBIT plus Depreciation and amortization, adjusted for net periodic pension and other benefit cost and operating lease expense. 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 one of the key metrics used by credit rating agencies in assessing the Company's financial capacities and constraints and determining the credit rating of the Company. By excluding the impact of certain items that are not considered by management in developing a minimum threshold, Adjusted net debt to Adjusted EBITDA ratio provides a metric that management uses to evaluate the Company's financial discipline with respect to capital markets credit sensitivities from management's perspective and communicates it publicly with investors, analysts and credit rating agencies. 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.

Calculation of Adjusted Net Debt to Adjusted EBITDA Ratio

(in millions, except for ratios)	2016	2015
Adjusted net debt as at March 31	\$ 8,568	\$ 6,989
Adjusted EBITDA for the twelve months ended March 31	3,310	3,087
Adjusted net debt to Adjusted EBITDA ratio	2.6	2.3

Reconciliation of Adjusted Net Debt to Long-term Debt

(in millions)	2016	2015
Adjusted net debt as at March 31	\$ 8,568	\$ 6,989
Add:		
Pension plans deficit	(290)	(293)
Net present value of operating leases ⁽¹⁾	(396)	(470)
Cash and cash equivalents	571	184
Long-term debt including long term debt maturing within one year as at March 31	\$ 8,453	\$ 6,410

⁽¹⁾ Operating leases were discounted at the Company's effective interest rate for each of the periods presented.

Reconciliation of Adjusted EBITDA to Adjusted EBIT

(in millions)	2016	2015
Adjusted EBITDA for the twelve months ended March 31	\$ 3,310	\$ 3,087
Add:		
Adjustment for net periodic pension and other benefit cost	98	119
Operating lease expense	(118)	(137)
Depreciation and amortization	(611)	(557)
Adjusted EBIT for the twelve months ended March 31	\$ 2,679	\$ 2,512

Off-Balance Sheet Arrangements

Guarantees

At March 31, 2016, the Company had residual value guarantees on operating lease commitments of \$26 million, compared to \$126 million at March 31, 2015. The maximum amount that could be payable under these and all of the Company's other guarantees cannot be reasonably estimated due to the nature of certain guarantees. All or a portion of amounts paid under certain guarantees could be recoverable from other parties or through insurance. As at March 31, 2016, the fair value of these guarantees recognized as a liability was \$3 million, compared to \$5 million at March 31, 2015.

Contractual Commitments

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

Contractual Commitments

At March 31, 2016

Payments due by period (in millions)	Total	2016	2017 & 2018	2019 & 2020	2021 & beyond
Contractual commitments					
Interest on long-term debt and capital lease	\$ 12,473	\$ 332	\$ 930	\$ 804	\$ 10,407
Long-term debt	8,390	15	782	542	7,051
Capital leases	164	3	9	10	142
Operating lease ⁽¹⁾	496	71	148	92	185
Supplier purchase	1,460	191	378	186	705
Other long-term liabilities ⁽²⁾	585	70	117	111	287
Total contractual commitments	\$ 23,568	\$ 682	\$ 2,364	\$ 1,745	\$ 18,777

⁽¹⁾ Residual value guarantees on certain leased equipment with a maximum exposure of \$26 million are not included in the minimum payments shown above, as management believes that CP will not be required to make payments under these residual guarantees.

⁽²⁾ Includes expected cash payments for restructuring, environmental remediation, asset retirement obligations, 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 2016 to 2025. Pension contributions for the Company's registered pension plans are not included due to the volatility in calculating them. Pension payments are discussed further in Critical Accounting Estimates of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Certain Other Financial Commitments

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

Letters of Credit

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

Capital Commitments

The Company remains committed to maintaining the current high level of plant quality and renewing the franchise. 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 2016 through 2032. These expenditures are expected to be financed by cash generated from operations or by issuing new debt.

At March 31, 2016

Amount of commitments per period (in millions)	Total	2016	2017 & 2018	2019 & 2020	2021 & beyond
Commitments					
Letters of credit	\$ 371	\$ 371	\$ —	\$ —	\$ —
Capital commitments	343	269	42	18	14
Total commitments	\$ 714	\$ 640	\$ 42	\$ 18	\$ 14

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, legal and personal injury liabilities and goodwill.

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.

Pensions and Other Benefits

Pension Liabilities and Pension Assets

The Company included pension benefit liabilities of \$280 million in Pension and other benefit liabilities and \$10 million in Accounts payable and accrued liabilities on the Company's Interim Consolidated Balance Sheets at March 31, 2016. The Company also included post-retirement benefits accruals of \$385 million in Pension and other benefit liabilities and \$21 million in Accounts payable and accrued liabilities on the Company's Interim Consolidated Balance Sheets at March 31, 2016.

The Company included pension benefit assets of \$1,489 million in Pension assets on the Company's Interim Consolidated Balance Sheets at March 31, 2016.

Pension Plan Contributions

The Company made contributions of \$20 million to the defined benefit pension plans in the first quarter of 2016, compared with \$21 million in the same period of 2015. The Company's main Canadian defined benefit pension plan accounts for 95% of CP's pension obligation and can produce significant volatility in pension funding requirements, given the pension fund's size, the many factors that drive the pension plan's funded status, and Canadian statutory pension funding requirements. The Company made voluntary prepayments of \$600 million in 2011, \$650 million in 2010 and \$500 million in 2009 to the Company's main Canadian defined benefit pension plan. CP has applied \$1,276 million of these voluntary prepayments to reduce its pension funding requirements in 2012–2015, leaving \$474 million of the voluntary prepayments still available at December 31, 2015 to reduce CP's pension funding requirements in 2016 and future years. CP continues to have significant flexibility with respect to the rate at which the remaining voluntary prepayments are applied to reduce future years' pension contribution requirements, which allows CP to manage the

volatility of future pension funding requirements. At this time, CP estimates it will apply \$35 million of the remaining voluntary prepayments against its 2016 pension funding requirements.

CP estimates its aggregate pension contributions, including its defined benefit and defined contribution plan, to be in the range of \$80 million to \$90 million in 2016, and in the range of \$60 million to \$110 million per year from 2017 to 2019. These estimates reflect the Company's current intentions with respect to the rate at which CP will apply the remaining voluntary prepayments against contribution requirements in the next few years.

Future pension contributions will be highly dependent on the Company's actual experience with such variables as investment returns, interest rate fluctuations and demographic changes, on the rate at which previous years' voluntary prepayments are applied against pension contribution requirements, and on any changes in the regulatory environment. CP will continue to make contributions to the pension plans that, at a minimum, meet pension legislative requirements.

Deferred Income Taxes

A deferred income tax expense of \$93 million was included in Income tax expense for the first quarter of 2016 and \$32 million was included in Income tax expense for the same period of 2015. The increase in deferred income tax expense in 2016 was primarily due to higher pretax earnings and deferred tax expense related to FX translation gains on U.S. dollar-denominated debt.

At March 31, 2016, deferred income tax liabilities of \$3,422 million were recorded as a long-term liability and are composed largely of temporary differences related to accounting for properties.

Legal and Personal Injury Liabilities

Provisions for incidents, claims and litigation charged to income, which were included in Purchase services and other expense, amounted to \$20 million in the first quarter of 2016 compared with \$33 million for the same period of 2015.

Forward-Looking Information

This MD&A and Quarterly Report on Form 10-Q contains certain forward-looking statements within the meaning of the United States Private Securities Litigation Reform Act of 1995 and other relevant securities legislation. These forward-looking statements include, but are not limited to, statements concerning the Company's operations, anticipated financial performance, business prospects and strategies, including statements concerning the anticipation that cash flow from operations and various sources of financing will be sufficient to meet debt repayments and obligations in the foreseeable future and concerning anticipated capital programs, statements regarding future payments including income taxes and pension contributions, and capital expenditures. Forward-looking information typically contains statements with words such as "financial expectations", "key assumptions", "anticipate", "believe", "expect", "plan", "will", "outlook", "should" or similar words suggesting future outcomes.

Readers are cautioned not to place undue reliance on forward-looking information because it is possible that CP will not achieve predictions, forecasts, projections and other forms of forward-looking information. Current economic conditions render assumptions, although reasonable when made, subject to greater uncertainty. In addition, except as required by law, CP undertakes no obligation to update publicly or otherwise revise any forward-looking information, whether as a result of new information, future events or otherwise.

By its nature, forward-looking information involves numerous assumptions, inherent risks and uncertainties, including but not limited to the following factors: changes in business strategies; general North American and global economic, credit and business conditions; risks in agricultural production such as weather conditions and insect populations; the availability and price of energy commodities; the effects of competition and pricing pressures; industry capacity; shifts in market demand; inflation; changes in laws and regulations, including regulation of rates; changes in taxes and tax rates; potential increases in maintenance and operating costs; uncertainties of investigations, proceedings or other types of claims and litigation; labour disputes; risks and liabilities arising from derailments; transportation of dangerous goods; timing of completion of capital and maintenance projects; currency and interest rate fluctuations; effects of changes in market conditions on the financial position of pension plans and investments; and various events that could disrupt operations, including severe weather, droughts, floods, avalanches and earthquakes as well as security threats and the governmental response to them, and technological changes.

There are more specific factors that could cause actual results to differ materially from those described in the forward-looking statements contained in this MD&A. These more specific factors are identified and discussed in Item 1A. Risk Factors of CP's 2015 Annual Report on Form 10-K. Other risks are detailed from time to time in reports filed by CP with securities regulators in Canada and the United States.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There have been no material changes to market risk during the three months ended March 31, 2016 from the information provided in Item 7A. Quantitative and Qualitative Disclosure about Market Risk of CP's 2015 Annual Report on Form 10-K other than foreign exchange risk discussed below:

Foreign Exchange Risk

Although CP conducts business primarily in Canada, a significant portion of its revenues, expenses, assets and liabilities including debt are denominated in U.S. dollars. The value of the Canadian dollar is affected by a number of domestic and international factors, including, without limitation, economic performance, and Canadian, U.S. and international monetary policies. Consequently, the Company's results are affected by fluctuations in the exchange rate between these currencies. On an annualized basis, a \$0.01 weakening (or strengthening) of the Canadian dollar positively (or negatively) impacts Freight revenues by approximately \$26 million and negatively (or positively) impacts Operating expenses by approximately \$13 million. FX translation on the Company's U.S. dollar-denominated long-term debt is excluded from these sensitivities. 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.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

As of March 31, 2016, 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, 2016, 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 2016, 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.