## Non-GAAP Measures

### Adjusted performance measures

For the three months ended March 31, 2014, the Company reported adjusted net income of $551 million, or $0.66 per diluted share. The adjusted figures exclude a gain on disposal of the Deux-Montagnes subdivision, including the Mont-Royal tunnel, together with the rail fixtures, of $80 million, or $72 million after-tax ($0.09 per diluted share). For the three months ended March 31, 2013, the Company reported adjusted net income of $519 million, or $0.61 per diluted share. The adjusted figures exclude a gain on disposal of a segment of the Oakville subdivision, together with the rail fixtures and certain passenger agreements, of $40 million, or $36 million after-tax ($0.04 per diluted share).

Management believes that adjusted net income and adjusted earnings per share are useful measures of performance that can facilitate period-to-period comparisons, as they exclude items that do not necessarily arise as part of the normal day-to-day operations of the Company and could distort the analysis of trends in business performance. The exclusion of such items in adjusted net income and adjusted earnings per share does not, however, imply that such items are necessarily non-recurring. These adjusted measures do not have any standardized meaning prescribed by GAAP and therefore, may not be comparable to similar measures presented by other companies. The reader is advised to read all information provided in the Company's 2014 unaudited Interim Consolidated Financial Statements and Notes thereto. The following table provides a reconciliation of net income and earnings per share, as reported for the three months ended March 31, 2014 and 2013, to the adjusted performance measures presented herein.

| | Three months ended March 31, 2014 | | | Three months ended March 31, 2013 | | |
|---|---|---|---|---|---|---|
| *In millions, except per share data* | **Reported** | **Adjustments** | **Adjusted** | **Reported** | **Adjustments** | **Adjusted** |
| Revenues | $ 2,693 | $ - | $ 2,693 | $ 2,466 | $ - | $ 2,466 |
| Operating expenses | 1,873 | - | 1,873 | 1,686 | - | 1,686 |
| *Operating income* | 820 | - | 820 | 780 | - | 780 |
| Interest expense | (92) | - | (92) | (89) | - | (89) |
| Other income | 94 | (80) | 14 | 42 | (40) | 2 |
| *Income before income taxes* | 822 | (80) | 742 | 733 | (40) | 693 |
| Income tax expense | (199) | 8 | (191) | (178) | 4 | (174) |
| *Net income* | **$ 623** | **$ (72)** | **$ 551** | **$ 555** | **$ (36)** | **$ 519** |
| Operating ratio | **69.6%** | | **69.6%** | **68.4%** | | **68.4%** |
| Effective tax rate | **24.2%** | | **25.7%** | **24.3%** | | **25.1%** |
| Basic earnings per share | **$ 0.75** | **$ (0.09)** | **$ 0.66** | **$ 0.65** | **$ (0.04)** | **$ 0.61** |
| Diluted earnings per share | **$ 0.75** | **$ (0.09)** | **$ 0.66** | **$ 0.65** | **$ (0.04)** | **$ 0.61** |

## Non-GAAP Measures

### Constant currency

Although CN conducts its business and reports its earnings in Canadian dollars, a large portion of revenues and expenses is denominated in US dollars. As such, the Company's results are affected by exchange rate fluctuations.

Financial results at "constant currency" allow results to be viewed without the impact of fluctuations in foreign currency exchange rates, thereby facilitating period-to-period comparisons in the analysis of trends in business performance. Measures at constant currency are considered non-GAAP measures and do not have any standardized meaning prescribed by GAAP and therefore, may not be comparable to similar measures presented by other companies. Financial results at constant currency are obtained by translating the current period results denominated in US dollars at the foreign exchange rates of the comparable period of the prior year. The average foreign exchange rates were $1.10 and $1.01 per US$1.00, respectively, for the three months ended March 31, 2014 and 2013.

On a constant currency basis, the Company's net income for the three months ended March 31, 2014 would have been lower by $26 million, or $0.03 per diluted share. The following table presents a reconciliation of 2014 net income as reported to net income on a constant currency basis:

| *In millions* | **Three months ended March 31, 2014** |
|---|---|
| Net income, as reported | **$ 623** |
| Impact due to the weakening Canadian dollar included in net income | **(26)** |
| *Net income, on a constant currency basis* | **$ 597** |

### Free cash flow

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 Company believes that free cash flow is a useful measure of performance as it demonstrates the Company's ability to generate cash. In the past, the Company defined free cash flow as the difference between net cash provided by operating activities and net cash used in investing activities; adjusted for changes in restricted cash and cash equivalents, the payment of dividends, changes in cash and cash equivalents resulting from foreign exchange fluctuations, and the impact of major acquisitions, if any.

Beginning with the fourth quarter of 2013, the Company redefined its free cash flow measure as the difference between net cash provided by operating activities and net cash used in investing activities; adjusted for changes in restricted cash and cash equivalents and the impact of major acquisitions, if any. The Company believes that free cash flow, as redefined, is a better measure of the Company's available cash for debt obligations and for discretionary uses such as payment of dividends and strategic opportunities.

| | **Three months ended March 31** | |
|---|---|---|
| *In millions* | **2014** | 2013 |
| Net cash provided by operating activities | **$ 645** | $ 321 |
| Net cash used in investing activities | **(174)** | (161) |
| *Net cash provided before financing activities* | **471** | 160 |
| *Adjustment:* | | |
| Change in restricted cash and cash equivalents | **23** | (9) |
| *Free cash flow* | **$ 494** | $ 151 |

## Non-GAAP Measures

### Credit measures

Management believes that the adjusted debt-to-total capitalization ratio is a useful credit measure that aims to show the true leverage of the Company. Similarly, the adjusted debt-to-adjusted earnings before interest, income taxes, depreciation and amortization (EBITDA) multiple is another useful credit measure because it reflects the Company's ability to service its debt. The Company excludes Other income in the calculation of EBITDA. However, since these measures do not have any standardized meaning prescribed by GAAP, they may not be comparable to similar measures presented by other companies and, as such, should not be considered in isolation.

***Adjusted debt-to-total capitalization ratio***

| *March 31,* | **2014** | 2013 |
|---|---|---|
| Debt-to-total capitalization ratio (1) | **38.5%** | 40.0% |
| *Add:* Impact of present value of operating lease commitments (2) | **1.6%** | 1.8% |
| *Adjusted debt-to-total capitalization ratio* | **40.1%** | 41.8% |

***Adjusted debt-to-adjusted EBITDA***

| *$ in millions, unless otherwise indicated* *Twelve months ended March 31,* | **2014** | 2013 |
|---|---|---|
| Debt | **$ 8,199** | $ 7,411 |
| *Add:* Present value of operating lease commitments (2) | **575** | 567 |
| *Adjusted debt* | **8,774** | 7,978 |
| Operating income | **3,913** | 3,672 |
| *Add:* Depreciation and amortization | **1,001** | 929 |
| EBITDA (excluding Other income) | **4,914** | 4,601 |
| *Add:* Deemed interest on operating leases | **28** | 29 |
| *Adjusted EBITDA* | **$ 4,942** | $ 4,630 |
| *Adjusted debt-to-adjusted EBITDA* | **1.78 times** | 1.72 times |

*(1) Debt-to-total capitalization is calculated as total long-term debt plus current portion of long-term debt, divided by the sum of total debt plus total shareholders' equity.*

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