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The Honorable Cynthia T. Brown
Chief, Section of Administration, Office of Proceedings
Surface Transportation Board
395 E Street S.W.
Washington, D.C. 20423

Re: Finance Docket No. 36500, *Canadian Pacific Ry. – Control – Kansas City Southern*

Dear Ms. Brown:

Pursuant to 49 C.F.R. § 1180.6(b)(4) (2000), Applicants are submitting the attached Form 10-Q for the period ending September 30, 2022, filed by Canadian Pacific Railway Limited with the SEC on October 26, 2022, and the attached Form 10-Q for the period ending September 30, 2022, filed by Kansas City Southern with the SEC, also on October 26, 2022. This submission updates Exhibit 9 of the Application, set forth at Volume 1 (CP-25/KCS-13) (at 1-49 to -50) and in Volume 4 (CP-28/KCS-16).

Applicants will continue to supplement the Application with any additional annual and quarterly reports filed with the SEC over the duration of the proceeding.

Please contact me with any questions.

Respectfully submitted,



David L. Meyer

*Attorney for Canadian Pacific Railway
Limited*

Attachments

cc: William A. Mullins, Esq.
All Parties of Record

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark one)

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2022

OR

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from _____ to _____
Commission File Number 001-01342

Canadian Pacific Railway Limited

(Exact name of registrant as specified in its charter)

Canada

(State or Other Jurisdiction
of Incorporation or Organization)

98-0355078

(IRS Employer
Identification No.)

7550 Ogden Dale Road S.E.

Calgary AB

(Address of Principal Executive Offices)

T2C 4X9

(Zip Code)

Registrant's Telephone Number, Including Area Code: (403) 319-7000

Securities registered pursuant to Section 12(b) of the Act:

<u>Title of Each Class</u>	<u>Trading Symbol(s)</u>	<u>Name of Each Exchange on which Registered</u>
Common Shares, without par value, of Canadian Pacific Railway Limited	CP	New York Stock Exchange Toronto Stock Exchange
Perpetual 4% Consolidated Debenture Stock of Canadian Pacific Railway Company	CP/40 BC87	New York Stock Exchange London Stock Exchange

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports); and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically, every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer ☒ Accelerated Filer ☐ Non-accelerated Filer ☐ Smaller Reporting Company ☐ Emerging Growth Company ☐

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

As of the close of business on October 25, 2022, there were 930,123,568 of the registrant's Common Shares issued and outstanding.

CANADIAN PACIFIC RAILWAY LIMITED
FORM 10-Q
TABLE OF CONTENTS

PART I - FINANCIAL INFORMATION

	<u>Page</u>
Item 1. Financial Statements:	
Interim Consolidated Statements of Income	2
For the Three and Nine Months Ended September 30, 2022 and 2021	
Interim Consolidated Statements of Comprehensive Income	3
For the Three and Nine Months Ended September 30, 2022 and 2021	
Interim Consolidated Balance Sheets	4
As at September 30, 2022 and December 31, 2021	
Interim Consolidated Statements of Cash Flows	5
For the Three and Nine Months Ended September 30, 2022 and 2021	
Interim Consolidated Statements of Changes in Shareholders' Equity	6
For the Three and Nine Months Ended September 30, 2022 and 2021	
Notes to Interim Consolidated Financial Statements	7
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	18
Executive Summary	18
Performance Indicators	20
Financial Highlights	23
Results of Operations	24
Liquidity and Capital Resources	41
Share Capital	45
Non-GAAP Measures	45
Critical Accounting Estimates	55
Forward-Looking Statements	55
Item 3. Quantitative and Qualitative Disclosures about Market Risk	57
Item 4. Controls and Procedures	58

PART II - OTHER INFORMATION

Item 1. Legal Proceedings	59
Item 1A. Risk Factors	59
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	59
Item 3. Defaults Upon Senior Securities	59
Item 4. Mine Safety Disclosures	59
Item 5. Other Information	59
Item 6. Exhibits	60
Signature	61

PART I

ITEM 1. FINANCIAL STATEMENTS

INTERIM CONSOLIDATED STATEMENTS OF INCOME (unaudited)

(in millions of Canadian dollars, except share and per share data)	For the three months ended September 30		For the nine months ended September 30	
	2022	2021	2022	2021
Revenues (Note 3)				
Freight	\$ 2,264	\$ 1,896	\$ 6,214	\$ 5,822
Non-freight	48	46	138	133
Total revenues	2,312	1,942	6,352	5,955
Operating expenses				
Compensation and benefits	393	381	1,154	1,165
Fuel	358	199	1,001	623
Materials	66	51	191	164
Equipment rents	33	31	97	92
Depreciation and amortization	213	203	634	605
Purchased services and other (Note 10)	312	303	935	932
Total operating expenses	1,375	1,168	4,012	3,581
Operating income	937	774	2,340	2,374
Less:				
Equity earnings of Kansas City Southern (Note 10)	(221)	—	(627)	—
Other expense (Note 4, 10)	7	124	13	253
Merger termination fee (Note 10)	—	—	—	(845)
Other components of net periodic benefit recovery (Note 15)	(102)	(95)	(304)	(286)
Net interest expense	166	104	486	315
Income before income tax expense	1,087	641	2,772	2,937
Income tax expense (Note 5)	196	169	526	617
Net income	\$ 891	\$ 472	\$ 2,246	\$ 2,320
Earnings per share (Note 6)				
Basic earnings per share	\$ 0.96	\$ 0.71	\$ 2.42	\$ 3.48
Diluted earnings per share	\$ 0.96	\$ 0.70	\$ 2.41	\$ 3.46
Weighted-average number of shares (millions) (Note 6)				
Basic	930.0	666.9	929.9	666.7
Diluted	932.9	669.8	932.8	669.8
Dividends declared per share	\$ 0.190	\$ 0.190	\$ 0.570	\$ 0.570

See Notes to Interim Consolidated Financial Statements.

INTERIM CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(unaudited)

(in millions of Canadian dollars)	For the three months ended September 30		For the nine months ended September 30	
	2022	2021	2022	2021
Net income	\$ 891	\$ 472	\$ 2,246	\$ 2,320
Net gain (loss) in foreign currency translation adjustments, net of hedging activities	1,565	(17)	1,948	3
Change in derivatives designated as cash flow hedges	2	141	5	69
Change in pension and post-retirement defined benefit plans	22	53	99	158
Equity accounted investments	47	—	182	—
Other comprehensive income before income taxes	1,636	177	2,234	230
Income tax recovery (expense) on above items	36	(29)	2	(59)
Other comprehensive income (Note 7)	1,672	148	2,236	171
Comprehensive income	\$ 2,563	\$ 620	\$ 4,482	\$ 2,491

See Notes to Interim Consolidated Financial Statements.

**INTERIM CONSOLIDATED BALANCE SHEETS AS AT
(unaudited)**

	September 30 2022	December 31 2021
(in millions of Canadian dollars)		
Assets		
Current assets		
Cash and cash equivalents	\$ 138	\$ 69
Restricted cash and cash equivalents	—	13
Accounts receivable, net (Note 8)	1,053	819
Materials and supplies	267	235
Other current assets	186	216
	1,644	1,352
Investment in Kansas City Southern (Note 11)	45,964	42,309
Investments	230	209
Properties	22,150	21,200
Goodwill and intangible assets	390	371
Pension asset	2,631	2,317
Other assets	426	419
Total assets	\$ 73,435	\$ 68,177
Liabilities and shareholders' equity		
Current liabilities		
Accounts payable and accrued liabilities	\$ 1,575	\$ 1,609
Long-term debt maturing within one year (Note 12, 13)	1,236	1,550
	2,811	3,159
Pension and other benefit liabilities	726	718
Other long-term liabilities	519	542
Long-term debt (Note 12, 13)	19,339	18,577
Deferred income taxes	12,226	11,352
Total liabilities	35,621	34,348
Shareholders' equity		
Share capital	25,498	25,475
Additional paid-in capital	77	66
Accumulated other comprehensive income (loss) (Note 7)	133	(2,103)
Retained earnings	12,106	10,391
	37,814	33,829
Total liabilities and shareholders' equity	\$ 73,435	\$ 68,177

See Contingencies (Note 17).

See Notes to Interim Consolidated Financial Statements.

INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)

(in millions of Canadian dollars)	For the three months ended September 30		For the nine months ended September 30	
	2022	2021	2022	2021
Operating activities				
Net income	\$ 891	\$ 472	\$ 2,246	\$ 2,320
Reconciliation of net income to cash provided by operating activities:				
Depreciation and amortization	213	203	634	605
Deferred income tax expense (Note 5)	38	130	151	190
Pension recovery and funding (Note 15)	(74)	(62)	(218)	(188)
Equity earnings of Kansas City Southern (Note 10)	(221)	—	(627)	—
Foreign exchange loss (gain) on debt and lease liabilities (Note 4)	—	46	—	(39)
Dividend from Kansas City Southern (Note 10)	259	—	593	—
Other operating activities, net	(3)	(14)	(102)	(50)
Change in non-cash working capital balances related to operations	(1)	(227)	(255)	246
Cash provided by operating activities	1,102	548	2,422	3,084
Investing activities				
Additions to properties	(422)	(372)	(1,018)	(1,111)
Payment to Kansas City Southern (Note 10)	—	(1,773)	—	(1,773)
Proceeds from sale of properties and other assets	11	16	37	65
Other	1	—	3	(1)
Cash used in investing activities	(410)	(2,129)	(978)	(2,820)
Financing activities				
Dividends paid	(177)	(127)	(530)	(380)
Issuance of CP Common Shares	9	4	18	20
Repayment of long-term debt, excluding commercial paper (Note 12)	(7)	(318)	(559)	(349)
Repayment of term loan (Note 12)	(504)	—	(636)	—
Proceeds from term loan	—	633	—	633
Net (repayment) issuance of commercial paper (Note 12)	(42)	713	298	(66)
Acquisition-related financing fees (Note 10)	—	—	—	(45)
Other	—	(3)	—	(7)
Cash (used in) provided by financing activities	(721)	902	(1,409)	(194)
Effect of foreign currency fluctuations on U.S. dollar-denominated cash and cash equivalents	13	10	21	6
Cash position				
(Decrease) increase in cash, cash equivalents, and restricted cash	(16)	(669)	56	76
Cash, cash equivalents, and restricted cash at beginning of period	154	892	82	147
Cash, cash equivalents, and restricted cash at end of period	\$ 138	\$ 223	\$ 138	\$ 223
Supplemental disclosures of cash flow information:				
Income taxes paid	\$ 67	\$ 129	\$ 319	\$ 401
Interest paid	\$ 148	\$ 153	\$ 467	\$ 365

See Notes to Interim Consolidated Financial Statements.

INTERIM CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
(unaudited)

(in millions of Canadian dollars except per share data)	For the three months ended September 30					
	Common Shares (in millions)	Share capital	Additional paid-in capital	Accumulated other comprehensive income (loss)	Retained earnings	Total shareholders' equity
Balance as at July 1, 2022	930.0	\$25,488	\$ 73	\$ (1,539)	\$ 11,392	\$ 35,414
Net income	—	—	—	—	891	891
Other comprehensive income (Note 7)	—	—	—	1,672	—	1,672
Dividends declared (\$0.190 per share)	—	—	—	—	(177)	(177)
Effect of stock-based compensation expense	—	—	5	—	—	5
Shares issued under stock option plan	0.1	10	(1)	—	—	9
Balance as at September 30, 2022	930.1	\$25,498	\$ 77	\$ 133	\$ 12,106	\$ 37,814
Balance as at July 1, 2021	666.8	\$ 2,003	\$ 63	\$ (2,791)	\$ 9,690	\$ 8,965
Net income	—	—	—	—	472	472
Other comprehensive income (Note 7)	—	—	—	148	—	148
Dividends declared (\$0.190 per share)	—	—	—	—	(127)	(127)
Effect of stock-based compensation expense	—	—	6	—	—	6
Shares issued under stock option plan	0.1	5	(1)	—	—	4
Balance as at September 30, 2021	666.9	\$ 2,008	\$ 68	\$ (2,643)	\$ 10,035	\$ 9,468

(in millions of Canadian dollars except per share data)	For the nine months ended September 30					
	Common Shares (in millions)	Share capital	Additional paid-in capital	Accumulated other comprehensive income (loss)	Retained earnings	Total shareholders' equity
Balance as at January 1, 2022	929.7	\$25,475	\$ 66	\$ (2,103)	\$ 10,391	\$ 33,829
Net income	—	—	—	—	2,246	2,246
Other comprehensive income (Note 7)	—	—	—	2,236	—	2,236
Dividends declared (\$0.570 per share)	—	—	—	—	(531)	(531)
Effect of stock-based compensation expense	—	—	17	—	—	17
Shares issued for Kansas City Southern acquisition	—	—	(2)	—	—	(2)
Shares issued under stock option plan	0.4	23	(4)	—	—	19
Balance as at September 30, 2022	930.1	\$25,498	\$ 77	\$ 133	\$ 12,106	\$ 37,814
Balance as at January 1, 2021	666.3	\$ 1,983	\$ 55	\$ (2,814)	\$ 8,095	\$ 7,319
Net income	—	—	—	—	2,320	2,320
Other comprehensive income (Note 7)	—	—	—	171	—	171
Dividends declared (\$0.570 per share)	—	—	—	—	(380)	(380)
Effect of stock-based compensation expense	—	—	18	—	—	18
Shares issued under stock option plan	0.6	25	(5)	—	—	20
Balance as at September 30, 2021	666.9	\$ 2,008	\$ 68	\$ (2,643)	\$ 10,035	\$ 9,468

See Notes to Interim Consolidated Financial Statements.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2022

(unaudited)

1 Basis of presentation

These unaudited Interim Consolidated Financial Statements ("Interim Consolidated Financial Statements") of Canadian Pacific Railway Limited ("CPRL") and its subsidiaries (collectively, "CP", or "the Company"), expressed in Canadian dollars, reflect management's estimates and assumptions that are necessary for their fair presentation in conformity with generally accepted accounting principles in the United States of America ("GAAP"). They do not include all disclosures required under GAAP for annual financial statements and should be read in conjunction with the 2021 annual Consolidated Financial Statements and notes included in CP's 2021 Annual Report on Form 10-K. The accounting policies used are consistent with the accounting policies used in preparing the 2021 annual Consolidated Financial Statements.

CP's operations can be affected by seasonal fluctuations such as changes in customer demand and weather-related issues. This seasonality could impact quarter-over-quarter comparisons.

In management's opinion, the Interim Consolidated Financial Statements include all adjustments (consisting of normal and recurring adjustments) necessary to present fairly such information. Interim results are not necessarily indicative of the results expected for the fiscal year.

2 Accounting changes

Implemented in 2022

Government Assistance

On January 1, 2022, the Company adopted the new Accounting Standards Update ("ASU") 2021-10, issued by the Financial Accounting Standards Board ("FASB"), and all related amendments under FASB Accounting Standards Codification ("ASC") Topic 832, Government Assistance. The amendment is made to increase transparency by introducing specific disclosure requirements for entities who apply a grant or contribution model by analogy to account for transactions with a government. This update is applied to government assistance transactions within the scope of this amendment that are in the financial statements at the date of initial application and prospectively to new transactions entered into after initial application. See Note 9 for further discussion on government assistance.

All other accounting pronouncements that became effective during the period covered by the Interim Consolidated Financial Statements did not have a material impact on the Company's Consolidated Financial Statements and related disclosures.

Future changes

Contract Assets and Contract Liabilities Acquired in a Business Combination

In October 2021, the FASB issued ASU 2021-08, Business Combinations (Topic 805), Accounting for Contract Assets and Contract Liabilities from Contracts with Customers. This amendment introduces the requirement for an acquirer to recognize and measure contract assets and contract liabilities acquired in a business combination in accordance with the requirements of FASB ASC Topic 606, Revenue from Contracts with Customers, rather than at fair value. This amendment will be effective prospectively from January 1, 2023, with early adoption permitted. The Company is currently assessing the impact of this amendment.

All other accounting pronouncements recently issued, but not effective until after September 30, 2022, have been assessed and are not expected to have a material impact on the Company's Consolidated Financial Statements and related disclosures.

3 Revenues

The following table disaggregates the Company's revenues from contracts with customers by major source:

(in millions of Canadian dollars)	For the three months ended September 30		For the nine months ended September 30	
	2022	2021	2022	2021
Freight				
Grain	\$ 391	\$ 352	\$ 1,121	\$ 1,244
Coal	156	158	458	491
Potash	170	113	445	348
Fertilizers and sulphur	81	72	244	227
Forest products	109	89	299	259
Energy, chemicals and plastics	360	392	1,010	1,149
Metals, minerals and consumer products	246	196	655	535
Automotive	111	83	322	289
Intermodal	640	441	1,660	1,280
Total freight revenues	2,264	1,896	6,214	5,822
Non-freight excluding leasing revenues	28	25	77	75
Revenues from contracts with customers	2,292	1,921	6,291	5,897
Leasing revenues	20	21	61	58
Total revenues	\$ 2,312	\$ 1,942	\$ 6,352	\$ 5,955

Contract liabilities

Contract liabilities represent payments received for performance obligations not yet satisfied and relate to deferred revenue and are presented as components of "Accounts payable and accrued liabilities" and "Other long-term liabilities" on the Company's Interim Consolidated Balance Sheets.

The following table summarizes the changes in contract liabilities:

(in millions of Canadian dollars)	For the three months ended September 30		For the nine months ended September 30	
	2022	2021	2022	2021
Opening balance	\$ 69	\$ 245	\$ 67	\$ 61
Revenue recognized that was included in the contract liability balance at the beginning of the period	(8)	(93)	(16)	(36)
Increase due to consideration received, net of revenue recognized during the period	4	4	14	131
Closing balance	\$ 65	\$ 156	\$ 65	\$ 156

4 Other expense

(in millions of Canadian dollars)	For the three months ended September 30		For the nine months ended September 30	
	2022	2021	2022	2021
Foreign exchange loss (gain) on debt and lease liabilities	\$ —	\$ 46	\$ —	\$ (39)
Other foreign exchange losses (gains)	2	(7)	1	(9)
Acquisition-related costs (Note 10)	—	83	—	295
Other	5	2	12	6
Other expense	\$ 7	\$ 124	\$ 13	\$ 253

5 Income taxes

(in millions of Canadian dollars)	For the three months ended September 30		For the nine months ended September 30	
	2022	2021	2022	2021
Current income tax expense	\$ 158	\$ 39	\$ 375	\$ 427
Deferred income tax expense	38	130	151	190
Income tax expense	\$ 196	\$ 169	\$ 526	\$ 617

During the three months ended September 30, 2022, legislation was enacted to decrease the Iowa state corporate income tax rate. As a result of this change, the Company recorded a deferred tax recovery of \$12 million related to the revaluation of deferred income tax balances as at January 1, 2022.

The effective tax rates including discrete items for the three and nine months ended September 30, 2022 were 18.01% and 18.97%, respectively, compared to 26.36% and 21.00%, respectively for the same periods of 2021.

For the three months ended September 30, 2022, the effective tax rate was 24.25%, excluding the discrete items of the equity earnings of Kansas City Southern ("KCS") of \$221 million, acquisition-related costs incurred by CP of \$18 million, the deferred tax recovery of \$12 million described above, and an outside basis deferred tax recovery of \$9 million arising from the difference between the carrying amount of CP's investment in KCS for financial reporting and the underlying tax basis of this investment.

For the three months ended September 30, 2021, the effective tax rate was 24.60%, excluding the discrete items of acquisition-related costs incurred by CP of \$98 million, and a foreign exchange ("FX") loss of \$46 million on debt and lease liabilities.

For the nine months ended September 30, 2022, the effective tax rate was 24.25%, excluding the discrete items of the equity earnings of KCS of \$627 million, acquisition-related costs incurred by CP of \$57 million, the deferred tax recovery of \$12 million described above, and an outside basis deferred tax expense of \$8 million arising from the difference between the carrying amount of CP's investment in KCS for financial reporting and the underlying tax basis of this investment.

For the nine months ended September 30, 2021, the effective tax rate was 24.60%, excluding the discrete items of acquisition-related costs incurred by CP of \$442 million, the merger termination payment received in connection with KCS's termination of the Agreement and Plan of Merger (the "Original Merger Agreement") of \$845 million (U.S. \$700 million), and an FX gain of \$39 million on debt and lease liabilities.

6 Earnings per share

Basic earnings per share has been calculated using Net income for the period divided by the weighted-average number of shares outstanding during the period. The number of shares used in the earnings per share calculations are reconciled as follows:

(in millions)	For the three months ended September 30		For the nine months ended September 30	
	2022	2021	2022	2021
Weighted-average basic shares outstanding	930.0	666.9	929.9	666.7
Dilutive effect of stock options	2.9	2.9	2.9	3.1
Weighted-average diluted shares outstanding	932.9	669.8	932.8	669.8

For the three and nine months ended September 30, 2022, there were nil and 0.3 million options, respectively, excluded from the computation of diluted earnings per share because their effects were not dilutive (three and nine months ended September 30, 2021 - 0.2 million and 0.1 million, respectively).

7 Changes in Accumulated other comprehensive income (loss) ("AOCI") by component

	For the three months ended September 30					
(in millions of Canadian dollars)	Foreign currency net of hedging activities ⁽¹⁾	Derivatives ⁽¹⁾⁽²⁾	Pension and post- retirement defined benefit plans ⁽¹⁾	Equity accounted investments ⁽¹⁾⁽²⁾		Total ⁽¹⁾
Opening balance, July 1, 2022	\$ 217	\$ (2)	\$ (1,856)	\$ 102		(1,539)
Other comprehensive income (loss) before reclassifications	1,618	—	(14)	37		1,641
Amounts reclassified from accumulated other comprehensive income	—	1	30	—		31
Net other comprehensive income	1,618	1	16	37		1,672
Closing balance, September 30, 2022	\$ 1,835	\$ (1)	\$ (1,840)	\$ 139		133
Opening balance, July 1, 2021	\$ 110	\$ (91)	\$ (2,800)	\$ (10)		(2,791)
Other comprehensive income before reclassifications	6	101	—	—		107
Amounts reclassified from accumulated other comprehensive loss	—	2	39	—		41
Net other comprehensive income	6	103	39	—		148
Closing balance, September 30, 2021	\$ 116	\$ 12	\$ (2,761)	\$ (10)		(2,643)

⁽¹⁾ Amounts are presented net of tax.

⁽²⁾ Comparative figures have been reclassified to conform with current period presentation.

	For the nine months ended September 30					
(in millions of Canadian dollars)	Foreign currency net of hedging activities ⁽¹⁾	Derivatives ⁽¹⁾⁽²⁾	Pension and post- retirement defined benefit plans ⁽¹⁾	Equity accounted investments ⁽¹⁾⁽²⁾		Total ⁽¹⁾
Opening balance, January 1, 2022	\$ (182)	\$ (4)	\$ (1,915)	\$ (2)		(2,103)
Other comprehensive income (loss) before reclassifications	2,017	—	(14)	140		2,143
Amounts reclassified from accumulated other comprehensive income	—	3	89	1		93
Net other comprehensive income	2,017	3	75	141		2,236
Closing balance, September 30, 2022	\$ 1,835	\$ (1)	\$ (1,840)	\$ 139		133
Opening balance, January 1, 2021	\$ 112	\$ (40)	\$ (2,878)	\$ (8)		(2,814)
Other comprehensive income (loss) before reclassifications	4	46	—	(2)		48
Amounts reclassified from accumulated other comprehensive loss	—	6	117	—		123
Net other comprehensive income (loss)	4	52	117	(2)		171
Closing balance, September 30, 2021	\$ 116	\$ 12	\$ (2,761)	\$ (10)		(2,643)

⁽¹⁾ Amounts are presented net of tax.

⁽²⁾ Comparative figures have been reclassified to conform with current period presentation.

Amounts in Pension and post-retirement defined benefit plans reclassified from AOCI are as follows:

(in millions of Canadian dollars)	For the three months ended September 30		For the nine months ended September 30	
	2022	2021	2022	2021
Recognition of net actuarial loss ⁽¹⁾	\$ 39	\$ 53	\$ 116	\$ 158
Income tax recovery	(9)	(14)	(27)	(41)
Total net of income tax	\$ 30	\$ 39	\$ 89	\$ 117

⁽¹⁾ Impacts "Other components of net periodic benefit recovery" on the Interim Consolidated Statements of Income.

8 Accounts receivable, net

(in millions of Canadian dollars)	As at September 30, 2022			As at December 31, 2021		
	Freight	Non-freight	Total	Freight	Non-freight	Total
Total accounts receivable	\$ 835	\$ 257	\$ 1,092	\$ 614	\$ 239	\$ 853
Allowance for credit losses	(26)	(13)	(39)	(20)	(14)	(34)
Total accounts receivable, net	\$ 809	\$ 244	\$ 1,053	\$ 594	\$ 225	\$ 819

(in millions of Canadian dollars)	For the three months ended September 30, 2022			For the three months ended September 30, 2021		
	Freight	Non-freight	Total	Freight	Non-freight	Total
Allowance for credit losses, opening balance	\$ (24)	\$ (15)	\$ (39)	\$ (23)	\$ (15)	\$ (38)
Current period credit loss provision, net	(2)	2	—	1	(1)	—
Allowance for credit losses, closing balance	\$ (26)	\$ (13)	\$ (39)	\$ (22)	\$ (16)	\$ (38)

(in millions of Canadian dollars)	For the nine months ended September 30, 2022			For the nine months ended September 30, 2021		
	Freight	Non-freight	Total	Freight	Non-freight	Total
Allowance for credit losses, opening balance	\$ (20)	\$ (14)	\$ (34)	\$ (25)	\$ (15)	\$ (40)
Current period credit loss provision, net	(6)	1	(5)	3	(1)	2
Allowance for credit losses, closing balance	\$ (26)	\$ (13)	\$ (39)	\$ (22)	\$ (16)	\$ (38)

9 Government assistance

By analogy to the grant model of accounting within International Accounting Standards ("IAS") 20, Accounting for Government Grants and Disclosure of Government Assistance, CP records government assistance from various levels of Canadian and U.S. governments and government agencies when the conditions of their receipt are complied with and there is reasonable assurance that the assistance will be received.

Government assistance related to properties has as a primary condition that CP should purchase, construct, or otherwise acquire property, plant and equipment. Under certain government assistance arrangements, there is a secondary condition that requires CP to repay a portion of the assistance if certain conditions related to the assets are not adhered to during a specified period. In these cases, it is CP's intention to comply with all conditions imposed by the terms of the government assistance. Government assistance received or receivable related to CP's property assets is deducted from the cost of the assets in the Interim Consolidated Balance Sheets within "Properties" and amortized over the same period as the related assets in "Depreciation and amortization" in the Interim Consolidated Statements of Income.

During the three and nine months ended September 30, 2022, the Company received \$6 million and \$25 million, respectively, of government assistance towards the purchase and construction of properties.

As of September 30, 2022, the total Properties balance of \$22,150 million is net of \$279 million of unamortized government assistance (December 31, 2021 - \$259 million), primarily related to the enhancement of CP's track and roadway infrastructure. Amortization expense related to government assistance for the three and nine months ended September 30, 2022 was \$3 million and \$8 million, respectively.

10 Business acquisition

Kansas City Southern

The Company accounts for its investment in KCS using the equity method of accounting while the U.S. Surface Transportation Board ("STB") considers the Company's application to control KCS. The STB review of CP's proposed control of KCS while KCS is in the voting trust is expected to be completed in the first quarter of 2023. The investment in KCS of \$45,964 million as at September 30, 2022 includes \$627 million of equity earnings of KCS and foreign currency translation of \$3,445 million, offset by dividends of \$593 million received in the nine months ended September 30, 2022. Included within the \$221 million and \$627 million of equity earnings of KCS recognized for the three and nine months ended September 30, 2022 was amortization (net of tax), of the approximately \$30 billion basis difference, representing the difference in value between the consideration paid to acquire KCS and the underlying carrying value of the net assets of KCS as at December 14, 2021, immediately prior to the acquisition by CP. The amortization (net of tax), recognized for the three and nine months ended September 30, 2022 was \$42 million and \$121 million, respectively. The basis difference is related to depreciable property, plant and equipment, intangible assets with definite lives, and long-term debt, and is amortized over the related assets' remaining useful lives, and the remaining terms to maturity of the debt instruments.

During the three and nine months ended September 30, 2022, the Company incurred \$18 million and \$57 million, in acquisition-related costs, respectively, recorded within "Purchased services and other" in the Company's Interim Consolidated Statements of Income. Acquisition-related costs of \$12 million and \$39 million incurred by KCS during the three and nine months ended September 30, 2022 are included within "Equity earnings of Kansas City Southern" in the Company's Interim Consolidated Statements of Income.

During the three and nine months ended September 30, 2021, the Company incurred \$98 million and \$442 million, respectively, in acquisition-related costs associated with the Original Merger Agreement and Merger Agreement, of which \$15 million and \$147 million were recorded within "Purchased services and other" and \$83 million and \$295 million were recorded within "Other expense", respectively, including the amortization of financing fees associated with new credit facilities. Total financing fees paid for a bridge facility associated with the KCS acquisition during the three and nine months ended September 30, 2021 were \$nil and \$45 million, respectively, presented under "Cash (used in) provided by financing activities" in the Company's Interim Consolidated Statements of Cash Flows.

On May 21, 2021, KCS terminated the Original Merger Agreement entered into on March 21, 2021 with CP to enter into a definitive agreement with Canadian National Railway ("CN"). At the same time and in accordance with the terms of the Original Merger Agreement, KCS paid CP a termination fee of \$845 million (U.S. \$700 million). This amount is reported as "Merger termination fee" in the Company's Interim Consolidated Statements of Income for the nine months ended September 30, 2021. No similar items were received in the same period of 2022.

In connection with the Merger Agreement, the Company remitted \$1,773 million (U.S. \$1,400 million) to KCS on September 15, 2021 in connection with KCS's payment of the CN merger termination fees, recorded within "Investment in KCS" in the Company's Balance Sheets.

11 Investment in KCS

The KCS investment carrying cost of \$45,964 million reported on the Company's Interim Consolidated Balance Sheets as at September 30, 2022 reflects the consideration paid to acquire KCS, the asset recorded upon recognition of a deferred tax liability computed on an outside basis (see Note 5), the subsequent recognition of equity earnings, the dividends received from KCS, and foreign currency translation based on the quarter-end exchange rate.

The following table presents summarized financial information for KCS, on its historical cost basis:

Statement of Income

(in millions of Canadian dollars) ⁽¹⁾	For the three months ended September 30, 2022	For the nine months ended September 30, 2022
Total revenues	\$ 1,152	\$ 3,216
Total operating expenses	728	2,024
Operating income	424	1,192
Less: Other ⁽²⁾	67	164
Income before income taxes	357	1,028
Net income	\$ 263	\$ 748

⁽¹⁾ Amounts translated at the average FX rate for the three and nine months ended September 30, 2022 of \$1.00 USD = \$1.31 CAD and \$1.00 USD = \$1.28 CAD, respectively.

⁽²⁾ Includes Equity in net earnings of KCS's affiliates, Interest expense, FX loss, and Other income, net.

12 Debt

During the nine months ended September 30, 2022, the Company repaid at maturity \$125 million 5.100% 10-year Medium Term Notes, U.S. \$250 million (\$313 million) 4.500% 10-year Notes, and a U.S. \$76 million (\$97 million) 6.99% finance lease.

Credit facility

Effective March 14, 2022, the Company extended the maturity date of the U.S. \$500 million unsecured non-revolving term credit facility (the "term facility") to September 15, 2022. During the three months ended June 30, 2022, the Company repaid U.S. \$100 million (\$132 million) of the term facility. During the three months ended September 30, 2022, the Company repaid in full the term facility's outstanding borrowings of U.S. \$400 million (\$504 million). The facility was automatically terminated on September 15, 2022 following the final principal repayment.

Commercial paper program

The Company has a commercial paper program which enables it to issue commercial paper up to a maximum aggregate principal amount of U.S. \$1.0 billion in the form of unsecured promissory notes. This commercial paper program is backed by the U.S. \$1.3 billion revolving credit facility. As at September 30, 2022, the Company had total commercial paper borrowings of U.S. \$525 million (\$720 million), included in "Long-term debt maturing within one year" on the Company's Interim Consolidated Balance Sheets (December 31, 2021 - U.S. \$265 million). The weighted-average interest rate on these borrowings as at September 30, 2022 was 3.48% (December 31, 2021 - 0.32%). The Company presents issuances and repayments of commercial paper, all of which have a maturity of less than 90 days, in the Company's Interim Consolidated Statements of Cash Flows on a net basis.

13 Financial instruments

A. Fair values of financial instruments

The Company categorizes its financial assets and liabilities measured at fair value into a three-level hierarchy established by GAAP that prioritizes those inputs to valuation techniques used to measure fair value based on the degree to which they are observable. The three levels of the fair value hierarchy are as follows: Level 1 inputs are quoted prices in active markets for identical assets and liabilities; Level 2 inputs, other than quoted prices included within Level 1, are observable for the asset or liability either directly or indirectly; and Level 3 inputs are not observable in the market.

The Company's short-term financial instruments may include Cash and cash equivalents, Restricted cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, and short-term borrowings including commercial paper and term loans. The carrying values of short-term financial instruments approximate their fair values.

The carrying value of the Company's long-term debt and finance lease liabilities does not approximate their fair value. Their estimated fair value has been determined based on market information, where available, or by discounting future payments of principal and interest at estimated interest rates expected to be available to the Company at period end. All measurements are classified as Level 2. The Company's long-term debt and finance lease liabilities, including current maturities, with a carrying value of \$19,855 million as at September 30, 2022 (December 31, 2021 - \$19,151 million), had a fair value of \$17,472 million (December 31, 2021 - \$21,265 million).

B. Financial risk management

FX management

Net investment hedge

The effect of the Company's net investment hedge for the three and nine months ended September 30, 2022 was an unrealized FX loss of \$440 million and \$558 million, respectively (three and nine months ended September 30, 2021 - unrealized FX loss of \$168 million and \$6 million, respectively) recognized in "Other comprehensive income".

14 Shareholders' equity

On January 27, 2021, the Company announced a normal course issuer bid ("NCIB"), commencing January 29, 2021, to purchase up to 16.7 million Common Shares in the open market for cancellation on or before January 28, 2022. Upon expiry of this NCIB, the Company had not purchased any Common Shares under this NCIB.

15 Pension and other benefits

In the three and nine months ended September 30, 2022, the Company made contributions to its defined benefit pension plans of \$5 million and \$12 million, respectively (three and nine months ended September 30, 2021 - \$4 million and \$15 million, respectively).

Net periodic benefit costs for defined benefit pension plans and other benefits included the following components:

(in millions of Canadian dollars)	For the three months ended September 30			
	Pensions		Other benefits	
	2022	2021	2022	2021
Current service cost (benefits earned by employees)	\$ 37	\$ 42	\$ 3	\$ 4
Other components of net periodic benefit (recovery) cost:				
Interest cost on benefit obligation	95	88	4	4
Expected return on fund assets	(240)	(240)	—	—
Recognized net actuarial loss	39	52	—	1
Total other components of net periodic benefit (recovery) cost	(106)	(100)	4	5
Net periodic benefit (recovery) cost	\$ (69)	\$ (58)	\$ 7	\$ 9

(in millions of Canadian dollars)	For the nine months ended September 30			
	Pensions		Other benefits	
	2022	2021	2022	2021
Current service cost (benefits earned by employees)	\$ 111	\$ 128	\$ 8	\$ 10
Other components of net periodic benefit (recovery) cost:				
Interest cost on benefit obligation	287	264	12	12
Expected return on fund assets	(719)	(720)	—	—
Recognized net actuarial loss	115	155	1	3
Total other components of net periodic benefit (recovery) cost	(317)	(301)	13	15
Net periodic benefit (recovery) cost	\$ (206)	\$ (173)	\$ 21	\$ 25

16 Stock-based compensation

As at September 30, 2022, the Company had several stock-based compensation plans including stock option plans, various cash-settled liability plans, and an employee share purchase plan. These plans resulted in an expense for the three and nine months ended September 30, 2022 of \$21 million and \$67 million, respectively (three and nine months ended September 30, 2021 - expense of \$26 million and \$75 million, respectively).

Stock option plans

In the nine months ended September 30, 2022, under CP's stock option plans, the Company issued 836,379 options at the weighted-average price of \$90.96 per share, based on the closing price on the grant date. Pursuant to the employee plan, these options may be exercised upon vesting, which is between 12 months and 48 months after the grant date, and will expire after seven years.

Under the fair value method, the fair value of the stock options at grant date was approximately \$16 million. The weighted-average fair value assumptions were approximately:

	For the nine months ended September 30, 2022
Expected option life (years) ⁽¹⁾	4.75
Risk-free interest rate ⁽²⁾	1.61%
Expected share price volatility ⁽³⁾	26.84%
Expected annual dividends per share ⁽⁴⁾	\$0.760
Expected forfeiture rate ⁽⁵⁾	3.00%
Weighted-average grant date fair value per option granted during the period	\$18.79

⁽¹⁾ Represents the period of time that awards are expected to be outstanding. Historical data on exercise behaviour or, when available, specific expectations regarding future exercise behaviour were used to estimate the expected life of the option.

⁽²⁾ Based on the implied yield available on zero-coupon government issues with an equivalent term commensurate with the expected option life.

⁽³⁾ Based on the historical volatility of the Company's share price over a period commensurate with the expected term of the option.

⁽⁴⁾ Determined by the current annual dividend at the time of grant. The Company does not employ different dividend yields throughout the contractual term of the option.

⁽⁵⁾ The Company estimates forfeitures based on past experience. This rate is monitored on a periodic basis.

Performance share unit plans

During the nine months ended September 30, 2022, the Company issued 414,375 Performance Share Units ("PSUs") with a grant date fair value of approximately \$36 million and 13,506 Performance Deferred Share Units ("PDSUs") with a grant date fair value, including the value of expected future matching units, of approximately \$2 million. PSUs and PDSUs attract dividend equivalents in the form of additional units based on dividends paid on the Company's Common Shares, and vest approximately three years after the grant date, contingent upon CP's performance ("performance factor"). The fair value of these PSUs and PDSUs is measured periodically until settlement. Vested PSUs are settled in cash. Vested PDSUs are settled in cash pursuant to the Deferred Share Unit ("DSU") Plan and are eligible for a 25% match if the holder has not exceeded their share ownership requirements, and are paid out only when the holder ceases their employment with CP.

The performance period for PSUs and PDSUs issued in the nine months ended September 30, 2022 is January 1, 2022 to December 31, 2024 and the performance factors are Free Cash Flow ("FCF"), Adjusted Net Debt to Adjusted earnings before interest, tax, depreciation, and amortization ("EBITDA") Modifier, Total Shareholder Return ("TSR") compared to the S&P/TSX 60 Index, and TSR compared to S&P 500 Industrials Index.

The performance period for PSUs issued in 2019 was January 1, 2019 to December 31, 2021. The performance factors for 668,405 PSUs were Return on Invested Capital ("ROIC"), TSR compared to the S&P/TSX 60 Index, and TSR compared to Class I Railways. The resulting payout was 200% of the outstanding units multiplied by the Company's average share price calculated using the last 30 trading days preceding December 31, 2021. In the first quarter of 2022, payouts occurred on 631,457 total outstanding awards, including dividends reinvested, totalling \$116 million.

Deferred share unit plan

During the nine months ended September 30, 2022, the Company granted 53,834 Deferred Share Units ("DSUs") with a grant date fair value of approximately \$5 million. DSUs vest over various periods of up to 36 months and are only redeemable for a specified period after employment is terminated. The expense for DSUs is recognized over the vesting period for both the initial subscription price and the change in value between reporting periods.

17 Contingencies

In the normal course of its operations, the Company becomes involved in various legal actions, including claims relating to injuries and damage to property. The Company maintains provisions it considers to be adequate for such actions. While the final outcome with respect to actions outstanding or pending at September 30, 2022 cannot be predicted with certainty, it is the opinion of management that their resolution will not have a material adverse effect on the Company's business, financial position or results of operations. However, an unexpected adverse resolution of one or more of these legal actions could have a material adverse effect on the Company's business, financial position, results of operations, or liquidity in a particular quarter or fiscal year.

Legal proceedings related to Lac-Mégantic rail accident

On July 6, 2013, a train carrying petroleum crude oil operated by Montréal Maine and Atlantic Railway ("MMAR") or a subsidiary, Montréal Maine & Atlantic Canada Co. ("MMAC" and collectively the "MMA Group"), derailed in Lac-Mégantic, Québec. The

derailment occurred on a section of railway owned and operated by the MMA Group and while the MMA Group exclusively controlled the train.

Following the derailment, MMAC sought court protection in Canada under the *Companies' Creditors Arrangement Act* and MMAR filed for bankruptcy in the U.S. Plans of arrangement were approved in both Canada and the U.S. (the "Plans"), providing for the distribution of approximately \$440 million amongst those claiming derailment damages.

A number of legal proceedings, set out below, were commenced in Canada and the U.S. against CP and others:

- (1) Québec's Minister of Sustainable Development, Environment, Wildlife and Parks ordered various parties, including CP, to remediate the derailment site (the "Cleanup Order") and served CP with a Notice of Claim for \$95 million for those costs. CP appealed the Cleanup Order and contested the Notice of Claim with the Administrative Tribunal of Québec. These proceedings are stayed pending determination of the Attorney General of Québec ("AGQ") action (paragraph 2 below).
- (2) The AGQ sued CP in the Québec Superior Court claiming \$409 million in damages, which was amended and reduced to \$315 million (the "AGQ Action"). The AGQ Action alleges that: (i) CP was responsible for the petroleum crude oil from its point of origin until its delivery to Irving Oil Ltd.; and (ii) CP is vicariously liable for the acts and omissions of the MMA Group.
- (3) A class action in the Québec Superior Court on behalf of persons and entities residing in, owning or leasing property in, operating a business in, or physically present in Lac-Mégantic at the time of the derailment was certified against CP on May 8, 2015 (the "Class Action"). Other defendants including MMAC and Mr. Thomas Harding ("Harding") were added to the Class Action on January 25, 2017. On November 28, 2019, the plaintiffs' motion to discontinue their action against Harding was granted. The Class Action seeks unquantified damages, including for wrongful death, personal injury, property damage, and economic loss.
- (4) Eight subrogated insurers sued CP in the Québec Superior Court claiming approximately \$16 million in damages, which was amended and reduced to approximately \$15 million (the "Promutuel Action"), and two additional subrogated insurers sued CP claiming approximately \$3 million in damages (the "Royal Action"). Both actions contain similar allegations as the AGQ Action. The actions do not identify the subrogated parties. As such, the extent of any overlap between the damages claimed in these actions and under the Plans is unclear. The Royal Action is stayed pending determination of the consolidated proceedings described below.

On December 11, 2017, the AGQ Action, the Class Action and the Promutuel Action were consolidated. The joint liability trial of these consolidated claims commenced on September 21, 2021 with oral arguments ending on June 15, 2022. A decision is expected by December 15, 2022. A damages trial will follow if necessary.

- (5) Forty-eight plaintiffs (all individual claims joined in one action) sued CP, MMAC, and Harding in the Québec Superior Court claiming approximately \$5 million in damages for economic loss and pain and suffering, and asserting similar allegations as in the Class Action and the AGQ Action. The majority of the plaintiffs opted-out of the Class Action and all but two are also plaintiffs in litigation against CP, described in paragraph 7 below. This action is stayed pending determination of the consolidated claims described above.
- (6) The MMAR U.S. bankruptcy estate representative commenced an action against CP in November 2014 in the Maine Bankruptcy Court claiming that CP failed to abide by certain regulations and seeking approximately U.S. \$30 million in damages for MMAR's loss in business value according to a recent expert report filed by the bankruptcy estate. This action asserts that CP knew or ought to have known that the shipper misclassified the petroleum crude oil and therefore should have refused to transport it. Summary judgment motion was argued and taken under advisement on June 9, 2022, and decision is pending.
- (7) The class and mass tort action commenced against CP in June 2015 in Texas (on behalf of Lac-Mégantic residents and wrongful death representatives) and the wrongful death and personal injury actions commenced against CP in June 2015 in Illinois and Maine, were all transferred and consolidated in Federal District Court in Maine (the "Maine Actions"). The Maine Actions allege that CP negligently misclassified and improperly packaged the petroleum crude oil. On CP's motion, the Maine Actions were dismissed. The plaintiffs appealed the dismissal decision to the United States First Circuit Court of Appeals, which dismissed the plaintiffs' appeal on June 2, 2021. The plaintiffs further petitioned the United States First Circuit Court of Appeals for a rehearing, which was denied on September 8, 2021. On January 24, 2022, the plaintiffs further appealed to the U.S. Supreme Court on two bankruptcy procedural grounds. On May 31, 2022, the U.S. Supreme Court denied the petition, thereby rejecting the plaintiffs' appeal.
- (8) The trustee for the wrongful death trust commenced Carmack Amendment claims against CP in North Dakota Federal Court, seeking to recover approximately U.S. \$6 million for damaged rail cars and lost crude and reimbursement for the settlement paid by the consignor and the consignee under the Plans (alleged to be U.S. \$110 million and U.S. \$60 million, respectively). The Court issued an Order on August 6, 2020 granting and denying in parts the parties' summary judgment motions which has been reviewed and confirmed following motions by the parties for clarification and reconsideration. Final briefs of

dispositive motions for summary judgment and for reconsideration on tariff applicability were submitted on September 30, 2022. In the event the dispositive motions are denied, this action is scheduled for trial from February 27 to March 2, 2023.

At this stage of the proceedings, any potential responsibility and the quantum of potential losses cannot be determined. Nevertheless, CP denies liability and is vigorously defending these proceedings.

Court decision related to Remington Development Corporation legal claim

On October 20, 2022, the Court of King's Bench of Alberta issued a decision in a claim brought by Remington Development Corporation ("Remington") against the Company and the Province of Alberta ("Alberta") with respect to an alleged breach of contract by the Company in relation to the sale of certain properties in Calgary. In its decision, the Court found the Company had breached its contract with Remington and Alberta had induced the contract breach. The Court found the Company and Alberta liable for damages of approximately \$164 million plus interest and costs, and subject to an adjustment to the acquisition value of the property. However, the court has not provided any indication of how the damages, which are currently estimated to total approximately \$200 million before Remington's costs are established, should be apportioned between the Company and Alberta. As a result, at this time, the Company cannot reasonably estimate the amount of damages, or range of damages, for which it is liable under the ruling of the Court and no amount has been accrued in the Company's financial statements as at September 30, 2022. The Company plans to appeal the Court's decision.

Environmental liabilities

Environmental remediation accruals, recorded on an undiscounted basis unless a reliable, determinable estimate as to an amount and timing of costs can be established, cover site-specific remediation programs.

The accruals for environmental remediation represent CP's best estimate of its probable future obligation and include both asserted and unasserted claims, without reduction for anticipated recoveries from third parties. Although the recorded accruals include CP's best estimate of all probable costs, CP's total environmental remediation costs cannot be predicted with certainty. Accruals for environmental remediation may change from time to time as new information about previously untested sites becomes known, and as environmental laws and regulations evolve and advances are made in environmental remediation technology. The accruals may also vary as the courts decide legal proceedings against outside parties responsible for contamination. These potential charges, which cannot be quantified at this time, may materially affect income in the particular period in which a charge is recognized. Costs related to existing, but as yet unknown, or future contamination will be accrued in the period in which they become probable and reasonably estimable.

The expense included in "Purchased services and other" in the Company's Interim Consolidated Statements of Income for the three and nine months ended September 30, 2022 was \$1 million and \$5 million, respectively (three and nine months ended September 30, 2021 - \$2 million and \$6 million, respectively). Provisions for environmental remediation costs are recorded in the Company's Interim Consolidated Balance Sheets in "Other long-term liabilities", except for the current portion, which is recorded in "Accounts payable and accrued liabilities". The total amount provided as at September 30, 2022 was \$85 million (December 31, 2021 - \$79 million). Payments are expected to be made over 10 years through 2031.

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

The following Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") is intended to enhance a reader's understanding of the Company's results of operations and financial condition. The MD&A is provided as a supplement to, and should be read in conjunction with the Company's Interim Consolidated Financial Statements and the related notes for the three and nine months ended September 30, 2022 in Item 1. Financial Statements, other information in this report, and Item 8. Financial Statements and Supplementary Data of the Company's 2021 Annual Report on Form 10-K. Except where otherwise indicated, all financial information reflected herein is expressed in Canadian dollars.

For purposes of this report, all references herein to "CP", "the Company", "we", "our" and "us" refer to Canadian Pacific Railway Limited ("CPRL"), CPRL and its subsidiaries, CPRL and one or more of its subsidiaries, or one or more of CPRL's subsidiaries, as the context may require.

Available Information

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

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

Executive Summary

Third Quarter of 2022 Results

- Financial performance* - In the third quarter of 2022, CP reported Diluted earnings per share ("EPS") of \$0.96, an increase of 37% compared to the same period of 2021. This increase was primarily due to equity earnings of Kansas City Southern ("KCS"), higher volumes as measured by revenue ton-miles ("RTMs"), and the favourable impact of changes in fuel prices, partially offset by a higher average number of shares outstanding due to shares issued related to the KCS acquisition and higher interest expense primarily due to debt issued related to the KCS acquisition. Core adjusted diluted EPS was \$1.01 in the third quarter of 2022, an increase of 15% compared to the same period of 2021. This increase was due to the same factors discussed above for the increase in Diluted EPS, except that Core adjusted EPS excludes the impact of KCS purchase accounting, acquisition-related costs, deferred tax recovery due to Iowa state tax rate change, deferred tax recovery on the outside basis difference of the investment in KCS, as well as FX loss on debt and lease liabilities recognized in 2021.

CP reported Net income of \$891 million in the third quarter of 2022, an increase of 89% compared to the same period of 2021. This increase was primarily due to equity earnings of KCS, higher volumes as measured by RTMs, and the favourable impact of changes in fuel prices, partially offset by higher interest expense primarily due to debt issued related to the KCS acquisition. Core adjusted income was \$945 million in the third quarter of 2022, an increase of 60% compared to the same period of 2021. This increase was due to the same factors discussed above for the increase in Net income, except that Core adjusted income excludes the impact of KCS purchase accounting, acquisition-related costs, deferred tax recovery due to Iowa state tax rate change, deferred tax recovery on the outside basis difference of the investment in KCS, as well as FX loss on debt and lease liabilities recognized in 2021.

CP reported an Operating ratio of 59.5% in the third quarter of 2022, a 70 basis point improvement compared to the same period of 2021. Adjusted operating ratio was 58.7%, a 70 basis point improvement compared to the same period of 2021. These improvements were primarily due to higher volumes as measured by RTMs and higher freight rates, partially offset cost inflation.

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

- Total revenues* - Total revenues increased by 19% in the third quarter of 2022 to \$2,312 million compared to the same period of 2021. This increase was primarily due to increased freight revenue per RTM and higher volumes as measured by RTMs.
- Operating performance* - CP's average train weight increased by 3% to 10,247 tons and average train length increased by 4% to 8,578 feet, compared to the same period in 2021. These increases were a result of improvements in operating plan efficiency and continued improvements in bulk train efficiency due to moving heavier and longer Potash trains. These

metrics are discussed further in Performance Indicators of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Recent Developments

- On March 16, 2022, CP issued a 72-hour notice to the Teamsters Canada Rail Conference ("TCRC") - Train & Engine, of its plan to lock-out employees at 00:01 Eastern Time on March 20, 2022 if the TCRC leadership and the Company were unable to come to a negotiated settlement or agree to binding arbitration. The TCRC represents approximately 3,000 locomotive engineers, conductors, and train and yard workers across Canada. On March 19, 2022, while the Company was still engaged in ongoing negotiations facilitated by federal mediators, the TCRC withdrew its services in the final hours before the deadline for a legal strike or lockout to potentially occur. On March 22, 2022, CP reached an agreement with the TCRC Negotiating Committee to enter into binding arbitration. This agreement enabled CP employees to return to work effective noon March 22, 2022 local time to resume our essential services for our customers and the North American supply chain.

The work stoppage resulted in lower volumes during the first quarter. Once the TCRC members returned to work on March 22, 2022, the Company quickly re-established service.

On August 15, 2022, CP entered into a new two-year collective agreement with the TCRC following binding arbitration. The new agreement includes a 3.5 percent wage increase in 2022 and 2023 and increased benefits. Under the arbitration decision, the TCRC will also join a CP pension improvement account. The new collective agreement is effective from January 1, 2022 to December 31, 2023.

Prior Developments

- On July 20, 2022, KCS and its affiliate Kansas City Southern de México, S.A. de C.V. ("KCSM") announced an agreement extending the concession exclusivity rights granted to KCSM for an additional 10 years.

KCSM reached an agreement with the Mexican Ministry of Infrastructure, Communications and Transportation ("SICT") to fund a new investment in the Celaya-NBA Line Railway Bypass and other infrastructure. As part of the agreement, the SICT has authorized the amendment of KCSM's Concession Title effective July 14, 2022, to extend the exclusivity rights granted to KCSM for an additional period of 10 years. Under this amendment, KCSM's exclusivity will now expire in 2037.

The U.S. Surface Transportation Board's ("STB") review of CP's proposed control of KCS is expected to be completed in the first quarter of 2023. Prior to obtaining STB control approval, KCS's management and Board of Directors will continue to steward KCS while it is in trust, pursuing its independent business plan and growth strategies.

Specific risk factors related to the KCS acquisition and pending KCS business combination are provided in Part I, Item 1A. Risk Factors of the Company's 2021 Annual Report on Form 10-K.

- On April 27, 2022, at the Company's Annual and Special Meeting of Shareholders, all nine director nominees were elected.

Performance Indicators

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

	For the three months ended September 30			For the nine months ended September 30		
	2022	2021	% Change	2022	2021	% Change
Operations Performance						
Gross ton-miles ("GTMs") (millions)	68,482	64,665	6	199,512	207,347	(4)
Train miles (thousands)	7,237	6,999	3	21,390	22,406	(5)
Average train weight - excluding local traffic (tons)	10,247	9,973	3	10,093	9,953	1
Average train length - excluding local traffic (feet)	8,578	8,285	4	8,387	8,192	2
Average terminal dwell (hours)	7.8	7.2	8	8.0	7.1	13
Average train speed (miles per hour, or "mph")	21.5	21.7	(1)	21.5	21.4	—
Locomotive productivity (GTMs / operating horsepower)	202	203	—	196	204	(4)
Fuel efficiency (U.S. gallons of locomotive fuel consumed / 1,000 GTMs)	0.927	0.907	2	0.949	0.928	2
Total Employees and Workforce						
Total employees (average)	13,004	12,485	4	12,427	12,411	—
Total employees (end of period)	13,087	12,262	7	13,087	12,262	7
Workforce (end of period)	13,144	12,301	7	13,144	12,301	7
Safety Indicators⁽¹⁾						
FRA personal injuries per 200,000 employee-hours	0.86	0.98	(12)	0.96	0.98	(2)
FRA train accidents per million train-miles	0.37	1.54	(76)	0.84	1.13	(26)

⁽¹⁾ Federal Railroad Administration ("FRA") personal injuries per 200,000 employee-hours for the three and nine months ended September 30, 2021, previously reported as 0.97 and 0.97, were restated to 0.98 and 0.98, respectively in this report. FRA train accidents per million train-miles for the nine months ended September 30, 2021, previously reported as 1.09, was restated to 1.13 in this report. These restatements reflect new information available within specified periods stipulated by the FRA but that exceed the Company's financial reporting timeline.

Operations Performance

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

Three months ended September 30, 2022 compared to the three months ended September 30, 2021

- A **GTM** is defined as the movement of one ton of train weight over one mile. GTMs are calculated by multiplying total train weight by the distance the train moved. Total train weight comprises the weight of the freight cars, their contents, and any inactive locomotives. An increase in GTMs indicates additional workload. GTMs increased by 6% in the third quarter of 2022 compared to the same period of 2021. This increase was mainly attributable to higher volumes of Intermodal, Potash and frac sand. This increase was partially offset by lower volumes of Coal and Canadian grain.
- **Train miles** are defined as the sum of the distance moved by all trains operated on the network. Train miles provide a measure of the productive utilization of our network. A smaller increase in train miles relative to increases in volumes, as measured by RTMs, and/or workload, as measured by GTMs, indicate improved train productivity. Train miles increased by 3% in the third quarter of 2022 compared to the same period of 2021. This increase reflects the impact of a 6% increase in workload (GTMs), partially offset by a 3% increase in average train weights.
- **Average train weight** is defined as the average gross weight of CP trains, both loaded and empty. This excludes trains in short-haul service, work trains used to move CP's track equipment and materials, and the haulage of other railways' trains on CP's network. An increase in average train weight indicates improved asset utilization and may also be the result of moving heavier commodities. Average train weight increased by 3% in the third quarter of 2022 compared to the same period of 2021. This increase was a result of improvements in operating plan efficiency and proportionally higher volumes of Potash, which is a heavier commodity.

- **Average train length** is defined as the average total length of CP trains, both loaded and empty. This includes all cars and locomotives on the train and is calculated as the sum of each car or locomotive's length multiplied by the distance travelled, divided by train miles. This excludes trains in short-haul service, work trains used to move CP's track equipment and materials, and the haulage of other railways' trains on CP's network. An increase in average train length indicates improved asset utilization. Average train length increased by 4% in the third quarter of 2022 compared to the same period of 2021. This increase was a result of improvements in operating plan efficiency and higher volumes of Intermodal and Potash, which move in longer trains.
- **Average terminal dwell** is defined as the average time a freight car resides within terminal boundaries expressed in hours. The timing starts with a train arriving at the terminal, a customer releasing the car to the Company, or a car arriving at interchange from another railway. The timing ends when the train leaves, a customer receives the car from CP, or the freight car is transferred to another railway. Freight cars are excluded if they are being stored at the terminal or used in track repairs. A decrease in average terminal dwell indicates improved terminal performance resulting in faster cycle times and improved railcar utilization. Average terminal dwell increased by 8% in the third quarter of 2022 compared to the same period of 2021, primarily as a result of moving proportionally lower volumes of bulk commodities, which require less processing times in yards.
- **Average train speed** is defined as a measure of the line-haul movement from origin to destination including terminal dwell hours. It is calculated by dividing the total train miles travelled by the total train hours operated. This calculation does not include delay time related to customers or foreign railroads and excludes the time and distance travelled by: i) trains used in or around CP's yards; ii) passenger trains; and iii) trains used for repairing track. An increase in average train speed indicates improved on-time performance resulting in improved asset utilization. Average train speed decreased by 1% in the third quarter of 2022 compared to the same period of 2021. This decrease is primarily as a result of increased track and roadway programs.
- **Locomotive productivity** is defined as the daily average GTMs divided by daily average operating horsepower. Operating horsepower excludes units offline, tied up or in storage, or in use on other railways, and includes foreign units online. An increase in locomotive productivity indicates more efficient locomotive utilization and may also be the result of moving heavier commodities. Locomotive productivity was flat in the third quarter of 2022 compared to the same period of 2021.
- **Fuel efficiency** is defined as U.S. gallons of locomotive fuel consumed per 1,000 GTMs. Fuel consumed includes gallons from freight, yard and commuter service but excludes fuel used in capital projects and other non-freight activities. An improvement in fuel efficiency indicates operational cost savings and CP's commitment to corporate sustainability through a reduction of greenhouse gas emissions intensity. Fuel efficiency decreased by 2% in the third quarter of 2022 compared to the same period of 2021. This decrease in efficiency was due to higher volumes of Intermodal, which has lower horsepower utilization.

Nine months ended September 30, 2022 compared to the nine months ended September 30, 2021

- **GTMs** decreased by 4% for the first nine months of 2022 compared to the same period of 2021. This decrease was mainly attributable to lower volumes of Canadian grain, Coal, and Energy, chemicals and plastics. This decrease was partially offset by higher volumes of U.S. grain, Intermodal, Potash, and frac sand.
- **Train miles** decreased by 5% for the first nine months of 2022 compared to the same period of 2021. This decrease reflected the impact of a 4% decrease in workload (GTMs) and a 1% increase in average train weights.
- **Average train weight** increased by 1% for the first nine months of 2022 compared to the same period of 2021. This increase was a result of improvements in operating plan efficiency and moving longer and heavier Potash trains. This increase was partially offset by moving lower volumes of Canadian grain and Coal, which are heavier commodities.
- **Average train length** increased by 2% for the first nine months of 2022 from the same period of 2021. This increase was primarily due to improvements in operating plan efficiency and higher volumes of Intermodal and Potash, which move in longer trains.
- **Average terminal dwell** increased by 13% in the first nine months of 2022 compared to the same period of 2021. This increase was primarily as a result of proportionally lower volumes of bulk commodities, which require less processing time in yards, and harsher winter operating conditions in the first quarter of 2022.
- **Average train speed** was flat in the first nine months of 2022 compared to the same period of 2021.
- **Locomotive productivity** decreased by 4% in the first nine months of 2022 compared to the same period of 2021, as a result of harsher winter operating conditions in the first quarter of 2022.

- **Fuel efficiency** decreased by 2% in the first nine months of 2022 compared to the same period of 2021. This decrease in efficiency was due to lower locomotive productivity and harsher winter operating conditions in the first quarter of 2022, and lower volumes of Canadian grain, which has higher horsepower utilization.

Total Employees and Workforce

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

The average number of total employees increased by 4% for the three months ended September 30, 2022 and was flat for the nine months ended, compared to the same periods of 2021. The total number of employees and total workforce as at September 30, 2022 increased 7% compared to September 30, 2021. The increase in average number of employees for the three months ended September 30, 2022, and the increase in total employees and workforce as at September 30, 2022 were due to increased workload as measured in GTMs.

Safety Indicators

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

The **FRA personal injuries per 200,000 employee-hours** frequency is the number of personal injuries, multiplied by 200,000 and divided by total employee hours. Personal injuries are defined as injuries that require employees to lose time away from work, modify their normal duties or obtain medical treatment beyond minor first aid. FRA employee-hours are the total hours worked, excluding vacation and sick time, by all employees, excluding contractors. The FRA personal injuries per 200,000 employee-hours frequency for CP was 0.86 in the third quarter of 2022, a decrease from 0.98 in the same period of 2021. For the first nine months of 2022, the FRA personal injury rate per 200,000 employee-hours for CP was 0.96, a decrease from 0.98 in the same period of 2021.

The **FRA train accidents per million train-miles** frequency is the number of train accidents, multiplied by 1,000,000 and divided by total train miles. Train accidents included in this metric meet or exceed the FRA reporting threshold of U.S. \$11,300 in 2022 and U.S. \$11,200 in damage for 2021. The FRA train accidents per million train-miles was 0.37 in the third quarter of 2022, a decrease from 1.54 in the same period of 2021. For the first nine months of 2022, the FRA train accidents per million train-miles was 0.84, a decrease from 1.13 in the same period of 2021.

Financial Highlights

The following table presents selected financial data related to the Company's financial results as of, and for the three and nine months ended, September 30, 2022 and the comparative figures in 2021. The financial highlights should be read in conjunction with Item 1. Financial Statements and this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

	For the three months ended September 30		For the nine months ended September 30	
(in millions, except per share data, percentages and ratios)	2022	2021	2022	2021
Financial Performance and Liquidity				
Total revenues	\$ 2,312	\$ 1,942	\$ 6,352	\$ 5,955
Operating income	937	774	2,340	2,374
Adjusted operating income ⁽¹⁾	955	789	2,397	2,521
Net income	891	472	2,246	2,320
Core adjusted income ⁽¹⁾	945	592	2,455	1,881
Basic EPS	0.96	0.71	2.42	3.48
Diluted EPS	0.96	0.70	2.41	3.46
Core adjusted diluted EPS ⁽¹⁾	1.01	0.88	2.63	2.81
Dividends declared per share	0.190	0.190	0.570	0.570
Cash provided by operating activities	1,102	548	2,422	3,084
Cash used in investing activities	(410)	(2,129)	(978)	(2,820)
Cash (used in) provided by financing activities	(721)	902	(1,409)	(194)
Free cash ⁽¹⁾	721	203	1,514	1,245
Financial Position	As at September 30, 2022		As at December 31, 2021	
Total assets	\$ 73,435		\$ 68,177	
Total long-term debt, including current portion	20,575		20,127	
Total shareholders' equity	37,814		33,829	
	For the three months ended September 30		For the nine months ended September 30	
Financial Ratios	2022	2021	2022	2021
Operating ratio ⁽²⁾	59.5%	60.2%	63.2%	60.1%
Adjusted operating ratio ⁽¹⁾	58.7%	59.4%	62.3%	57.7%
	For the twelve months ended September 30			
	2022		2021	
Return on average shareholders' equity ⁽³⁾		11.8%		36.6%
Adjusted return on invested capital ("Adjusted ROIC") ⁽¹⁾		8.9%		15.9%
Long-term debt to Net income ratio ⁽⁴⁾		7.4		3.2
Adjusted net debt to adjusted EBITDA ratio ⁽¹⁾		4.3		2.4
Pro-forma adjusted Net Debt to Pro-forma adjusted EBITDA Ratio ⁽¹⁾		4.1		N/A

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

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

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

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

Results of Operations

Three months ended September 30, 2022 compared to the three months ended September 30, 2021

Income

Operating income was \$937 million in the third quarter of 2022, an increase of \$163 million, or 21%, from \$774 million in the same period of 2021. This increase was primarily due to:

- higher freight volumes as measured by RTMs;
- the favourable impact of changes in fuel prices of \$84 million;
- higher freight rates; and
- lower casualty costs.

This increase was partially offset by lower crude liquidated damages, including customer volume commitments, due to the completion of customer contracts and cost inflation.

Adjusted operating income was \$955 million in the third quarter of 2022, an increase of \$166 million, or 21%, from \$789 million in the same period of 2021. This increase was due to the same factors discussed above for the increase in Operating income.

Net income was \$891 million in the third quarter of 2022, an increase of \$419 million, or 89%, from \$472 million in the same period of 2021. This increase was primarily due to:

- equity earnings of KCS of \$221 million;
- higher operating income of \$163 million;
- lower acquisition-related costs associated with the KCS acquisition of \$83 million in Other expense; and
- no FX translation loss on U.S. dollar-denominated debt and lease liabilities compared to \$46 million recognized in 2021.

This increase was partially offset by higher interest expense primarily due to debt issued related to the KCS acquisition and higher income tax expense as a result of higher taxable earnings.

Core adjusted income was \$945 million in the third quarter of 2022, an increase of \$353 million, or 60%, from \$592 million in the same period of 2021. This increase was due to equity earnings of KCS, excluding the impact of KCS purchase accounting of \$42 million and acquisition-related costs of \$12 million and higher Adjusted operating income of \$166 million.

This increase was partially offset by higher interest expense primarily due to debt issued related to the KCS acquisition and higher income tax expense due to higher taxable earnings.

Diluted Earnings per Share

Diluted EPS was \$0.96 in the third quarter of 2022, an increase of \$0.26, or 37%, from \$0.70 in the same period of 2021. This increase was due to higher Net income, partially offset by a higher average number of outstanding shares due to shares issued for the KCS acquisition.

Core adjusted diluted EPS was \$1.01 in the third quarter of 2022, an increase of \$0.13, or 15%, from \$0.88 in the same period of 2021. This increase was due to higher Core adjusted income, partially offset by a higher average number of outstanding shares due to shares issued for the KCS acquisition.

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 59.5% in the third quarter of 2022, a 70 basis point improvement from 60.2% in the same period of 2021. This improvement was primarily due to:

- higher freight volumes as measured by RTMs;
- higher freight rates; and
- lower casualty costs.

This improvement was partially offset by:

- cost inflation;
- lower crude liquidated damages, including customer volume commitments, due to the completion of customer contracts; and
- a decrease in fuel efficiency of 2% due to higher volumes of Intermodal, which has lower horsepower utilization.

Adjusted operating ratio was 58.7% in the third quarter of 2022, a 70 basis point improvement from 59.4% in the same period of 2021. This improvement was primarily due to the same factors discussed above for the improvement in Operating ratio, except that Adjusted operating ratio excludes the acquisition-related costs associated with the KCS acquisition that were recognized in Purchased services and other in both periods.

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

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

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

Return on average shareholders' equity was 11.8% for the twelve months ended September 30, 2022, a 2,480 basis point decrease compared to 36.6% for the twelve months ended September 30, 2021. This decrease was primarily due to higher average shareholders' equity driven by shares issued for the KCS acquisition and lower accumulated Net income.

Adjusted ROIC was 8.9% for the twelve months ended September 30, 2022, a 700 basis point decrease compared to 15.9% for the twelve months ended September 30, 2021. This decrease was primarily due to shares and higher average long-term debt issued for the KCS acquisition, partially offset by higher Adjusted income. Adjusted ROIC is a Non-GAAP measure, which is defined and reconciled from Return on average shareholders' equity, the most comparable measure calculated in accordance with GAAP, in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Nine months ended September 30, 2022 compared to the nine months ended September 30, 2021

Income

Operating income was \$2,340 million in the first nine months of 2022, a decrease of \$34 million, or 1%, from \$2,374 million in the same period of 2021. This decrease was primarily due to:

- lower volumes as measured by RTMs;
- lower crude liquidated damages, including customer volume commitments, due to the completion of customer contracts;
- cost inflation; and
- a gain on exchange of property and construction easements in Chicago of \$50 million in 2021.

This decrease was partially offset by:

- higher freight rates;
- the favourable impact of changes in fuel prices of \$137 million; and
- lower acquisition-related costs of \$90 million associated with the KCS acquisition that were recognized in Purchased services and other.

Adjusted operating income was \$2,397 million in the first nine months of 2022, a decrease of \$124 million, or 5%, from \$2,521 million in the same period of 2021. This decrease reflected the same factors discussed above for the decrease in Operating income, except that Adjusted operating income excludes the acquisition-related costs associated with the KCS acquisition that were recognized in Purchased services and other in both periods.

Net income was \$2,246 million in the first nine months of 2022, a decrease of \$74 million, or 3%, from \$2,320 million in the same period of 2021. This decrease was primarily due to:

- the \$845 million merger termination payment received in the second quarter of 2021 in connection with KCS's termination of the Agreement and Plan of Merger (the "Original Merger Agreement");
- higher interest expense primarily due to debt issued related to the KCS acquisition;
- no FX translation gain on U.S. dollar-denominated debt and lease liabilities compared to \$39 million recognized in 2021; and
- lower Operating income of \$34 million.

This decrease was partially offset by:

- equity earnings of KCS of \$627 million;
- lower acquisition-related costs associated with the KCS transaction of \$295 million in Other expense; and
- lower income tax expense due to lower taxable earnings.

Core adjusted income was \$2,455 million in the first nine months of 2022, an increase of \$574 million, or 31%, from \$1,881 million in the same period of 2021. This increase was due to equity earnings of KCS, excluding the impact of KCS purchase accounting of \$121 million and acquisition-related costs of \$39 million, and lower income tax expense due to lower taxable earnings, partially offset by higher interest expense primarily due to debt issued related to the KCS acquisition and lower Adjusted operating income of \$124 million.

Diluted Earnings per Share

Diluted EPS was \$2.41 in the first nine months of 2022, a decrease of \$1.05, or 30%, from \$3.46 in the same period of 2021. This decrease was due to a higher average number of outstanding shares driven by shares issued for the KCS acquisition and lower Net income.

Core adjusted diluted EPS was \$2.63 in the first nine months of 2022, a decrease of \$0.18, or 6%, from \$2.81 in the same period of 2021. This decrease was due to a higher average number of outstanding shares driven by shares issued for the KCS acquisition, partially offset by higher Core adjusted income.

Operating Ratio

The Company's Operating ratio was 63.2% in the first nine months of 2022, a 310 basis point increase from 60.1% in the same period of 2021. This increase was primarily due to:

- cost inflation;
- lower crude liquidated damages, including customer volume commitments, due to the completion of customer contracts; and
- the unfavourable impact of changes in fuel prices, net of fuel recoveries;
- lower volumes as measured by RTMs; and
- a gain on the exchange of property and construction easements in Chicago in 2021.

This increase was partially offset by higher freight rates and lower acquisition-related costs associated with the KCS acquisition that were recognized in Purchased services and other.

Adjusted operating ratio was 62.3% in the first nine months of 2022, a 460 basis point increase from 57.7% in the same period of 2021. This increase was due to the same factors as discussed above for the increase in operating ratio, except that Adjusted operating ratio excludes the acquisition-related costs associated with the KCS transaction that were recognized in Purchased services and other in both periods.

Adjusted operating income, Core adjusted income, Core adjusted diluted EPS, and Adjusted Operating ratio 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.

On October 21, 2022, the noon buying rate certified for customs purposes by the U.S. Federal Reserve Bank of New York was U.S. \$1.00 = \$1.37 Canadian dollar.

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

Average exchange rates (Canadian/U.S. dollar)	2022	2021
For the three months ended - September 30	\$ 1.31	\$ 1.26
For the nine months ended - September 30	\$ 1.28	\$ 1.25

Ending exchange rates (Canadian/U.S. dollar)	2022	2021
Beginning of year - January 1	\$ 1.28	\$ 1.28
Beginning of quarter - July 1	\$ 1.29	\$ 1.24
End of quarter - September 30	\$ 1.38	\$ 1.27

	For the three months ended September 30		For the nine months ended September 30	
High/Low exchange rates (Canadian/U.S. dollar)	2022	2021	2022	2021
High	\$ 1.38	\$ 1.29	\$ 1.38	\$ 1.29
Low	\$ 1.27	\$ 1.23	\$ 1.25	\$ 1.20

In the third quarter of 2022, the impact of a stronger U.S. dollar resulted in an increase in total revenues of \$31 million, an increase in total operating expenses of \$17 million, and an increase in interest expense of \$2 million from the same period of 2021. In the first nine months of 2022, the impact of a stronger U.S. dollar resulted in an increase in total revenues of \$65 million, an increase in total operating expenses of \$34 million, and an increase in interest expense of \$6 million from the same period of 2021.

There was no material change in the impact of FX on total revenues and operating expenses during the third quarter and first nine months ended September 30, 2022 from the information provided in Part II, Item 7A. Quantitative and Qualitative Disclosure about Market Risk in CP's 2021 Annual Report on Form 10-K.

Impact of Fuel Price on Earnings

Fluctuations in fuel prices affect the Company's results because fuel expense constitutes a significant portion of CP's operating costs. As fuel prices fluctuate, there will be an impact on earnings due to the timing of recoveries from CP's fuel cost adjustment program. The following table indicates the average fuel price for the three and nine months ended September 30, 2022 and the comparative periods of 2021.

Average Fuel Price (U.S. dollars per U.S. gallon)	2022	2021
For the three months ended - September 30	\$ 4.33	\$ 2.70
For the nine months ended - September 30	\$ 4.13	\$ 2.59

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

In the third quarter of 2022, the favourable impact of fuel prices on Operating income was \$84 million. Higher fuel prices, the favourable impact of the timing of recoveries under CP's fuel cost adjustment program, and increased carbon tax recoveries resulted in an increase in Total revenues of \$206 million. Higher fuel prices resulted in an increase in Total operating expenses of \$122 million from the same period of 2021.

In the first nine months of 2022, the favourable impact of fuel prices on Operating income was \$137 million. Higher fuel prices and increased carbon tax recoveries resulted in an increase in Total revenues of \$511 million. Higher fuel prices resulted in Total operating expenses of \$374 million from the same period of 2021.

Impact of Share Price on Earnings

Fluctuations in the Common Share price affect the Company's operating expenses because share-based liabilities are measured at fair value. The Company's Common Shares are listed on the Toronto Stock Exchange ("TSX") and the New York Stock Exchange ("NYSE") with ticker symbol "CP". The following tables indicate the opening and closing Common Share price on the TSX and the NYSE for the three and nine months ended September 30, 2022 and the comparative periods in 2021.

TSX (in Canadian dollars)	2022	2021
Opening Common Share price, as at January 1	\$ 90.98	\$ 88.31
Ending Common Share price, as at June 30	\$ 89.91	\$ 95.32
Ending Common Share price, as at September 30	\$ 92.21	\$ 82.71
Change in Common Share price for the three months ended September 30	\$ 2.30	\$ (12.61)
Change in Common Share price for the nine months ended September 30	\$ 1.23	\$ (5.60)
NYSE (in U.S. dollars)	2022	2021
Opening Common Share price, as at January 1	\$ 71.94	\$ 69.34
Ending Common Share price, as at June 30	\$ 69.84	\$ 76.91
Ending Common Share price, as at September 30	\$ 66.72	\$ 65.07
Change in Common Share price for the three months ended September 30	\$ (3.12)	\$ (11.84)
Change in Common Share price for the nine months ended September 30	\$ (5.22)	\$ (4.27)

In the third quarter of 2022, the impact of the change in Common Share prices resulted in a decrease in stock-based compensation expense of \$3 million compared to a decrease of \$27 million in the same period of 2021.

In the first nine months of 2022, the impact of the change in Common Share prices resulted in a decrease in stock-based compensation expense of \$6 million compared to a decrease of \$10 million in the same period of 2021.

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

Operating Revenues

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

For the three months ended September 30	2022	2021	Total Change	% Change	FX Adjusted % Change ⁽¹⁾
Freight revenues (in millions)	\$ 2,264	\$ 1,896	\$ 368	19	17
Non-freight revenues (in millions)	48	46	2	4	4
Total revenues (in millions)	\$ 2,312	\$ 1,942	\$ 370	19	17
Carloads (in thousands)	730.0	665.0	65.0	10	N/A
Revenue ton-miles (in millions)	37,569	35,391	2,178	6	N/A
Freight revenue per carload (in dollars)	\$ 3,101	\$ 2,851	\$ 250	9	7
Freight revenue per revenue ton-mile (in cents)	6.03	5.36	0.67	13	11

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

Freight revenues were \$2,264 million in the third quarter of 2022, an increase of \$368 million, or 19%, from \$1,896 million in the same period of 2021. This increase was primarily due to increased freight revenue per RTM and higher volumes as measured by RTMs.

RTMs are defined as the movement of one revenue-producing ton of freight over a distance of one mile. RTMs measure the relative weight and distance of rail freight moved by the Company. RTMs for the third quarter of 2022 were 37,569 million, an increase of 2,178 million, or 6%, from 35,391 million in the same period of 2021. This increase was mainly attributable to higher volumes of Intermodal, Potash, and frac sand. This increase was partially offset by lower volumes of Coal and Canadian grain.

Freight revenue per RTM is defined as freight revenue per revenue-producing ton of freight over a distance of one mile. This is an indicator of yield. Freight revenue per RTM was 6.03 cents in the third quarter of 2022, an increase of 0.67 cents, or 13%, from 5.36 cents in the same period of 2021. This increase was primarily due to higher fuel surcharge revenue as a result of higher fuel prices of \$206 million, higher freight rates, and the favourable impact of the change in FX of \$31 million. This increase was partially offset by lower crude liquidated damages, including customer volume commitments, due to the completion of customer contracts.

Carloads are defined as revenue-generating shipments of containers and freight cars. Carloads were 730.0 thousand in the third quarter of 2022, an increase of 65.0 thousand, or 10%, from 665.0 thousand in the same period of 2021. This increase was primarily due to higher volumes of Intermodal, Potash, and frac sand. This increase was partially offset by lower volumes of crude.

Freight revenue per carload is defined as freight revenue per revenue-generating shipment of containers or freight cars. This is an indicator of yield. Freight revenue per carload was \$3,101 in the third quarter of 2022, an increase of \$250, or 9%, from \$2,851 in the same period of 2021. This increase was primarily due to higher fuel surcharge revenue as a result of higher fuel prices of \$206 million, higher freight rates, and the favourable impact of the change in FX of \$31 million. This increase was partially offset by lower crude liquidated damages, including customer volume commitments, due to the completion of customer contracts.

Non-freight revenues were \$48 million in the third quarter of 2022, an increase of \$2 million, or 4%, from \$46 million in the same period of 2021. This increase was primarily due to higher interline switching fees.

For the nine months ended September 30	2022	2021	Total Change	% Change	FX Adjusted % Change ⁽¹⁾
Freight revenues (in millions)	\$ 6,214	\$ 5,822	\$ 392	7	6
Non-freight revenues (in millions)	138	133	5	4	3
Total revenues (in millions)	\$ 6,352	\$ 5,955	\$ 397	7	6
Carloads (in thousands)	2,068.4	2,079.9	(11.5)	(1)	N/A
Revenue ton-miles (in millions)	109,355	113,725	(4,370)	(4)	N/A
Freight revenue per carload (in dollars)	\$ 3,004	\$ 2,799	\$ 205	7	6
Freight revenue per revenue ton-mile (in cents)	5.68	5.12	0.56	11	10

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

Freight revenues were \$6,214 million in the first nine months of 2022, an increase of \$392 million, or 7%, from \$5,822 million in the same period of 2021. This increase was primarily due to increased freight revenue per RTM, partially offset by lower volumes as measured by RTMs.

RTMs for the first nine months of 2022 were 109,355 million, a decrease of 4,370 million, or 4% from 113,725 million in the same period of 2021. This decrease was mainly attributable to lower volumes of Canadian grain, Coal, and Energy, chemicals and plastics. This decrease was partially offset by higher volumes of U.S. grain, Intermodal, Potash, and frac sand.

Freight revenue per RTM was 5.68 cents in the first nine months of 2022, an increase of 0.56 cents, or 11%, from 5.12 cents in the same period in 2021. This increase was primarily due to higher fuel surcharge revenue as a result of higher fuel prices of \$511 million, higher freight rates, and the favourable impact of the change in FX of \$64 million. This increase was partially offset by lower crude liquidated damages, including customer volume commitments, due to the completion of customer contracts.

Carloads were 2,068.4 thousand in the first nine months of 2022, a decrease of 11.5 thousand, or 1%, from 2,079.9 thousand in the same period of 2021. This decrease was primarily due to lower volumes of Canadian grain, Energy, chemicals and plastics, Coal, and Automotive. This decrease was partially offset by higher volumes of Intermodal, frac sand, and Potash.

Freight revenue per carload was \$3,004 in the first nine months of 2022, an increase of \$205, or 7%, from \$2,799 in the same period of 2021. This increase was primarily due to higher fuel surcharge revenue as a result of higher fuel prices of \$511 million, higher freight rates, and the favourable impact of the change in FX of \$64 million. This increase was partially offset by lower crude liquidated damages, including customer volume commitments, due to the completion of customer contracts.

Non-freight revenues were \$138 million in the first nine months of 2022, an increase of \$5 million, or 4%, from \$133 million in the same period of 2021. This increase was primarily due to higher revenue from passenger service operators and higher leasing revenue, partially offset by lower revenue from logistical services.

Fuel Cost Adjustment Program

Freight revenues include fuel surcharge revenues associated with CP's fuel cost adjustment program, which is designed to respond to fluctuations in fuel prices and help reduce exposure to changing fuel prices. The surcharge is applied to shippers through tariffs and by contract, within agreed-upon guidelines. This program includes recoveries of carbon taxes, levies, and obligations under cap-and-trade programs. Freight revenues included fuel surcharge revenues of \$393 million in the third quarter of 2022, an increase of \$245 million, or 166%, from \$148 million in the same period of 2021. This increase was primarily due to higher fuel prices, higher volumes, and increased carbon tax recoveries.

In the first nine months of 2022, fuel surcharge revenues were \$941 million, an increase of \$575 million, or 157%, from \$366 million in the same period of 2021. This increase was primarily due to higher fuel prices and increased carbon tax recoveries.

Lines of Business

Grain

For the three months ended September 30	2022	2021	Total Change	% Change	FX Adjusted % Change ⁽¹⁾
Freight revenues (in millions)	\$ 391	\$ 352	\$ 39	11	9
Carloads (in thousands)	87.6	89.0	(1.4)	(2)	N/A
Revenue ton-miles (in millions)	7,577	7,715	(138)	(2)	N/A
Freight revenue per carload (in dollars)	\$ 4,463	\$ 3,955	\$ 508	13	11
Freight revenue per revenue ton-mile (in cents)	5.16	4.56	0.60	13	11

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Grain revenue was \$391 million in the third quarter of 2022, an increase of \$39 million, or 11%, from \$352 million in the same period of 2021. This increase was primarily due to increased freight revenue per RTM and higher volumes of U.S. corn from the U.S. Midwest to western Canada. This increase was partially offset by lower volumes of Canadian grain primarily to eastern Canada and Vancouver due to drought conditions that impacted the 2021-2022 Canadian crop size, as well as a delayed harvest for the 2022-2023 crop year. Freight revenue per RTM increased due to higher fuel surcharge revenue as a result of higher fuel prices, higher freight rates, and the favourable impact of the change in FX.

For the nine months ended September 30	2022	2021	Total Change	% Change	FX Adjusted % Change ⁽¹⁾
Freight revenues (in millions)	\$ 1,121	\$ 1,244	\$ (123)	(10)	(11)
Carloads (in thousands)	255.4	323.8	(68.4)	(21)	N/A
Revenue ton-miles (in millions)	23,335	28,564	(5,229)	(18)	N/A
Freight revenue per carload (in dollars)	\$ 4,389	\$ 3,842	\$ 547	14	13
Freight revenue per revenue ton-mile (in cents)	4.80	4.36	0.44	10	9

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Grain revenue was \$1,121 million in the first nine months of 2022, a decrease of \$123 million, or 10%, from \$1,244 million in the same period of 2021. This decrease was primarily due to lower volumes of Canadian grain to Vancouver and eastern Canada due to drought conditions that impacted the 2021-2022 Canadian crop size. This decrease was partially offset by higher volumes of U.S. corn from the U.S. Midwest to western Canada and increased freight revenue per RTM. Freight revenue per RTM increased due to higher fuel surcharge revenue as a result of higher fuel prices, higher freight rates, and the favourable impact of the change in FX. RTMs decreased less than carloads due to moving higher volumes of U.S. corn from the U.S. Midwest to western Canada, which has a longer length of haul.

Coal

For the three months ended September 30	2022	2021	Total Change	% Change	FX Adjusted % Change ⁽¹⁾
Freight revenues (in millions)	\$ 156	\$ 158	\$ (2)	(1)	(2)
Carloads (in thousands)	71.6	73.4	(1.8)	(2)	N/A
Revenue ton-miles (in millions)	3,857	4,334	(477)	(11)	N/A
Freight revenue per carload (in dollars)	\$ 2,179	\$ 2,153	\$ 26	1	1
Freight revenue per revenue ton-mile (in cents)	4.04	3.65	0.39	11	10

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Coal revenue was \$156 million in the third quarter of 2022, a decrease of \$2 million, or 1%, from \$158 million in the same period of 2021. This decrease was primarily due to lower volumes of Canadian coal to Vancouver as a result of production challenges at the mines. This decrease was partially offset by increased freight revenue per RTM and higher volumes of Canadian coal to Kamloops, B.C. Freight revenue per RTM increased due to higher fuel surcharge revenue as a result of higher fuel prices, higher freight rates, and the favourable impact of the change in FX. RTMs decreased more than carloads due to moving lower volumes

of Canadian coal to Vancouver, which has a longer length of haul, and moving higher volumes of Canadian coal to Kamloops, B.C., which has a shorter length of haul.

For the nine months ended September 30	2022	2021	Total Change	% Change	FX Adjusted % Change ⁽¹⁾
Freight revenues (in millions)	\$ 458	\$ 491	\$ (33)	(7)	(7)
Carloads (in thousands)	213.2	224.2	(11.0)	(5)	N/A
Revenue ton-miles (in millions)	12,037	14,451	(2,414)	(17)	N/A
Freight revenue per carload (in dollars)	\$ 2,148	\$ 2,190	\$ (42)	(2)	(2)
Freight revenue per revenue ton-mile (in cents)	3.80	3.40	0.40	12	12

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Coal revenue was \$458 million in the first nine months of 2022, a decrease of \$33 million, or 7%, from \$491 million in the same period of 2021. This decrease was primarily due to lower volumes of Canadian coal to Vancouver as a result of production challenges at the mines, partially offset by higher volumes of Canadian coal to Kamloops, B.C. and increased freight revenue per RTM. Freight revenue per RTM increased due to higher fuel surcharge revenue as a result of higher fuel prices and higher freight rates. RTMs decreased more than carloads due to moving lower volumes of Canadian coal to Vancouver, which has a longer length of haul, and moving higher volumes of Canadian coal to Kamloops, B.C., which has a shorter length of haul.

Potash

For the three months ended September 30	2022	2021	Total Change	% Change	FX Adjusted % Change ⁽¹⁾
Freight revenues (in millions)	\$ 170	\$ 113	\$ 57	50	48
Carloads (in thousands)	45.7	35.8	9.9	28	N/A
Revenue ton-miles (in millions)	5,164	3,941	1,223	31	N/A
Freight revenue per carload (in dollars)	\$ 3,720	\$ 3,156	\$ 564	18	16
Freight revenue per revenue ton-mile (in cents)	3.29	2.87	0.42	15	13

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Potash revenue was \$170 million in the third quarter of 2022, an increase of \$57 million, or 50%, from \$113 million in the same period of 2021. This increase was primarily due to higher volumes of export potash to Vancouver as a result of the prior year impacts of the B.C. wildfires, higher volumes of export potash to Thunder Bay, higher volumes of domestic potash as a result of the prior year impact of mine closures, and increased freight revenue per RTM. Freight revenue per RTM increased due to higher fuel surcharge revenue as a result of higher fuel prices, higher freight rates, and the favourable impact of the change in FX. RTMs increased more than carloads due to moving higher volumes of export potash to Vancouver, which has a longer length of haul.

For the nine months ended September 30	2022	2021	Total Change	% Change	FX Adjusted % Change ⁽¹⁾
Freight revenues (in millions)	\$ 445	\$ 348	\$ 97	28	26
Carloads (in thousands)	125.1	114.8	10.3	9	N/A
Revenue ton-miles (in millions)	14,297	12,705	1,592	13	N/A
Freight revenue per carload (in dollars)	\$ 3,557	\$ 3,031	\$ 526	17	16
Freight revenue per revenue ton-mile (in cents)	3.11	2.74	0.37	14	12

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Potash revenue was \$445 million in the first nine months of 2022, an increase of \$97 million, or 28%, from \$348 million in the same period of 2021. This increase was primarily due to increased freight revenue per RTM and higher volumes of export potash to Vancouver, Thunder Bay, and the U.S. Pacific Northwest. This increase was partially offset by lower volumes of domestic potash. Freight revenue per RTM increased due to higher fuel surcharge revenue as a result of higher fuel prices, higher freight rates, and the favourable impact of the change in FX. RTMs increased more than carloads due to moving higher volumes of export potash, which has a longer length of haul.

Fertilizers and Sulphur

For the three months ended September 30	2022	2021	Total Change	% Change	FX Adjusted % Change ⁽¹⁾
Freight revenues (in millions)	\$ 81	\$ 72	\$ 9	13	11
Carloads (in thousands)	14.9	15.1	(0.2)	(1)	N/A
Revenue ton-miles (in millions)	1,138	1,141	(3)	—	N/A
Freight revenue per carload (in dollars)	\$ 5,436	\$ 4,768	\$ 668	14	12
Freight revenue per revenue ton-mile (in cents)	7.12	6.31	0.81	13	11

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Fertilizers and sulphur revenue was \$81 million in the third quarter of 2022, an increase of \$9 million, or 13%, from \$72 million in the same period of 2021. This increase was primarily due to increased freight revenue per RTM and higher volumes of dry fertilizers, partially offset by lower volumes of sulphur and wet fertilizers. Freight revenue per RTM increased due to higher fuel surcharge revenue as a result of higher fuel prices, higher freight rates, and the favourable impact of the change in FX.

For the nine months ended September 30	2022	2021	Total Change	% Change	FX Adjusted % Change ⁽¹⁾
Freight revenues (in millions)	\$ 244	\$ 227	\$ 17	7	6
Carloads (in thousands)	46.8	48.4	(1.6)	(3)	N/A
Revenue ton-miles (in millions)	3,585	3,673	(88)	(2)	N/A
Freight revenue per carload (in dollars)	\$ 5,214	\$ 4,690	\$ 524	11	9
Freight revenue per revenue ton-mile (in cents)	6.81	6.18	0.63	10	8

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Fertilizers and sulphur revenue was \$244 million in the first nine months of 2022, an increase of \$17 million, or 7%, from \$227 million in the same period of 2021. This increase was primarily due to increased freight revenue per RTM and higher volumes of dry fertilizers, partially offset by lower volumes of wet fertilizers and sulphur. Freight revenue per RTM increased due to higher fuel surcharge revenue as a result of higher fuel prices, higher freight rates, and the favourable impact of the change in FX.

Forest Products

For the three months ended September 30	2022	2021	Total Change	% Change	FX Adjusted % Change ⁽¹⁾
Freight revenues (in millions)	\$ 109	\$ 89	\$ 20	22	18
Carloads (in thousands)	18.5	18.7	(0.2)	(1)	N/A
Revenue ton-miles (in millions)	1,488	1,419	69	5	N/A
Freight revenue per carload (in dollars)	\$ 5,892	\$ 4,759	\$ 1,133	24	20
Freight revenue per revenue ton-mile (in cents)	7.33	6.27	1.06	17	13

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Forest products revenue was \$109 million in the third quarter of 2022, an increase of \$20 million, or 22%, from \$89 million in the same period of 2021. This increase was primarily due to increased freight revenue per RTM and higher volumes of lumber, partially offset by lower volumes of paperboard. Freight revenue per RTM increased due to higher fuel surcharge revenue as a result of higher fuel prices, higher freight rates, and the favourable impact of the change in FX. RTMs increased while carloads decreased due to moving higher volumes of lumber from western Canada to the U.S. Midwest, which has a longer length of haul, and lower volumes of paperboard from Kansas City and Minneapolis to the U.S. Midwest, which have shorter lengths of haul.

For the nine months ended September 30	2022	2021	Total Change	% Change	FX Adjusted % Change ⁽¹⁾
Freight revenues (in millions)	\$ 299	\$ 259	\$ 40	15	13
Carloads (in thousands)	55.3	55.1	0.2	—	N/A
Revenue ton-miles (in millions)	4,366	4,290	76	2	N/A
Freight revenue per carload (in dollars)	\$ 5,407	\$ 4,701	\$ 706	15	12
Freight revenue per revenue ton-mile (in cents)	6.85	6.04	0.81	13	11

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

Forest products revenue was \$299 million in the first nine months of 2022, an increase of \$40 million, or 15%, from \$259 million in the same period of 2021. This increase was primarily due to increased freight revenue per RTM, higher volumes of newsprint from Saint John, N.B., and higher volumes of paper and panel products from B.C. This increase was partially offset by lower volumes of lumber. Freight revenue per RTM increased due to higher fuel surcharge revenue as a result of higher fuel prices, higher freight rates, and the favourable impact of the change in FX.

Energy, Chemicals and Plastics

For the three months ended September 30	2022	2021	Total Change	% Change	FX Adjusted % Change ⁽¹⁾
Freight revenues (in millions)	\$ 360	\$ 392	\$ (32)	(8)	(10)
Carloads (in thousands)	75.1	78.2	(3.1)	(4)	N/A
Revenue ton-miles (in millions)	6,286	6,330	(44)	(1)	N/A
Freight revenue per carload (in dollars)	\$ 4,794	\$ 5,013	\$ (219)	(4)	(6)
Freight revenue per revenue ton-mile (in cents)	5.73	6.19	(0.46)	(7)	(9)

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Energy, chemicals and plastics revenue was \$360 million in the third quarter of 2022, a decrease of \$32 million, or 8%, from \$392 million in the same period of 2021. This decrease was primarily due to decreased freight revenue per RTM and lower volumes of conventional crude and petroleum products. This decrease was partially offset by higher fuel surcharge revenue as a result of higher fuel prices, higher volumes of DRUbit™ crude to Kansas City and ethylene glycol, the favourable impact of the change in FX, and higher freight rates. Freight revenue per RTM decreased primarily due to lower crude liquidated damages, including customer volume commitments, as a result of the completion of customer contracts. Carloads decreased more than RTMs due to moving lower volumes of conventional crude to Noyes, MN and Kingsgate, B.C., which have shorter lengths of haul, and higher volumes to DRUbit™ crude to Kansas City, which has a longer length of haul.

For the nine months ended September 30	2022	2021	Total Change	% Change	FX Adjusted % Change ⁽¹⁾
Freight revenues (in millions)	\$ 1,010	\$ 1,149	\$ (139)	(12)	(13)
Carloads (in thousands)	221.2	241.5	(20.3)	(8)	N/A
Revenue ton-miles (in millions)	18,221	19,328	(1,107)	(6)	N/A
Freight revenue per carload (in dollars)	\$ 4,566	\$ 4,758	\$ (192)	(4)	(5)
Freight revenue per revenue ton-mile (in cents)	5.54	5.94	(0.40)	(7)	(8)

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

Energy, chemicals and plastics revenue was \$1,010 million in the first nine months of 2022, a decrease of \$139 million, or 12%, from \$1,149 million in the same period of 2021. This decrease was primarily due to decreased freight revenue per RTM and lower volumes of conventional crude, petroleum products, and plastics. This decrease was partially offset by higher fuel surcharge revenue as a result of higher fuel prices, higher volumes of DRUbit™ crude to Kansas City, higher freight rates, and the favourable impact of the change in FX. Freight revenue per RTM decreased primarily due to lower crude liquidated damages, including customer volume commitments, as a result of the completion of customer contracts. Carloads decreased more than RTMs due to moving lower volumes of conventional crude to Noyes, MN and Kingsgate, B.C., which have shorter lengths of haul, and moving higher volumes of DRUbit™ crude to Kansas City, which has a longer length of haul.

Metals, Minerals and Consumer Products

For the three months ended September 30	2022	2021	Total Change	% Change	FX Adjusted % Change ⁽¹⁾
Freight revenues (in millions)	\$ 246	\$ 196	\$ 50	26	22
Carloads (in thousands)	66.0	60.4	5.6	9	N/A
Revenue ton-miles (in millions)	3,225	2,992	233	8	N/A
Freight revenue per carload (in dollars)	\$ 3,727	\$ 3,245	\$ 482	15	12
Freight revenue per revenue ton-mile (in cents)	7.63	6.55	1.08	16	14

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Metals, minerals and consumer products revenue was \$246 million in the third quarter of 2022, an increase of \$50 million, or 26%, from \$196 million in the same period of 2021. This increase was primarily due to increased freight revenue per RTM and higher volumes of frac sand to the Bakken and Marcellus shale formations, partially offset by lower volumes of steel. Freight revenue per RTM increased due to higher fuel surcharge revenue as a result of higher fuel prices, higher freight rates, and the favourable impact of the change in FX.

For the nine months ended September 30	2022	2021	Total Change	% Change	FX Adjusted % Change ⁽¹⁾
Freight revenues (in millions)	\$ 655	\$ 535	\$ 120	22	20
Carloads (in thousands)	187.2	177.2	10.0	6	N/A
Revenue ton-miles (in millions)	8,852	8,328	524	6	N/A
Freight revenue per carload (in dollars)	\$ 3,499	\$ 3,019	\$ 480	16	14
Freight revenue per revenue ton-mile (in cents)	7.40	6.42	0.98	15	13

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

Metals, minerals and consumer products revenue was \$655 million in the first nine months of 2022, an increase of \$120 million, or 22%, from \$535 million in the same period of 2021. This increase was primarily due to increased freight revenue per RTM and higher volumes of frac sand to the Marcellus and Bakken shale formations, partially offset by lower volumes of steel. Freight revenue per RTM increased due to higher fuel surcharge revenue as a result of higher fuel prices, higher freight rates, and the favourable impact of the change in FX.

Automotive

For the three months ended September 30	2022	2021	Total Change	% Change	FX Adjusted % Change ⁽¹⁾
Freight revenues (in millions)	\$ 111	\$ 83	\$ 28	34	31
Carloads (in thousands)	25.1	23.3	1.8	8	N/A
Revenue ton-miles (in millions)	418	403	15	4	N/A
Freight revenue per carload (in dollars)	\$ 4,422	\$ 3,562	\$ 860	24	21
Freight revenue per revenue ton-mile (in cents)	26.56	20.60	5.96	29	26

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

Automotive revenue was \$111 million in the third quarter of 2022, an increase of \$28 million, or 34%, from \$83 million in the same period of 2021. This increase was primarily due to increased freight revenue per RTM and higher volumes moving from Ontario to Chicago and Kansas City. Freight revenue per RTM increased due to higher fuel surcharge revenue as a result of higher fuel prices, the favorable impact of the change in FX and higher freight rates. Carloads increased more than RTMs due to moving higher volumes from Ontario to Chicago and Kansas City, which have shorter lengths of haul.

For the nine months ended September 30	2022	2021	Total Change	% Change	FX Adjusted % Change ⁽¹⁾
Freight revenues (in millions)	\$ 322	\$ 289	\$ 33	11	10
Carloads (in thousands)	78.0	85.4	(7.4)	(9)	N/A
Revenue ton-miles (in millions)	1,308	1,378	(70)	(5)	N/A
Freight revenue per carload (in dollars)	\$ 4,128	\$ 3,384	\$ 744	22	20
Freight revenue per revenue ton-mile (in cents)	24.62	20.97	3.65	17	15

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

Automotive revenue was \$322 million in the first nine months of 2022, an increase of \$33 million, or 11%, from \$289 million in the same period of 2021. This increase was primarily due to increased freight revenue per RTM, partially offset by lower volumes as a result of global supply chain challenges. Freight revenue per RTM increased due to higher fuel surcharge revenue as a result of higher fuel prices, higher freight rates, and the favourable impact of the change in FX. Carloads decreased more than RTMs due to moving proportionately lower volumes within the U.S. Midwest and eastern Canada, which has a shorter length of haul.

Intermodal

For the three months ended September 30	2022	2021	Total Change	% Change	FX Adjusted % Change ⁽¹⁾
Freight revenues (in millions)	\$ 640	\$ 441	\$ 199	45	44
Carloads (in thousands)	325.5	271.1	54.4	20	N/A
Revenue ton-miles (in millions)	8,416	7,116	1,300	18	N/A
Freight revenue per carload (in dollars)	\$ 1,966	\$ 1,627	\$ 339	21	20
Freight revenue per revenue ton-mile (in cents)	7.60	6.20	1.40	23	22

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

Intermodal revenue was \$640 million in the third quarter of 2022, an increase of \$199 million, or 45%, from \$441 million in the same period of 2021. This increase was primarily due to increased freight revenue per RTM, higher international intermodal volumes to and from the Port of Vancouver and the Port of Saint John, onboarding new international intermodal customers, and higher domestic retail volumes. Freight revenue per RTM increased due to higher fuel surcharge revenue as a result of higher fuel prices, higher intermodal ancillary revenue, higher freight rates, and the favourable impact of the change in FX.

For the nine months ended September 30	2022	2021	Total Change	% Change	FX Adjusted % Change ⁽¹⁾
Freight revenues (in millions)	\$ 1,660	\$ 1,280	\$ 380	30	29
Carloads (in thousands)	886.2	809.5	76.7	9	N/A
Revenue ton-miles (in millions)	23,354	21,008	2,346	11	N/A
Freight revenue per carload (in dollars)	\$ 1,873	\$ 1,581	\$ 292	18	18
Freight revenue per revenue ton-mile (in cents)	7.11	6.09	1.02	17	16

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

Intermodal revenue was \$1,660 million in the first nine months of 2022, an increase of \$380 million, or 30%, from \$1,280 million in the same period of 2021. This increase was primarily due to increased freight revenue per RTM, higher volumes due to onboarding new international customers, higher international volumes to and from the Port of Saint John and the Port of Montreal, and higher domestic wholesale and retail volumes. Freight revenue per RTM increased due to higher fuel surcharge revenue as a result of higher fuel prices, higher intermodal ancillary revenue, higher freight rates, and the favourable impact of the change in FX.

Operating Expenses

For the three months ended September 30
(in millions of Canadian dollars)

	2022	2021	Total Change	% Change	FX Adjusted % Change ⁽¹⁾
Compensation and benefits	\$ 393	\$ 381	\$ 12	3	2
Fuel	358	199	159	80	75
Materials	66	51	15	29	29
Equipment rents	33	31	2	6	3
Depreciation and amortization	213	203	10	5	4
Purchased services and other	312	303	9	3	2
Total operating expenses	\$ 1,375	\$ 1,168	\$ 207	18	16

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

Operating expenses were \$1,375 million in the third quarter of 2022, an increase of \$207 million, or 18%, from \$1,168 million in the same period of 2021. This increase was primarily due to:

- the unfavourable impact of changes in fuel prices of \$122 million;
- cost inflation;
- higher volume variable expenses as a result of an increase in workload as measured by GTMs;
- the unfavourable impact of the change in FX of \$17 million; and
- a decrease in fuel efficiency of 2% due to higher volumes of Intermodal, which has lower horsepower utilization.

This increase was partially offset by lower casualty costs incurred in 2022.

For the nine months ended September 30
(in millions of Canadian dollars)

	2022	2021	Total Change	% Change	FX Adjusted % Change ⁽¹⁾
Compensation and benefits	\$ 1,154	\$ 1,165	\$ (11)	(1)	(2)
Fuel	1,001	623	378	61	58
Materials	191	164	27	16	16
Equipment rents	97	92	5	5	3
Depreciation and amortization	634	605	29	5	4
Purchased services and other	935	932	3	—	—
Total operating expenses	\$ 4,012	\$ 3,581	\$ 431	12	11

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

Operating expenses were \$4,012 million in the first nine months of 2022, an increase of \$431 million, or 12%, from \$3,581 million in the same period of 2021. This increase was primarily due to:

- the unfavourable impact of changes in fuel prices of \$374 million;
- cost inflation;
- a gain on the exchange of property and construction easements in Chicago of \$50 million in 2021;
- a decrease in efficiencies primarily due to harsh winter weather conditions in the first quarter of 2022; and
- the unfavourable impact of the changes in FX of \$34 million.

This increase was partially offset by lower acquisition-related costs of \$90 million associated with the KCS acquisition that were recognized in Purchased services and other and lower volume variable expenses as a result of a decrease in workload as measured by GTMs.

Compensation and Benefits

Compensation and benefits expense includes employee wages, salaries, fringe benefits, and stock-based compensation. Compensation and benefits expense was \$393 million in the third quarter of 2022, an increase of \$12 million, or 3%, from \$381 million in the same period of 2021.

This increase was primarily due to:

- impact of wage and benefit inflation;
- increased volume variable expense as a result of an increase in workload as measured by GTMs; and

- increased new hire training costs.

This increase was partially offset by:

- lower stock-based compensation of \$5 million;
- lower defined benefit pension current service cost of \$5 million; and
- decreased incentive compensation.

Compensation and benefits expense was \$1,154 million in the first nine months of 2022, a decrease of \$11 million, or 1%, from \$1,165 million in the same period of 2021. This decrease was primarily due to:

- decreased incentive compensation;
- lower volume variable expense as a result of a decrease in workload as measured by GTMs; and
- lower defined benefit pension current service cost of \$17 million.

This decrease was partially offset by the impact of wage and benefit inflation and unfavourable impact of the change in FX of \$8 million.

Fuel

Fuel expense consists mainly of fuel used by locomotives and includes provincial, state, and federal fuel taxes. Fuel expense was \$358 million in the third quarter of 2022, an increase of \$159 million, or 80%, from \$199 million in the same period of 2021. This increase was primarily due to:

- the unfavourable impact of higher fuel prices of \$122 million;
- an increase in workload, as measured by GTMs;
- a decrease in fuel efficiency of 2% due to higher volumes of Intermodal, which has lower horsepower utilization; and
- the unfavourable impact of the change in FX of \$6 million.

Fuel expense was \$1,001 million in the first nine months of 2022, an increase of \$378 million, or 61%, from \$623 million in the same period of 2021. This increase was primarily due to:

- the unfavourable impact of higher fuel prices of \$374 million;
- a decrease in fuel efficiency of 2% due to lower locomotive productivity and harsher winter operating conditions in the first quarter of 2022, and lower volumes of Canadian grain, which has higher horsepower utilization; and
- the unfavourable impact of the change in FX of \$12 million.

This increase was partially offset by a decrease in workload, as measured by GTMs.

Materials

Materials expense includes the cost of materials used for the maintenance of track, locomotives, freight cars, and buildings, as well as software sustainment. Materials expense was \$66 million in the third quarter of 2022, an increase of \$15 million, or 29%, from \$51 million in the same period of 2021. This increase was primarily due to the unfavourable impact of inflation including higher non-locomotive fuel prices, and higher spending on locomotive and track maintenance.

Materials expense was \$191 million in the first nine months of 2022, an increase of \$27 million, or 16%, from \$164 million in the same period of 2021. This increase was primarily due to:

- the unfavourable impact of inflation including higher non-locomotive fuel prices;
- an increase in non-locomotive fuel consumption; and
- higher spending on track maintenance.

Equipment Rents

Equipment rents expense includes the cost associated with using other railways' freight cars, intermodal equipment, and locomotives, net of rental income received from other railways for the use of CP's equipment. Equipment rents expense was \$33 million in the third quarter of 2022, an increase of \$2 million, or 6%, from \$31 million in the same period of 2021. This increase was primarily due to greater usage of pooled freight cars and lower price incentives received on Intermodal cars.

This increase was partially offset by higher container rents in 2022 and higher receipts for CP rolling stock used by other railways.

Equipment rents expense was \$97 million in the first nine months of 2022, an increase of \$5 million, or 5%, from \$92 million in the same period of 2021. This increase was primarily due to:

- lower price incentives received on Intermodal cars;
- greater usage of pooled freight cars; and
- slower cycle times.

This increase was partially offset by higher receipts for CP rolling stock used by other railways and higher container rents in 2022.

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 was \$213 million and \$634 million for the three and nine months ended September 30, 2022, an increase of \$10 million or 5%, and an increase of \$29 million or 5%, respectively, compared to the same periods of 2021. These increases were primarily due to a higher depreciable asset base as well as the unfavourable impact of the change in FX of \$2 million.

Purchased Services and Other

For the three months ended September 30 (in millions of Canadian dollars)	2022	2021	Total Change	% Change
Support and facilities	\$ 83	\$ 80	\$ 3	4
Track and operations	68	66	2	3
Intermodal	59	50	9	18
Equipment	26	26	—	—
Casualty	24	42	(18)	(43)
Property taxes	32	30	2	7
Other	23	17	6	35
Land sales	(3)	(8)	5	(63)
Total Purchased services and other	\$ 312	\$ 303	\$ 9	3

Purchased services and other expense encompasses a wide range of third-party costs, including expenses for joint facilities, personal injuries and damage claims, environmental remediation, property taxes, contractor and consulting fees, insurance, and gains on land sales. Purchased services and other expense was \$312 million in the third quarter of 2022, an increase of \$9 million, or 3%, from \$303 million in the same period of 2021. This increase was primarily due to:

- cost inflation;
- higher expenses due to higher events and sponsorship costs;
- lower gains on land sales; and
- the unfavorable impact of the change in FX of \$4 million.

This increase was partially offset by:

- lower expenses primarily due to the reduced severity of casualty incidents;
- expenses due to the wildfire response in British Columbia in 2021, reported in Support and facilities, and Track and operations; and
- lower legal expenses compared to the same period in 2021, reported in Support and facilities.

For the nine months ended September 30 (in millions of Canadian dollars)	2022	2021	Total Change	% Change
Support and facilities	\$ 249	\$ 214	\$ 35	16
Track and operations	217	204	13	6
Intermodal	167	154	13	8
Equipment	82	80	2	3
Casualty	74	101	(27)	(27)
Property taxes	103	98	5	5
Other	56	148	(92)	(62)
Land sales	(13)	(67)	54	(81)
Total Purchased services and other	\$ 935	\$ 932	\$ 3	—

Purchased services and other expense was \$935 million in the first nine months of 2022, an increase of \$3 million from \$932 million in the same period of 2021. This increase was primarily due to:

- a gain on the exchange of property and construction easements in Chicago of \$50 million in 2021;
- cost inflation;
- higher expenses primarily due to higher events and sponsorship costs;

- increased purchased services due to harsher weather conditions, reported in Track and operations;
- a \$7 million arbitration settlement in 2021, reported in Track and operations;
- the unfavorable impact of the change in FX of \$7 million; and
- higher intermodal expenses related to pickup and delivery, reported in Intermodal.

This increase was partially offset by:

- lower acquisition-related costs of \$90 million associated with the KCS acquisition, reported in Other;
- lower expenses primarily due to the reduced severity of casualty incidents; and
- lower expenses from lower volumes, reported in Intermodal, and Track and operations.

Other Income Statement Items

Equity Earnings of Kansas City Southern

In the third quarter of 2022, the Company recognized \$221 million (U.S. \$169 million) equity income of KCS in the Company's Interim Consolidated Statements of Income. This amount is net of amortization of basis differences of \$42 million (U.S. \$32 million) associated with KCS purchase accounting and net of acquisition-related costs incurred by KCS. No similar equity income existed in the same period of 2021 as CP acquired KCS into trust on December 14, 2021.

On a historical basis, without any effect of purchase accounting, KCS recorded net income attributable to controlling interests of \$263 million (U.S. \$201 million) in the third quarter of 2022, a favourable change of \$66 million (U.S. \$45 million), or 34%, from a \$197 million (U.S. \$156 million) net income. This change was primarily due to higher revenues of \$180 million (U.S. \$138 million) and lower acquisition-related costs, partially offset by higher fuel cost of \$56 million (U.S. \$43 million). Acquisition-related costs (net of tax) incurred by KCS in the third quarter of 2022 were \$12 million (U.S. \$10 million), a decrease of \$23 million (U.S. \$18 million), or 66%, from \$35 million (U.S. \$28 million) in the same period of 2021. These values have been translated at the average FX rate of \$1.31 and \$1.26 CAD per USD for the three months ended September 30, 2022 and 2021, respectively.

In the first nine months of 2022, the Company recognized \$627 million (U.S. \$489 million) equity income of KCS in the Company's Interim Consolidated Statements of Income. This amount is net of amortization of basis differences of \$121 million (U.S. \$94 million) associated with KCS purchase accounting and net of acquisition-related costs incurred by KCS.

On a historical basis, without any effect of purchase accounting, KCS recorded net income attributable to controlling interests of \$748 million (U.S. \$583 million) in the first nine months of 2022, a favourable change of \$835 million (U.S. \$653 million), or 961%, from a \$87 million (U.S. \$70 million) net loss. This change was primarily due to lower acquisition-related costs, including the merger termination fee paid to CP in the same period of 2021, and higher revenues of \$393 million (U.S. \$306 million), partially offset by higher fuel cost of \$145 million (U.S. \$113 million). Acquisition-related costs (net of tax) incurred by KCS in the first nine months of 2022 were \$39 million (U.S. \$30 million), a decrease of \$727 million (U.S. \$583 million), or 95%, from \$766 million (U.S. \$613 million) in the same period of 2021. These values have been translated at the average FX rate of \$1.28 and \$1.25 CAD per USD for the first nine months of 2022 and 2021, respectively.

Other Expense

Other expense consists of gains and losses from the change in FX on debt and lease liabilities and working capital, costs related to financing, shareholder costs, equity income, and other non-operating expenditures. Other expense was \$7 million in the third quarter of 2022, a decrease of \$117 million, or 94%, compared to other expense of \$124 million in the same period of 2021. This decrease was primarily due to acquisition-related costs of \$83 million in 2021 which included losses on interest rate hedges of \$111 million, bridge facility fees of \$2 million, and gains on FX hedges of \$30 million. In addition, an FX translation loss of \$46 million was incurred in the third quarter of 2021 compared to nil in the same period of 2022 as a result of the designation of all U.S. dollar-denominated debt and lease liabilities as a net investment hedge following the KCS acquisition in the fourth quarter of 2021. This decrease was partially offset by higher FX losses on cash and working capital of \$9 million in the third quarter of 2022 as compared to the same period in 2021.

Other expense was \$13 million in the first nine months of 2022, a decrease of \$240 million, or 95%, from \$253 million in the same period of 2021. This decrease was primarily due to acquisition-related costs of \$295 million in 2021 which included losses on interest rate hedges of \$261 million, bridge facility and backstop revolver fees of \$47 million, and gains on FX hedges of \$13 million. This decrease was partially offset by an FX translation gain of \$39 million in the first nine months of 2021 compared to nil in the same period of 2022 as a result of the designation of all U.S. dollar-denominated debt and lease liabilities as discussed above, and higher FX losses on cash and working capital of \$10 million in the nine months ended September 30, 2022 as compared to the same period in 2021.

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

Merger Termination Fee

On May 21, 2021, KCS terminated the Original Merger Agreement with CP to enter into a definitive agreement with Canadian National Railway. At the same time and in accordance with the terms of the Original Merger Agreement, KCS paid CP a termination fee of \$845 million (U.S. \$700 million). This amount is reported as "Merger termination fee" in the Company's Interim Consolidated Statements of Income for the nine months ended September 30, 2021. No similar items were received in the same period of 2022.

Other Components of Net Periodic Benefit Recovery

Other components of net periodic benefit recovery is related to the Company's pension and other post-retirement and post-employment benefit plans. It includes interest cost on benefit obligations, expected return on fund assets, recognized net actuarial losses, and amortization of prior service costs. Other components of net periodic benefit recovery was \$102 million and \$304 million for the three and nine months ended September 30, 2022, an increase of \$7 million or 7%, and an increase of \$18 million or 6%, respectively, compared to the same periods of 2021. These increases were primarily due to decreases in recognized net actuarial losses of \$14 million and \$42 million, respectively, partially offset by increases in the interest cost on benefit obligations of \$7 million and \$23 million, respectively.

Net Interest Expense

Net interest expense includes interest on long-term debt and finance leases. Net interest expense was \$166 million in the third quarter of 2022, an increase of \$62 million, or 60%, from \$104 million in the same period of 2021. This increase was primarily due to interest of \$65 million incurred on long-term debt and the U.S. \$500 million term facility issued for the KCS acquisition, and higher interest on commercial paper of \$5 million as a result of higher interest rates along with a higher average outstanding balance, partially offset by the favourable impact of \$9 million related to repayment of maturing long-term debt.

Net interest expense was \$486 million in the first nine months of 2022, an increase of \$171 million, or 54%, from \$315 million in the same period of 2021. This increase was primarily due to interest of \$192 million incurred on long-term debt and the U.S. \$500 million term facility issued for the KCS acquisition, and higher interest on commercial paper of \$7 million as a result of higher interest rates along with a higher average outstanding balance, partially offset by the favourable impacts of \$25 million related to repayment of maturing long-term debt and \$13 million as a result of a lower effective interest rates.

Income Tax Expense

Income tax expense was \$196 million in the third quarter of 2022, an increase of \$27 million, or 16%, from \$169 million in the same period of 2021. This increase was primarily due to higher taxable earnings and lower tax recoveries on acquisition-related costs associated with the KCS acquisition.

This increase was partially offset by:

- a deferred tax recovery of \$12 million on the revaluation of deferred income tax balances as at January 1, 2022 as a result of an Iowa state corporate tax rate decrease enacted during the third quarter of 2022;
- an outside basis deferred tax recovery arising from the difference between the carrying amount of CP's investment in KCS for financial reporting and the underlying tax basis of this investment; and
- a lower effective tax rate.

Income tax expense was \$526 million in the first nine months of 2022, a decrease of \$91 million, or 15%, from \$617 million in the same period of 2021. This decrease was primarily due to:

- higher taxable earnings in 2021 due to the merger termination payment received in connection with KCS's termination of the Original Merger Agreement of \$845 million (U.S. \$700 million);
- the deferred tax recovery described above; and
- a lower effective tax rate.

This decrease was partially offset by lower tax recoveries on acquisition-related costs associated with the KCS acquisition, and an outside basis deferred tax expense arising from the difference between the carrying amount of CP's investment in KCS for financial reporting and the underlying tax basis of this investment.

The effective tax rate in the third quarter and first nine months of 2022, including equity earnings of KCS and other discrete items, was 18.01% and 18.97%, respectively, compared to 26.36% and 21.00% in the same periods of 2021. The effective tax rate in the third quarter and first nine months of 2022, excluding discrete items, was 24.25% compared to 24.60% for the same periods in 2021.

The Company expects an annualized effective tax rate in 2022 between 24.00% and 24.50%, which excludes equity earnings of KCS and other discrete items. The Company's 2022 outlook for its annualized effective income tax rate is based on certain assumptions about events and developments that may or may not materialize or that may be offset entirely or partially by new events and developments. This is discussed further in Item 1A. Risk Factors of CP's 2021 Annual Report on Form 10-K.

Liquidity and Capital Resources

The Company's primary sources of liquidity include its Cash and cash equivalents, commercial paper program, bilateral letter of credit facilities, and revolving credit facility. The Company believes that these sources as well as cash flow generated through operations and existing debt capacity are adequate to meet its short-term and long-term cash requirements. The Company is not aware of any material trends, events, or uncertainties that would create any deficiencies in the Company's liquidity.

As at September 30, 2022, the Company had \$138 million of Cash and cash equivalents compared to \$69 million at December 31, 2021.

As at September 30, 2022, the Company's existing revolving credit facility was undrawn, unchanged from December 31, 2021, from a total available amount of U.S. \$1.3 billion. During the three and nine months ended September 30, 2022, the Company repaid in full the outstanding borrowings of U.S. \$400 million (\$504 million) and U.S. \$500 million (\$636 million) respectively on the U.S. \$500 million unsecured non-revolving term credit facility (the "term facility"). The facility was automatically terminated on September 15, 2022 following the final principal repayment. The revolving credit facility agreement requires the Company to maintain a financial covenant. As at September 30, 2022, the Company was in compliance with all terms and conditions of the credit facility arrangements and satisfied the financial covenant.

The Company has a commercial paper program that enables it to issue commercial paper up to a maximum aggregate principal amount of U.S. \$1.0 billion in the form of unsecured promissory notes. This commercial paper program is backed by the revolving credit facility. As at September 30, 2022, total commercial paper borrowings were U.S. \$525 million, compared to U.S. \$265 million as at December 31, 2021.

As at September 30, 2022, under its bilateral letter of credit facilities, the Company had letters of credit drawn of \$75 million, compared to \$58 million as at December 31, 2021, from a total available amount of \$300 million. Under the bilateral letter of credit facilities, the Company has the option to post collateral in the form of Cash or cash equivalents, equal at least to the face value of the letter of credit issued. As at September 30, 2022 and December 31, 2021, the Company did not have any collateral posted on its bilateral letter of credit facilities.

Contractual Commitments

The Company's material cash requirements from known contractual obligations and commitments to make future payments primarily consist of long-term debt and related interest, future capital commitments, supplier purchases, leases, and other long term liabilities. Debt and finance leases, interest obligations related to debt and finance leases, and letters of credit amount to \$1,237 million, \$656 million and \$75 million within the next 12 months, respectively, with the remaining amount committed thereafter of \$19,513 million, \$14,044 million and nil, respectively. Future capital commitments amount to \$356 million within the next 12 months, with the remaining amount committed thereafter of \$144 million.

Supplier purchase agreements, operating leases, and other long-term liabilities amount to \$943 million, \$74 million, and \$56 million within the next 12 months, respectively, with the remaining amount committed thereafter of \$548 million, \$231 million and \$402 million, respectively. Other long-term liabilities include expected cash payments for environmental remediation, post-retirement benefits, worker's compensation benefits, long-term disability benefits, pension benefit payments for the Company's non-registered supplemental pension plan, and certain other long-term liabilities. 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.

Guarantees

The Company accrues for all guarantees that it expects to pay. As at September 30, 2022, these accruals amounted to \$5 million (December 31, 2021 - \$14 million).

Operating Activities

Cash provided by operating activities was \$1,102 million in the third quarter of 2022, an increase of \$554 million, or 101%, compared to \$548 million in the same period of 2021. This increase was primarily due to a dividend received of \$259 million from KCS in the third quarter of 2022, the favourable change in working capital, and an increase in cash generating income compared to the same period of 2021.

Cash provided by operating activities was \$2,422 million in the first nine months of 2022, a decrease of \$662 million, or 21%, compared to \$3,084 million in the same period of 2021. The decrease for the first nine months was primarily due to lower cash generating income as a result of the \$845 million merger termination fee received from KCS in the second quarter of 2021 and an unfavourable change in working capital driven by acquisition-related payables in 2021, offset by dividends of \$593 million received from KCS in 2022.

Investing Activities

Cash used in investing activities was \$410 million in the third quarter of 2022, a decrease of \$1,719 million, or 81%, compared to \$2,129 million in the same period of 2021. This decrease was primarily due to merger payments of \$1,773 million (U.S. \$1,400 million) made to KCS in September 2021, partially offset by higher capital additions.

Cash used in investing activities was \$978 million in the first nine months of 2022, a decrease of \$1,842 million, or 65%, compared to \$2,820 million in the same period of 2021. The decrease for the first nine months of 2022 compared to the same periods of 2021 was primarily due to merger payments of \$1,773 million (U.S.\$1,400) made to KCS in September 2021 and lower capital additions, partially offset by lower proceeds from the sale of properties and other assets.

Free Cash

CP generated positive Free cash of \$721 million in the third quarter of 2022, an increase of \$518 million, or 255%, from \$203 million in the same period of 2021. The increase was due to an increase in Cash provided by operating activities, partially offset by higher capital additions during the third quarter of 2022 compared to the same period of 2021. For the first nine months of 2022, CP generated positive Free cash of \$1,514 million, an increase of \$269 million, or 22%, from \$1,245 million in the same period of 2021. The increase was due to an increase in Cash provided by operating activities and lower capital additions during the first nine months of 2022 compared to the same periods of 2021.

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

Financing Activities

Cash used in financing activities was \$721 million in the third quarter of 2022, a change of \$1,623 million, or 180%, compared to cash provided by financing activities of \$902 million in the same period of 2021. This change was primarily due to the net repayment of commercial paper of \$42 million in the third quarter of 2022 compared to a net issuance of \$713 million in the third quarter of 2021, principal repayments of \$504 million (U.S. \$400 million) on a term loan during the third quarter of 2022 compared to borrowings under term loan of \$633 million (U.S. \$500 million) in the third quarter of 2021, and higher dividends paid as a result of a higher number of shares outstanding associated with the shares issued to acquire KCS in the fourth quarter of 2021. This change was partially offset by repayments on long term debt of \$7 million during the three months ended September 30, 2022 compared to \$318 million during the same period of 2021.

Cash used in financing activities was \$1,409 million in the first nine months of 2022, an increase of \$1,215 million, or 626%, compared to \$194 million in the same period of 2021. This increase was primarily due to principal repayments of \$636 million (U.S. \$500 million) on a term loan compared to borrowings under term loan of \$633 million (U.S. \$500 million) in 2021, principal repayments of \$125 million of the Company's 5.100% 10-year Medium Term Notes and \$313 million (U.S. \$250 million) of the Company's 4.500% 10-year Notes at maturity in January 2022, principal repayment of \$97 million (U.S. \$76 million) of the Company's 6.99% Finance lease at maturity in March 2022, and higher dividends paid as a result of a higher number of shares outstanding associated with the shares issued to acquire KCS in the fourth quarter of 2021. This increase was partially offset by a net issuance of commercial paper of \$298 million during the nine months ended September 30, 2022 compared to net repayments of \$66 million during the first nine months of 2021, and repayment of long-term debt of \$349 million during the first nine months of 2021.

Credit Measures

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

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

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

As at September 30, 2022, CP's credit ratings from Standard & Poor's Rating Services ("Standard & Poor's") and Moody's Investor Service ("Moody's") remain unchanged from December 31, 2021.

Credit ratings as at September 30, 2022⁽¹⁾

Long-term debt		Outlook
Standard & Poor's		
Long-term corporate credit	BBB+	stable
Senior secured debt	A	stable
Senior unsecured debt	BBB+	stable
Moody's		
Senior unsecured debt	Baa2	stable
Commercial paper program		
Standard & Poor's	A-2	N/A
Moody's	P-2	N/A

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

Financial Ratios

The Long-term debt to Net income ratio for the twelve months ended September 30, 2022 and September 30, 2021 was 7.4 and 3.2, respectively. This increase was primarily due to a higher debt balance in connection with the KCS acquisition and lower net income for the twelve months ended September 30, 2022.

The Adjusted net debt to Adjusted earnings before interest, tax, depreciation and amortization ("EBITDA") ratio for the twelve months ended September 30, 2022 and September 30, 2021 was 4.3 and 2.4, respectively. This increase was primarily due to a higher debt balance in connection with the KCS acquisition, partially offset by higher Adjusted EBITDA. The Adjusted net debt to Adjusted EBITDA ratio is a Non-GAAP measure, which is defined and reconciled from the Long-term debt to Net income ratio, the most comparable measure calculated in accordance with GAAP, in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

The Pro-forma Adjusted Net Debt to Pro-forma Adjusted EBITDA ratio for the trailing twelve month ended September 30, 2022 was 4.1. This increase from the Adjusted net debt to Adjusted EBITDA ratio in the same period of 2021 was primarily due to a higher debt balance in connection with the KCS acquisition, partially offset by higher Pro-forma adjusted EBITDA. Beginning in the first quarter of 2022, CP added disclosure of Pro-forma Adjusted Net Debt to Pro-forma Adjusted EBITDA Ratio to better align with CP's debt covenant calculation, which takes into account the trailing twelve month adjusted EBITDA of KCS as well as KCS's outstanding debt. Please see Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations for further discussion. Over the long term, CP targets an Adjusted net debt to Adjusted EBITDA ratio of 2.0 to 2.5.

Although CP has provided a target Non-GAAP measure (Adjusted Net Debt to Adjusted EBITDA ratio), management is unable to reconcile, without unreasonable efforts, the target Adjusted Net Debt to Adjusted EBITDA ratio to the most comparable GAAP measure (Long-term debt to Net income ratio), due to unknown variables and uncertainty related to future results. These unknown variables may include unpredictable transactions of significant value. In recent years, CP has recognized acquisition-related costs, the merger termination payment received, changes in the outside basis tax difference between the carrying amount of CP's equity investment in KCS and its tax basis of the investment, changes in income tax rates, and a change to an uncertain tax item. Acquisition-related costs include legal, consulting, financing fees, integration planning costs consisting of third-party services and system migration, fair value gain or loss on FX forward contracts and interest rate hedges, FX gain on U.S. dollar-denominated cash on hand from the issuances of long-term debt to fund the KCS acquisition, and transaction and integration costs (net of tax) incurred by KCS which were recognized within the Equity loss of KCS). KCS has also recognized significant transaction costs and FX gains and losses. These or other similar, large unforeseen transactions affect Net income but may be excluded from CP's Adjusted EBITDA. Additionally, the U.S.-to-Canada dollar exchange rate is unpredictable and can have a significant impact on CP's reported results but may be excluded from CP's Adjusted EBITDA. In particular, CP excludes the FX impact of translating the Company's debt and lease liabilities, interest and taxes from Adjusted EBITDA. Please see Forward-Looking Statements in this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations for further discussion.

Supplemental Guarantor Financial Information

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

As of the date of the filing of the Form 10-Q, CPRC had U.S. \$12,050 million principal amount of debt securities outstanding due through 2115, and U.S. \$30 million and GBP £3 million in perpetual 4% consolidated debenture stock, for all of which CPRL is the guarantor subject to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (the "Exchange Act"), as amended. As of the same date, CPRC also had \$3,300 million principal amount of debt securities issued under Canadian securities law due through 2050 for which CPRL is the guarantor and not subject to the Exchange Act.

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

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

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

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

Summarized Financial Information

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

Statements of Income

(in millions of Canadian dollars)	CPRC (Subsidiary Issuer) and CPRL (Parent Guarantor)	
	For the nine months ended September 30, 2022	For the year ended December 31, 2021
Total revenues	\$ 4,566	\$ 5,924
Total operating expenses	2,985	3,712
Operating income ⁽¹⁾	1,581	2,212
Less: Other ⁽²⁾	192	(522)
Income before income tax expense	1,389	2,734
Net income	\$ 1,005	\$ 2,548

⁽¹⁾ Includes net lease costs incurred from non-guarantor subsidiaries for the nine months ended September 30, 2022 and for the year ended December 31, 2021 of \$323 million and \$431 million, respectively.

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

Balance Sheets

(in millions of Canadian dollars)	CPRC (Subsidiary Issuer) and CPRL (Parent Guarantor)	
	As at September 30, 2022	As at December 31, 2021
Assets		
Current assets	\$ 1,229	\$ 963
Properties	11,590	11,342
Other non-current assets	2,865	2,536
Liabilities		
Current liabilities	\$ 2,397	\$ 2,789
Long-term debt	19,334	18,574
Other non-current liabilities	3,108	3,008

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

Cash Transactions with Non-Guarantor Subsidiaries

(in millions of Canadian dollars)	CPRC (Subsidiary Issuer) and CPRL (Parent Guarantor)	
	For the nine months ended September 30, 2022	For the year ended December 31, 2021
Dividend income from non-guarantor subsidiaries	\$ 126	\$ 297
Capital contributions to non-guarantor subsidiaries	—	(134)
Redemption of shares by non-guarantor subsidiaries	115	1,370

Balances with Non-Guarantor Subsidiaries

(in millions of Canadian dollars)	CPRC (Subsidiary Issuer) and CPRL (Parent Guarantor)	
	As at September 30, 2022	As at December 31, 2021
Assets		
Accounts receivable, intercompany	\$ 226	\$ 344
Short-term advances to affiliates	2,680	2,859
Long-term advances to affiliates	7,714	7,616
Liabilities		
Accounts payable, intercompany	\$ 187	\$ 212
Short-term advances from affiliates	2,633	2,777
Long-term advances from affiliates	89	82

Share Capital

At October 25, 2022, the latest practicable date, there were 930,123,568 Common Shares and no preferred shares issued and outstanding, which consists of 15,288 holders of record of the Common Shares. In addition, CP has a Management Stock Option Incentive Plan ("MSOIP"), under which key officers and employees are granted options to purchase the Common Shares. Options issued prior to the share split described in the Executive Summary now each provide rights over five shares. For consistency, all number of options presented herein are shown on the basis of the number of shares subject to the options. On April 27, 2022, at the Annual and Special Meeting, the Company's shareholders approved an amendment to the MSOIP to increase the maximum number of shares available for issuance under the MSOIP, effective at and after April 27, 2022, by 20,000,000 Common Shares. At October 25, 2022, 7,727,281 options were outstanding under the MSOIP and stand-alone option agreements entered into with Mr. Keith Creel. There are 22,509,537 options available to be issued by the Company's MSOIP in the future. CP has a Director's Stock Option Plan ("DSOP"), under which directors are granted options to purchase Common Shares. There are no outstanding options under the DSOP, which has 1,700,000 options available to be issued in the future.

Non-GAAP Measures

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

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

Non-GAAP Performance Measures

The Company uses adjusted earnings results including Adjusted income, Adjusted diluted earnings per share, Adjusted operating income and Adjusted operating ratio to evaluate the Company's operating performance and for planning and forecasting future business operations and future profitability. Core adjusted income and Core adjusted diluted earnings per share are presented to provide financial statement users with additional transparency by isolating for the impact of KCS purchase accounting. KCS purchase accounting represents the amortization of basis differences, being the difference in value between the consideration paid to acquire KCS and the underlying carrying value of the net assets of KCS immediately prior to its acquisition by the Company. All assets subject to KCS purchase accounting contribute to income generation and will continue to amortize over their estimated useful lives. 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 or provide improved comparability to past performance. As a result, these items are excluded for management assessment of operational performance, allocation of resources and preparation of annual budgets. These significant items may include, but are not limited to, restructuring and asset impairment charges, individually significant gains and losses from sales of assets, acquisition-related costs, the merger termination payment received, the foreign exchange ("FX") impact of translating the Company's debt and lease liabilities (including borrowings under the credit facility), discrete tax items, changes in the outside basis tax difference between the carrying amount of CP's equity investment in KCS and its tax basis of this investment, changes in income tax rates, changes to an uncertain tax item, and certain items outside the control of management. Acquisition-related costs include legal, consulting, financing fees, integration planning costs consisting of third-party services and system migration, fair value gain or loss on FX forward contracts and interest rate hedges, FX gain on U.S. dollar-denominated cash on hand from the issuances of long-term debt to fund the KCS acquisition, and transaction and integration costs incurred by KCS which were recognized within Equity earnings of Kansas City Southern in the Company's Interim Consolidated Statements of Income. These items may not be non-recurring. However, excluding these significant items from GAAP results allows for a consistent understanding of the Company's consolidated financial performance when performing a multi-period assessment including assessing the likelihood of future results. Accordingly, these Non-GAAP financial measures may provide insight to investors and other external users of the Company's consolidated financial information.

In the first nine months of 2022, there were three significant items included in Net income as follows:

- in the third quarter, a deferred tax recovery of \$12 million due to a decrease in the Iowa state tax rate that favourably impacted Diluted EPS by 1 cent;
- a net deferred tax expense of \$8 million on changes in the outside basis difference of the equity investment in KCS that unfavourably impacted Diluted EPS by 1 cent as follows:
 - in the third quarter, a deferred tax recovery of \$9 million on changes in the outside basis difference of the equity investment in KCS that favourably impacted Diluted EPS by 1 cent;
 - in the second quarter, a deferred tax expense of \$49 million on changes in the outside basis difference of the equity investment in KCS that unfavourably impacted Diluted EPS by 5 cents; and
 - in the first quarter, a deferred tax recovery of \$32 million on changes in the outside basis difference of the equity investment in KCS that favourably impacted Diluted EPS by 3 cents; and
- acquisition-related costs of \$96 million in connection with the KCS acquisition (\$92 million after current tax recovery of \$4 million), including costs of \$57 million recognized in Purchased services and other, and \$39 million recognized in Equity earnings of KCS, that unfavourably impacted Diluted EPS by 9 cents as follows:
 - in the third quarter, acquisition-related costs of \$30 million (\$33 million after current tax expense of \$3 million), including costs of \$18 million recognized in Purchased services and other and \$12 million recognized in Equity earnings of KCS, that unfavourably impacted Diluted EPS by 3 cents;
 - in the second quarter, acquisition-related costs of \$33 million (\$29 million after current tax recovery of \$4 million), including costs of \$19 million recognized in Purchased services and other and \$14 million recognized in Equity earnings of KCS, that unfavourably impacted Diluted EPS by 3 cents; and
 - in the first quarter, acquisition-related costs of \$33 million (\$30 million after current tax recovery of \$3 million), including costs of \$20 million recognized in Purchased services and other and \$13 million recognized in Equity earnings of KCS, that unfavourably impacted Diluted EPS by 3 cents.

In 2021, there were four significant items included in Net income as follows:

- in the fourth quarter, a deferred tax recovery of \$33 million on changes in the outside basis difference of the equity investment in KCS that favourably impacted Diluted EPS by 5 cents;
- in the second quarter, the merger termination payment received of \$845 million (\$748 million after current taxes) in connection with KCS's termination of the Original Merger Agreement effective May 21, 2021 that favourably impacted Diluted EPS by \$1.11;
- during the course of the year, acquisition-related costs of \$599 million in connection with the KCS acquisition (\$500 million after current tax recovery of \$107 million net of deferred tax expense of \$8 million), including costs of \$183 million recognized in Purchased services and other, \$169 million recognized in Equity loss of KCS, and \$247 million recognized in Other expense (income), that unfavourably impacted Diluted EPS by 75 cents as follows:
 - in the fourth quarter, acquisition-related costs of \$157 million (\$157 million after current tax recovery of \$13 million net of deferred tax expense of \$13 million), including costs of \$36 million recognized in Purchased services and other, \$169

million in Equity loss of KCS, and a \$48 million recovery recognized in Other (income) expense, that unfavourably impacted Diluted EPS by 22 cents;

- in the third quarter, acquisition-related costs of \$98 million (\$80 million after current tax recovery of \$61 million net of deferred tax expense of \$43 million), including costs of \$15 million recognized in Purchased services and other and \$83 million recognized in Other expense (income), that unfavourably impacted Diluted EPS by 12 cents;
- in the second quarter, acquisition-related costs of \$308 million (\$236 million after current taxes of \$25 million and deferred taxes of \$47 million), including costs of \$99 million recognized in Purchased services and other and \$209 million recognized in Other expense (income), that unfavourably impacted Diluted EPS by 35 cents; and
- in the first quarter, acquisition-related costs of \$36 million (\$27 million after current taxes of \$8 million and deferred taxes of \$1 million), including costs of \$33 million recognized in Purchased services and other and \$3 million recognized in Other expense (income), that unfavourably impacted Diluted EPS by 4 cents; and
- during the course of the year, a net non-cash gain of \$7 million (\$6 million after deferred tax) due to FX translation of debt and lease liabilities that favourably impacted Diluted EPS by 1 cent as follows:
 - in the fourth quarter, a \$32 million loss (\$28 million after deferred tax) that unfavourably impacted Diluted EPS by 4 cents;
 - in the third quarter, a \$46 million loss (\$40 million after deferred tax) that unfavourably impacted Diluted EPS by 6 cents;
 - in the second quarter, a \$52 million gain (\$45 million after deferred tax) that favourably impacted Diluted EPS by 7 cents; and
 - in the first quarter, a \$33 million gain (\$29 million after deferred tax) that favourably impacted Diluted EPS by 4 cents.

In the three months ended December 31, 2020, there were two significant items included in Net income as follows:

- a deferred tax recovery of \$29 million due to a change relating to a tax return filing election for the state of North Dakota that favourably impacted Diluted EPS by 5 cents; and
- a \$103 million non-cash gain (\$90 million after deferred tax) due to FX translation of debt that favourably impacted Diluted EPS by 13 cents.

Reconciliation of GAAP Performance Measures to Non-GAAP Performance Measures

The following tables reconcile the most directly comparable measures presented in accordance with GAAP to the Non-GAAP measures presented in Financial Highlights and discussed further in other sections of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations:

Adjusted income is calculated as Net income reported on a GAAP basis adjusted for significant items. Core adjusted income is calculated as Adjusted income less KCS purchase accounting.

(in millions of Canadian dollars)	For the three months ended September 30		For the nine months ended September 30	
	2022	2021	2022	2021
Net income as reported	\$ 891	\$ 472	\$ 2,246	\$ 2,320
Less significant items (pre-tax):				
Acquisition-related costs	(30)	(98)	(96)	(442)
Merger termination fee	—	—	—	845
Impact of FX translation (loss) gain on debt and lease liabilities	—	(46)	—	39
Add:				
Tax effect of adjustments ⁽¹⁾	3	(24)	(4)	3
Deferred tax (recovery) expense on the outside basis difference of the investment in KCS	(9)	—	8	—
Income tax rate changes	(12)	—	(12)	—
Adjusted income	\$ 903	\$ 592	\$ 2,334	\$ 1,881
Less: KCS purchase accounting	(42)	—	(121)	—
Core adjusted income	\$ 945	\$ 592	\$ 2,455	\$ 1,881

⁽¹⁾ The tax effect of adjustments was calculated as the pre-tax effect of the adjustments multiplied by the applicable tax rate for the above items of (6.73%) and 4.35% for the three and nine months ended September 30, 2022, respectively, and 16.88% and 0.68% for the three and nine months ended September 30, 2021, respectively. The applicable tax rates reflect the taxable jurisdictions and nature, being on account of capital or income, of the significant items.

Adjusted diluted earnings per share is calculated using Adjusted income, as defined above, divided by the weighted-average diluted number of Common Shares outstanding during the period as determined in accordance with GAAP. Core adjusted diluted earnings per share is calculated as Adjusted diluted earnings per share less KCS purchase accounting.

	For the three months ended September 30		For the nine months ended September 30	
	2022	2021	2022	2021
Diluted earnings per share as reported	\$ 0.96	\$ 0.70	\$ 2.41	\$ 3.46
Less significant items (pre-tax):				
Acquisition-related costs	(0.03)	(0.15)	(0.10)	(0.66)
Merger termination fee	—	—	—	1.26
Impact of FX translation (loss) gain on debt and lease liabilities	—	(0.07)	—	0.06
Add:				
Tax effect of adjustments ⁽¹⁾	—	(0.04)	(0.01)	0.01
Deferred tax (recovery) expense on the outside basis difference of the investment in KCS	(0.01)	—	0.01	—
Income tax rate changes	(0.01)	—	(0.01)	—
Adjusted diluted earnings per share	\$ 0.97	\$ 0.88	\$ 2.50	\$ 2.81
Less: KCS purchase accounting	(0.04)	—	(0.13)	—
Core adjusted diluted earnings per share	\$ 1.01	\$ 0.88	\$ 2.63	\$ 2.81

⁽¹⁾ The tax effect of adjustments was calculated as the pre-tax effect of the adjustments multiplied by the applicable tax rate for the above items of (6.73%) and 4.35% for the three and nine months ended September 30, 2022, respectively, and 16.88% and 0.68% for the three and nine months ended September 30, 2021, respectively. The applicable tax rates reflect the taxable jurisdictions and nature, being on account of capital or income, of the significant items.

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

	For the three months ended September 30		For the nine months ended September 30	
(in millions of Canadian dollars)	2022	2021	2022	2021
Operating income as reported	\$ 937	\$ 774	\$ 2,340	\$ 2,374
Less significant item:				
Acquisition-related costs	(18)	(15)	(57)	(147)
Adjusted operating income	\$ 955	\$ 789	\$ 2,397	\$ 2,521

Adjusted operating ratio excludes those significant items that are reported within operating income.

	For the three months ended September 30		For the nine months ended September 30	
	2022	2021	2022	2021
Operating ratio as reported	59.5 %	60.2 %	63.2 %	60.1 %
Less significant item:				
Acquisition-related costs	0.8 %	0.8 %	0.9 %	2.4 %
Adjusted operating ratio	58.7 %	59.4 %	62.3 %	57.7 %

Adjusted ROIC

Adjusted ROIC is calculated as Adjusted return divided by Adjusted average invested capital. Adjusted return is defined as Net income adjusted for interest expense, tax effected at the Company's adjusted annualized effective tax rate, and significant items in the Company's Consolidated Financial Statements, tax effected at the applicable tax rate. Adjusted average invested capital is defined as the sum of total Shareholders' equity, Long-term debt, and Long-term debt maturing within one year, as presented in the Company's Consolidated Financial Statements, each averaged between the beginning and ending balance over a trailing twelve month period, adjusted for the impact of significant items, tax effected at the applicable tax rate, on closing balances as part of this average. Adjusted ROIC excludes significant items reported in the Company's Consolidated Financial Statements, as these significant items are not considered indicative of future financial trends either by nature or amount, and excludes interest expense, net of tax, to incorporate returns on the Company's overall capitalization. Adjusted ROIC is a performance measure that measures how productively the Company uses its long-term capital investments, representing critical indicators of good

operating and investment decisions made by management, and is an important performance criteria in determining certain elements of the Company's long-term incentive plan. Adjusted ROIC, which is reconciled below from Return on average shareholders' equity, the most comparable measure calculated in accordance with GAAP, is also presented in Financial Highlights and discussed further in Results of Operations of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Calculation of Return on average shareholders' equity

(in millions of Canadian dollars, except for percentages)	For the twelve months ended September 30	
	2022	2021
Net income as reported	\$ 2,778	\$ 3,122
Average shareholders' equity	\$ 23,641	\$ 8,524
Return on average shareholders' equity	11.8 %	36.6 %

Reconciliation of Net income to Adjusted return

(in millions of Canadian dollars)	For the twelve months ended September 30	
	2022	2021
Net income as reported	\$ 2,778	\$ 3,122
Add:		
Net interest expense	611	427
Tax on interest ⁽¹⁾	(145)	(104)
Significant items (pre-tax):		
Acquisition-related costs	253	442
Merger termination fee	—	(845)
Impact of FX translation loss (gain) on debt and lease liabilities	32	(142)
Tax on significant items ⁽²⁾	(8)	16
Deferred tax recovery on the outside basis difference of the investment in KCS	(25)	—
Income tax rate changes	(12)	(29)
Adjusted return	\$ 3,484	\$ 2,887

⁽¹⁾ Tax was calculated at the adjusted annualized effective tax rate of 23.73% and 24.34% for the twelve months ended September 30, 2022 and 2021, respectively.

⁽²⁾ Tax was calculated as the pre-tax effect of the adjustments multiplied by the applicable tax rate for the above items of 2.97% and 2.57% for the twelve months ended September 30, 2022 and 2021, respectively. The applicable tax rates reflect the taxable jurisdictions and nature, being on account of capital or income, of the significant items.

Reconciliation of Average shareholders' equity to Adjusted average invested capital

(in millions of Canadian dollars)	For the twelve months ended September 30	
	2022	2021
Average shareholders' equity	\$ 23,641	\$ 8,524
Average long-term debt, including long-term debt maturing within one year	15,272	9,877
	\$ 38,913	\$ 18,401
Less:		
Significant items (pre-tax):		
Acquisition-related costs	(127)	(221)
Merger termination fee	—	423
Tax on significant items ⁽¹⁾	2	—
Deferred tax recovery on the outside basis difference of the investment in KCS	13	—
Income tax rate changes	6	15
Adjusted average invested capital	\$ 39,019	\$ 18,184

⁽¹⁾ Tax was calculated at the pre-tax effect of the adjustment multiplied by the applicable tax rate of 1.71% and 0.51% for the twelve months ended September 30, 2022 and 2021, respectively. The applicable tax rate reflects the taxable jurisdiction and nature, being on account of capital or income, of the significant item.

Calculation of Adjusted ROIC

(in millions of Canadian dollars, except for percentages)	For the twelve months ended September 30	
	2022	2021
Adjusted return	\$ 3,484	\$ 2,887
Adjusted average invested capital	\$ 39,019	\$ 18,184
Adjusted ROIC	8.9 %	15.9 %

Free Cash

Free cash is calculated as Cash provided by operating activities, less Cash used in investing activities, adjusted for changes in Cash and cash equivalents balances resulting from FX fluctuations, the operating cash flow impacts of acquisition-related costs associated with the KCS transaction, the merger termination payment received related to KCS's termination of the Original Merger Agreement and the payment to KCS related to the KCS Acquisition. Free cash is a measure that management considers to be a valuable indicator of liquidity. Free cash is useful to investors and other external users of the Company's Consolidated Financial Statements as it assists with the evaluation of the Company's ability to generate cash to satisfy debt obligations and discretionary activities such as dividends, share repurchase programs, and other strategic opportunities. The acquisition-related costs and the merger termination fee related to the KCS acquisition are not indicative of operating trends and have been excluded from Free cash. The payment to KCS is not indicative of investment trends and has also been excluded from free cash. Free cash should be considered in addition to, rather than as a substitute for, Cash provided by operating activities. Free cash is presented in Financial Highlights and discussed further in Liquidity and Capital Resources of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Reconciliation of Cash Provided by Operating Activities to Free Cash

(in millions of Canadian dollars)	For the three months ended September 30		For the nine months ended September 30	
	2022	2021	2022	2021
Cash provided by operating activities	\$ 1,102	\$ 548	\$ 2,422	\$ 3,084
Cash used in investing activities	(410)	(2,129)	(978)	(2,820)
Effect of foreign currency fluctuations on U.S. dollar-denominated cash and cash equivalents	13	10	21	6
Less:				
Acquisition-related costs	(16)	(1)	(49)	(47)
Merger termination fee	—	—	—	845
Payment to Kansas City Southern	—	(1,773)	—	(1,773)
Free cash	\$ 721	\$ 203	\$ 1,514	\$ 1,245

Foreign Exchange Adjusted % Change

FX adjusted % change allows certain financial results to be viewed without the impact of fluctuations in foreign currency exchange rates, thereby facilitating period-to-period comparisons in the analysis of trends in business performance. Financial result variances at constant currency are obtained by translating the comparable period of the prior year results denominated in U.S. dollars at the foreign exchange rates of the current period.

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

For the three months ended September 30					
(in millions of Canadian dollars)	Reported 2022	Reported 2021	Variance due to FX	FX Adjusted 2021	FX Adjusted % Change
Freight revenues by line of business					
Grain	\$ 391	\$ 352	\$ 7	\$ 359	9
Coal	156	158	1	159	(2)
Potash	170	113	2	115	48
Fertilizers and sulphur	81	72	1	73	11
Forest products	109	89	3	92	18
Energy, chemicals and plastics	360	392	7	399	(10)
Metals, minerals and consumer products	246	196	5	201	22
Automotive	111	83	2	85	31
Intermodal	640	441	3	444	44
Freight revenues	2,264	1,896	31	1,927	17
Non-freight revenues	48	46	—	46	4
Total revenues	\$ 2,312	\$ 1,942	\$ 31	\$ 1,973	17

For the nine months ended September 30					
(in millions of Canadian dollars)	Reported 2022	Reported 2021	Variance due to FX	FX Adjusted 2021	FX Adjusted % Change
Freight revenues by line of business					
Grain	\$ 1,121	\$ 1,244	\$ 14	\$ 1,258	(11)
Coal	458	491	1	492	(7)
Potash	445	348	4	352	26
Fertilizers and sulphur	244	227	4	231	6
Forest products	299	259	6	265	13
Energy, chemicals and plastics	1,010	1,149	14	1,163	(13)
Metals, minerals and consumer products	655	535	10	545	20
Automotive	322	289	5	294	10
Intermodal	1,660	1,280	6	1,286	29
Freight revenues	6,214	5,822	64	5,886	6
Non-freight revenues	138	133	1	134	3
Total revenues	\$ 6,352	\$ 5,955	\$ 65	\$ 6,020	6

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

(in millions of Canadian dollars)	For the three months ended September 30				
	Reported 2022	Reported 2021	Variance due to FX	FX Adjusted 2021	FX Adjusted % Change
Compensation and benefits	\$ 393	\$ 381	\$ 4	\$ 385	2
Fuel	358	199	6	205	75
Materials	66	51	—	51	29
Equipment rents	33	31	1	32	3
Depreciation and amortization	213	203	2	205	4
Purchased services and other	312	303	4	307	2
Total operating expenses	\$ 1,375	\$ 1,168	\$ 17	\$ 1,185	16

(in millions of Canadian dollars)	For the nine months ended September 30				
	Reported 2022	Reported 2021	Variance due to FX	FX Adjusted 2021	FX Adjusted % Change
Compensation and benefits	\$ 1,154	\$ 1,165	\$ 8	\$ 1,173	(2)
Fuel	1,001	623	12	635	58
Materials	191	164	1	165	16
Equipment rents	97	92	2	94	3
Depreciation and amortization	634	605	4	609	4
Purchased services and other	935	932	7	939	—
Total operating expenses	\$ 4,012	\$ 3,581	\$ 34	\$ 3,615	11

Adjusted Net Debt to Adjusted EBITDA Ratio and Pro-forma adjusted Net Debt to Pro-forma adjusted EBITDA Ratio

Adjusted net debt to Adjusted earnings before interest, tax, depreciation and amortization ("EBITDA") ratio is calculated as Adjusted net debt divided by Adjusted EBITDA. The Adjusted net debt to Adjusted EBITDA ratio is a key credit measure used to assess the Company's financial capacity. The ratio provides information on the Company's ability to service its debt and other long-term obligations from operations, excluding significant items. The Adjusted net debt to Adjusted EBITDA ratio, which is reconciled below from the Long-term debt to Net income ratio, the most comparable measure calculated in accordance with GAAP, is also presented in Financial Highlights and discussed further in Results of Operations of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Beginning in the first quarter of 2022, CP added disclosure of Pro-forma adjusted net debt to Pro-forma adjusted EBITDA ratio to better align with CP's debt covenant calculation, which incorporates the trailing twelve month adjusted EBITDA of KCS as well as KCS's outstanding debt. CP is incorporating the trailing twelve month adjusted EBITDA of KCS on a pro-forma basis, as CP is not entitled to earnings prior to the acquisition date of December 14, 2021. CP does not control KCS while it is in the voting trust during review of our merger application by the STB, though CP is the beneficial owner of KCS's outstanding shares and receives cash dividends from KCS. The adjustment to include the trailing twelve month EBITDA and KCS's outstanding debt provides users of the financial statements with better insight into CP's progress in achieving deleveraging commitments. KCS's disclosed U.S. dollar financial values for the trailing twelve months ended September 30, 2022 were adjusted to Canadian dollars reflecting the FX rate for the appropriate period presented. We have not presented 2021 Pro-forma adjusted net debt to Pro-forma adjusted EBITDA as CP was not the beneficial owner of KCS's shares as at September 30, 2021.

Calculation of Long-term Debt to Net Income Ratio

(in millions of Canadian dollars, except for ratios)	2022	2021
Long-term debt including long-term debt maturing within one year as at September 30	\$ 20,575	\$ 9,968
Net income for the twelve months ended September 30	\$ 2,778	\$ 3,122
Long-term debt to Net income ratio	7.4	3.2

Reconciliation of Long-term Debt to Adjusted Net Debt and Pro-forma Adjusted Net Debt

Adjusted net debt is defined as Long-term debt, Long-term debt maturing within one year, and Short-term borrowing as reported on the Company's Consolidated Balance Sheets adjusted for pension plans deficit, operating lease liabilities recognized on the Company's Consolidated Balance Sheets, and Cash and cash equivalents. Adjusted net debt is used as a measure of debt and long-term obligations as part of the calculation of Adjusted Net Debt to Adjusted EBITDA.

(in millions of Canadian dollars) ⁽¹⁾	2022	2021
CP Long-term debt including long-term debt maturing within one year as at September 30	\$ 20,575	\$ 9,968
Add:		
Pension plans deficit ⁽²⁾	265	323
Operating lease liabilities	280	274
Less:		
Cash and cash equivalents	138	210
CP Adjusted net debt as at September 30	\$ 20,982	\$ 10,355
KCS's long-term debt including long-term debt maturing within one year as at September 30	\$ 5,183	N/A
Add:		
KCS operating lease liabilities	116	N/A
Less:		
KCS cash and cash equivalents	225	N/A
KCS Adjusted net debt as at September 30	5,074	N/A
CP Adjusted net debt as at September 30	20,982	N/A
Pro-forma Adjusted net debt as at September 30	\$ 26,056	N/A

⁽¹⁾ KCS's amounts were translated at the September 30, 2022 period end FX rate of \$1.37.

⁽²⁾ Pension plans deficit is the total funded status of the Pension plans in deficit only.

Reconciliation of Net Income to EBIT, Adjusted EBIT and Adjusted EBITDA and Pro-forma Adjusted EBITDA

Earnings before interest and tax ("EBIT") is calculated as Net income before Net interest expense and Income tax expense. Adjusted EBIT excludes significant items reported in both Operating income and Other expense. Adjusted EBITDA is calculated as Adjusted EBIT plus operating lease expense and Depreciation and amortization, less Other components of net periodic benefit recovery. Adjusted EBITDA is used as a measure of liquidity derived from operations, excluding significant items, as part of the calculation of Adjusted Net Debt to Adjusted EBITDA.

(in millions of Canadian dollars) ⁽¹⁾	For the twelve months ended September 30	
	2022	2021
CP Net income as reported	\$ 2,778	\$ 3,122
Add:		
Net interest expense	611	427
Income tax expense	677	812
EBIT	4,066	4,361
Less significant items (pre-tax):		
Acquisition-related costs	(253)	(442)
Merger termination fee	—	845
Impact of FX translation (loss) gain on debt and lease liabilities	(32)	142
Adjusted EBIT	4,351	3,816
Add:		
Operating lease expense	77	71
Depreciation and amortization	840	802
Less:		
Other components of net periodic benefit recovery	405	371
CP Adjusted EBITDA	\$ 4,863	\$ 4,318
Net income attributable to KCS and subsidiaries	\$ 1,497	N/A
Add:		
KCS interest expense	200	N/A
KCS income tax expense	498	N/A
KCS EBIT	2,195	N/A
Less significant item (pre-tax):		
KCS merger income	599	N/A
KCS Adjusted EBIT	1,596	N/A
Add:		
KCS total lease cost	40	N/A
KCS depreciation and amortization	491	N/A
KCS Adjusted EBITDA	2,127	N/A
CP Adjusted EBITDA	\$ 4,863	N/A
Less:		
Equity earnings of KCS ⁽²⁾	486	N/A
Acquisition-related costs of KCS ⁽³⁾	208	N/A
Pro-forma Adjusted EBITDA	\$ 6,296	N/A

⁽¹⁾ KCS's amounts were translated at the quarterly average FX rate of \$1.30, \$1.28, \$1.27, and \$1.26 for Q3 2022, Q2 2022, Q1 2022, and Q4 2021, respectively.

⁽²⁾ Equity earnings of KCS were part of CP's reported net income and therefore have been deducted in arriving to the Pro-forma Adjusted EBITDA.

⁽³⁾ Acquisition-related costs of KCS have been adjusted in CP's Adjusted EBITDA calculation above, therefore have been deducted in arriving to the Pro-forma Adjusted EBITDA.

Calculation of Adjusted Net Debt to Adjusted EBITDA Ratio and Pro-forma Adjusted Net Debt to Pro-forma Adjusted EBITDA Ratio

(in millions of Canadian dollars, except for ratios)	2022	2021
Adjusted net debt as at September 30	\$ 20,982	\$ 10,355
Adjusted EBITDA for the twelve months ended September 30	\$ 4,863	\$ 4,318
Adjusted net debt to Adjusted EBITDA ratio	4.3	2.4

(in millions of Canadian dollars, except for ratios)	2022	2021
Pro-forma adjusted net debt as at September 30	\$ 26,056	N/A
Pro-forma adjusted EBITDA for the twelve months ended September 30	\$ 6,296	N/A
Pro-forma adjusted net debt to Pro-forma adjusted EBITDA ratio	4.1	N/A

Critical Accounting Estimates

To prepare Consolidated Financial Statements that conform with GAAP, the Company is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the Consolidated Financial Statements, and the reported amounts of revenues and expenses during the reported periods. Using the most current information available, the Company reviews estimates on an ongoing basis, including those related to environmental liabilities, pensions and other benefits, property, plant and equipment, deferred income taxes, and personal injury and other claims liabilities. Additional information concerning critical accounting estimates is supplemented in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations of the Company's 2021 Annual Report on Form 10-K.

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

Forward-Looking Statements

This Management's Discussion and Analysis of Financial Condition and Results of Operations and Quarterly Report on Form 10-Q contains certain forward-looking statements within the meaning of the *United States Private Securities Litigation Reform Act of 1995* and forward-looking information within the meaning of other relevant securities legislation, including applicable securities laws in Canada (collectively referred to herein as "forward-looking statements"). Forward-looking statements typically include words such as "financial expectations", "key assumptions", "anticipate", "believe", "expect", "plan", "will", "outlook", "should" or similar words suggesting future outcomes. To the extent that CP has provided forecasts or targets using Non-GAAP financial measures, the Company may not be able to provide a reconciliation to a GAAP measure without unreasonable efforts, due to unknown variables and uncertainty related to future results.

This Management's Discussion and Analysis of Financial Condition and Results of Operations and Quarterly Report on Form 10-Q includes forward-looking statements relating, but not limited to, statements concerning the Company's expected impacts resulting from changes in the U.S.-to-Canadian dollar exchange rate, and the effective tax rate, as well as 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, statements regarding the Company's greenhouse gas ("GHG") emissions targets and statements concerning the pending KCS business combination.

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

With respect to the pending KCS business combination, we can provide no assurance when or if the combination will be completed. Completion of the combination is subject to the receipt of final approval from the STB of the CP-KCS control application by December 31, 2023. There can be no assurance of receipt of this final approval by December 31, 2023. Additionally, even if such final approval is received, there can be no guarantee of the successful integration of KCS or that the combined Company will realize the anticipated benefits of the business combination, whether financial, strategic or otherwise, and this may be exacerbated by changes to the economic, political and global environment in which the merged company will operate.

Our GHG emissions targets are subject to a number of inherent risks, assumptions and uncertainties that include, but are not limited to, changes in carbon markets, evolving sustainability strategies and scientific or technological developments. Additionally, although our data underlying GHG emissions estimates have been internally vetted using accepted and relevant

scientific and technical methodologies, historical performance data may become outdated due to a variety of factors, including improvement in our data collection and measuring systems, activities such as joint ventures, mergers and acquisitions or divestitures, and industry-driven changes to methodologies. As a result of these and other factors, we may not achieve our stated targets.

Undue reliance should not be placed on forward-looking statements as actual results may differ materially from those expressed or implied by forward-looking statements. By their nature, forward-looking statements involve numerous inherent risks and uncertainties that could cause actual results to differ materially from the forward-looking statements, including but not limited to the following factors: changes in business strategies; general North American and global economic, credit and business conditions; risks associated with agricultural production such as weather conditions and insect populations; the availability and price of energy commodities; the effects of competition and pricing pressures; industry capacity; shifts in market demand; changes in commodity prices; uncertainty surrounding timing and volumes of commodities being shipped via CP; inflation; geopolitical instability; changes in laws, regulations and government policies, including regulation of rates; changes in taxes and tax rates; potential increases in maintenance and operating costs; changes in fuel prices; uncertainties of investigations, proceedings or other types of claims and litigation; labour disputes; risks and liabilities arising from derailments; transportation of dangerous goods; timing of completion of capital and maintenance projects; currency and interest rate fluctuations; effects of changes in market conditions and discount rates on the financial position of pension plans and investments; trade restrictions or other changes to international trade arrangements; climate change; various events that could disrupt operations, including severe weather, such as droughts, floods, avalanches and earthquakes, and cybersecurity attacks, as well as security threats and governmental response to them, and technological changes; and the pandemic created by the outbreak of COVID-19 and its variants and resulting effects on economic conditions, the demand environment for logistics requirements and energy prices, restrictions imposed by public health authorities or governments, fiscal and monetary policy responses by governments and financial institutions, and disruptions to global supply chains. The foregoing list of factors is not exhaustive.

There are more specific factors that could cause actual results to differ materially from those described in the forward-looking statements contained in this Management's Discussion and Analysis of Financial Condition and Results of Operations and Quarterly Report on Form 10-Q. These more specific factors are identified and discussed in Item 1A. Risk Factors of CP's 2021 Annual Report on Form 10-K. Other risks are detailed from time to time in reports filed by CP with securities regulators in Canada and the United States.

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

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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. In addition, equity earnings or losses of KCS 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. As at September 30, 2022, CP expects that every \$0.01 weakening (or strengthening) of the Canadian dollar relative to the U.S. dollar, positively (or negatively) impacts Total revenues by approximately \$35 million (December 31, 2021 – approximately \$30 million), negatively (or positively) impacts Operating expenses by approximately \$20 million (December 31, 2021 – approximately \$13 million), and negatively (or positively) impacts Net interest expense by approximately \$4 million (December 31, 2021 – approximately \$3 million) on an annualized basis.

CP uses U.S. dollar-denominated debt and operating lease liabilities to hedge its net investment in U.S. operations. As at September 30, 2022, the net investment in U.S. operations is greater than the total U.S. denominated debt. Consequently, FX translation on the Company's unhedged net investment in U.S. operations is recognized in Other comprehensive income. There is no additional impact on earnings in Other expense (income) related to the FX translation on the Company's debt and operating lease liabilities.

To manage its 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.

Subject to final approval by the STB, CP anticipates consummating a business combination with KCS at which time CP will also reassess its functional currency.

Share Price Impact on Stock-Based Compensation

Based on information available at September 30, 2022, for every \$1.00 change in share price, stock-based compensation expense has a corresponding change of approximately \$1.9 million to \$2.0 million (December 31, 2021 - approximately \$1.5 million to \$2.0 million). This excludes the impact of changes in share price relative to the S&P/TSX 60 Index, S&P 500 Industrials Index, and to Class I railways, which may trigger different performance share unit payouts. Stock-based compensation may also be impacted by non-market performance conditions.

Additional information concerning stock-based compensation is included in Item 1. Financial Statements, Note 16 Stock-based compensation.

Interest Rate Risk

Debt financing forms part of the Company's capital structure. The debt agreements entered into expose CP to increased interest costs on future fixed debt instruments and existing variable rate debt instruments, should market rates increase. As at September 30, 2022, a hypothetical one percentage point change in interest rates on the Company's floating rate debt obligations outstanding is not material. In addition, the present value of the Company's assets and liabilities will also vary with interest rate changes. To manage interest rate exposure, CP may enter into forward rate agreements such as treasury rate locks or bond locks that lock in rates for a future date, thereby protecting against interest rate increases. CP may also enter into swap agreements whereby one party agrees to pay a fixed rate of interest while the other party pays a floating rate. Contingent on the direction of interest rates, the Company may incur higher costs depending on the contracted rate.

The fair value of the Company's fixed rate debt may fluctuate with changes in market interest rates. A hypothetical one percentage point decrease in interest rates as of September 30, 2022 would result in an increase of approximately \$1.4 billion to the fair value of the Company's debt as at September 30, 2022 (December 31, 2021 - approximately \$2.3 billion). Fair values of CP's fixed rate debt are estimated by considering the impact of the hypothetical interest rates on quoted market prices and current borrowing rates, but do not consider other factors that could impact actual results.

Information concerning market risks is supplemented in Item 1. Financial Statements, Note 13 Financial instruments.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

As of September 30, 2022, an evaluation was carried out under the supervision of and with the participation of CP's management, including its CEO and CFO, of the effectiveness of the design and operation of the Company's disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act. Based on that evaluation, the CEO and CFO concluded that these disclosure controls and procedures were effective as of September 30, 2022, to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is (i) recorded, processed, summarized and reported within the time periods specified by the SEC rules and forms and (ii) accumulated and communicated to the Company's management, including the CEO and CFO, as appropriate, to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

During the third quarter of 2022, the Company has not identified any changes in internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II

ITEM 1. LEGAL PROCEEDINGS

For further details refer to Item 1. Financial Statements, Note 17 Contingencies.

SEC regulations require the disclosure of any proceeding under environmental laws to which a government authority is a party unless the registrant reasonably believes it will not result in sanctions over a certain threshold. The Company uses a threshold of U.S. \$1 million for the purposes of determining proceedings requiring disclosure.

ITEM 1A. RISK FACTORS

There have been no material changes to the risk factors from the information provided in Item 1A. Risk Factors of CP's 2021 Annual Report on Form 10-K.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Issuer Purchase of Equity Securities

CP established a share repurchase program which is further described in Item 1. Financial Statements, Note 14 Shareholders' equity. This program expired on January 28, 2022 and upon expiry of this normal course issuer bid ("NCIB"), the Company had not purchased any Common Shares under this NCIB.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

Exhibit	Description
<u>3.1</u>	<u>Restated Certificate and Articles of Incorporation of Canadian Pacific Railway Limited (incorporated by reference to Exhibit 99.2 to Canadian Pacific Railway Limited's Form 6-K filed with the Securities and Exchange Commission on October 22, 2015, File No. 001-01342).</u>
<u>3.2</u>	<u>Articles of Amendment to Restated Certificate and Articles of Incorporation of Canadian Pacific Railway Limited (incorporated by reference to Exhibit 3.1 to Canadian Pacific Railway Limited's Form 8-K filed with the Securities and Exchange Commission on May 5, 2021, File No. 001-01342).</u>
<u>3.3</u>	<u>By-law No. 1, as amended, of Canadian Pacific Railway Limited (incorporated by reference to Exhibit 1 to Canadian Pacific Railway Limited's Form 6-K filed with the Securities and Exchange Commission on May 22, 2009, File No. 001-01342).</u>
<u>3.4</u>	<u>By-law No. 2 of Canadian Pacific Railway Limited (incorporated by reference to Exhibit 99.1 to Canadian Pacific Railway Limited's Form 6-K filed with the Securities and Exchange Commission on March 13, 2015, File No. 001-01342).</u>
<u>3.5</u>	<u>General By-law, as amended, of Canadian Pacific Railway Company, a wholly owned subsidiary of Canadian Pacific Railway Limited (incorporated by reference to Exhibit 2 to Canadian Pacific Railway Limited's Form 6-K filed with the Securities and Exchange Commission on May 22, 2009, File No. 001-01342).</u>
<u>22.1*</u>	<u>List of Issuers and Guarantor Subsidiaries</u>
<u>31.1*</u>	<u>CEO Rule 13a-14(a) Certifications</u>
<u>31.2*</u>	<u>CFO Rule 13a-14(a) Certifications</u>
<u>32.1*</u>	<u>CEO Section 1350 Certifications</u>
<u>32.2*</u>	<u>CFO Section 1350 Certifications</u>
101.INS*	Inline XBRL Instance Document - the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document.
101.SCH*	Inline XBRL Taxonomy Extension Schema Document
101.CAL*	Inline XBRL Taxonomy Extension Calculation Linkbase Document
101.LAB*	Inline XBRL Taxonomy Extension Label Linkbase Document
101.DEF*	Inline XBRL Taxonomy Extension Definition Linkbase Document
101.PRE*	Inline XBRL Taxonomy Extension Presentation Linkbase Document
	The following financial information from Canadian Pacific Railway Limited's Quarterly Report on Form 10-Q for the third quarter ended September 30, 2022, formatted in Extensible Business Reporting Language (XBRL) includes: (i) the Interim Consolidated Statements of Income for the third quarters and first nine months ended September 30, 2022 and 2021; (ii) the Interim Consolidated Statements of Comprehensive Income for the third quarters and first nine months ended September 30, 2022 and 2021; (iii) the Interim Consolidated Balance Sheets at September 30, 2022, and December 31, 2021; (iv) the Interim Consolidated Statements of Cash Flows for the third quarters and first nine months ended September 30, 2022 and 2021; (v) the Interim Consolidated Statements of Changes in Shareholders' Equity for the third quarters and first nine months ended September 30, 2022 and 2021; and (vi) the Notes to Interim Consolidated Financial Statements.
104*	Cover Page Interactive Data File (embedded within the Inline XBRL document)

* Filed with this Quarterly Report on Form 10-Q

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

CANADIAN PACIFIC RAILWAY LIMITED

(Registrant)

By: /s/ NADEEM VELANI

Nadeem Velani

Executive Vice-President and
Chief Financial Officer
(Principal Financial Officer)

Date: October 26, 2022

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

Form 10-Q

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2022

or

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from _____ to _____

Commission File Number 1-4717

KANSAS CITY SOUTHERN

(Exact name of registrant as specified in its charter)

Delaware

*(State or other jurisdiction of
incorporation or organization)*

427 West 12th Street

Kansas City , Missouri

(Address of principal executive offices)



87-3883291

*(I.R.S. Employer
Identification No.)*

64105

(Zip Code)

816.983.1303

(Registrant's telephone number, including area code)

No Change

(Former name, former address and former fiscal year, if changed since last report.)

Securities registered pursuant to Section 12(b) of the Act: None

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☐ No ☒ (The registrant is a voluntary filer and is not subject to the filing requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934. However, the registrant has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months.)

Indicate by check mark whether the registrant has submitted electronically, every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☐ Accelerated filer ☐ Non-accelerated filer ☒ Smaller reporting company ☐ Emerging growth company ☐

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class
Common Stock, \$0.01 per share par value

October 25, 2022
100 Shares

Kansas City Southern and Subsidiaries

Form 10-Q
September 30, 2022

Index

	<u>Page</u>
PART I — FINANCIAL INFORMATION	
Item 1.	Financial Statements (unaudited) 3
	Consolidated Statements of Operations — Three and nine months ended September 30, 2022 and 2021 3
	Consolidated Statements of Comprehensive Income (Loss) — Three and nine months ended September 30, 2022 and 2021 4
	Consolidated Balance Sheets — September 30, 2022 and December 31, 2021 5
	Consolidated Statements of Cash Flows — Nine months ended September 30, 2022 and 2021 6
	Consolidated Statements of Changes in Equity — Three months ended September 30, 2022, June 30, 2022, March 31, 2022, December 31, 2021, September 30, 2021, June 30, 2021 and March 31, 2021 7
	Notes to the Unaudited Consolidated Financial Statements 8
Item 2.	Management’s Discussion and Analysis of Financial Condition and Results of Operations 18
Item 3.	Quantitative and Qualitative Disclosures About Market Risk 33
Item 4.	Controls and Procedures 33
PART II — OTHER INFORMATION	
Item 1.	Legal Proceedings 34
Item 1A.	Risk Factors 34
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds 34
Item 3.	Defaults Upon Senior Securities 34
Item 4.	Mine Safety Disclosures 34
Item 5.	Other Information 34
Item 6.	Exhibits 35
	SIGNATURES 36

PART I — FINANCIAL INFORMATION

Item 1. Financial Statements (unaudited)

Kansas City Southern and Subsidiaries

Consolidated Statements of Operations

(In millions)

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2022	2021	2022	2021
Revenues	\$ 882.2	\$ 744.0	\$ 2,505.9	\$ 2,199.5
Operating expenses:				
Compensation and benefits	154.4	133.3	423.8	391.2
Purchased services	57.8	51.4	163.6	161.0
Fuel	121.0	78.0	341.1	227.9
Equipment costs	25.5	19.6	67.2	64.8
Depreciation and amortization	98.2	90.5	292.1	273.7
Materials and other	88.8	82.8	252.4	231.1
Merger costs, net	11.5	36.5	36.8	776.6
Total operating expenses	557.2	492.1	1,577.0	2,126.3
Operating income	325.0	251.9	928.9	73.2
Equity in net earnings (losses) of affiliates	(0.1)	3.8	7.9	13.2
Interest expense	(38.9)	(39.0)	(118.0)	(117.1)
Foreign exchange loss	(12.3)	(0.5)	(18.0)	(1.0)
Other income, net	0.2	0.5	0.3	0.7
Income (loss) before income taxes	273.9	216.7	801.1	(31.0)
Income tax expense	72.2	60.2	217.3	37.1
Net income (loss)	201.7	156.5	583.8	(68.1)
Less: Net income attributable to noncontrolling interest	0.4	0.3	1.0	1.2
Net income (loss) attributable to Kansas City Southern and subsidiaries	201.3	156.2	582.8	(69.3)
Preferred stock dividends	—	0.1	—	0.2
Net income (loss) available to common stockholder(s)	\$ 201.3	\$ 156.1	\$ 582.8	\$ (69.5)

See accompanying notes to the unaudited consolidated financial statements.

Kansas City Southern and Subsidiaries
Consolidated Statements of Comprehensive Income (Loss)
(In millions)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2022	2021	2022	2021
Net income (loss)	\$ 201.7	\$ 156.5	\$ 583.8	\$ (68.1)
Other comprehensive income (loss):				
Unrealized gain (loss) on interest rate derivative instruments, net of tax of \$9.9 million, \$(0.4) million, \$36.7 million and \$11.6 million, respectively	37.5	(1.7)	138.1	43.5
Reclassification adjustment from cash flow hedges included in net income, net of tax of \$0.2 million, \$0.1 million, \$0.4 million and \$0.3 million, respectively	0.5	0.5	1.5	1.5
Foreign currency translation adjustments	(0.2)	(0.2)	0.1	(0.1)
Other comprehensive income (loss)	37.8	(1.4)	139.7	44.9
Comprehensive income (loss)	239.5	155.1	723.5	(23.2)
Less: Comprehensive income attributable to noncontrolling interest	0.4	0.3	1.0	1.2
Comprehensive income (loss) attributable to Kansas City Southern and subsidiaries	\$ 239.1	\$ 154.8	\$ 722.5	\$ (24.4)

See accompanying notes to the unaudited consolidated financial statements.

Kansas City Southern and Subsidiaries
Consolidated Balance Sheets

	September 30, 2022	December 31, 2021
	(In millions, except share and per share amounts)	
	(Unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 163.8	\$ 339.3
Accounts receivable, net	600.9	271.0
Materials and supplies	169.0	131.0
Other current assets	359.5	142.1
Total current assets	1,293.2	883.4
Operating lease right-of-use assets	86.4	69.6
Investments	58.9	48.3
Property and equipment (including concession assets), net	9,317.9	9,209.3
Other assets	110.9	217.5
Total assets	<u>\$ 10,867.3</u>	<u>\$ 10,428.1</u>
LIABILITIES AND EQUITY		
Current liabilities:		
Long-term debt due within one year	\$ 455.2	\$ 8.8
Accounts payable and accrued liabilities	600.1	479.7
Total current liabilities	1,055.3	488.5
Long-term operating lease liabilities	60.6	46.4
Long-term debt	3,326.4	3,768.8
Deferred income taxes	1,292.2	1,213.7
Other noncurrent liabilities and deferred credits	140.5	178.1
Total liabilities	5,875.0	5,695.5
Stockholder equity:		
\$.01 par, common stock, 100 shares authorized; 100 shares issued; 100 shares outstanding at September 30, 2022 and December 31, 2021	—	—
Additional paid-in capital	860.6	860.6
Retained earnings	3,642.2	3,524.4
Accumulated other comprehensive income	159.1	19.4
Total stockholder equity	4,661.9	4,404.4
Noncontrolling interest	330.4	328.2
Total equity	4,992.3	4,732.6
Total liabilities and equity	<u>\$ 10,867.3</u>	<u>\$ 10,428.1</u>

See accompanying notes to the unaudited consolidated financial statements.

Kansas City Southern and Subsidiaries
Consolidated Statements of Cash Flows
(In millions)
(Unaudited)

	Nine Months Ended September 30,	
	2022	2021
Operating activities:		
Net income (loss)	\$ 583.8	\$ (68.1)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	292.1	273.7
Deferred income taxes	41.4	(129.5)
Equity in net earnings of affiliates	(7.9)	(13.2)
Share-based compensation	—	20.5
(Gain) loss on foreign currency derivative instruments	18.9	(0.8)
Foreign exchange (gain) loss	(0.9)	1.8
Merger costs, net	36.8	776.6
Distributions from affiliates	2.0	2.5
Settlement of foreign currency derivative instruments	(2.2)	(1.9)
Cash payments for merger costs	(32.3)	(2,125.7)
Reimbursement of merger termination fee	—	2,100.0
Refundable Mexican value added tax payments	—	(41.9)
Changes in working capital items:		
Accounts receivable	(333.1)	(25.9)
Materials and supplies	(40.0)	2.2
Other current assets	75.7	9.2
Accounts payable and accrued liabilities	82.3	39.5
Other, net	(3.7)	11.1
Net cash provided by operating activities	<u>712.9</u>	<u>830.1</u>
Investing activities:		
Capital expenditures	(381.2)	(377.7)
Property investments in MSLLC	(25.1)	(22.3)
Investments in and advances to affiliates	(8.3)	(7.8)
Proceeds from disposal of property	4.5	5.5
Other, net	(3.3)	(5.0)
Net cash used for investing activities	<u>(413.4)</u>	<u>(407.3)</u>
Financing activities:		
Repayment of long-term debt	(7.7)	(5.7)
Dividends paid	(465.0)	(138.4)
Proceeds from employee stock plans	—	4.2
Net cash used for financing activities	<u>(472.7)</u>	<u>(139.9)</u>
Effect of exchange rate changes on cash	<u>(2.3)</u>	<u>(1.1)</u>
Cash and cash equivalents:		
Net increase (decrease) during each period	(175.5)	281.8
At beginning of year	339.3	188.2
At end of period	<u>\$ 163.8</u>	<u>\$ 470.0</u>

See accompanying notes to the unaudited consolidated financial statements.

Kansas City Southern and Subsidiaries
Consolidated Statements of Changes in Equity
(in millions, except per share amounts)
(Unaudited)

	\$25 Par Preferred Stock	\$.01 Par Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Non- controlling Interest	Total
Balance at December 31, 2020	\$ 5.4	\$ 0.9	\$ 830.9	\$ 3,219.6	\$ 0.4	\$ 326.4	\$ 4,383.6
Net income				153.0		0.4	153.4
Other comprehensive income					79.4		79.4
Dividends on common stock (\$0.54/share)			—	(49.1)			(49.1)
Dividends on \$25 par preferred stock (\$0.25/share)				—			—
Share repurchases	—	—	(2.1)	(72.9)			(75.0)
Settlement of forward contract for accelerated share repurchases			75.0				75.0
Options exercised and stock subscribed, net of shares withheld for employee taxes		—	(3.0)				(3.0)
Share-based compensation			8.2				8.2
Balance at March 31, 2021	5.4	0.9	909.0	3,250.6	79.8	326.8	4,572.5
Net income (loss)				(378.5)		0.5	(378.0)
Other comprehensive loss					(33.1)		(33.1)
Dividends on common stock (\$0.54/share)			—	(49.1)			(49.1)
Dividends on \$25 par preferred stock (\$0.25/share)				(0.1)			(0.1)
Options exercised and stock subscribed, net of shares withheld for employee taxes		—	(2.0)				(2.0)
Share-based compensation			6.2				6.2
Balance at June 30, 2021	5.4	0.9	913.2	2,822.9	46.7	327.3	4,116.4
Net income				156.2		0.3	156.5
Other comprehensive loss					(1.4)		(1.4)
Dividends on common stock (\$0.54/share)			—	(49.1)			(49.1)
Dividends on \$25 par preferred stock (\$0.25/share)				(0.1)			(0.1)
Options exercised and stock subscribed, net of shares withheld for employee taxes		—	4.4				4.4
Share-based compensation			6.1				6.1
Balance at September 30, 2021	5.4	0.9	923.7	2,929.9	45.3	327.6	4,232.8
Net income				594.5		0.6	595.1
Other comprehensive loss					(25.9)		(25.9)
Options exercised and stock subscribed, net of shares withheld for employee taxes		—	0.4				0.4
Share-based compensation			59.9				59.9
Replacement of equity share awards with liability awards			(54.5)				(54.5)
Cash settlement of stock options			(75.2)				(75.2)
Recapitalization of stock	(5.4)	(0.9)	6.3				—
Balance at December 31, 2021	—	—	860.6	3,524.4	19.4	328.2	4,732.6
Net income				187.4		0.6	188.0
Other comprehensive income					48.1		48.1
Dividend to Canadian Pacific				(265.0)			(265.0)
Balance at March 31, 2022	—	—	860.6	3,446.8	67.5	328.8	4,703.7
Net income				194.1		—	194.1
Other comprehensive income					53.8		53.8
Contribution from noncontrolling interest						1.2	1.2
Balance at June 30, 2022	—	—	860.6	3,640.9	121.3	330.0	4,952.8
Net income				201.3		0.4	201.7
Other comprehensive income					37.8		37.8
Dividend to Canadian Pacific				(200.0)			(200.0)
Balance at September 30, 2022	\$ —	\$ —	\$ 860.6	\$ 3,642.2	\$ 159.1	\$ 330.4	\$ 4,992.3

See accompanying notes to the unaudited consolidated financial statements.

Kansas City Southern and Subsidiaries
Notes to the Unaudited Consolidated Financial Statements

For purposes of this Quarterly Report on Form 10-Q, “KCS” or the “Company” may refer to Kansas City Southern or, as the context requires, to one or more subsidiaries of Kansas City Southern.

1. Basis of Presentation

In the opinion of the management of KCS, the accompanying unaudited consolidated financial statements contain all adjustments (consisting of normal and recurring adjustments) necessary to reflect a fair statement of the results for interim periods in accordance with U.S. generally accepted accounting principles (“U.S. GAAP”). Pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”), certain information and note disclosures normally included in financial statements prepared in accordance with U.S. GAAP have been condensed or omitted. These consolidated financial statements should be read in conjunction with the consolidated financial statements and accompanying notes included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2021. The results of operations for the three and nine months ended September 30, 2022, are not necessarily indicative of the results to be expected for the full year ending December 31, 2022.

On September 15, 2021, KCS and Canadian Pacific Railway Limited (“CP”), a Canadian corporation, entered into a merger agreement (the “Merger Agreement”) and on December 14, 2021, CP acquired the outstanding common and preferred stock of KCS. Therefore, earnings per share data is not presented as the Company does not have any outstanding or issued publicly traded stock. The merger is further discussed in Note 2, Merger Agreement.

In November 2021, the Financial Accounting Standards Board (“FASB”) issued Accounting Standard Update (“ASU”) 2021-10, Government Assistance (Topic 832), Disclosures by Business Entities about Government Assistance. The standard is intended to increase transparency of government assistance by requiring disclosures of the following: (1) the types of assistance, (2) an entity’s accounting for the assistance, and (3) the effect of the assistance on the entity’s financial statements. This ASU was effective for the Company on January 1, 2022 and the Company adopted the ASU prospectively. See Note 4, Property and Equipment for the newly required disclosure.

2. Merger Agreement

On December 14, 2021, CP acquired the outstanding common and preferred stock of KCS. Each share of common stock, par value \$0.01 per share, of KCS that was outstanding immediately prior to the merger was converted into the right to receive (1) 2.884 common shares of CP and (2) \$90 in cash (together, the “Merger Consideration”), and each share of preferred stock, par value \$25 per share, that was outstanding immediately prior to the merger was converted into the right to receive \$37.50 in cash. The Merger Consideration value received by KCS stockholders was \$301.20 per KCS common share.

The merger transaction was completed through a series of mergers as outlined in the Merger Agreement. These mergers ultimately resulted in KCS being merged with and into Cygnus Merger Sub 1 Corporation (“Surviving Merger Sub”), a wholly owned subsidiary of CP, with Surviving Merger Sub continuing as the surviving entity. Pursuant to the Merger Agreement, Surviving Merger Sub was renamed “Kansas City Southern” and as successor company of KCS, continued to own the assets of KCS. Immediately following the consummation of the mergers, CP caused the contribution, directly and indirectly, of all of the outstanding shares of capital stock of Surviving Merger Sub, as successor to KCS, to be deposited into an independent, irrevocable voting trust (the “Voting Trust”) under a voting trust agreement (the “Voting Trust Agreement”) approved by the U.S. Surface Transportation Board (“STB”), pending receipt of the final and non-appealable approval or exemption by the STB pursuant to 49 U.S.C. § 11323 et seq., of the transactions contemplated by the Merger Agreement (“STB Final Approval”). The Voting Trust prevents CP, or any affiliate of CP, from controlling or having the power to control KCS prior to STB Final Approval. Following receipt of STB Final Approval, the Voting Trust will be terminated and CP will acquire control over KCS’s railroad operations.

On December 14, 2021, the merger of KCS and Surviving Merger Sub was accounted for as a recapitalization of KCS’s equity. Upon STB Final Approval, the transaction will be accounted for as a business combination using the acquisition method of accounting.

Pursuant to the Merger Agreement, KCS paid a cash dividend in the first and third quarters of 2022 of \$265.0 million and \$200.0 million, respectively, to a wholly-owned subsidiary of CP. Periodic cash distributions may be made to a wholly-owned subsidiary of CP based upon cash generated, the timing of capital expenditures and working capital needs of the Company.

For the three and nine months ended September 30, 2022, KCS reported \$11.5 million and \$36.8 million, respectively, of merger-related costs, which primarily related to incentive compensation costs. During the three and nine months ended September 30, 2021, the Company recognized merger-related costs of \$36.5 million and \$776.6 million, respectively. For the three months ended September 30, 2021, the merger costs primarily related to compensation and benefits costs and legal fees. For the nine months ended

Kansas City Southern and Subsidiaries

Notes to the Unaudited Consolidated Financial Statements—(Continued)

September 30, 2021, merger costs included the fee associated with the termination of the Canadian National (“CN”) merger agreement by KCS of \$700.0 million, in addition to compensation and benefits costs and bankers’ and legal fees. For the year ended December 31, 2021, KCS incurred \$1,400.0 million of merger termination fees, completely offset by the recovery of \$1,400.0 million of merger termination fees recognized in merger costs, net within the consolidated statements of operations.

3. Revenue

Disaggregation of Revenue

The following table presents revenues disaggregated by the major commodity groups as well as the product types included within the major commodity groups (*in millions*). The Company believes disaggregation by product type best depicts how cash flows are affected by economic factors. See Note 10 for revenues by geographical area.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2022	2021	2022	2021
<i>Chemical & Petroleum</i>				
Chemicals	\$ 76.3	\$ 71.0	\$ 220.9	\$ 196.4
Petroleum	85.4	93.7	245.8	361.8
Plastics	42.9	39.4	125.6	109.7
Total	204.6	204.1	592.3	667.9
<i>Industrial & Consumer Products</i>				
Forest Products	79.2	71.6	221.5	191.9
Metals & Scrap	70.2	54.1	191.5	151.4
Other	39.0	33.3	110.6	94.3
Total	188.4	159.0	523.6	437.6
<i>Agriculture & Minerals</i>				
Grain	99.9	87.0	316.7	250.6
Food Products	46.9	35.4	130.2	109.0
Ores & Minerals	9.6	7.5	25.3	18.8
Stone, Clay & Glass	11.2	9.9	31.3	25.7
Total	167.6	139.8	503.5	404.1
<i>Energy</i>				
Utility Coal	45.2	45.8	123.3	108.7
Coal & Petroleum Coke	12.3	12.8	37.3	35.2
Frac Sand	4.6	4.0	14.4	11.6
Crude Oil	20.8	12.0	51.4	31.1
Total	82.9	74.6	226.4	186.6
<i>Intermodal</i>	121.9	86.9	335.3	259.3
<i>Automotive</i>	70.1	40.1	190.8	133.6
Total Freight Revenues	835.5	704.5	2,371.9	2,089.1
<i>Other Revenue</i>	46.7	39.5	134.0	110.4
Total Revenues	\$ 882.2	\$ 744.0	\$ 2,505.9	\$ 2,199.5

Contract Balances

The amount of revenue recognized in the third quarter of 2022 from performance obligations partially satisfied in previous periods was \$28.9 million. The performance obligations that were unsatisfied or partially satisfied as of September 30, 2022 were \$21.8 million, which represents in-transit shipments that are fully satisfied the following month.

A receivable is any unconditional right to consideration, and is recognized as shipments have been completed and the relating performance obligation has been fully satisfied. At September 30, 2022 and December 31, 2021, the accounts receivable, net balance was \$600.9 million and \$271.0 million, respectively. Contract assets represent a conditional right to consideration in exchange for goods or services. The Company did not have any contract assets at September 30, 2022 and December 31, 2021.

Kansas City Southern and Subsidiaries

Notes to the Unaudited Consolidated Financial Statements—(Continued)

Contract liabilities represent consideration received in advance from customers, and are recognized as revenue over time as the relating performance obligation is satisfied. The amount of revenue recognized in the third quarter of 2022 that was included in the opening contract liability balance was \$8.0 million. The Company has recognized contract liabilities within the accounts payable and accrued liabilities and other long-term liabilities financial statement captions on the consolidated balance sheets.

The following tables summarize the changes in contract liabilities (*in millions*):

Contract liabilities

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2022	2021	2022	2021
Beginning balance	\$ 49.4	\$ 19.7	\$ 68.4	\$ 29.9
Revenue recognized that was included in the contract liability balance at the beginning of the period	(8.0)	(9.6)	(30.1)	(25.3)
Increases due to consideration received, excluding amounts recognized as revenue during the period	4.7	2.4	7.8	7.9
Ending balance	<u>\$ 46.1</u>	<u>\$ 12.5</u>	<u>\$ 46.1</u>	<u>\$ 12.5</u>

4. Property and Equipment (including Concession Assets)

Property and equipment, including concession assets, and related accumulated depreciation and amortization are summarized below (*in millions*):

	September 30, 2022	December 31, 2021
Land	\$ 244.7	\$ 243.0
Concession land rights	141.1	141.1
Road property	8,630.7	8,430.6
Equipment	2,868.0	2,842.4
Technology and other	433.4	372.6
Construction in progress	393.0	335.8
Total property	<u>12,710.9</u>	<u>12,365.5</u>
Accumulated depreciation and amortization	<u>3,393.0</u>	<u>3,156.2</u>
Property and equipment (including concession assets), net	<u>\$ 9,317.9</u>	<u>\$ 9,209.3</u>

Concession assets, net of accumulated amortization of \$775.5 million and \$744.8 million, totaled \$2,475.3 million and \$2,459.3 million at September 30, 2022 and December 31, 2021, respectively.

The Company has historically received assistance from governmental entities, typically in the form of cash, for purposes of making improvements to its rail network as part of public safety and/or economic revitalization initiatives. The governmental entity generally specifies how the monetary assistance is to be spent, and may include limited conditions requiring the Company to return the assistance. The Company accounts for this assistance received as reductions to property and equipment in the period in which the improvement is made, with the assistance being amortized as an offset to depreciation expense over the life of the improvement. As of September 30, 2022 and December 31, 2021, the total governmental assistance received, net of accumulated amortization, was \$35.5 million and \$37.3 million, respectively. For the three and nine months ended September 30, 2022, governmental assistance amortization was \$0.7 million and \$1.9 million, respectively.

5. Fair Value Measurements

The Company's derivative financial instruments are measured at fair value on a recurring basis and consist of foreign currency forward contracts and treasury lock agreements, which are classified as Level 2 valuations. The Company determines the fair value of its derivative financial instrument positions based upon pricing models using inputs observed from actively quoted markets and also takes into consideration the contract terms as well as other inputs, including market currency exchange rates and in the case of option contracts, volatility, the risk-free interest rate and the time to expiration.

The Company's short-term financial instruments include cash and cash equivalents, accounts receivable, accounts payable and short-term borrowings. The carrying value of the short-term financial instruments approximates their fair value.

Kansas City Southern and Subsidiaries

Notes to the Unaudited Consolidated Financial Statements—(Continued)

The fair value of the Company's debt is estimated using quoted market prices when available. When quoted market prices are not available, fair value is estimated based on current market interest rates for debt with similar maturities and credit quality. The carrying value of the Company's debt was \$3,781.6 million and \$3,777.6 million at September 30, 2022 and December 31, 2021, respectively. If the Company's debt were measured at fair value, the fair value measurements of the individual debt instruments would have been classified as Level 2 in the fair value hierarchy.

The fair value of the Company's financial instruments is presented in the following table (*in millions*):

	September 30, 2022	December 31, 2021
	Level 2	Level 2
Assets		
Treasury lock agreements	\$ 232.2	\$ 57.4
Liabilities		
Debt instruments	3,235.8	4,311.1
Foreign currency derivative instruments	18.5	1.8

6. Derivative Instruments

The Company enters into derivative transactions in certain situations based on management's assessment of current market conditions and perceived risks. Management intends to respond to evolving business and market conditions and in doing so, may enter into such transactions as deemed appropriate.

Credit Risk. As a result of the use of derivative instruments, the Company is exposed to counterparty credit risk. The Company manages this risk by limiting its counterparties to large financial institutions which meet the Company's credit rating standards and have an established banking relationship with the Company. As of September 30, 2022, the Company did not expect any losses as a result of default of its counterparties.

Interest Rate Derivative Instruments. In 2020, the Company executed six 30-year treasury lock agreements with an aggregate notional value of \$650.0 million and a weighted average interest rate of 1.58%. The purpose of the treasury locks is to hedge the U.S. Treasury benchmark interest rate associated with future interest payments related to the anticipated refinancing of the \$444.7 million principal amount of 3.00% senior notes due May 15, 2023 (the "3.00% Senior Notes") and the \$200.0 million principal amount of 3.85% senior notes due November 15, 2023 (the "3.85% Senior Notes"). The Company has designated the treasury locks as cash flow hedges and recorded unrealized gains and losses in accumulated other comprehensive income (loss). For the nine months ended September 30, 2022, the total unrealized gain of \$232.2 million recognized in accumulated other comprehensive income increased by \$174.8 million compared to December 31, 2021, reflecting a change in the value of the treasury locks as U.S. treasury rates rose. Upon settlement, the unrealized gain or loss in accumulated other comprehensive income (loss) will be amortized to interest expense over the life of the future underlying debt issuance.

Foreign Currency Derivative Instruments. The Company's Mexican subsidiaries have net U.S. dollar-denominated monetary liabilities which, for Mexican income tax purposes, are subject to periodic revaluation based on changes in the value of the Mexican peso against the U.S. dollar. This revaluation creates fluctuations in the Company's Mexican income tax expense in the consolidated statements of operations and the amount of income taxes paid in Mexico. The Company also has net monetary assets denominated in Mexican pesos that are subject to periodic re-measurement and settlement that create fluctuations in foreign currency gains and losses in the consolidated statements of operations. The Company hedges its net exposure to foreign currency fluctuations in earnings by entering into foreign currency forward contracts. The foreign currency forward contracts involve the Company's agreement to buy or sell pesos at an agreed-upon exchange rate on a future date.

Kansas City Southern and Subsidiaries

Notes to the Unaudited Consolidated Financial Statements—(Continued)

Below is a summary of the Company's 2022 and 2021 foreign currency derivative contracts (*amounts in millions, except Ps./USD*):

Foreign currency forward contracts

	Contracts to sell Ps./receive USD			Offsetting contracts to purchase Ps./pay USD				
	Notional amount	Notional amount	Weighted-average exchange rate (in Ps./USD)	Notional amount	Notional amount	Weighted-average exchange rate (in Ps./USD)	Cash received/ (paid) on settlement	
Contracts executed in 2022 and outstanding	\$ 460.0	Ps. 9,797.1	Ps. 21.3	—	—	—	—	—
Contracts executed in 2022 and settled in 2022	\$ 50.0	Ps. 1,105.3	Ps. 22.1	\$ 50.5	Ps. 1,105.3	Ps. 21.9	\$ (0.5)	
Contracts executed in 2021 and settled in 2022	\$ 270.0	Ps. 5,583.3	Ps. 20.7	\$ 271.7	Ps. 5,583.3	Ps. 20.6	\$ (1.7)	

	Contracts to purchase Ps./pay USD			Offsetting contracts to sell Ps./receive USD				
	Notional amount	Notional amount	Weighted-average exchange rate (in Ps./USD)	Notional amount	Notional amount	Weighted-average exchange rate (in Ps./USD)	Cash received/ (paid) on settlement	
Contracts executed in 2021 and settled in 2021 (i)	\$ 100.0	Ps. 1,993.5	Ps. 19.9	\$ 98.1	Ps. 1,993.5	Ps. 20.3	\$ (1.9)	

(i) During the nine months ended September 2021, the Company settled \$100.0 million of these forward contracts, resulting in cash paid of \$1.9 million.

The Company has not designated any of the foreign currency derivative contracts as hedging instruments for accounting purposes. The Company measures the foreign currency derivative contracts at fair value each period and recognizes any change in fair value in foreign exchange gain (loss) within the consolidated statements of operations. The cash flows associated with these instruments is classified as an operating activity within the consolidated statements of cash flows.

Offsetting. The Company's treasury lock agreements and foreign currency forward contracts are executed with counterparties in the U.S. and are governed by International Swaps and Derivatives Association agreements that include standard netting arrangements. Asset and liability positions from contracts with the same counterparty are net settled upon maturity/expiration and presented on a net basis in the consolidated balance sheets prior to settlement.

The following tables present the fair value of derivative instruments included in the Consolidated Balance Sheets (*in millions*):

Derivative Assets			
Balance Sheet Location		September 30, 2022	December 31, 2021
Derivatives designated as hedging instruments:			
Treasury lock agreements		\$ 232.2	\$ —
		—	57.4
Total derivatives designated as hedging instruments		232.2	57.4
Total derivative assets		\$ 232.2	\$ 57.4

Derivative Liabilities			
Balance Sheet Location		September 30, 2022	December 31, 2021
Derivatives not designated as hedging instruments:			
Foreign currency forward contracts		\$ 18.5	\$ 1.8
Total derivatives not designated as hedging instruments		18.5	1.8
Total derivative liabilities		\$ 18.5	\$ 1.8

Kansas City Southern and Subsidiaries

Notes to the Unaudited Consolidated Financial Statements—(Continued)

The following table summarizes the gross and net fair value of derivative liabilities (*in millions*):

As of September 30, 2022	Gross Liabilities	Gross Assets	Net Amounts Presented in the Consolidated Balance Sheets
Derivatives subject to a master netting arrangement or similar agreement	\$ 18.5	\$ —	\$ 18.5
As of December 31, 2021			
Derivatives subject to a master netting arrangement or similar agreement	\$ 2.8	\$ (1.0)	\$ 1.8

The following table presents the effects of derivative instruments on the Consolidated Statements of Operations and Consolidated Statements of Comprehensive Income (Loss) for the three months ended September 30 (*in millions*):

Derivatives in Cash Flow Hedging Relationships	Amount of Gain/(Loss) Recognized in OCI on Derivative		Location of Gain/(Loss) Reclassified from AOCI into Income	Amount of Gain/(Loss) Reclassified from AOCI into Income	
	2022	2021		2022	2021
Treasury lock agreements	\$ 47.4	\$ (2.1)	Interest expense	\$ (0.7)	\$ (0.6)
Total	\$ 47.4	\$ (2.1)		\$ (0.7)	\$ (0.6)
Derivatives Not Designated as Hedging Instruments			Location of Gain/(Loss) Recognized in Income on Derivative	Amount of Gain/(Loss) Recognized in Income on Derivative	
				2022	2021
Foreign currency forward contracts			Foreign exchange loss	\$ (8.1)	\$ 4.9
Total				\$ (8.1)	\$ 4.9

The following table presents the effects of derivative instruments on the Consolidated Statements of Operations and Consolidated Statements of Comprehensive Income (Loss) for the nine months ended September 30 (*in millions*):

Derivatives in Cash Flow Hedging Relationships	Amount of Gain/(Loss) Recognized in OCI on Derivative		Location of Gain/(Loss) Reclassified from AOCI into Income	Amount of Gain/(Loss) Reclassified from AOCI into Income	
	2022	2021		2022	2021
Treasury lock agreements	\$ 174.8	\$ 55.1	Interest expense	\$ (1.9)	\$ (1.8)
Total	\$ 174.8	\$ 55.1		\$ (1.9)	\$ (1.8)
Derivatives Not Designated as Hedging Instruments			Location of Gain/(Loss) Recognized in Income on Derivative	Amount of Gain/(Loss) Recognized in Income on Derivative	
				2022	2021
Foreign currency forward contracts			Foreign exchange loss	\$ (18.9)	\$ 0.8
Total				\$ (18.9)	\$ 0.8

See Note 5, Fair Value Measurements, for the determination of the fair values of derivatives.

7. Short-Term Borrowings

Commercial Paper. The Company's commercial paper program generally serves as the primary means of short-term funding. As of September 30, 2022 and December 31, 2021, KCS had no commercial paper outstanding. For the nine months ended September 30, 2022 and 2021, any commercial paper borrowings were outstanding for less than 90 days and the related activity is presented on a net basis in the consolidated statements of cash flows.

8. Refundable Mexican Value Added Tax

Kansas City Southern de México, S.A. de C.V. ("KCSM") is not required to charge its customers value added tax ("VAT") on international import or export transportation services, which prior to 2022 resulted in KCSM paying more VAT on its expenses than it

Kansas City Southern and Subsidiaries

Notes to the Unaudited Consolidated Financial Statements—(Continued)

collected from customers. These excess VAT payments are refundable by the Mexican government. Prior to 2019, Mexican companies could offset their monthly refundable VAT balance with other tax obligations. In January 2019, Mexico tax reform eliminated the ability to offset other tax obligations with refundable VAT. Over 2019 through 2021, KCSM generated a refundable VAT balance and filed refund claims with the Servicio de Administración Tributaria (the “SAT”), which have not been refunded.

In November 2021, changes to the VAT law were announced and became effective beginning January 1, 2022. These changes reduced the recoverability of VAT paid by KCSM on its expenditures that support international import transportation service revenues that are not subject to a VAT charge. VAT that is unrecoverable from the Mexican government results in incremental VAT expense for KCSM. Beginning in 2022, KCSM changed certain service offerings to either require VAT to be charged to customers on revenue, or impose a rate increase to offset the incremental VAT expense. These measures implemented by KCSM increased the VAT to be collected from customers and payable to the Mexican government.

As of September 30, 2022 and December 31, 2021, the KCSM refundable VAT balance was \$98.6 million and \$152.2 million, respectively. KCSM has prior favorable Mexican court decisions and a legal opinion supporting its right under Mexican law to recover the refundable VAT balance from the Mexican government and believes the VAT to be fully recoverable. KCSM will recover the refundable VAT balance as VAT billed to customers exceeds creditable VAT charged by vendors. As of September 30, 2022 and December 31, 2021, \$81.0 million and \$78.0 million, respectively, of the refundable VAT balance was classified as a short-term asset.

9. Commitments and Contingencies

Concession Duty. Under KCSM’s 50-year railroad concession from the Mexican government (the “Concession”), which could expire in 2047 unless extended, KCSM pays annual concession duty expense of 1.25% of gross revenues. For the three and nine months ended September 30, 2022, the concession duty expense, which is recorded within materials and other in operating expenses, was \$5.5 million and \$16.0 million, respectively, compared to \$4.7 million and \$14.1 million, for the same periods in 2021.

Litigation. Occasionally, the Company is a party to various legal proceedings, regulatory examinations, investigations, administrative actions, and other legal matters, arising for the most part in the ordinary course of business, incidental to its operations. Included in these proceedings are various tort claims brought by current and former employees for job-related injuries and by third parties for injuries related to railroad operations. KCS aggressively defends these matters and has established liability provisions that management believes are adequate to cover expected costs. The outcome of litigation and other legal matters is always uncertain. KCS believes it has valid defenses to the legal matters currently pending against it, is defending itself vigorously, and has recorded accruals determined in accordance with U.S. GAAP, where appropriate. In making a determination regarding accruals, using available information, KCS evaluates the likelihood of an unfavorable outcome in legal or regulatory proceedings to which it is a party to and records a loss contingency when it is probable a liability has been incurred and the amount of the loss can be reasonably estimated. These subjective determinations are based on the status of such legal or regulatory proceedings, the merits of KCS’s defenses and consultation with legal counsel. Actual outcomes of these legal and regulatory proceedings may materially differ from the current estimates. It is possible that resolution of one or more of the legal matters currently pending or threatened could result in losses material to KCS’s consolidated results of operations, liquidity or financial condition.

Environmental Liabilities. The Company’s U.S. operations are subject to extensive federal, state and local environmental laws and regulations. The major U.S. environmental laws to which the Company is subject include, among others, the federal Comprehensive Environmental Response, Compensation and Liability Act (“CERCLA,” also known as the Superfund law), the Toxic Substances Control Act, the Clean Water Act, and the Hazardous Materials Transportation Act. CERCLA can impose joint and several liabilities for cleanup and investigation costs, without regard to fault or legality of the original conduct, on current and predecessor owners and operators of a site, as well as those who generate, or arrange for the disposal of hazardous substances. The Company does not believe that compliance with the requirements imposed by the environmental legislation will impair its competitive capability or result in any material additional capital expenditures, operating or maintenance costs. The Company is, however, subject to environmental remediation costs as described in the following paragraphs.

The Company’s Mexico operations are subject to Mexican federal and state laws and regulations relating to the protection of the environment through the establishment of standards for water discharge, water supply, emissions, noise pollution, hazardous substances and transportation and handling of hazardous and solid waste. The Mexican government may bring administrative and criminal proceedings, impose economic sanctions against companies that violate environmental laws, and temporarily or even permanently close non-complying facilities.

The risk of incurring environmental liability is inherent in the railroad industry. As part of serving the petroleum and chemicals industry, the Company transports hazardous materials and has a professional team available to respond to and handle environmental issues that might occur in the transport of such materials.

Kansas City Southern and Subsidiaries**Notes to the Unaudited Consolidated Financial Statements—(Continued)**

The Company performs ongoing reviews and evaluations of the various environmental programs and issues within the Company's operations, and, as necessary, takes actions intended to limit the Company's exposure to potential liability. Although these costs cannot be predicted with certainty, management believes that the ultimate outcome of identified matters will not have a material adverse effect on the Company's consolidated financial statements.

Personal Injury. The Company's personal injury liability is based on semi-annual actuarial studies performed on an undiscounted basis by an independent third party actuarial firm and reviewed by management. This liability is based on personal injury claims filed and an estimate of claims incurred but not yet reported. Actual results may vary from estimates due to the number, type and severity of the injury, costs of medical treatments and uncertainties in litigation. Adjustments to the liability are reflected within operating expenses in the period in which changes to estimates are known. Personal injury claims in excess of self-insurance levels are insured up to certain coverage amounts, depending on the type of claim and year of occurrence. The personal injury liability as of September 30, 2022, is based on an updated actuarial study of personal injury claims through April 30, 2022, and review of the last five months' experience. Although these estimates cannot be predicted with certainty, management believes that the ultimate outcome will not have a material adverse effect on the Company's consolidated financial statements.

Tax Contingencies. Tax returns filed in the U.S. for periods after 2015 and in Mexico for periods after 2012 remain open to examination by the taxing authority. The Internal Revenue Service ("IRS") has completed its examination of the 2017 deemed mandatory repatriation tax included in the 2017 U.S. federal tax return and the 2016 U.S. federal tax return with no material impact to the consolidated financial statements. The Servicio de Administración Tributaria (the "SAT"), the Mexican equivalent of the IRS, has initiated examinations of the KCSM 2013 through 2020 Mexico tax returns and the Financiera Inspira, S.A. de C.V. SOFOM, E.N.R. 2016 and 2017 Mexico tax returns. The Company does not expect that these examinations will have a material impact on the consolidated financial statements. During 2017, the Company received audit assessments from the SAT for the KCSM 2009 and 2010 Mexico tax returns. The Company commenced administrative actions with the SAT and the audit assessments were subsequently nullified. In the third quarter of 2018, the SAT issued new assessments and the Company filed administrative appeals with the SAT. During the first quarter of 2022, the Company received an audit assessment from the SAT for the KCSM 2013 Mexico tax return and filed an administrative appeal of the assessment in the second quarter of 2022.

On April 13, 2022, the SAT used an electronic tax mailbox to deliver an audit assessment on the 2014 KCSM tax returns, which as of September 30, 2022 was Ps.5.7 billion (approximately \$280.0 million USD) of tax, interest, penalties and inflation (the "2014 Audit Assessment"). In 2014, KCSM filed an amparo lawsuit with the district court, objecting to the SAT's electronic accounting requirements, including the SAT's use of the electronic tax mailbox, and KCSM was granted a permanent injunction in 2015 preventing the SAT from delivering any notification of assessments using the electronic tax mailbox. The permanent injunction remained in effect through the date the SAT issued the 2014 Audit Assessment. The Company became aware of the 2014 Audit Assessment on June 30, 2022 and based on the permanent injunction on the electronic accounting requirements, the Company believed it had thirty business days from that date to file an appeal. On July 7, 2022, the Company filed an administrative appeal of the 2014 Audit Assessment with the SAT. During the third quarter of 2022, the SAT dismissed the administrative appeal of the 2014 Audit Assessment on the basis it wasn't filed timely. The Company plans to challenge in Mexican court the SAT's use of the electronic mailbox and the dismissal of the administrative appeal of the 2014 Audit Assessment. The Company believes that it has strong legal arguments in its favor and it is more likely than not that the administrative appeal of the 2014 Audit Assessment was timely filed.

The 2014 Audit Assessment includes tax positions where KCSM has prior favorable court decisions or strong legal arguments in its favor. Management believes it is more likely than not it will prevail in any challenge of the 2014 Audit Assessment. Historically, the Company has not been required to pay to settle previous SAT audit assessments or has settled SAT audit assessments for an immaterial amount.

On July 1, 2022, the SAT froze KCSM's Mexico bank accounts without any request for payment of the 2014 Audit Assessment or notification of the freeze. The Company filed an amparo lawsuit challenging the legality of the bank account freeze. The district court issued a permanent injunction requiring the SAT to remove the freeze subject to KCSM posting a performance bond or other collateral upon the SAT demonstrating a tax obligation exists. In August 2022, KCSM posted a performance bond in the amount of Ps.5.6 billion (approximately \$278.0 million USD) and the bank account freeze was removed. The freeze and cost of obtaining the performance bond did not have a significant impact on KCSM's cash flows or operations. The provision of the performance bond is not an agreement or concession with regard to the 2014 Audit Assessment and in no way impacts KCSM's ability to further defend its tax position.

The Company believes that it has strong legal arguments in its favor and it is more likely than not that it will prevail in any challenge of the assessments.

Kansas City Southern and Subsidiaries

Notes to the Unaudited Consolidated Financial Statements—(Continued)

U.S. Collective Bargaining. KCSR participates in industry-wide multi-employer bargaining as a member of the National Carriers' Conference Committee ("NCCC"), as well as local bargaining for agreements that are limited to KCSR's property. Approximately 72% of KCSR employees are covered by collective bargaining agreements. For the 2016 bargaining round, 5-year agreements were reached voluntarily or through the arbitration process during 2017 and 2018 covering all of the participating unions. The terms of these agreements remain in effect until new agreements are reached in the 2020 national bargaining round. In November 2019, KCSR and its unions commenced negotiations in connection with the 2020 collective bargaining round.

On July 15, 2022, President Biden signed an executive order creating a Presidential Emergency Board ("PEB") to assist the railroads and its unions in ongoing national labor negotiations. The PEB reviewed the parties' proposals, held hearings and issued non-binding settlement recommendations to the President. Under the terms of the PEB, the parties had until September 16, 2022 to reach a voluntary settlement based on those recommendations. On September 15, 2022, the NCCC and unions reached a tentative agreement resulting in the Company recognizing estimated retroactive union wages and bonuses of approximately \$9.0 million in compensation and benefits on the consolidated statements of operations.

The union ratification began in mid-September and is expected to be complete by mid-November. As of October 26, 2022, six of the twelve railroad unions have ratified their respective tentative agreements; however, the third largest union rejected the tentative agreement. The NCCC and this union agreed to continue negotiations through November 19, 2022, before the union seeks other self-help remedies, including strikes or work stoppages. Under the Railway Labor Act, Congress can impose a resolution based upon the PEB recommendations or order trains to operate as usual while the two sides continue to negotiate and ultimately reach a new agreement. A strike or work stoppage could result in a significant disruption of the Company's operations and have significant financial impacts, such as lower revenues and higher operating costs.

Contractual Agreements. In the normal course of business, the Company enters into various contractual agreements related to commercial arrangements and the use of other railroads' or governmental entities' infrastructure needed for the operations of the business. The Company is involved or may become involved in certain disputes involving transportation rates, product loss or damage, charges, and interpretations related to these agreements. While the outcome of these matters cannot be predicted with certainty, the Company believes that, when resolved, these disputes will not have a material effect on its consolidated financial statements.

On July 14, 2022, KCSM reached an agreement with the Mexican Ministry of Infrastructure, Communications and Transportation ("SICT") to fund a new investment in the Celaya-NBA Line Railway Bypass and related infrastructure in an amount not to exceed Ps.4.0 billion (approximately \$200.0 million USD). In exchange for the investment, the SICT agreed to amend KCSM's Concession Title effective July 14, 2022, to extend the exclusivity rights granted to KCSM for an additional period of 10 years. Under this amendment, KCSM's exclusivity will now expire in 2037.

Credit Risk. The Company continually monitors risks related to economic changes and certain customer receivables concentrations. Significant changes in customer concentration or payment terms, deterioration of customer creditworthiness, bankruptcy, insolvency or liquidation of a customer, or weakening in economic trends could have a significant impact on the collectability of the Company's receivables and its operating results. If the financial condition of the Company's customers were to deteriorate and result in an impairment of their ability to make payments, additional allowances may be required. The Company has recorded provisions for credit losses based on its best estimate at September 30, 2022.

Panama Canal Railway Company ("PCRC") Guarantees and Indemnities. At September 30, 2022, the Company had issued and outstanding \$5.7 million under a standby letter of credit to fulfill its obligation to fund fifty percent of the debt service reserve and liquidity reserve established by PCRC in connection with the issuance of the 7.0% Senior Secured Notes due November 1, 2026 (the "PCRC Notes"). Additionally, KCS has pledged its shares of PCRC as security for the PCRC Notes.

Kansas City Southern and Subsidiaries

Notes to the Unaudited Consolidated Financial Statements—(Continued)

10. Geographic Information

The Company strategically manages its rail operations as one reportable business segment over a single coordinated rail network that extends from the midwest and southeast portions of the United States south into Mexico and connects with other Class I railroads. Financial information reported at this level, such as revenues, operating income and cash flows from operations, is used by corporate management, including the Company's chief operating decision-maker, in evaluating overall financial and operational performance, market strategies, as well as the decisions to allocate capital resources. The Company's chief operating decision-maker is the chief executive officer.

The following tables provide information by geographic area (*in millions*):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2022	2021	2022	2021
Revenues				
U.S.	\$ 476.0	\$ 409.5	\$ 1,351.6	\$ 1,160.5
Mexico	406.2	334.5	1,154.3	1,039.0
Total revenues	<u>\$ 882.2</u>	<u>\$ 744.0</u>	<u>\$ 2,505.9</u>	<u>\$ 2,199.5</u>
Property and equipment (including concession assets), net			September 30, 2022	December 31, 2021
U.S.			\$ 5,849.2	\$ 5,744.4
Mexico			3,468.7	3,464.9
Total property and equipment (including concession assets), net			<u>\$ 9,317.9</u>	<u>\$ 9,209.3</u>

11. Subsequent Event

On October 26, 2022, the Company's Board of Directors declared a cash dividend of up to \$225.0 million, to be paid to a wholly-owned subsidiary of CP on October 31, 2022.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The discussion below, as well as other portions of this Form 10-Q, contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, Section 21E of the Securities Exchange Act of 1934, as amended and the Private Securities Litigation Reform Act of 1995. In addition, management may make forward-looking statements orally or in other writing, including, but not limited to, in press releases, quarterly earnings calls, executive presentations, in the annual report to stockholders and in other filings with the Securities and Exchange Commission (the "SEC"). Readers can usually identify these forward-looking statements by the use of such words as "may," "will," "should," "likely," "plans," "projects," "expects," "anticipates," "believes" or similar words. These statements involve a number of risks and uncertainties. Actual results could materially differ from those anticipated by such forward-looking statements. Such differences could be caused by a number of factors or combination of factors including, but not limited to, the factors identified below and those discussed under the captions "Part II - Item 1A - Risk Factors" herein and Item 1A, "Risk Factors", of the Company's Annual Report on Form 10-K for the year ended December 31, 2021 (the "Annual Report"). Readers are strongly encouraged to consider these factors and the following factors when evaluating any forward-looking statements concerning the Company: public health threats or outbreaks of communicable diseases, such as the ongoing COVID-19 pandemic (including its variants) and its impact on KCS's business, suppliers, consumers, customers, employees and supply chains; rail accidents or other incidents or accidents on KCS's rail network or at KCS's facilities or customer facilities involving the release of hazardous materials, including toxic inhalation hazards; legislative and regulatory developments and disputes, including tax disputes and environmental regulations; loss of the rail concession of Kansas City Southern's subsidiary, Kansas City Southern de México, S.A. de C.V.; North American and global economic, political and social conditions; disruptions to the Company's technology infrastructure, including its computer systems; increased demand and traffic congestion; the level of trade between the United States and Asia or Mexico; fluctuations in the peso-dollar exchange rate; natural events such as severe weather, hurricanes and floods; the outcome of claims and litigation involving the Company or its subsidiaries; changes in business strategy and strategic opportunities; competition and consolidation within the transportation industry; the business environment in industries that produce and use items shipped by rail; the termination of, or failure to renew, agreements with customers, other railroads and third parties; the satisfaction of by third parties of their obligations; fluctuation in prices or availability of key materials, fluctuations in commodity demand; in particular diesel fuel; insurance coverage limitations; access to capital; sufficiency of budgeted capital expenditures in carrying out business plans; services infrastructure; climate change and the market and regulatory responses to climate change; dependency on certain key suppliers of core rail equipment; changes in securities and capital markets; unavailability of qualified personnel; difficulty attracting, motivating, and retaining executives and other key employees due to the uncertainty of the merger transaction with Canadian Pacific Railway Limited ("CP"); significant demands placed on the Company as a result of the merger of the Company with CP; labor difficulties, including strikes and work stoppages; acts of terrorism or risk of terrorist activities, war or other acts of violence; and other factors affecting the operation of the business. For more discussion about each risk factor, see "Part II - Item 1A - Risk Factors" herein and Part I, Item 1A - "Risk Factors" in the Company's Annual Report and "Management's Discussion and Analysis of Financial Condition and Results of Operations" herein and in the Company's Annual Report, in each case as updated by the Company's periodic filings with the SEC.

Forward-looking statements reflect the information only as of the date on which they are made. The Company does not undertake any obligation to update any forward-looking statements to reflect future events, developments, or other information. If KCS does update one or more forward-looking statements, no inference should be drawn that additional updates will be made regarding that statement or any other forward-looking statements.

This discussion is intended to clarify and focus on KCS's results of operations, certain changes in its financial position, liquidity, capital structure and business developments for the periods covered by the consolidated financial statements included under Item 1 of this Quarterly Report on Form 10-Q for the quarter ended September 30, 2022. This discussion should be read in conjunction with those consolidated financial statements and the related notes and is qualified by reference to them.

Critical Accounting Policies and Estimates

The Company's discussion and analysis of its financial position and results of operations is based upon its consolidated financial statements. The preparation of these consolidated financial statements requires estimation and judgment that affect the reported amounts of revenue, expenses, assets and liabilities. The Company bases its estimates on historical experience and on various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the accounting for assets and liabilities that are not readily apparent from other sources. If the estimates differ materially from actual results, the impact on the consolidated financial statements may be material. The Company's critical accounting policies are disclosed in its 2021 Annual Report.

Overview

The Company is engaged primarily in the freight rail transportation business, operating a single coordinated rail network under one reportable business segment. The primary operating subsidiaries of the Company consist of the following: The Kansas City Southern Railway Company (“KCSR”), Kansas City Southern de México, S.A. de C.V. (“KCSM”), Meridian Speedway, LLC (“MSLLC”), and The Texas Mexican Railway Company (“TexMex”). The Company generates revenues and cash flows by providing customers with freight delivery services both within its regions and throughout North America through connections with other Class I rail carriers. KCS’s customers conduct business in a number of different industries, including chemical and petroleum, industrial and consumer products, agriculture and minerals, energy, automotive, and intermodal transportation. Appropriate eliminations and reclassifications have been recorded in preparing the consolidated financial statements.

Merger Agreement

On September 15, 2021, KCS and CP entered into a merger agreement (the “Merger Agreement”) and on December 14, 2021, CP acquired the outstanding common and preferred stock of KCS. Each share of common stock, par value \$0.01 per share, of KCS that was outstanding immediately prior to the merger was converted into the right to receive (1) 2.884 common shares of CP and (2) \$90 in cash (together, the “Merger Consideration”), and each share of preferred stock, par value \$25 per share, that was outstanding immediately prior to the merger was converted into the right to receive \$37.50 in cash. The Merger Consideration value received by KCS stockholders was \$301.20 per KCS common share.

The merger transaction was completed through a series of mergers as outlined in the Merger Agreement. These mergers ultimately resulted in KCS being merged with and into Cygnus Merger Sub 1 Corporation (“Surviving Merger Sub”), a wholly owned subsidiary of CP, with Surviving Merger Sub continuing as the surviving entity. Pursuant to the Merger Agreement, Surviving Merger Sub was renamed “Kansas City Southern” and as successor company of KCS, continued to own the assets of KCS. Immediately following the consummation of the mergers, CP caused the contribution, directly and indirectly, of all of the outstanding shares of capital stock of Surviving Merger Sub, as successor to KCS, to be deposited into an independent, irrevocable voting trust (the “Voting Trust”) under a voting trust agreement (the “Voting Trust Agreement”) approved by the U.S. Surface Transportation Board (“STB”), pending receipt of the final and non-appealable approval or exemption by the STB pursuant to 49 U.S.C. § 11323 et seq., of the transactions contemplated by the Merger Agreement (“STB Final Approval”). The Voting Trust prevents CP, or any affiliate of CP, from controlling or having the power to control KCS prior to STB Final Approval. Following receipt of STB Final Approval, the Voting Trust will be terminated and CP will acquire control over KCS’s railroad operations. STB Final Approval is expected to be granted in the first quarter of 2023, subject to the regulatory review process.

On December 14, 2021, the merger of KCS and Surviving Merger Sub was accounted for as a recapitalization of KCS’s equity. Upon STB Final Approval, the transaction will be accounted for as a business combination using the acquisition method of accounting.

Pursuant to the Merger Agreement, KCS paid a cash dividend in the first and third quarters of 2022 of \$265.0 million and \$200.0 million, respectively, to a wholly-owned subsidiary of CP. On October 26, 2022, the Company’s Board of Directors declared a cash dividend of up to \$225.0 million, to be paid to a wholly-owned subsidiary of CP on October 31, 2022. Periodic cash distributions may be made to a wholly-owned subsidiary of CP based upon cash generated, the timing of capital expenditures and working capital needs of the Company.

For the three and nine months ended September 30, 2022, KCS reported \$11.5 million and \$36.8 million, respectively, of merger-related costs, which primarily related to incentive compensation costs. During the three and nine months ended September 30, 2021, the Company recognized merger-related costs of \$36.5 million and \$776.6 million, respectively. For the three months ended September 30, 2021, the merger costs primarily related to compensation and benefits costs and legal fees. For the nine months ended September 30, 2021, merger costs included the fee associated with the termination of the CN merger agreement by KCS of \$700.0 million, in addition to compensation and benefits costs and bankers’ and legal fees. These costs were recognized in merger costs, net within the consolidated statements of operations.

Ukraine Crisis

The invasion of Ukraine by Russia in February 2022 has led to disruption, instability, and volatility in global markets and industries. The U.S. government and other foreign governments have imposed severe economic sanctions and export controls against Russia, certain regions of Ukraine and particular entities and individuals, removed Russia from the Society for Worldwide Interbank Financial Telecommunication (“SWIFT”) system, and may impose additional sanctions and controls. The full impact of these sanctions and controls, as well as responses to them by Russia has and could in the future result in, among other things, severe or complete restrictions on exports to and other commerce and business dealings involving Russia, certain regions of Ukraine, and/or particular entities and individuals. In addition, this ongoing invasion has caused energy prices to rise, leading to increased inflationary impacts. To date, the Company has not experienced a material impact to operations or the consolidated financial statements as a result of the invasion of Ukraine; however, KCS will continue to monitor for events that could materially impact the Company.

Inflation

U.S. consumer price inflation rose at its fastest pace in over 40 years and Mexico inflation reached levels not seen for 20 years. Consumer price annual inflation rates as of September 30, 2022 were 8.2% and 8.7% in the U.S. and Mexico, respectively. KCS continues to closely monitor the impact of rapidly increasing inflation on the Company's financial results and procurement supply chain. As of September 30, 2022, higher inflation has not had a material impact on the Company's financial results. Additionally, supply chain disruptions have not materially impacted the Company's ability to procure essential materials and services on a timely basis.

Inflation is expected to remain elevated for the near future. Inflationary factors, such as increases in interest rates, overhead costs and transportation costs may adversely affect the Company's financial results. Although the Company does not believe that inflation has had a material impact on KCS's financial results to date, the Company may experience some effect in the near future due to supply chain constraints, consequences associated with COVID-19, and the ongoing invasion of Ukraine by Russia, employee availability and wage increases.

Third Quarter Highlights

For the three months ended September 30, 2022, revenues increased 19% compared to the same period in 2021, primarily due to a 10% increase in carload/unit volumes and an 8% increase in revenue per carload/unit. Volumes increased due to partial recovery of the global microchip shortage, strong demand, new business, and new steel plants that opened on the KCSM network in 2021. These increases were partially offset by decreased volumes in chemicals and petroleum refined fuel products due to regulatory impacts. Revenue per carload/unit increased due to higher fuel surcharge, positive pricing impacts, and longer average length of haul, partially offset by mix and unfavorable foreign currency impacts.

Operating expenses increased 13% during the three months ended September 30, 2022, as compared to the same period in 2021, primarily due to higher diesel fuel prices, tentative agreements with U.S. unions resulting in incremental estimated retroactive wage and bonus expense, and wage and benefit inflation, partially offset by decreased merger costs. Operating expenses as a percentage of revenues was 63.2% for the three months ended September 30, 2022, compared to 66.1% for the same period in 2021.

Results of Operations

The following summarizes KCS's consolidated statement of operations components (*in millions*):

	Three Months Ended		
	September 30,		
	2022	2021	Change
Revenues	\$ 882.2	\$ 744.0	\$ 138.2
Operating expenses	557.2	492.1	65.1
Operating income	325.0	251.9	73.1
Equity in net earnings (losses) of affiliates	(0.1)	3.8	(3.9)
Interest expense	(38.9)	(39.0)	0.1
Foreign exchange loss	(12.3)	(0.5)	(11.8)
Other income, net	0.2	0.5	(0.3)
Income before income taxes	273.9	216.7	57.2
Income tax expense	72.2	60.2	12.0
Net income	201.7	156.5	45.2
Less: Net income attributable to noncontrolling interest	0.4	0.3	0.1
Net income attributable to Kansas City Southern and subsidiaries	\$ 201.3	\$ 156.2	\$ 45.1

	Nine Months Ended		
	September 30,		Change
	2022	2021	
Revenues	\$ 2,505.9	\$ 2,199.5	\$ 306.4
Operating expenses	1,577.0	2,126.3	(549.3)
Operating income	928.9	73.2	855.7
Equity in net earnings of affiliates	7.9	13.2	(5.3)
Interest expense	(118.0)	(117.1)	(0.9)
Foreign exchange loss	(18.0)	(1.0)	(17.0)
Other income, net	0.3	0.7	(0.4)
Income (loss) before income taxes	801.1	(31.0)	832.1
Income tax expense	217.3	37.1	180.2
Net income (loss)	583.8	(68.1)	651.9
Less: Net income attributable to noncontrolling interest	1.0	1.2	(0.2)
Net income (loss) available to common stockholder(s)	\$ 582.8	\$ (69.3)	\$ 652.1

Operating Metrics

The Company has established the following key metrics to measure precision scheduled railroading (“PSR”) progress and performance:

	Three Months Ended			Nine Months Ended		
	September 30,		Improvement/ (Deterioration)	September 30,		Improvement/ (Deterioration)
	2022	2021		2022	2021	
Gross velocity (mph) (i)	14.1	15.3	(8)%	14.4	13.4	7%
Terminal dwell (hours) (ii)	23.3	21.5	(8)%	21.7	24.9	13%
Train length (feet) (iii)	6,510	6,481	—	6,465	6,690	(3)%
Fuel efficiency (gallons per 1,000 GTM's) (iv)	1.26	1.22	(3)%	1.25	1.24	(1)%

(i) Gross velocity is the average train speed between origin and destination in miles per hour calculated as the sum of the miles traveled divided by the sum of total transit hours. Transit hours are measured as the difference between a train’s origin departure and destination arrival date and times broken down by segment across the train route (includes all time spent including crew changes, terminal dwell, delays, and incidents).

(ii) Terminal dwell is the average amount of time in hours between car arrival to and departure from the yard (excludes cars that move through a terminal on a run-through train, stored, bad ordered, and maintenance-of-way cars). Calculated by dividing the total number of hours cars spent in terminals by the total count of car dwell events.

(iii) Train length is the average length of a train across its reporting stations, including the origin and intermediate stations. Length of a train is the sum of car and locomotive lengths measured in feet.

(iv) Fuel efficiency is calculated by taking locomotive fuel consumed in gallons divided by thousand gross ton miles (“GTM’s”) net of detours with no associated fuel gallons. GTM’s are the movement of one ton of train weight over one mile calculated by multiplying total train weight by distance the train moved. GTM’s exclude locomotive gross ton miles.

For the three months ended September 30, 2022, the decrease in velocity and increase in dwell, as compared to the same period in 2021, were due to congestion and resource pressure in northern Mexico. For the nine months ended September 30, 2022, the improvement in velocity and dwell, as compared to the same period in 2021, were due to efforts to improve network fluidity and customer service, along with other operating initiatives, investments in crew resources and new capacity projects.

Revenues

The following summarizes revenues (*in millions*), carload/unit statistics (*in thousands*) and revenue per carload/unit:

	Revenues			Carloads and Units			Revenue per Carload/Unit		
	Three Months Ended			Three Months Ended			Three Months Ended		
	September 30,			September 30,			September 30,		
	2022	2021	% Change	2022	2021	% Change	2022	2021	% Change
Chemical and petroleum	\$ 204.6	\$ 204.1	—	82.6	86.9	(5%)	\$ 2,477	\$ 2,349	5%
Industrial and consumer products	188.4	159.0	18%	85.9	79.0	9%	2,193	2,013	9%
Agriculture and minerals	167.6	139.8	20%	68.4	67.1	2%	2,450	2,083	18%
Energy	82.9	74.6	11%	73.2	73.4	—	1,133	1,016	12%
Intermodal	121.9	86.9	40%	269.8	231.6	16%	452	375	21%
Automotive	70.1	40.1	75%	34.0	22.4	52%	2,062	1,790	15%
Carload revenues, carloads and units	835.5	704.5	19%	613.9	560.4	10%	\$ 1,361	\$ 1,257	8%
Other revenue	46.7	39.5	18%						
Total revenues (i)	\$ 882.2	\$ 744.0	19%						

(i) Included in revenues:

Fuel surcharge	\$ 147.9	\$ 75.3
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	Revenues			Carloads and Units			Revenue per Carload/Unit		
	Nine Months Ended			Nine Months Ended			Nine Months Ended		
	September 30,			September 30,			September 30,		
	2022	2021	% Change	2022	2021	% Change	2022	2021	% Change
Chemical and petroleum	\$ 592.3	\$ 667.9	(11%)	244.9	291.9	(16%)	\$ 2,419	\$ 2,288	6%
Industrial and consumer products	523.6	437.6	20%	250.2	225.7	11%	2,093	1,939	8%
Agriculture and minerals	503.5	404.1	25%	214.6	193.7	11%	2,346	2,086	12%
Energy	226.4	186.6	21%	203.5	198.1	3%	1,113	942	18%
Intermodal	335.3	259.3	29%	780.6	714.7	9%	430	363	18%
Automotive	190.8	133.6	43%	98.1	76.5	28%	1,945	1,746	11%
Carload revenues, carloads and units	2,371.9	2,089.1	14%	1,791.9	1,700.6	5%	\$ 1,324	\$ 1,228	8%
Other revenue	134.0	110.4	21%						
Total revenues (i)	\$ 2,505.9	\$ 2,199.5	14%						

(i) Included in revenues:

Fuel surcharge	\$ 364.2	\$ 196.0
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For the three months ended September 30, 2022, revenues increased 19% compared to the same period in 2021. Revenues increased due to a 10% increase in carload/unit volumes and an 8% increase in revenue per carload/unit. Volumes increased due to partial recovery of the global microchip shortage, strong demand, new business, and new steel plants that opened on the KCSM network in 2021. These increases were partially offset by decreased volumes in chemicals and petroleum refined fuel products due to regulatory impacts. Revenue per carload/unit increased due to higher fuel surcharge, positive pricing impacts, and longer average length of haul, partially offset by mix and unfavorable foreign currency impacts.

For the nine months ended September 30, 2022, revenues increased 14% compared to the same period in 2021. Revenues increased due to an 8% increase in revenue per carload/unit and a 5% increase in carload/unit volumes. Revenue per carload/unit increased due to higher fuel surcharge, positive pricing impacts, and longer average length of haul, partially offset by mix. Volumes increased due to partial recovery of the global microchip shortage, improved cycle times, strong demand, and new steel plants that

opened on the KCSM network in 2021. These increases were partially offset by decreased volumes in chemicals and petroleum refined fuel products due to regulatory impacts.

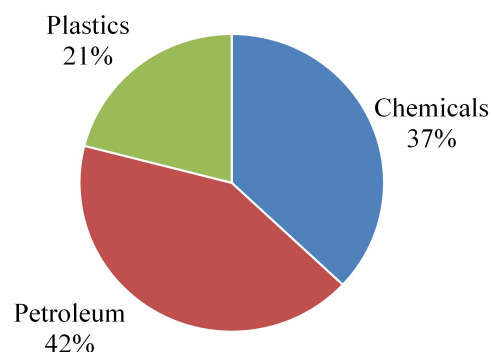
The fluctuations of the Mexican peso against the U.S. dollar during the three and nine months ended September 30, 2022, resulted in a decrease in revenues of approximately \$2.0 million compared to the same periods in 2021, for revenue transactions denominated in Mexican pesos. The average exchange rate of Mexican pesos per U.S. dollar was Ps.20.2 and Ps.20.3 for the three and nine months ended September 30, 2022, respectively, compared to Ps.20.0 and Ps.20.1 for the same periods in 2021.

KCS's fuel surcharges are a mechanism to adjust revenue based upon changes in fuel prices above fuel price thresholds set in KCS's tariffs or contracts. Fuel surcharge revenue is calculated using a fuel price from a prior time period that can be up to 60 days earlier. In a period of volatile fuel prices or changing customer business mix, changes in fuel expense and fuel surcharge revenue may differ.

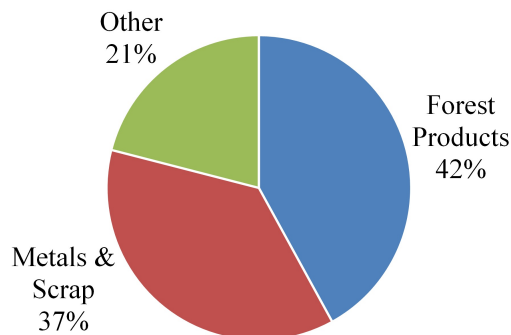
For the three and nine months ended September 30, 2022, fuel surcharge revenue increased \$72.6 million and \$168.2 million, respectively, compared to the same periods in 2021, primarily due to higher fuel prices.

The following discussion provides an analysis of revenues by commodity group:

**Revenues by commodity group
for the three months ended
September 30, 2022**



Chemical and petroleum. Revenues increased \$0.5 million for the three months ended September 30, 2022, compared to the same period in 2021, due to a 5% decrease in carload/unit volumes, offset by a 5% increase in revenue per carload/unit. Revenues decreased \$75.6 million for the nine months ended September 30, 2022, compared to the same period in 2021, due to a 16% decrease in carload/unit volumes, partially offset by a 6% increase in revenue per carload/unit. Volumes decreased due to refined fuel product shipments into Mexico being negatively impacted by supply chain disruptions as a result of increased regulation. Refer to Mexico Regulatory and Legal Updates for further discussion. Revenue per carload/unit increased due to higher fuel surcharge, positive pricing impacts, and mix, partially offset by shorter average length of haul.

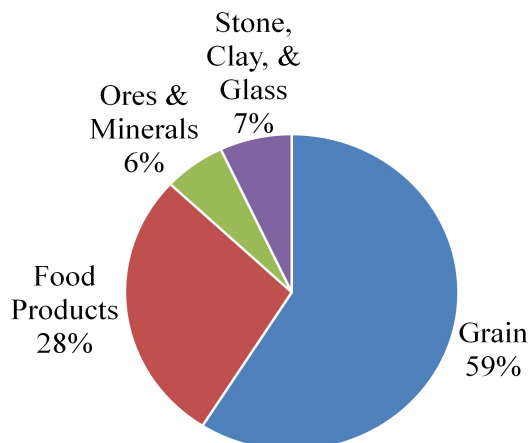


Industrial and consumer products. Revenues increased \$29.4 million for the three months ended September 30, 2022, compared to the same period in 2021, due to a 9% increase in both carload/unit volumes and revenue per carload/unit. Revenues increased \$86.0 million for the nine months ended September 30, 2022, compared to the same period in 2021, due to an 11% increase in carload/unit volumes and an 8% increase in revenue per carload/unit. Metal volumes increased for the three and nine months ended September 30, 2022 due to higher demand and new steel plants that opened on the KCSM network in 2021. Additionally for the three months ended September 30, 2022, volumes increased due to cement shipments in the Mexican market, partially offset by slower paper and appliance shipments due to customer rationalization of inventory. Revenue per carload/unit increased due to higher fuel surcharge, positive pricing impacts, and longer average length of haul, partially offset by mix.

**Revenues by commodity group
for the three months ended
September 30, 2022**

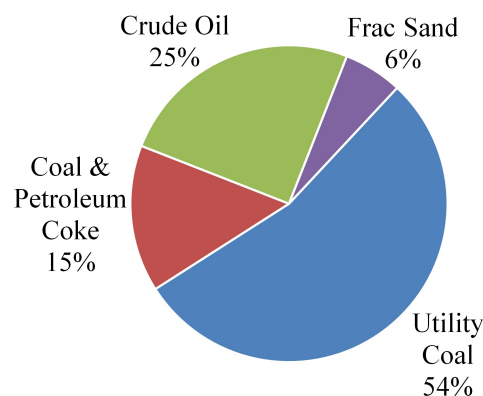
Agriculture and minerals. Revenues increased \$27.8 million for the three months ended September 30, 2022, compared to the same period in 2021, due to an 18% increase in revenue per carload/unit and a 2% increase in carload/unit volumes. Revenue per carload/unit increased due to higher fuel surcharge, positive pricing impacts, mix, and longer average length of haul. Volumes increased due to higher demand.

Revenues increased \$99.4 million for the nine months ended September 30, 2022, compared to the same period in 2021, due to a 12% increase in revenue per carload/unit and an 11% increase in carload/unit volumes. Revenue per carload/unit increased due to higher fuel surcharge, positive pricing impacts, longer average length of haul, and mix. Volumes increased due to improved cycle times and higher demand.



Energy. Revenues increased \$8.3 million for the three months ended September 30, 2022, compared to the same period in 2021, due to a 12% increase in revenue per carload/unit. Revenue per carload/unit increased due to higher fuel surcharge and positive pricing impacts, partially offset by shorter average length of haul and mix.

Revenues increased \$39.8 million for the nine months ended September 30, 2022, compared to the same period in 2021, due to an 18% increase in revenue per carload/unit and a 3% increase in carload/unit volumes. Revenue per carload/unit increased due to higher fuel surcharge, longer average length of haul, and positive pricing impacts, partially offset by mix. Volumes increased in crude oil due to new business, partially offset by a decline in utility coal as a result of deteriorated interchange cycle times and utility plant maintenance outages.



Intermodal. Revenues increased \$35.0 million for the three months ended September 30, 2022, compared to the same period in 2021, due to a 21% increase in revenue per carload/unit and a 16% increase in carload/unit volumes. Revenue per carload/unit increased due to higher fuel surcharge, positive pricing impacts, and mix, partially offset by a shorter average length of haul. Volumes increased due to service interruptions at the Lazaro Cardenas port in Mexico in 2021, new business, a partial recovery of the global microchip shortage affecting auto parts shipments, and stronger demand.

Revenues increased \$76.0 million for the nine months ended September 30, 2022, compared to the same period in 2021, due to an 18% increase in revenue per carload/unit and a 9% increase in carload/unit volumes. Revenue per carload/unit increased due to higher fuel surcharge, mix, and positive pricing impacts. Volumes increased due to stronger demand, a partial recovery of the global microchip shortage affecting auto parts shipments, new business, and service interruptions at Lazaro Cardenas port in Mexico in 2021.

Automotive. Revenues increased \$30.0 million for the three months ended September 30, 2022, compared to the same period in 2021, due to a 52% increase in carload/unit volumes and a 15% increase in revenue per carload/unit. Revenues increased \$57.2 million for the nine months ended September 30, 2022, compared to the same period in 2021, due to a 28% increase in carload/unit volumes and an 11% increase in revenue per carload/unit. Volumes increased for both the three months and nine months ended September 30, 2022, due to partial recovery of the global microchip shortage. For the three months ended September 30, 2022, revenue per carload/

unit increased due to higher fuel surcharge, positive pricing impacts, and longer average length of haul, partially offset by mix. For the nine months ended September 30, 2022, revenue per carload/unit increased due to higher fuel surcharge, positive pricing impacts, longer average length of haul, and mix.

Operating Expenses

Operating expenses, as shown below (*in millions*), increased \$65.1 million for the three months ended September 30, 2022, compared to the same period in 2021, primarily due to higher diesel fuel prices, tentative agreements with U.S. unions resulting in incremental estimated retroactive wage and bonus expense, and wage and benefit inflation, partially offset by decreased merger costs.

Operating expenses, as shown below (*in millions*), decreased \$549.3 million for the nine months ended September 30, 2022, compared to the same period in 2021, primarily due to decreased merger costs related to the termination fee for the termination of the CN merger agreement by KCS of \$700.0 million, partially offset by higher diesel fuel prices, tentative agreements with U.S. unions resulting in incremental estimated retroactive wage and bonus expense, and wage and benefit inflation.

The fluctuations of the Mexican peso against the U.S. dollar during the three and nine months ended September 30, 2022, resulted in an immaterial change compared to the same periods in 2021, for expense transactions denominated in Mexican pesos. The average exchange rate of Mexican pesos per U.S. dollar was Ps.20.2 and Ps.20.3 for the three and nine months ended September 30, 2022, respectively, compared to Ps.20.0 and Ps.20.1 for the same periods in 2021.

	Three Months Ended September 30,		Change	
	2022	2021	Dollars	Percent
Compensation and benefits	\$ 154.4	\$ 133.3	\$ 21.1	16%
Purchased services	57.8	51.4	6.4	12%
Fuel	121.0	78.0	43.0	55%
Equipment costs	25.5	19.6	5.9	30%
Depreciation and amortization	98.2	90.5	7.7	9%
Materials and other	88.8	82.8	6.0	7%
Merger costs, net	11.5	36.5	(25.0)	(68%)
Total operating expenses	<u>\$ 557.2</u>	<u>\$ 492.1</u>	<u>\$ 65.1</u>	<u>13%</u>

	Nine Months Ended September 30,		Change	
	2022	2021	Dollars	Percent
Compensation and benefits	\$ 423.8	\$ 391.2	\$ 32.6	8%
Purchased services	163.6	161.0	2.6	2%
Fuel	341.1	227.9	113.2	50%
Equipment costs	67.2	64.8	2.4	4%
Depreciation and amortization	292.1	273.7	18.4	7%
Materials and other	252.4	231.1	21.3	9%
Merger costs, net	36.8	776.6	(739.8)	(95%)
Total operating expenses	<u>\$ 1,577.0</u>	<u>\$ 2,126.3</u>	<u>\$ (549.3)</u>	<u>(26%)</u>

Compensation and benefits. Compensation and benefits increased \$21.1 million for the three months ended September 30, 2022, compared to the same period in 2021, due to tentative agreements on the U.S. 2020 collective bargaining round resulting in estimated retroactive union wages and bonuses of approximately \$9.0 million. In addition, compensation and benefits increased due to wage and benefit inflation of approximately \$9.0 million, increased headcount and hours worked of approximately \$4.0 million, and increased incentive compensation of approximately \$2.0 million, partially offset by lower costs relating to Mexican outsourcing reform of approximately \$3.0 million.

Compensation and benefits increased \$32.6 million for the nine months ended September 30, 2022, compared to the same period in 2021, due to wage and benefit inflation of approximately \$20.0 million, increase in headcount and hours worked of approximately \$9.0 million, and tentative agreements on the U.S. 2020 collective bargaining round resulting in estimated retroactive union wages and bonuses of approximately \$9.0 million, partially offset by decreased incentive compensation of approximately \$6.0 million.

The Company expects compensation and benefits will increase in 2023, as compared to 2022, by approximately \$10.0 million due to an increase in U.S. union wages as a result of the tentative agreements on the 2020 collective bargaining round. As of October 26, 2022, six of the twelve unions have ratified their respective agreements; however, the third largest union rejected the tentative agreement. Negotiations will continue with this union and any other union that does not ratify, which could result in compensation and benefits that differs from current estimates upon settlement. See the Collective Bargaining section within Other Matters for further discussion.

Purchased services. Purchased services expense increased \$6.4 million for the three months ended September 30, 2022, compared to the same period in 2021, primarily due to increased corporate services expense of approximately \$4.0 million, increased software and programming expense of approximately \$2.0 million, and increases in repairs and maintenance of approximately \$2.0 million, partially offset by cost reductions of approximately \$4.0 million as a result of Mexico outsourcing reform.

Purchased services expense increased \$2.6 million for the nine months ended September 30, 2022 compared to the same period in 2021, due to increased software and programming expense of approximately \$7.0 million, an increase in repairs and maintenance expense of approximately \$4.0 million, an increase in intermodal lift services of approximately \$3.0 million, and increases in security costs of approximately \$2.0 million, partially offset by cost reductions of approximately \$15.0 million as a result of Mexico outsourcing reform.

Fuel. Fuel increased \$43.0 million for the three months ended September 30, 2022, compared to the same period in 2021, due to higher diesel fuel prices in the U.S. and Mexico of approximately \$26.0 million and \$9.0 million, respectively, increased consumption of approximately \$6.0 million and decreased efficiency of approximately \$2.0 million.

Fuel increased \$113.2 million for the nine months ended September 30, 2022, compared to the same period in 2021, due to higher diesel fuel prices in the U.S. and Mexico of approximately \$74.0 million and \$27.0 million, respectively, increased consumption of approximately \$9.0 million, and decreased efficiency of approximately \$4.0 million, partially offset by the weakening of the Mexican peso against the U.S. dollar of approximately \$1.0 million. The average price per gallon was \$3.61 and \$3.44 for the three and nine months ended September 30, 2022, respectively, compared to \$2.52 and \$2.43 for the same periods in 2021.

Equipment costs. Equipment costs increased \$5.9 million for the three months ended September 30, 2022, compared to the same period in 2021, due to increased car hire expense of approximately \$5.0 million due to increased cycle times and volumes, and higher lease expense of approximately \$1.0 million.

Equipment costs increased \$2.4 million for the nine months ended September 30, 2022, compared to the same period in 2021, due to increased car hire expense of approximately \$2.0 million due to increased volumes.

Depreciation and amortization. Depreciation and amortization expense increased \$7.7 million and \$18.4 million for the three and nine months ended September 30, 2022, respectively, compared to the same periods in 2021, due to a larger asset base and an increase in depreciation rates on equipment as a result of an updated depreciation study.

Materials and other. Materials and other expense increased \$6.0 million for the three months ended September 30, 2022, compared to the same period in 2021, due to increased materials expense of approximately \$7.0 million, including approximately \$3.0 million of material purchases resulting from Mexico outsourcing reform, increased expense of approximately \$3.0 million related to the non-creditable VAT due to VAT law changes in Mexico, and higher employee expenses of approximately \$2.0 million. These increases were partially offset by lower derailments and casualties of approximately \$5.0 million.

Materials and other expense increased \$21.3 million for the nine months ended September 30, 2022, compared to the same period in 2021, due to increased expense of approximately \$11.0 million related to the non-creditable VAT due to VAT law changes in Mexico, increased material purchases resulting from Mexico outsourcing reform of approximately \$10.0 million and higher employee expenses of approximately \$10.0 million. These increases were partially offset by a one-time contract dispute of approximately \$10.0 million recognized in 2021.

Merger costs, net. During the three and nine months ended September 30, 2022, the Company recognized merger costs of \$11.5 million and \$36.8 million, respectively, primarily related to incentive compensation. During the three and nine months ended September 30, 2021, the Company recognized merger costs of \$36.5 million and \$776.6 million, respectively. For the three months ended September 30, 2021, the merger costs primarily related to compensation and benefits costs and legal fees. For the nine months ended September 30, 2021, merger costs included the fee associated with the termination of the CN merger agreement by KCS of \$700.0 million, in addition to compensation and benefits costs and bankers' and legal fees. See Note 2, Merger Agreement for more information.

Non-Operating Income and Expenses

Equity in net earnings (losses) of affiliates. For the three months ended September 30, 2022, equity in net earnings (losses) of affiliates decreased \$3.9 million, compared to the same period in 2021, primarily due to a decrease in net earnings from the operations of Panama Canal Railway Company (“PCRC”) resulting from a gain on insurance recoveries recognized in the third quarter of 2021, and decreased net earnings from unrealized depreciation of investments held in a fifteen percent-owned equity investment.

For the nine months ended September 30, 2022, equity in net earnings of affiliates decreased \$5.3 million, compared to the same period in 2021, primarily due to a decrease in net earnings from the operations of TFCM, S. de R.L de C.V. (“TCM”) due to higher interest and tax expense and decreased net earnings from the operations of PCRC as a result of the aforementioned insurance recoveries in 2021, partially offset by increased net earnings from unrealized appreciation of investments held in a fifteen percent-owned equity investment.

Interest expense. For the three and nine months ended September 30, 2022, interest expense decreased \$0.1 million and increased \$0.9 million, respectively, compared to the same periods in 2021, due to lower and higher average debt balances, respectively. During the three and nine months ended September 30, 2022, the average debt balance (including commercial paper) was \$3,811.7 million and \$3,812.3 million, respectively, compared to \$3,812.4 million and \$3,809.1 million for the same periods in 2021. The average interest rate during the three and nine months ended September 30, 2022 and 2021 was 4.1% for all periods.

Foreign exchange loss. For the three and nine months ended September 30, 2022, the Company incurred a foreign exchange loss of \$12.3 million and \$18.0 million, respectively, compared to a foreign exchange loss of \$0.5 million and \$1.0 million, for the same periods in 2021. Foreign exchange gain (loss) includes the re-measurement and settlement of net monetary assets denominated in Mexican pesos and the gain (loss) on foreign currency derivative contracts.

For the three and nine months ended September 30, 2022, the re-measurement and settlement of monetary assets and liabilities denominated in Mexican pesos resulted in a foreign exchange loss of \$4.2 million and a gain of \$0.9 million, respectively, compared to a loss of \$5.4 million and \$1.8 million for the same periods in 2021.

The Company enters into foreign currency derivative contracts to hedge its net exposure to fluctuations in foreign currency caused by fluctuations in the value of the Mexican peso against the U.S. dollar. For the three and nine months ended September 30, 2022, the Company incurred a foreign exchange loss on foreign currency derivative contracts of \$8.1 million and \$18.9 million, respectively, compared to a gain of \$4.9 million and \$0.8 million, for the same periods in 2021.

Other income, net. Other income, net decreased \$0.3 million and \$0.4 million for the three and nine months ended September 30, 2022, compared to the same periods in 2021, due to a decrease in miscellaneous income.

Income tax expense. Income tax expense increased \$12.0 million for the three months ended September 30, 2022 compared to the same period in 2021, primarily due to higher pre-tax income. Income tax expense increased \$180.2 million for the nine months ended September 30, 2022, compared to the same period in 2021, primarily due to higher pre-tax income resulting from the recognition of the CN termination fee, which was recognized as a discrete tax benefit of \$147.0 million for the nine months ended September 30, 2021.

See the discussion regarding the Company's tax contingencies in Item 1, Financial Statements and Supplementary Data — Note 9, Commitments and Contingencies.

The components of the effective tax rates for the three and nine months ended September 30, 2022, compared to the same periods in 2021, are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2022	2021	2022	2021
Statutory rate in effect	21.0%	21.0%	21.0%	21.0%
Tax effect of:				
Difference between U.S. and foreign tax rate	5.6%	5.5%	5.6%	(123.3%)
Inflation	(2.8%)	(0.6%)	(2.2%)	11.2%
State and local income tax provision, net	1.2%	1.3%	1.3%	(28.1%)
Foreign exchange (i)	0.8%	—	0.9%	(10.2%)
Other, net	0.6%	0.6%	0.5%	9.7%
Effective tax rate	26.4%	27.8%	27.1%	(119.7%)

- (i) The Company's Mexican subsidiaries have net U.S. dollar-denominated monetary liabilities which, for Mexican income tax purposes, are subject to periodic revaluation based on changes in the value of the Mexican peso against the U.S. dollar. This revaluation creates fluctuations in the Company's Mexican income tax expense in the consolidated income statements and the amount of income taxes paid in Mexico. The Company also has net monetary assets denominated in Mexican pesos, that are subject to periodic re-measurement and settlement that creates fluctuations in foreign currency gains and losses in the consolidated income statements. The Company hedges its net exposure to variations in earnings by entering into foreign currency forward contracts. The foreign currency forward contracts involve the Company's agreement to buy or sell pesos at an agreed-upon exchange rate on a future date. Refer to Note 6, Derivative Instruments for more information.

Mexico Regulatory and Legal Updates

Hydrocarbons Law. On May 5, 2021, new legislation pertaining to the transport and handling of hydrocarbons in Mexico became effective. This legislation addresses a wide array of issues related to the storage, transportation and handling of petroleum products, as well as the illegal import of hydrocarbons. The legislation is being challenged in the court system by a number of stakeholders and is currently subject to a court-ordered injunction, resulting in a suspension of the implementation and enforcement of this new law. To date, this law has not had a material effect on the Company or its operations. However, the Company is continuing to monitor this law and is evaluating the effect on the Company and its business operations.

Inspections Related to Imports and Terminals. During 2021, the Ministry of Infrastructure, Communications, and Transportation ("SICT") and other relevant Mexican authorities increased inspections of imports and enforcement of various regulations and permit requirements related to terminal operations, with specific focus on imports of refined products and refined fuel transloading terminals and freight terminals, in order to prevent the illegal importation of refined fuel products. These inspections resulted in delays related to the import of shipments into Mexico as well as the shutdown of several refined fuel terminals in the second half of 2021. The SICT has instructed KCSM to provide railway service only to those terminals that have the applicable permits. If KCSM were to fail to comply with the SICT requirements, the Company could be subject to fines and potential revocation of the Concession. As a result, KCS's freight revenue from refined products decreased in the second half of 2021 and continued to decrease for the nine months ended September 30, 2022. See further discussion in the Revenues section.

Value-Added Tax Law. KCSM is not required to charge its customers value added tax ("VAT") on international import or export transportation services, which prior to 2022 resulted in KCSM paying more VAT on its expenses than it collected from customers. These excess VAT payments are refundable by the Mexican government. Prior to 2019, Mexican companies could offset their monthly refundable VAT balance with other tax obligations. In January 2019, Mexico tax reform eliminated the ability to offset other tax obligations with refundable VAT. Over 2019 through 2021, KCSM generated a refundable VAT balance and filed refund claims with the Servicio de Administración Tributaria (the "SAT"), which have not been refunded.

In November 2021, changes to the VAT law were announced and became effective beginning January 1, 2022. These changes reduced the recoverability of VAT paid by KCSM on its expenditures that support international import transportation service revenues that are not subject to a VAT charge. VAT that is unrecoverable from the Mexican government results in incremental VAT expense for KCSM. Beginning in 2022, KCSM changed certain service offerings to either require VAT to be charged to customers on revenue, or impose a rate increase to offset the incremental VAT expense. These measures implemented by KCSM increased the VAT to be collected from customers and payable to the Mexican government.

As of September 30, 2022 and December 31, 2021, the KCSM refundable VAT balance was \$98.6 million and \$152.2 million, respectively. KCSM has prior favorable Mexican court decisions and a legal opinion supporting its right under Mexican law to recover the refundable VAT balance from the Mexican government and believes the VAT to be fully recoverable. KCSM will recover the refundable VAT balance as VAT billed to customers exceeds creditable VAT charged by vendors. As of September 30, 2022 and December 31, 2021, \$81.0 million and \$78.0 million, respectively, of the refundable VAT balance was classified as a short-term asset.

Carta Porte. In the second quarter of 2021, KCSM was notified by the SAT that shipping companies (cargo airlines, trucks, maritime, railroads, and other similar companies) must include additional bill of lading information (referred to in Mexico as “Carta Porte”) with the invoice for all merchandise shipped in Mexico, including cross-border, international and Mexico domestic shipments. The Carta Porte requirements and deadline were modified several times throughout 2021. The effective date of January 1, 2022 included a three month grace period during which penalties and fines for inaccurate information would not be imposed. In the first quarter of 2022, the grace period was extended to September 30, 2022 and in the third quarter of 2022, the grace period was further extended to December 31, 2022. KCSM adapted its systems to comply with the Carta Porte requirements, which delayed KCSM’s invoicing and cash collections by approximately 60 days in the second and third quarters of 2022.

Failure to comply with Carta Porte requirements subsequent to the grace period could result in penalties and fines imposed by the SAT, shipping delays causing network congestion and delayed invoicing and cash collections. In addition, in the event of repeated noncompliance with Carta Porte requirements, the SAT has the power to shut down operations of a company.

Liquidity and Capital Resources

Overview

The Company focuses its cash and capital resources on investing in the business, shareholder returns and optimizing its capital structure.

The Company believes, based on current expectations, that cash and other liquid assets, operating cash flows, and other available financing resources will be sufficient to fund anticipated operating expenses, capital expenditures, debt service costs, dividends, and other commitments for the foreseeable future.

During the nine months ended September 30, 2022, the Company invested \$361.1 million in capital expenditures. See the Capital Expenditures section for further details.

Pursuant to the Merger Agreement, KCS paid a cash dividend in the first and third quarters of 2022 of \$265.0 million and \$200.0 million, respectively, to a wholly-owned subsidiary of CP. On October 26, 2022, the Company’s Board of Directors declared a cash dividend of up to \$225.0 million, to be paid to a wholly-owned subsidiary of CP on October 31, 2022. KCS plans to make further periodic cash distributions based upon cash generated, the timing of capital expenditures, and working capital needs of the Company.

The Company’s current financing instruments contain restrictive covenants that limit or preclude certain actions; however, the covenants are structured such that the Company expects to have sufficient flexibility to conduct its operations. The Company has been, and expects to continue to be, in compliance with all of its debt covenants. For additional discussion of the agreements representing the indebtedness of KCS, see Note 11, Short-Term Borrowings and Note 12, Long-Term Debt in the “Notes to the Consolidated Financial Statements” section of the Company’s Annual Report on Form 10-K for the year ended December 31, 2021.

KCS believes it has a strong liquidity position to continue business operations and service its debt obligations. The Company has total available liquidity of \$763.8 million as of September 30, 2022, consisting of cash on hand and a revolving credit facility, compared to available liquidity at December 31, 2021 of \$939.3 million.

As of September 30, 2022, the total cash and cash equivalents held outside of the U.S. in foreign subsidiaries was \$89.9 million, after repatriating \$108.3 million during 2022. The Company expects that this cash will be available to fund operations without incurring significant additional income taxes.

On January 1, 2022, KCSM complied with Carta Porte requirements, providing customers with additional bill of lading information with the invoice for all merchandise shipped in Mexico. KCSM adapted its systems to comply with the Carta Porte requirements, which delayed KCSM’s invoicing and cash collections by approximately 60 days in the second and third quarters of 2022, resulting in the accounts receivable as of September 30, 2022 to be elevated compared to historical balances. The Company is targeting its accounts receivable balance to begin decreasing in the fourth quarter of 2022 and returning to historical balance levels during the first quarter of 2023.

Cash Flow Information

Summary cash flow data follows (*in millions*):

	Nine Months Ended September 30,	
	2022	2021
Cash flows provided by (used for):		
Operating activities	\$ 712.9	\$ 830.1
Investing activities	(413.4)	(407.3)
Financing activities	(472.7)	(139.9)
Effect of exchange rate changes on cash	(2.3)	(1.1)
Net increase (decrease) in cash and cash equivalents	(175.5)	281.8
Cash and cash equivalents beginning of year	339.3	188.2
Cash and cash equivalents end of period	<u>\$ 163.8</u>	<u>\$ 470.0</u>

Cash flows from operating activities decreased \$117.2 million for the nine months ended September 30, 2022, compared to the same period in 2021, primarily due to a delay in invoicing and decreased cash collections resulting from implementation of Carta Porte regulations, partially offset by lower Mexican value added tax payments.

Net cash used for investing activities increased \$6.1 million for the nine months ended September 30, 2022, compared to the same period in 2021, primarily due to an increase in capital expenditures of approximately \$3.5 million and an increase of property investments in MSLLC of approximately \$2.8 million.

Net cash used for financing activities increased \$332.8 million for the nine months ended September 30, 2022, compared to the same period in 2021, primarily due to an increase in cash dividend payments. In 2022, \$465.0 million of dividends was paid to a wholly-owned subsidiary of CP.

Capital Expenditures

KCS has funded, and expects to continue to fund capital expenditures with operating cash flows and short and long-term debt.

The following table summarizes capital expenditures by type (*in millions*):

	Nine Months Ended September 30,	
	2022	2021
Roadway capital program	\$ 215.8	\$ 189.2
Locomotives and freight cars	35.1	59.8
Capacity	68.9	81.5
Information technology	35.3	29.5
Positive train control	3.9	12.4
Other	2.1	4.4
Total capital expenditures (accrual basis)	<u>361.1</u>	<u>376.8</u>
Change in capital accruals	20.1	0.9
Total cash capital expenditures	<u>\$ 381.2</u>	<u>\$ 377.7</u>

Supplemental Guarantor Financial Information

The following is a description of the terms and conditions of the guarantees with respect to senior notes for which KCS is an issuer or provides full and unconditional guarantee.

Note Guarantees

As of September 30, 2022, KCS had outstanding \$3,736.2 million principal amount of senior notes due through 2069. KCSR had outstanding \$2.7 million principal amount of senior notes due through 2045 (together, the “Senior Notes”). The senior notes for which KCS is the issuer are unconditionally guaranteed, jointly and severally, on an unsecured senior basis, by each of KCS’s current and future domestic consolidated subsidiaries that from time to time guarantees certain of KCS’s credit agreements, or any other debt of

KCS, or any of KCS's significant subsidiaries that is a guarantor (each, a "Guarantor Subsidiary," and collectively, the "Guarantor Subsidiaries"). In addition, the senior notes for which KCSR is the issuer are unconditionally guaranteed, jointly and severally, on an unsecured senior basis, by KCS and each of its current and future domestic consolidated subsidiaries that from time to time guarantees KCSR's credit agreement, or any other debt of KCSR or any of KCSR's significant subsidiaries that is a Guarantor Subsidiary. The obligations of each Guarantor Subsidiary under its note guarantee are limited as necessary to prevent such note guarantee from constituting a fraudulent conveyance under applicable law. A guarantee of the Senior Notes by KCS or a Guarantor Subsidiary is subject to release in the following circumstances: (i) the sale, disposition, exchange or other transfer (including through merger, consolidation, amalgamation or otherwise) of the capital stock of the Guarantor Subsidiary made in a manner not in violation of the indenture; (ii) the designation of the subsidiary as an "Unrestricted Subsidiary" under the indenture; (iii) the legal defeasance or covenant defeasance of the Senior Notes in accordance with the terms of the indenture; or (iv) the Guarantor Subsidiary ceasing to be KCS's subsidiary as a result of any foreclosure of any pledge or security interest securing KCS's Revolving Credit Facility or other exercise of remedies in respect thereof.

KCSM and any other foreign subsidiaries of KCS do not and will not guarantee the Senior Notes ("Non-Guarantor Subsidiaries").

The following tables present summarized financial information for KCS and the Guarantor Subsidiaries on a combined basis after intercompany transactions have been eliminated, including adjustments to remove the receivable and payable balances, investment in, and equity in earnings from the Non-Guarantor Subsidiaries.

Summarized Financial Information

Income Statements

	KCS and Guarantor Subsidiaries	
	Nine Months Ended September 30, 2022	Twelve Months Ended December 31, 2021
Revenues	\$ 1,336.0	\$ 1,561.3
Operating expenses	854.1	1,200.8
Operating income	481.9	360.5
Income before income taxes	368.8	207.7
Net income	293.5	182.7

Balance Sheets

	KCS and Guarantor Subsidiaries	
	September 30, 2022	December 31, 2021
<i>Assets:</i>		
Current assets	\$ 552.4	\$ 524.6
Property and equipment (including concession assets), net	4,914.3	4,876.5
Other non-current assets	72.3	125.8
<i>Liabilities and equity:</i>		
Current liabilities	\$ 812.3	\$ 316.5
Non-current liabilities	4,550.4	4,942.7
Noncontrolling interest	330.4	328.2

Excluded from current assets in the table above are \$286.8 million and \$199.8 million of current intercompany receivables due to KCS and the Guarantor Subsidiaries from the Non-Guarantor Subsidiaries as of September 30, 2022 and December 31, 2021, respectively. Excluded from current liabilities in the table above are \$207.7 million and \$267.5 million of current intercompany payables due to the Non-Guarantor Subsidiaries from KCS and the Guarantor Subsidiaries as of September 30, 2022 and December 31, 2021, respectively.

The Senior Notes are structurally subordinated to the indebtedness and other liabilities of the Non-Guarantor Subsidiaries. The Non-Guarantor Subsidiaries are separate and distinct legal entities and have no obligation, contingent or otherwise, to pay any amounts due pursuant to the Senior Notes or the indentures, or to make any funds available therefor, whether by dividends, loans, distributions or other payments. Any right that KCS or the Guarantor Subsidiaries have to receive any assets of any of the Non-Guarantor Subsidiaries upon the liquidation or reorganization of any Non-Guarantor Subsidiary, and the consequent rights of holders of Senior Notes to realize proceeds from the sale of any of a Non-Guarantor Subsidiary's assets, would be effectively subordinated to

the claims of such Non-Guarantor Subsidiary's creditors, including trade creditors and holders of preferred equity interests, if any, of such Non-Guarantor Subsidiary. Accordingly, in the event of a bankruptcy, liquidation or reorganization of any of the Non-Guarantor Subsidiaries, the Non-Guarantor Subsidiaries will pay the holders of their debts, holders of preferred equity interests, if any, and their trade creditors before they will be able to distribute any of their assets to KCSR or any Guarantor Subsidiary.

If a Guarantor Subsidiary were to become a debtor in a case under the U.S. Bankruptcy Code or encounter other financial difficulty, under federal or state fraudulent transfer or conveyance law, a court may avoid, subordinate or otherwise decline to enforce its guarantee of the Senior Notes. A court might do so if it is found that when such Guarantor Subsidiary entered into its guarantee of the Senior Notes, or in some states when payments became due under the Senior Notes, such Guarantor Subsidiary received less than reasonably equivalent value or fair consideration and either:

- was insolvent or rendered insolvent by reason of such incurrence;
- was left with unreasonably small or otherwise inadequate capital to conduct its business; or
- believed or reasonably should have believed that it would incur debts beyond its ability to pay.

The court might also avoid the guarantee of the Senior Notes without regard to the above factors, if the court found that a Guarantor Subsidiary entered into its guarantee with actual intent to hinder, delay or defraud its creditors.

A court would likely find that a Guarantor Subsidiary did not receive reasonably equivalent value or fair consideration for its guarantee of the Senior Notes, if such Guarantor Subsidiary did not substantially benefit directly or indirectly from the funding made available by the issuance of the Senior Notes. If a court were to avoid a guarantee of the Senior Notes provided by a Guarantor Subsidiary, holders of the Senior Notes would no longer have any claim against such Guarantor Subsidiary. The measures of insolvency for purposes of these fraudulent transfer or conveyance laws will vary depending upon the law applied in any proceeding to determine whether a fraudulent transfer or conveyance has occurred, such that the Company cannot predict what standards a court would use to determine whether or not a Guarantor Subsidiary was solvent at the relevant time or, regardless of the standard that a court uses, that the guarantee of a Guarantor Subsidiary would not be subordinated to such Guarantor Subsidiary's other debt. As noted above, each guarantee provided by a Guarantor Subsidiary includes a provision intended to limit the Guarantor Subsidiary's liability to the maximum amount that it could incur without causing the incurrence of obligations under its guarantee to be a fraudulent transfer or conveyance. This provision may not be effective to protect those guarantees from being avoided under fraudulent transfer or conveyance law, or it may reduce that Guarantor Subsidiary's obligation to an amount that effectively makes its guarantee worthless, and the Company cannot predict whether a court will ultimately find it to be effective.

On the basis of historical financial information, operating history and other factors, the Company believes that each of the Guarantor Subsidiaries, after giving effect to the issuance of its guarantee of the Senior Notes when such guarantee was issued, was not insolvent, did not have unreasonably small capital for the business in which it engaged and did not and has not incurred debts beyond its ability to pay such debts as they mature. The Company cannot predict, however, as to what standard a court would apply in making these determinations or that a court would agree with the Company's conclusions in this regard.

Other Matters

Collective Bargaining

KCSR participates in industry-wide multi-employer bargaining as a member of the National Carriers' Conference Committee ("NCCC"), as well as local bargaining for agreements that are limited to KCSR's property. Approximately 72% of KCSR employees are covered by collective bargaining agreements. For the 2016 bargaining round, 5-year agreements were reached voluntarily or through the arbitration process during 2017 and 2018 covering all of the participating unions. The terms of these agreements remain in effect until new agreements are reached in the 2020 national bargaining round. In November 2019, KCSR and its unions commenced negotiations in connection with the 2020 collective bargaining round.

On July 15, 2022, President Biden signed an executive order creating a Presidential Emergency Board ("PEB") to assist the railroads and its unions in ongoing national labor negotiations. The PEB reviewed the parties' proposals, held hearings, and issued non-binding settlement recommendations to the President. Under the terms of the PEB, the parties had until September 16, 2022 to reach a voluntary settlement based on those recommendations. On September 15, 2022, the NCCC and unions reached a tentative agreement resulting in the Company recognizing estimated retroactive union wages and bonuses of approximately \$9.0 million in compensation and benefits on the consolidated statements of operations.

The union ratification began in mid-September and is expected to be complete by mid-November. As of October 26, 2022, six of the twelve railroad unions have ratified their respective tentative agreements; however, the third largest union rejected the tentative agreement. The NCCC and this union agreed to continue negotiations through November 19, 2022, before the union seeks other self-help remedies, including strikes or work stoppages. Under the Railway Labor Act, Congress can impose a resolution based upon the PEB recommendations or order trains to operate as usual while the two sides continue to negotiate and ultimately reach a new agreement. A strike or work stoppage could result in a significant disruption of the Company's operations and have significant financial impacts, such as lower revenues and higher operating costs.

For further information, see Compensation and benefits section within Results of Operations - Operating Expenses.

KCSM union employees are covered by one labor agreement, which was signed on April 16, 2012, between KCSM Servicios, a previously wholly-owned subsidiary of KCS that was merged into KCSM in 2021, and the Sindicato de Trabajadores Ferrocarrileros de la República Mexicana (“Mexican Railroad Union”). This labor agreement remains in effect during the period of the Concession for the purpose of regulating the relationship between the parties. Approximately 77% of KCSM employees are covered by this labor agreement. The compensation terms under this labor agreement are subject to renegotiation on an annual basis and all other benefits are subject to negotiation every two years. The parties finalized negotiations over compensation terms and benefits that applied until June 30, 2021, along with other terms, and will remain in effect until new terms have been negotiated.

Union labor negotiations have not historically resulted in any strike, boycott, or other disruption in the Company’s business operations.

Item 3. *Quantitative and Qualitative Disclosures about Market Risk*

There was no material change during the quarter from the information set forth in Part II, Item 7A. “Quantitative and Qualitative Disclosure about Market Risk” in the Annual Report on Form 10-K for the year ended December 31, 2021.

Item 4. *Controls and Procedures*

(a) Disclosure Controls and Procedures

The Company maintains disclosure controls and procedures (as that term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”)) that are designed to ensure that information required to be disclosed in the Company’s reports under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms, and that such information is accumulated and communicated to the Company’s management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosures. Any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. The Company’s management, with the participation of the Company’s Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the design and operation of the Company’s disclosure controls and procedures as of the end of the quarterly period covered by this Quarterly Report on Form 10-Q. Based upon that evaluation, the Company’s Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the fiscal quarter ended September 30, 2022, the design and operation of the Company’s disclosure controls and procedures were effective to accomplish their objectives at a reasonable assurance level.

(b) Changes in Internal Control over Financial Reporting

There have been no changes in the Company’s internal control over financial reporting (as that term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the fiscal quarter ended September 30, 2022 that have materially affected, or are reasonably likely to materially affect, the Company’s internal control over financial reporting.

PART II — OTHER INFORMATION

Item 1. *Legal Proceedings*

For information related to the Company's legal proceedings, see Note 9, Commitments and Contingencies, under Part I, Item 1 of this quarterly report on Form 10-Q.

Item 1A. *Risk Factors*

There were no material changes during the quarter to the Risk Factors disclosed in Item 1A - "Risk Factors" in the Company's Annual Report on Form 10-K for the year ended December 31, 2021.

Item 2. *Unregistered Sales of Equity Securities and Use of Proceeds*

None.

Item 3. *Defaults upon Senior Securities*

None.

Item 4. *Mine Safety Disclosures*

Not applicable.

Item 5. *Other Information*

None.

Item 6. Exhibits

Exhibit No.	Exhibits
10.1*	English translation of amendment no. 6, dated July 14, 2022, of concession title granted by SICT in favor of KCSM, formerly known as FNE, December 2, 1996, as amended February 12, 2001, November 22, 2006, December 31, 2013, December 20, 2017, and April 27, 2018, filed as Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q, filed on July 28, 2022 (File No. 1-4717), is incorporated herein by reference as Exhibit 10.1.
22.1	List of Issuers and Guarantor Subsidiaries, filed as Exhibit 22.1 to the Company's Form 10-Q for the quarter ended March 31, 2020, filed on April 17, 2020 (File No. 1-4717), is incorporated herein by reference as Exhibit 22.1.
31.1*	Principal Executive Officer's Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 is attached to this Form 10-Q as Exhibit 31.1.
31.2*	Principal Financial Officer's Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 is attached to this Form 10-Q as Exhibit 31.2.
32.1**	Principal Executive Officer's Certification furnished Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 is attached to this Form 10-Q as Exhibit 32.1.
32.2**	Principal Financial Officer's Certification furnished Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 is attached to this Form 10-Q as Exhibit 32.2.
101.INS	XBRL Instance Document - the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document.
101.SCH	Inline XBRL Taxonomy Extension Schema Document.
101.CAL	Inline XBRL Taxonomy Extension Calculation Linkbase Document.
101.DEF	Inline XBRL Taxonomy Extension Definition Linkbase Document.
101.LAB	Inline XBRL Taxonomy Extension Label Linkbase Document.
101.PRE	Inline XBRL Taxonomy Extension Presentation Linkbase Document.
104	Cover Page Interactive Data File (formatted as an Inline XBRL document and included in Exhibit 101).

* Filed herewith.

** Furnished herewith.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Company has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized and in the capacities indicated on October 26, 2022.

Kansas City Southern

/s/ MICHAEL W. UPCHURCH

Michael W. Upchurch
Executive Vice President and Chief Financial Officer
(Principal Financial Officer)

/s/ SUZANNE M. GRAFTON

Suzanne M. Grafton
Vice President and Chief Accounting Officer
(Principal Accounting Officer)