# INVESTING *for the* LONG HAUL

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2018 QUARTERLY REVIEW **FOURTH QUARTER**

North America's Railroad

*NEWS RELEASE*

# CN building strong momentum into 2019

### *Q4 results driven by solid top-line growth and significantly improved operating efficiency*

**MONTREAL, Jan. 29, 2019** — CN (TSX: CNR) (NYSE: CNI) today reported its financial and operating results for the fourth quarter and year ended Dec. 31, 2018.

"I'm very pleased with our fourth quarter results and the strong finish to 2018," said JJ Ruest, president and chief executive officer of CN. "With approximately C$1.3 billion of revenue growth in the final three quarters of the year, CN regained its position of strength and demonstrated again its ability to grow at low incremental cost. 2019 will be a year of building on this momentum."

"We are focused on operational productivity and services that resonate with customers," Ruest continued. "In 2019, our record capital program of C$3.9 billion will be focused on investing in the renewal of a more efficient and reliable locomotive fleet, adding network capacity to accommodate our solid pipeline of growth in diverse markets and bringing technology to our Precision Scheduled Railroading."

**Financial results highlights**

***Fourth-quarter 2018 compared to fourth-quarter 2017***

- Revenues of C$3,808 million, an increase of 16 per cent.
- Diluted EPS of C$1.56, a decrease of 55 per cent and adjusted diluted EPS of C$1.49, an increase of 24 per cent. (1) Included in diluted EPS in the fourth quarter of 2017 was a deferred income tax recovery of C$2.35 per diluted share resulting from the enactment of a lower U.S. federal corporate income tax rate.
- Operating margin of 38.1 per cent, an increase of 0.8 points (operating ratio of 61.9 per cent). (2) (3)
- Adjusted operating margin of 38.8 per cent, an increase of 1.5 points (adjusted operating ratio of 61.2 per cent). (1)
- Operating income of C$1,452 million, an increase of 19 per cent. (2)

***Full-year 2018 compared to full-year 2017***

- Revenues of C$14,321 million, an increase of 10 per cent.
- Diluted EPS of C$5.87, a decrease of 19 per cent and adjusted diluted EPS of C$5.50, an increase of 10 per cent. (1) Included in diluted EPS in 2017 was a deferred income tax recovery of C$2.33 per diluted share resulting from the enactment of a lower U.S. federal corporate income tax rate.
- Operating margin of 38.4 per cent, a decrease of 1.8 points (operating ratio of 61.6 per cent). (2) (3)
- Adjusted operating margin of 38.5 per cent, a decrease of 1.7 points (adjusted operating ratio of 61.5 per cent). (1)
- Operating income of C$5,493 million, an increase of five per cent. (2)
- Adjusted return on invested capital (adjusted ROIC) of 15.7 per cent, a decrease of 0.2 points. (1)

## 2019 outlook and shareholder distribution [4]

"With CN-specific growth opportunities, combined with a broadly positive economic backdrop, we expect high single-digit volume growth in 2019 in terms of revenue ton miles (RTMs)," said Ruest.

CN expects to deliver EPS growth in the low double-digit range this year compared to adjusted diluted EPS of C$5.50 in 2018. [1]

The Company's Board of Directors today approved an 18 per cent increase to CN's 2019 quarterly cash dividend, effective for the first quarter of 2019, demonstrating our confidence in the long-term financial health of the Company. In addition, the Company's Board of Directors also approved a new normal course issuer bid that permits CN to purchase, for cancellation, over a 12-month period up to 22 million common shares, starting on Feb. 1, 2019, and ending no later than Jan. 31, 2020.

## Foreign currency impact on results

Although CN reports its earnings in Canadian dollars, a large portion of its revenues and expenses is denominated in U.S. dollars. The fluctuation of the Canadian dollar relative to the U.S. dollar affects the conversion of the Company's U.S.-dollar-denominated revenues and expenses. On a constant currency basis, CN's net income for the three months and year ended Dec. 31, 2018 would have been lower by C$24 million (C$0.03 per diluted share) and higher by C$4 million (C$0.01 per diluted share), respectively. [1]

## Fourth-quarter 2018 revenues, traffic volumes and expenses

Revenues for the quarter increased by 16 per cent to C$3,808 million, when compared to the same period in 2017. Revenues increased for petroleum and chemicals (C$272 million or 50 per cent), intermodal (C$75 million or nine per cent), grain and fertilizers (C$74 million or 13 per cent), coal (C$30 million or 21 per cent), forest products (C$29 million or seven per cent), metals and minerals (C$20 million or five per cent), other revenues (C$13 million or seven per cent), and automotive (C$10 million or five per cent).

The increase in revenues was mainly attributable to higher volumes of petroleum crude and Canadian grain, freight rate increases, higher applicable fuel surcharge rates, and the positive translation impact of a weaker Canadian dollar; partly offset by lower volumes of frac sand.

Carloadings for the quarter increased by five per cent to 1,537 thousand.

RTMs, measuring the weight and distance of rail freight transported by CN, increased by 12 per cent. Rail freight revenue per RTM increased by four per cent.

Operating expenses for the quarter increased by 14 per cent to C$2,356 million, [2] mainly due to higher labor costs mainly as a result of an increase in headcount, and employee termination benefits and severance costs related to a workforce reduction program; higher fuel prices; higher costs as a result of increased volumes of traffic; and the negative translation impact of a weaker Canadian dollar.

## Full-year 2018 revenues, traffic volumes and expenses

Revenues for 2018 increased by 10 per cent to C$14,321 million, when compared to 2017. Revenues increased for petroleum and chemicals (C$452 million or 20 per cent), intermodal (C$265 million or eight per cent), metals and minerals (C$166 million or 11 per cent), grain and fertilizers (C$143 million or six per cent), coal (C$126 million or 24 per cent), forest products (C$98 million or five per cent), other revenues (C$25 million or three per cent), and automotive (C$5 million or one per cent).

The increase in revenues was mainly attributable to freight rate increases, higher applicable fuel surcharge rates and higher volumes of petroleum crude, refined petroleum products, coal, international container traffic and Canadian grain.

Carloadings increased by four per cent to 5,976 thousand.

RTMs increased by five per cent. Rail freight revenue per RTM increased by five per cent, mainly driven by freight rate increases and higher applicable fuel surcharge rates.

Operating expenses increased by 13 per cent to C$8,828 million, (2) mainly due to higher fuel prices, higher costs as a result of increased volumes of traffic and operating performance below 2017 levels.

**(1) Non-GAAP Measures**
CN reports its financial results in accordance with United States generally accepted accounting principles (GAAP). CN also uses non-GAAP measures in this news release that do not have any standardized meaning prescribed by GAAP, including adjusted performance measures, constant currency, free cash flow and adjusted ROIC. These non-GAAP measures may not be comparable to similar measures presented by other companies. For further details of these non-GAAP measures, including a reconciliation to the most directly comparable GAAP financial measures, refer to the attached supplementary schedule, Non-GAAP Measures.

CN's full-year adjusted EPS outlook (4) excludes the expected impact of certain income and expense items. However, management cannot individually quantify on a forward-looking basis the impact of these items on its EPS because these items, which could be significant, are difficult to predict and may be highly variable. As a result, CN does not provide a corresponding GAAP measure for, or reconciliation to, its adjusted EPS outlook.

**(2) Accounting Standard Update (ASU)**
The Company adopted ASU 2017-07: Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost in 2018 on a retrospective basis. Comparative figures have been adjusted to conform to the current presentation. The adoption of ASU 2017-07 had the effect of increasing the Company's operating ratio by 1.9 percentage points and 2.1 percentage points for the three months and year ended Dec. 31, 2018, respectively (2.3 percentage points and 2.4 percentage points for the three months and year ended Dec. 31, 2017, respectively).

**(3) Operating Margin**
Operating margin is defined as operating income as a percentage of revenues.

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

***2019 key assumptions***
CN has made a number of economic and market assumptions in preparing its 2019 outlook. The Company assumes that North American industrial production for the year will increase by approximately two per cent, and assumes U.S. housing starts of approximately 1.28 million units and U.S. motor vehicle sales of approximately 17 million units. For the 2018/2019 crop year, the grain crops in both Canada and the United States were in line with their respective three-year averages. The Company assumes that the 2019/2020 grain crops in both Canada and the United States will be in line with their respective three-year averages. CN assumes total RTMs in 2019 will increase in the high single digits versus 2018. CN assumes continued pricing above inflation. CN assumes that in 2019, the value of the Canadian dollar in U.S. currency will be approximately $0.75, and assumes that in 2019 the average price of crude oil (West Texas Intermediate) will be in the range of US$50 to US$55 per barrel. In 2019, CN plans to invest approximately C$3.9 billion in its capital program, of which C$1.6 billion is targeted toward track and railway infrastructure maintenance.

Forward-looking statements are not guarantees of future performance and involve risks, uncertainties and other factors which may cause the actual results or performance of the Company to be materially different from the outlook or any future results or performance implied by such statements. Accordingly, readers are advised not to place undue reliance on forward-looking statements. Important risk factors that could affect the forward-looking statements include, but are not limited to, the effects of general economic and business conditions; industry competition; inflation, currency and interest rate fluctuations; changes in fuel prices; legislative and/or regulatory developments; compliance with environmental laws and regulations; actions by regulators; increases in maintenance and operating costs; security threats; reliance on technology and related cybersecurity risk; trade restrictions or other changes to international trade arrangements; transportation of hazardous materials; various events which could disrupt operations, including natural events such as severe weather, droughts, fires, floods and earthquakes; climate change; labor negotiations and disruptions; environmental claims; uncertainties of investigations, proceedings or other types of claims and litigation; risks and liabilities arising from derailments; timing and completion of capital programs; and other risks detailed from time to time in reports filed by CN with securities regulators in Canada and the United States. Reference should be made to Management's Discussion and Analysis in CN's annual and interim reports, Annual Information Form and Form 40-F, filed with Canadian and U.S. securities regulators and available on CN's website, for a description of major risk factors.

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

This earnings news release is available on the Company's website at www.cn.ca/financial-results and on SEDAR at www.sedar.com as well as on the U.S. Securities and Exchange Commission's website at www.sec.gov through EDGAR.

CN is a true backbone of the economy whose team of approximately 26,000 railroaders transports more than C$250 billion worth of goods annually for a wide range of business sectors, ranging from resource products to manufactured products to consumer goods, across a rail network of approximately 20,000 route-miles spanning Canada and mid-America. CN – Canadian National Railway Company, along with its operating railway subsidiaries – serves the cities and ports of Vancouver, Prince Rupert, B.C., Montreal, Halifax, New Orleans, and Mobile, Ala., and the metropolitan areas of Toronto, Edmonton, Winnipeg, Calgary, Chicago, Memphis, Detroit, Duluth, Minn./Superior, Wis., and Jackson, Miss., with connections to all points in North America. For more information about CN, visit the Company's website at www.cn.ca.

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# Selected Railroad Statistics - unaudited

| | Three months ended December 31 | | Year ended December 31 | |
|---|---|---|---|---|
| | **2018** | 2017 | **2018** | 2017 |
| **Financial measures** | | | | |
| ***Key financial performance indicators*** [(1)] | | | | |
| Total revenues *($ millions)* | **3,808** | 3,285 | **14,321** | 13,041 |
| Rail freight revenues *($ millions)* | **3,601** | 3,091 | **13,548** | 12,293 |
| Operating income *($ millions)* [(2)] | **1,452** | 1,225 | **5,493** | 5,243 |
| Adjusted operating income *($ millions)* [(3)] | **1,479** | 1,225 | **5,520** | 5,243 |
| Net income *($ millions)* | **1,143** | 2,611 | **4,328** | 5,484 |
| Adjusted net income *($ millions)* [(3)] | **1,093** | 897 | **4,056** | 3,778 |
| Diluted earnings per share *($)* | **1.56** | 3.48 | **5.87** | 7.24 |
| Adjusted diluted earnings per share *($)* [(3)] | **1.49** | 1.20 | **5.50** | 4.99 |
| Free cash flow *($ millions)* [(3)] | **633** | 457 | **2,514** | 2,778 |
| Gross property additions *($ millions)* | **1,264** | 908 | **3,531** | 2,703 |
| Share repurchases *($ millions)* | **463** | 456 | **2,000** | 2,000 |
| Dividends per share *($)* | **0.4550** | 0.4125 | **1.8200** | 1.6500 |
| ***Financial position*** [(1)] | | | | |
| Total assets *($ millions)* | **41,214** | 37,629 | **41,214** | 37,629 |
| Total liabilities *($ millions)* | **23,573** | 20,973 | **23,573** | 20,973 |
| Shareholders' equity *($ millions)* | **17,641** | 16,656 | **17,641** | 16,656 |
| ***Financial ratio*** | | | | |
| Operating ratio *(%)* [(2)] | **61.9** | 62.7 | **61.6** | 59.8 |
| Adjusted operating ratio *(%)* [(3)] | **61.2** | 62.7 | **61.5** | 59.8 |
| **Operational measures** [(4)] | | | | |
| ***Statistical operating data*** | | | | |
| Gross ton miles (GTMs) *(millions)* | **130,792** | 117,599 | **490,414** | 469,200 |
| Revenue ton miles (RTMs) *(millions)* | **66,535** | 59,477 | **248,383** | 237,098 |
| Carloads *(thousands)* | **1,537** | 1,461 | **5,976** | 5,737 |
| Route miles *(includes Canada and the U.S.)* | **19,500** | 19,500 | **19,500** | 19,500 |
| Employees *(end of period)* | **25,720** | 23,945 | **25,720** | 23,945 |
| Employees *(average for the period)* | **26,047** | 23,859 | **25,423** | 23,074 |
| ***Key operating measures*** | | | | |
| Rail freight revenue per RTM *(cents)* | **5.41** | 5.20 | **5.45** | 5.18 |
| Rail freight revenue per carload *($)* | **2,343** | 2,116 | **2,267** | 2,143 |
| GTMs per average number of employees *(thousands)* | **5,021** | 4,929 | **19,290** | 20,335 |
| Operating expenses per GTM *(cents)* [(2)] | **1.80** | 1.75 | **1.80** | 1.66 |
| Labor and fringe benefits expense per GTM *(cents)* [(2)] | **0.60** | 0.57 | **0.58** | 0.54 |
| Diesel fuel consumed *(US gallons in millions)* | **122.8** | 112.2 | **462.7** | 441.4 |
| Average fuel price *($/US gallon)* | **3.35** | 2.98 | **3.32** | 2.74 |
| GTMs per US gallon of fuel consumed | **1,065** | 1,048 | **1,060** | 1,063 |
| Car velocity *(car miles per day)* | **204** | 185 | **188** | 211 |
| Through dwell *(hours)* [(5)] | **7.5** | 8.8 | **8.3** | 7.7 |
| Through network train speed *(miles per hour)* [(5)] | **18.6** | 18.8 | **18.0** | 20.3 |
| Locomotive utilization *(trailing GTMs per total horsepower)* | **211** | 220 | **208** | 225 |
| ***Safety indicators*** [(6)] | | | | |
| Injury frequency rate *(per 200,000 person hours)* | **1.90** | 2.16 | **1.81** | 1.83 |
| Accident rate *(per million train miles)* | **1.56** | 2.18 | **2.02** | 1.83 |

*(1) Amounts expressed in Canadian dollars and prepared in accordance with United States generally accepted accounting principles (GAAP), unless otherwise noted.*

*(2) The Company adopted Accounting Standards Update (ASU) 2017-07: Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost in the first quarter of 2018 on a retrospective basis. Comparative figures have been adjusted to conform to the current presentation. See Note 2 - Recent accounting pronouncements to CN's 2018 unaudited Interim Consolidated Financial Statements for additional information.*

*(3) See supplementary schedule entitled Non-GAAP Measures for an explanation of these non-GAAP measures.*

*(4) Statistical operating data, key operating measures and safety indicators are unaudited and based on estimated data available at such time and are subject to change as more complete information becomes available. Definitions of these indicators are provided on our website, www.cn.ca/glossary.*

*(5) The Company no longer reports Terminal dwell and Train velocity, and has replaced these measures with Through dwell and Through network train speed, respectively. Comparative figures have been adjusted to conform to the current presentation.*

*(6) Based on Federal Railroad Administration (FRA) reporting criteria.*

## Supplementary Information – unaudited

| | Three months ended December 31 | | | | Year ended December 31 | | | |
|---|---|---|---|---|---|---|---|---|
| | **2018** | 2017 | % Change Fav (Unfav) | % Change at constant currency Fav (Unfav) (1) | **2018** | 2017 | % Change Fav (Unfav) | % Change at constant currency Fav (Unfav) (1) |
| **Revenues *($ millions)*** (2) | | | | | | | | |
| Petroleum and chemicals | **815** | 543 | 50% | 46% | **2,660** | 2,208 | 20% | 20% |
| Metals and minerals | **397** | 377 | 5% | 3% | **1,689** | 1,523 | 11% | 11% |
| Forest products | **466** | 437 | 7% | 4% | **1,886** | 1,788 | 5% | 6% |
| Coal | **175** | 145 | 21% | 19% | **661** | 535 | 24% | 24% |
| Grain and fertilizers | **659** | 585 | 13% | 11% | **2,357** | 2,214 | 6% | 7% |
| Intermodal | **891** | 816 | 9% | 8% | **3,465** | 3,200 | 8% | 8% |
| Automotive | **198** | 188 | 5% | 2% | **830** | 825 | 1% | 1% |
| *Total rail freight revenues* | **3,601** | 3,091 | 16% | 14% | **13,548** | 12,293 | 10% | 10% |
| Other revenues | **207** | 194 | 7% | 4% | **773** | 748 | 3% | 3% |
| *Total revenues* | **3,808** | 3,285 | 16% | 13% | **14,321** | 13,041 | 10% | 10% |
| **Revenue ton miles (RTMs) *(millions)*** (3) | | | | | | | | |
| Petroleum and chemicals | **16,113** | 10,697 | 51% | 51% | **50,722** | 44,375 | 14% | 14% |
| Metals and minerals | **6,069** | 6,833 | (11%) | (11%) | **27,993** | 27,938 | —% | —% |
| Forest products | **7,115** | 7,418 | (4%) | (4%) | **29,918** | 30,510 | (2%) | (2%) |
| Coal | **5,011** | 3,866 | 30% | 30% | **17,927** | 14,539 | 23% | 23% |
| Grain and fertilizers | **16,148** | 14,590 | 11% | 11% | **57,819** | 56,123 | 3% | 3% |
| Intermodal | **15,237** | 15,127 | 1% | 1% | **60,120** | 59,356 | 1% | 1% |
| Automotive | **842** | 946 | (11%) | (11%) | **3,884** | 4,257 | (9%) | (9%) |
| *Total RTMs* | **66,535** | 59,477 | 12% | 12% | **248,383** | 237,098 | 5% | 5% |
| **Rail freight revenue / RTM *(cents)*** (2) (3) | | | | | | | | |
| Petroleum and chemicals | **5.06** | 5.08 | —% | (3%) | **5.24** | 4.98 | 5% | 5% |
| Metals and minerals | **6.54** | 5.52 | 18% | 16% | **6.03** | 5.45 | 11% | 11% |
| Forest products | **6.55** | 5.89 | 11% | 8% | **6.30** | 5.86 | 8% | 8% |
| Coal | **3.49** | 3.75 | (7%) | (9%) | **3.69** | 3.68 | —% | —% |
| Grain and fertilizers | **4.08** | 4.01 | 2% | —% | **4.08** | 3.94 | 4% | 4% |
| Intermodal | **5.85** | 5.39 | 9% | 7% | **5.76** | 5.39 | 7% | 7% |
| Automotive | **23.52** | 19.87 | 18% | 15% | **21.37** | 19.38 | 10% | 11% |
| *Total rail freight revenue / RTM* | **5.41** | 5.20 | 4% | 2% | **5.45** | 5.18 | 5% | 5% |
| **Carloads *(thousands)*** (3) | | | | | | | | |
| Petroleum and chemicals | **184** | 154 | 19% | 19% | **653** | 614 | 6% | 6% |
| Metals and minerals | **255** | 257 | (1%) | (1%) | **1,030** | 995 | 4% | 4% |
| Forest products | **101** | 102 | (1%) | (1%) | **418** | 424 | (1%) | (1%) |
| Coal | **94** | 76 | 24% | 24% | **346** | 303 | 14% | 14% |
| Grain and fertilizers | **169** | 161 | 5% | 5% | **632** | 619 | 2% | 2% |
| Intermodal | **668** | 647 | 3% | 3% | **2,634** | 2,514 | 5% | 5% |
| Automotive | **66** | 64 | 3% | 3% | **263** | 268 | (2%) | (2%) |
| *Total carloads* | **1,537** | 1,461 | 5% | 5% | **5,976** | 5,737 | 4% | 4% |
| **Rail freight revenue / carload *($)*** (2) (3) | | | | | | | | |
| Petroleum and chemicals | **4,429** | 3,526 | 26% | 22% | **4,074** | 3,596 | 13% | 13% |
| Metals and minerals | **1,557** | 1,467 | 6% | 3% | **1,640** | 1,531 | 7% | 8% |
| Forest products | **4,614** | 4,284 | 8% | 5% | **4,512** | 4,217 | 7% | 7% |
| Coal | **1,862** | 1,908 | (2%) | (4%) | **1,910** | 1,766 | 8% | 8% |
| Grain and fertilizers | **3,899** | 3,634 | 7% | 6% | **3,729** | 3,577 | 4% | 4% |
| Intermodal | **1,334** | 1,261 | 6% | 4% | **1,315** | 1,273 | 3% | 3% |
| Automotive | **3,000** | 2,938 | 2% | (1%) | **3,156** | 3,078 | 3% | 3% |
| *Total rail freight revenue / carload* | **2,343** | 2,116 | 11% | 8% | **2,267** | 2,143 | 6% | 6% |

*(1) See supplementary schedule entitled Non-GAAP Measures for an explanation of this non-GAAP measure.*

*(2) Amounts expressed in Canadian dollars.*

*(3) Statistical operating data and related key operating measures are unaudited and based on estimated data available at such time and are subject to change as more complete information becomes available.*

## Non-GAAP Measures – unaudited

In this supplementary schedule, the "Company" or "CN" refers to Canadian National Railway Company and, as the context requires, its wholly-owned subsidiaries. Financial information included in this schedule is expressed in Canadian dollars, unless otherwise noted.

CN reports its financial results in accordance with United States generally accepted accounting principles (GAAP). The Company also uses non-GAAP measures that do not have any standardized meaning prescribed by GAAP, including adjusted performance measures, constant currency, free cash flow, adjusted debt-to-adjusted EBITDA multiple, return on invested capital (ROIC) and adjusted ROIC. These non-GAAP measures may not be comparable to similar measures presented by other companies. From management's perspective, these non-GAAP measures are useful measures of performance and provide investors with supplementary information to assess the Company's results of operations and liquidity. These non-GAAP measures should not be considered in isolation or as a substitute for financial measures prepared in accordance with GAAP.

## Adjusted performance measures

Management believes that adjusted net income, adjusted earnings per share, adjusted operating income, adjusted operating ratio and adjusted operating margin are useful measures of performance that can facilitate period-to-period comparisons, as they exclude items that do not necessarily arise as part of CN's normal day-to-day operations and could distort the analysis of trends in business performance. In 2018, the Company began disclosing adjusted operating income, adjusted operating ratio and adjusted operating margin. Management uses adjusted performance measures, which exclude certain income and expense items in its results that management believes are not reflective of CN's underlying business operations, to set performance goals and as a means to measure CN's performance. The exclusion of such income and expense items in these measures does not, however, imply that these items are necessarily non-recurring. These measures do not have any standardized meaning prescribed by GAAP and therefore, may not be comparable to similar measures presented by other companies.

For the three months and year ended December 31, 2018, the Company reported adjusted net income of $1,093 million, or $1.49 per diluted share, and $4,056 million, or $5.50 per diluted share, respectively. The adjusted figures for the three months ended December 31, 2018 exclude employee termination benefits and severance costs related to a workforce reduction program of $27 million, or $20 million after-tax ($0.03 per diluted share) and a gain previously deferred on the 2014 disposal of a segment of the Guelph subdivision located between Georgetown and Kitchener, Ontario, together with the rail fixtures and certain passenger agreements (the "Guelph"), of $79 million, or $70 million after-tax ($0.10 per diluted share). The adjusted figures for the year ended December 31, 2018 exclude employee termination benefits and severance costs related to a workforce reduction program of $27 million, or $20 million after-tax ($0.03 per diluted share) and the gains on disposals of property of $338 million, or $292 million after-tax ($0.40 per diluted share), consisting of the following:

- in the fourth quarter, a gain previously deferred on the 2014 disposal of the Guelph, of $79 million, or $70 million after-tax ($0.10 per diluted share);
- in the third quarter, a gain on disposal of property located in Montreal, Quebec (the "Doney and St-Francois Spurs") of $36 million, or $32 million after-tax ($0.04 per diluted share); and
- in the second quarter, a gain on transfer of the Company's capital lease in the passenger rail facilities in Montreal, Quebec, together with its interests in related railway operating agreements (the "Central Station Railway Lease"), of $184 million, or $156 million after-tax ($0.21 per diluted share), and a gain on disposal of land located in Calgary, Alberta, excluding the rail fixtures (the "Calgary Industrial Lead"), of $39 million, or $34 million after-tax ($0.05 per diluted share).

For the three months and year ended December 31, 2017, the Company's adjusted net income was $897 million, or $1.20 per diluted share, and $3,778 million, or $4.99 per diluted share, respectively. The adjusted figures for the three months ended December 31, 2017 exclude a deferred income tax recovery of $1,764 million ($2.35 per diluted share) resulting from the enactment of a lower federal corporate income tax rate due to the U.S. *Tax Cuts and Jobs Act* ("U.S. Tax Reform") and a deferred income tax expense of $50 million ($0.07 per diluted share) resulting from the enactment of higher provincial corporate income tax rates. The adjusted figures for the year ended December 31, 2017 exclude a net deferred income tax recovery of $1,706 million ($2.25 per diluted share) consisting of the following:

- in the fourth quarter, a deferred income tax recovery of $1,764 million ($2.33 per diluted share) resulting from the enactment of the U.S. Tax Reform and a deferred income tax expense of $50 million ($0.07 per diluted share) resulting from the enactment of higher provincial corporate income tax rates;
- in the third quarter, a deferred income tax expense of $31 million ($0.04 per diluted share) resulting from the enactment of a higher state corporate income tax rate;
- in the second quarter, a deferred income tax recovery of $18 million ($0.02 per diluted share) resulting from the enactment of a lower provincial corporate income tax rate; and
- in the first quarter, a deferred income tax recovery of $5 million ($0.01 per diluted share) resulting from the enactment of a lower provincial corporate income tax rate.

## Non-GAAP Measures – unaudited

The following table provides a reconciliation of net income and earnings per share, as reported for the three months and years ended December 31, 2018 and 2017, to the adjusted performance measures presented herein:

| | Three months ended December 31 | | Year ended December 31 | |
|---|---|---|---|---|
| *In millions, except per share data* | **2018** | 2017 | **2018** | 2017 |
| Net income | **$ 1,143** | $ 2,611 | **$ 4,328** | $ 5,484 |
| *Adjustments:* | | | | |
| Operating expenses | **27** | — | **27** | — |
| Other income | **(79)** | — | **(338)** | — |
| Income tax expense (recovery) (1) | **2** | (1,714) | **39** | (1,706) |
| *Adjusted net income* | **$ 1,093** | $ 897 | **$ 4,056** | $ 3,778 |
| Basic earnings per share | **$ 1.57** | $ 3.50 | **$ 5.89** | $ 7.28 |
| *Impact of adjustments, per share* | **(0.07)** | (2.29) | **(0.37)** | (2.26) |
| *Adjusted basic earnings per share* | **$ 1.50** | $ 1.21 | **$ 5.52** | $ 5.02 |
| Diluted earnings per share | **$ 1.56** | $ 3.48 | **$ 5.87** | $ 7.24 |
| *Impact of adjustments, per share* | **(0.07)** | (2.28) | **(0.37)** | (2.25) |
| *Adjusted diluted earnings per share* | **$ 1.49** | $ 1.20 | **$ 5.50** | $ 4.99 |

(1) *The tax effect of adjustments to Other income reflects tax rates in the applicable jurisdiction and the nature of the item for tax purposes.*

The following table provides a reconciliation of operating income, operating ratio and operating margin, as reported for the three months and years ended December 31, 2018 and 2017, to the adjusted performance measures presented herein:

| | Three months ended December 31 | | Year ended December 31 | |
|---|---|---|---|---|
| *In millions, except percentage* | **2018** | 2017 | **2018** | 2017 |
| Operating income (1) | **$ 1,452** | $ 1,225 | **$ 5,493** | $ 5,243 |
| *Adjustment:* Operating expenses | **27** | — | **27** | — |
| *Adjusted operating income* | **$ 1,479** | $ 1,225 | **$ 5,520** | $ 5,243 |
| Operating ratio (1) (2) | **61.9%** | 62.7% | **61.6%** | 59.8% |
| *Impact of adjustment* | **(0.7)-pts** | — | **(0.1)-pts** | — |
| *Adjusted operating ratio* | **61.2%** | 62.7% | **61.5%** | 59.8% |
| Operating margin (1) (3) | **38.1%** | 37.3% | **38.4%** | 40.2% |
| *Impact of adjustment* | **0.7-pts** | — | **0.1-pts** | — |
| *Adjusted operating margin* | **38.8%** | 37.3% | **38.5%** | 40.2% |

(1) *The Company adopted Accounting Standards Update (ASU) 2017-07: Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost in 2018 on a retrospective basis. Comparative figures have been adjusted to conform to the current presentation. See Note 2 - Recent accounting pronouncements to CN's 2018 unaudited Interim Consolidated Financial Statements for additional information.*

(2) *Operating ratio is defined as operating expenses as a percentage of revenues.*

(3) *Operating margin is defined as operating income as a percentage of revenues.*

## Constant currency

Financial results at constant currency allow results to be viewed without the impact of fluctuations in foreign currency exchange rates, thereby facilitating period-to-period comparisons in the analysis of trends in business performance. Measures at constant currency are considered non-GAAP measures and do not have any standardized meaning prescribed by GAAP and therefore, may not be comparable to similar measures presented by other companies. Financial results at constant currency are obtained by translating the current period results denominated in US dollars at the foreign exchange rates of the comparable period in the prior year. The average foreign exchange rates were $1.321 and $1.296 per US$1.00, respectively, for the three months and year ended December 31, 2018, and $1.272 and $1.298 per US $1.00 for the three months and year ended December 31, 2017.

On a constant currency basis, the Company's net income for the three months and year ended December 31, 2018 would have been lower by $24 million ($0.03 per diluted share) and higher by $4 million ($0.01 per diluted share), respectively.

## Non-GAAP Measures – unaudited

### Free cash flow

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

The following table provides a reconciliation of net cash provided by operating activities as reported to free cash flow for the three months and years ended December 31, 2018 and 2017:

| | **Three months ended December 31** | | **Year ended December 31** | |
|---|---|---|---|---|
| *In millions* | **2018** | 2017 | **2018** | 2017 |
| Net cash provided by operating activities | **$ 1,917** | $ 1,349 | **$ 5,918** | $ 5,516 |
| Net cash used in investing activities | **(1,284)** | (892) | **(3,404)** | (2,738) |
| *Free cash flow* | **$ 633** | $ 457 | **$ 2,514** | $ 2,778 |

### Adjusted debt-to-adjusted EBITDA multiple

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

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

| *In millions, unless otherwise indicated* *As at and for the year ended December 31,* | **2018** | 2017 |
|---|---|---|
| Debt | **$ 12,569** | $ 10,828 |
| *Adjustments:* | | |
| Present value of operating lease commitments (1) | **579** | 478 |
| Pension plans in deficiency | **477** | 455 |
| *Adjusted debt* (2) | **$ 13,625** | $ 11,761 |
| Net income | **$ 4,328** | $ 5,484 |
| Interest expense | **489** | 481 |
| Income tax expense (recovery) | **1,354** | (395) |
| Depreciation and amortization | **1,329** | 1,281 |
| *EBITDA* | **7,500** | 6,851 |
| *Adjustments:* | | |
| Other income | **(376)** | (12) |
| Other components of net periodic benefit income | **(302)** | (315) |
| Operating lease expense | **218** | 191 |
| *Adjusted EBITDA* (2) | **$ 7,040** | $ 6,715 |
| Adjusted debt-to-adjusted EBITDA multiple *(times)* | **1.94** | 1.75 |

*(1) Operating lease commitments have been discounted using the Company's implicit interest rate for each of the periods presented.*

*(2) In the first quarter of 2018, the Company redefined adjusted debt to include the present value of operating lease commitments and pension plans in deficiency, and adjusted EBITDA to exclude other income, other components of net periodic benefit income and operating lease expense, in order to better align the Company's definition of adjusted debt-to-adjusted EBITDA multiple with similar measures used by credit rating agencies. Comparative figures have been adjusted to conform to the current definition.*

## Return on invested capital (ROIC) and adjusted ROIC

In 2018, the Company began disclosing ROIC and adjusted ROIC, which management believes are useful measures of the efficiency in the use of capital funds. The Company calculates ROIC as return divided by average invested capital. Return is defined as net income plus interest expense after tax, calculated using the Company's effective tax rate. Average invested capital is defined as the sum of total shareholders' equity, long-term debt and current portion of long-term debt less cash and cash equivalents, and restricted cash and cash equivalents, averaged between the beginning and ending balance over a twelve-month period. The Company calculates adjusted ROIC as adjusted return divided by average invested capital. Adjusted return is defined as adjusted net income plus interest expense after-tax, calculated using the Company's effective tax rate, excluding the tax effect of adjustments used to determine adjusted net income. ROIC and adjusted ROIC do not have any standardized meaning prescribed by GAAP and therefore, may not be comparable to similar measures presented by other companies.

The following table provides a reconciliation of net income and adjusted net income to return and adjusted return, respectively, as well as the calculation of average invested capital, which have been used to calculate ROIC and adjusted ROIC:

| *In millions, except percentage* *As at and for the year ended December 31,* | | **2018** | | 2017 |
|---|---|---|---|---|
| Net income | **$** | **4,328** | $ | 5,484 |
| Interest expense | | **489** | | 481 |
| Tax on interest expense (1) | | **(116)** | | (124) |
| *Return* | **$** | **4,701** | $ | 5,841 |
| Average total shareholders' equity | | **17,149** | | 15,749 |
| Average long-term debt | | **10,067** | | 9,098 |
| Average current portion of long-term debt | | **1,632** | | 1,785 |
| *Less:* Average cash, cash equivalents, restricted cash and restricted cash equivalents | | **(656)** | | (613) |
| *Average invested capital* | **$** | **28,192** | $ | 26,019 |
| ***ROIC*** | | **16.7%** | | 22.4% |
| Adjusted net income (2) | **$** | **4,056** | $ | 3,778 |
| Interest expense | | **489** | | 481 |
| Adjusted tax on interest expense (3) | | **(120)** | | (124) |
| *Adjusted return* | **$** | **4,425** | $ | 4,135 |
| Average invested capital | **$** | **28,192** | $ | 26,019 |
| ***Adjusted ROIC*** | | **15.7%** | | 15.9% |

*(1) The effective tax rate for 2018 used to calculate the tax on interest expense was 23.8% (2017 - 25.8%). Due to the negative effective tax rate reported by the Company in 2017, tax on interest expense for 2017 was calculated using an adjusted effective tax rate.*

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

*(3) The adjusted effective tax rate for 2018 used to calculate the adjusted tax on interest expense was 24.5% (2017 - 25.8%).*

## Consolidated Statements of Income – unaudited

| *In millions, except per share data* | Three months ended December 31 2018 | Three months ended December 31 2017 | Year ended December 31 2018 | Year ended December 31 2017 |
|---|---|---|---|---|
| **Revenues** | **$ 3,808** | $ 3,285 | **$ 14,321** | $ 13,041 |
| **Operating expenses** | | | | |
| Labor and fringe benefits (1) | **791** | 665 | **2,860** | 2,536 |
| Purchased services and material | **527** | 473 | **1,971** | 1,769 |
| Fuel | **466** | 379 | **1,732** | 1,362 |
| Depreciation and amortization | **346** | 316 | **1,329** | 1,281 |
| Equipment rents | **115** | 107 | **467** | 418 |
| Casualty and other | **111** | 120 | **469** | 432 |
| *Total operating expenses* (1) | **2,356** | 2,060 | **8,828** | 7,798 |
| *Operating income* (1) | **1,452** | 1,225 | **5,493** | 5,243 |
| Interest expense | **(122)** | (117) | **(489)** | (481) |
| Other components of net periodic benefit income (1) | **73** | 76 | **302** | 315 |
| Other income | **93** | 4 | **376** | 12 |
| *Income before income taxes* | **1,496** | 1,188 | **5,682** | 5,089 |
| Income tax recovery (expense) *(Note 3)* | **(353)** | 1,423 | **(1,354)** | 395 |
| **Net income** | **$ 1,143** | $ 2,611 | **$ 4,328** | $ 5,484 |
| **Earnings per share** | | | | |
| Basic | **$ 1.57** | $ 3.50 | **$ 5.89** | $ 7.28 |
| Diluted | **$ 1.56** | $ 3.48 | **$ 5.87** | $ 7.24 |
| **Weighted-average number of shares** | | | | |
| Basic | **728.4** | 746.2 | **734.5** | 753.6 |
| Diluted | **731.3** | 750.0 | **737.7** | 757.3 |
| **Dividends declared per share** | **$ 0.4550** | $ 0.4125 | **$ 1.8200** | $ 1.6500 |

*(1) The Company adopted Accounting Standards Update (ASU) 2017-07: Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost in the first quarter of 2018 on a retrospective basis. Comparative figures have been adjusted to conform to the current presentation. See Note 2 - Recent accounting pronouncements for additional information.*

*See accompanying notes to unaudited consolidated financial statements.*

## Consolidated Statements of Comprehensive Income – unaudited

| *In millions* | Three months ended December 31 2018 | Three months ended December 31 2017 | Year ended December 31 2018 | Year ended December 31 2017 |
|---|---|---|---|---|
| Net income | **$ 1,143** | $ 2,611 | **$ 4,328** | $ 5,484 |
| **Other comprehensive income (loss)** | | | | |
| Net gain (loss) on foreign currency translation | **293** | (6) | **403** | (197) |
| Net change in pension and other postretirement benefit plans | **(910)** | (361) | **(759)** | (224) |
| *Other comprehensive loss before income taxes* | **(617)** | (367) | **(356)** | (421) |
| Income tax recovery (expense) | **302** | 105 | **291** | (5) |
| *Other comprehensive loss* | **(315)** | (262) | **(65)** | (426) |
| ***Comprehensive income*** | **$ 828** | $ 2,349 | **$ 4,263** | $ 5,058 |

*See accompanying notes to unaudited consolidated financial statements.*

## Consolidated Balance Sheets – unaudited

| *In millions* | | December 31 2018 | | December 31 2017 |
|---|---|---|---|---|
| **Assets** | | | | |
| ***Current assets*** | | | | |
| Cash and cash equivalents | **$** | **266** | $ | 70 |
| Restricted cash and cash equivalents | | **493** | | 483 |
| Accounts receivable | | **1,169** | | 984 |
| Material and supplies | | **557** | | 424 |
| Other current assets | | **243** | | 229 |
| *Total current assets* | | **2,728** | | 2,190 |
| Properties | | **37,773** | | 34,189 |
| Pension asset | | **446** | | 994 |
| Intangible and other assets | | **267** | | 256 |
| ***Total assets*** | **$** | **41,214** | $ | 37,629 |
| **Liabilities and shareholders' equity** | | | | |
| ***Current liabilities*** | | | | |
| Accounts payable and other | **$** | **2,316** | $ | 1,903 |
| Current portion of long-term debt | | **1,184** | | 2,080 |
| *Total current liabilities* | | **3,500** | | 3,983 |
| Deferred income taxes | | **7,480** | | 6,953 |
| Other liabilities and deferred credits | | **501** | | 590 |
| Pension and other postretirement benefits | | **707** | | 699 |
| Long-term debt | | **11,385** | | 8,748 |
| ***Shareholders' equity*** | | | | |
| Common shares *(Note 4)* | | **3,634** | | 3,613 |
| Common shares in Share Trusts | | **(175)** | | (168) |
| Additional paid-in capital *(Note 4)* | | **408** | | 434 |
| Accumulated other comprehensive loss | | **(2,849)** | | (2,784) |
| Retained earnings *(Note 4)* | | **16,623** | | 15,561 |
| *Total shareholders' equity* | | **17,641** | | 16,656 |
| ***Total liabilities and shareholders' equity*** | **$** | **41,214** | $ | 37,629 |

*See accompanying notes to unaudited consolidated financial statements.*

## Consolidated Statements of Changes in Shareholders' Equity – unaudited

| In millions | Number of common shares Outstanding | Number of common shares Share Trusts | Common shares | Common shares in Share Trusts | Additional paid-in capital | Accumulated other comprehensive loss | Retained earnings | Total shareholders' equity |
|---|---|---|---|---|---|---|---|---|
| *Balance at December 31, 2016* | 762.0 | 1.8 | $ 3,647 | $ (137) | $ 450 | $ (2,358) | $ 13,239 | $ 14,841 |
| Net income | | | | | | | 5,484 | 5,484 |
| Stock options exercised | 1.2 | | 68 | | (10) | | | 58 |
| Settlement of equity settled awards *(Note 4)* | 0.3 | (0.3) | | 24 | (84) | | (22) | (82) |
| Stock-based compensation expense and other | | | | | 78 | | (3) | 75 |
| Repurchase of common shares | (20.4) | | (102) | | | | (1,898) | (2,000) |
| Share purchases by Share Trusts | (0.5) | 0.5 | | (55) | | | | (55) |
| Other comprehensive loss | | | | | | (426) | | (426) |
| Dividends ($1.65 per share) | | | | | | | (1,239) | (1,239) |
| *Balance at December 31, 2017* | 742.6 | 2.0 | 3,613 | (168) | 434 | (2,784) | 15,561 | 16,656 |
| Net income | | | | | | | 4,328 | 4,328 |
| Stock options exercised | 1.7 | | 120 | | (17) | | | 103 |
| Settlement of equity settled awards *(Note 4)* | 0.4 | (0.4) | | 31 | (68) | | (30) | (67) |
| Stock-based compensation expense and other | | | | | 59 | | (2) | 57 |
| Repurchase of common shares | (19.0) | | (99) | | | | (1,901) | (2,000) |
| Share purchases by Share Trusts | (0.4) | 0.4 | | (38) | | | | (38) |
| Other comprehensive loss | | | | | | (65) | | (65) |
| Dividends ($1.82 per share) | | | | | | | (1,333) | (1,333) |
| ***Balance at December 31, 2018*** | **725.3** | **2.0** | **$ 3,634** | **$ (175)** | **$ 408** | **$ (2,849)** | **$ 16,623** | **$ 17,641** |

*See accompanying notes to unaudited consolidated financial statements.*

## Consolidated Statements of Cash Flows – unaudited

| | Three months ended December 31 | | Year ended December 31 | |
|---|---|---|---|---|
| *In millions* | **2018** | 2017 | **2018** | 2017 |
| **Operating activities** | | | | |
| Net income | **$ 1,143** | $ 2,611 | **$ 4,328** | $ 5,484 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | | |
| Depreciation and amortization | **346** | 316 | **1,329** | 1,281 |
| Deferred income taxes | **126** | (1,603) | **527** | (1,195) |
| Gain on disposal of property | **(79)** | — | **(338)** | — |
| Changes in operating assets and liabilities: | | | | |
| Accounts receivable | **26** | 3 | **(91)** | (125) |
| Material and supplies | **13** | (2) | **(120)** | (70) |
| Accounts payable and other | **394** | 118 | **379** | 418 |
| Other current assets | **(37)** | (61) | **14** | (80) |
| Pensions and other, net | **(15)** | (33) | **(110)** | (197) |
| *Net cash provided by operating activities* | **1,917** | 1,349 | **5,918** | 5,516 |
| **Investing activities** | | | | |
| Property additions | **(1,264)** | (878) | **(3,531)** | (2,673) |
| Disposal of property | **—** | — | **194** | — |
| Other, net | **(20)** | (14) | **(67)** | (65) |
| *Net cash used in investing activities* | **(1,284)** | (892) | **(3,404)** | (2,738) |
| **Financing activities** | | | | |
| Issuance of debt | **845** | 423 | **3,268** | 916 |
| Repayment of debt | **(371)** | (777) | **(2,393)** | (841) |
| Change in commercial paper, net | **(348)** | 662 | **99** | 379 |
| Settlement of foreign exchange forward contracts on debt | **15** | 15 | **53** | (15) |
| Issuance of common shares for stock options exercised | **27** | 20 | **103** | 58 |
| Withholding taxes remitted on the net settlement of equity settled awards | **(2)** | (2) | **(51)** | (57) |
| Repurchase of common shares | **(479)** | (473) | **(2,000)** | (2,016) |
| Purchase of common shares for settlement of equity settled awards | **(1)** | (3) | **(16)** | (25) |
| Purchase of common shares by Share Trusts | **(38)** | (55) | **(38)** | (55) |
| Dividends paid | **(331)** | (307) | **(1,333)** | (1,239) |
| *Net cash used in financing activities* | **(683)** | (497) | **(2,308)** | (2,895) |
| Effect of foreign exchange fluctuations on cash, cash equivalents, restricted cash and restricted cash equivalents | **—** | 2 | **—** | (2) |
| *Net increase (decrease) in cash, cash equivalents, restricted cash, and restricted cash equivalents* | **(50)** | (38) | **206** | (119) |
| Cash, cash equivalents, restricted cash, and restricted cash equivalents, beginning of period | **809** | 591 | **553** | 672 |
| ***Cash, cash equivalents, restricted cash, and restricted cash equivalents, end of period*** | **$ 759** | $ 553 | **$ 759** | $ 553 |
| Cash and cash equivalents, end of period | **$ 266** | $ 70 | **$ 266** | $ 70 |
| Restricted cash and cash equivalents, end of period | **493** | 483 | **493** | 483 |
| ***Cash, cash equivalents, restricted cash, and restricted cash equivalents, end of period*** | **$ 759** | $ 553 | **$ 759** | $ 553 |
| **Supplemental cash flow information** | | | | |
| Interest paid | **$ (89)** | $ (104) | **$ (488)** | $ (477) |
| Income taxes paid | **$ (107)** | $ (214) | **$ (776)** | $ (712) |

*See accompanying notes to unaudited consolidated financial statements.*

# Notes to Unaudited Consolidated Financial Statements

## 1 – Basis of presentation

In these notes, the "Company" or "CN" refers to, Canadian National Railway Company and, as the context requires, its wholly-owned subsidiaries.

The accompanying unaudited Interim Consolidated Financial Statements, expressed in Canadian dollars, have been prepared in accordance with United States generally accepted accounting principles (GAAP) for interim financial statements. Accordingly, they do not include all of the disclosures required by GAAP for complete financial statements. In management's opinion, all adjustments (consisting of normal recurring accruals) considered necessary for fair presentation have been included. Interim operating results are not necessarily indicative of the results that may be expected for the full year.

These unaudited Interim Consolidated Financial Statements have been prepared using accounting policies consistent with those used in preparing CN's 2017 Annual Consolidated Financial Statements, except as disclosed in *Note 2 – Recent accounting pronouncements*, and should be read in conjunction with such statements and Notes thereto.

## 2 – Recent accounting pronouncements

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

**ASU 2017-07 Compensation - Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost**

The ASU requires employers that sponsor defined benefit pension plans and/or other postretirement benefit plans to report the service cost component in the same line item or items as other compensation costs. The other components of net periodic benefit cost are required to be presented in the statement of income separately from the service cost component and outside a subtotal of income from operations. The new guidance allows only the service cost component to be eligible for capitalization. The guidance must be applied retrospectively for the presentation of the service cost component and other components of net periodic benefit cost in the statement of income and prospectively for the capitalization of the service cost component of net periodic benefit cost.

The Company adopted this ASU in the first quarter of 2018 with an effective date of January 1, 2018. As a result, the classification of the components of pension and postretirement benefit costs other than current service cost are now shown outside of Operating income in a separate caption entitled Other components of net periodic benefit income in the Company's Consolidated Statements of Income.

As a result of applying this ASU, for the three months and year ended December 31, 2018, operating income was reduced by $73 million and $302 million, respectively ($76 million and $315 million for the three months and year ended December 31, 2017, respectively) with a corresponding increase presented in the new caption below Operating income with no impact on Net income. The guidance allowing only the service cost component to be eligible for capitalization did not have a significant impact on the Company's Consolidated Financial Statements.

**ASU 2016-01 Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities**

The ASU provides guidance for the recognition, measurement, presentation and disclosure of financial instruments. The guidance requires equity investments, except for those accounted for under the equity method or that result in consolidation, to be measured at fair value with changes in fair value recognized in net income. However, an entity may choose to measure equity investments that do not have readily determinable fair value at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or similar investment of the same issuer. The guidance must be applied prospectively by means of a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption.

The Company adopted this ASU in the first quarter of 2018 on a prospective basis with an effective date of January 1, 2018. As a result of applying this ASU, the Company elected to measure all existing equity investments without readily determinable fair values, other than those accounted for using the equity method or that result in consolidation, at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer. The adoption of the ASU did not have a significant impact on the Company's Consolidated Financial Statements.

**ASU 2014-09 Revenue from Contracts with Customers and related amendments (Topic 606)**

The ASU requires entities to recognize revenue when control of the promised goods or services is transferred to customers at an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those goods or services. Additional disclosures are required to assist users of financial statements to understand the nature, amount, timing and uncertainty of revenues and cash flows arising from an entity's contracts. The guidance can be applied using either the retrospective or modified retrospective transition method.

The Company adopted this standard in the first quarter of 2018 with an effective date of January 1, 2018 using the modified retrospective transition method applied to contracts that were not completed as of January 1, 2018. The adoption of this standard did not have an impact on the Company's Consolidated Financial Statements, other than for the new disclosure requirements.

**ASU 2018-02 Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income**

The ASU provides entities the option to reclassify the stranded tax effects resulting from the *Tax Cuts and Jobs Act* ("U.S. Tax Reform") from accumulated other comprehensive income to retained earnings. The guidance also requires certain disclosures about stranded tax effects and a description of the accounting policy for releasing income tax effects from accumulated other comprehensive income. The guidance can either be applied prospectively from the beginning of the period of adoption or retrospectively to each period (or periods) in which the effect of the change in the U.S. federal corporate income tax rate in the U.S. Tax Reform is recognized.

The Company adopted the amendments of this ASU during the fourth quarter of 2018 with an effective date of October 1, 2018. The Company did not elect to reclassify the income tax effects resulting from the U.S. Tax Reform from Accumulated other comprehensive loss to Retained earnings. The adoption of this standard did not have an impact on the Company's Consolidated Financial Statements, other than for the new disclosure requirements.

The following recent ASU issued by FASB has an effective date after December 31, 2018 and has not been adopted by the Company:

**ASU 2016-02 Leases and related amendments (Topic 842)**

The ASU requires a lessee to recognize a right-of-use asset and a lease liability on the balance sheet for all leases greater than twelve months and requires additional qualitative and quantitative disclosures. The lessor accounting model under the new standard is substantially unchanged. The guidance must be applied using a modified retrospective approach. Entities may elect to apply the guidance to each prior period presented with a cumulative-effect adjustment to retained earnings recognized at the beginning of the earliest period presented or to apply the guidance with a cumulative-effect adjustment to retained earnings recognized at the beginning of the period of adoption. The ASU is effective for annual and interim reporting periods beginning after December 15, 2018.

The standard will have a significant impact on the Company's Consolidated Balance Sheets due to the recognition of right-of-use assets and lease liabilities for leases currently classified as operating leases with a term over twelve months. The Company has identified all contracts that contain a lease and has assembled the data necessary to calculate the estimated impact on transition. The Company has implemented a new lease management system and has made changes to processes and internal controls necessary to meet the reporting and disclosure requirements of this standard.

The new standard provides a number of practical expedients and accounting policy elections upon transition. The Company will not elect the package of three practical expedients that permits the Company not to reassess prior conclusions about lease identification, lease classification and initial direct costs. The Company will elect:

- the use-of-hindsight practical expedient to reassess lease term and the likelihood that a purchase option will be exercised;
- the land easement practical expedient to not evaluate land easements that were not previously accounted for as leases under Topic 840;
- the short-term lease exemption for all asset classes that permits entities not to recognize right-of-use assets and lease liabilities onto the balance sheet; and
- the practical expedient to not separate lease and non-lease components for the freight car asset category.

The Company will adopt the requirements of the ASU effective January 1, 2019, using a modified retrospective approach with a cumulative-effect adjustment to Retained earnings recognized on January 1, 2019, with no restatement of the comparative periods' financial information. As at January 1, 2019, the cumulative-effect adjustment required to adopt the new standard will increase the balance of Retained earnings by approximately $30 million. The initial adoption transition adjustment to record right-of-use assets and lease liabilities for leases over twelve months on the Company's Consolidated Balance Sheet will be approximately $750 million.

Other recently issued ASUs required to be applied for periods beginning on or after January 1, 2019 have been evaluated by the Company and will not have a significant impact on the Company's Consolidated Financial Statements.

## 3 - Income taxes

**U.S. Tax Cuts and Job Act**

On December 22, 2017, the President of the United States signed into law the *Tax Cuts and Jobs Act* ("U.S. Tax Reform"). The U.S. Tax Reform reduces the U.S. federal corporate income tax rate from 35% to 21%, effective as of January 1, 2018. The U.S. Tax Reform also allows for immediate capital expensing of new investments in certain qualified depreciable assets made after September 27, 2017, which will be phased down starting in year 2023. As a result of the U.S. Tax Reform, the Company's net deferred income tax liability decreased by $1,764 million for the year ended December 31, 2017.

The U.S. Tax Reform introduced other important changes to U.S. corporate income tax laws that may significantly affect CN in future years including the creation of a new Base Erosion Anti-abuse Tax (BEAT) that subjects certain payments from U.S. corporations to foreign related parties to additional taxes, and limitations to the deduction for net interest expense incurred by U.S. corporations. Since the enactment of the U.S. Tax Reform, U.S. authorities have issued various proposed regulations and preliminary guidance interpreting its provisions. These interpretations have been taken into account and did not affect the calculation of the Company's current year income tax provision and tax payments. However, the U.S. Tax Reform and these proposed regulations are expected to impact the Company’s income tax provisions and tax payments in future years.

## 4 - Share capital

**Additional paid-in capital**

In the fourth quarter of 2018, the Company changed its presentation for the settlement of equity-settled awards when purchasing shares on the open market, on a retrospective basis. Whereas previously upon settlement, the stock-based compensation expense was reclassified from Additional paid-in capital to Common shares and the settlement cost was recorded in Additional paid-in capital, now upon settlement, the Company records in Retained earnings the excess, if any, of the settlement cost of the awards over the related stock-based compensation expense, with no adjustment to Common shares. The Company reclassified prior year balances for Common shares, Additional paid-in capital, and Retained earnings in the Consolidated Balance Sheets to conform with the new presentation. For the years ended December 31, 2017 and 2016, the impact of this reclassification increased Additional paid-in capital by $192 million and $86 million, respectively, decreased Common shares by $167 million and $83 million, respectively, and decreased Retained earnings by $25 million and $3 million, respectively.