Adjusted performance measures

For the three months ended March 31, 2013, the Company reported adjusted net income of $519 million, or $1.22 per diluted share. The adjusted figures exclude the gain on disposal of a segment of the Oakville subdivision, together with the rail fixtures and certain passenger agreements (collectively the "Lakeshore West"), of $40 million, or $36 million after-tax ($0.08 per diluted share). For the three months ended March 31, 2012, the Company reported adjusted net income of $523 million, or $1.18 per diluted share. The adjusted figures exclude the gain on disposal of a segment of the Bala and a segment of the Oakville subdivisions, together with the rail fixtures and certain passenger agreements (collectively the "Bala-Oakville"), of $281 million, or $252 million after-tax ($0.57 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 may, therefore, not be comparable to similar measures presented by other companies. The reader is advised to read all information provided in the Company's 2013 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, 2013 and 2012, to the adjusted performance measures presented herein.

	Three months ended March 31, 2013			Three months ended March 31, 2012		
In millions, except per share data	Reported	Adjustments	Adjusted	Reported	Adjustments	Adjusted
Revenues	$ 2,466	$ -	$ 2,466	$ 2,346	$ -	$ 2,346
Operating expenses	1,686	-	1,686	1,553	-	1,553
Operating income	780	-	780	793	-	793
Interest expense	(89)	-	(89)	(86)	-	(86)
Other income	42	(40)	2	293	(281)	12
Income before income taxes	733	(40)	693	1,000	(281)	719
Income tax expense	(178)	4	(174)	(225)	29	(196)
Net income	**$ 555**	**$ (36)**	**$ 519**	**$ 775**	**$ (252)**	**$ 523**
Operating ratio	**68.4%**		**68.4%**	**66.2%**		**66.2%**
Effective tax rate	**24.3%**		**25.1%**	**22.5%**		**27.3%**
Basic earnings per share	**$ 1.30**	**$ (0.08)**	**$ 1.22**	**$ 1.76**	**$ (0.57)**	**$ 1.19**
Diluted earnings per share	**$ 1.30**	**$ (0.08)**	**$ 1.22**	**$ 1.75**	**$ (0.57)**	**$ 1.18**

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 may, therefore, 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 $1.01 and $1.00 per US$1.00, respectively, for the three months ended March 31, 2013 and 2012. There was minimal impact on the Company's 2013 first quarter net income on a constant currency basis.

Free cash flow

The Company utilized $20 million of free cash flow for the three months ended March 31, 2013 compared to generated $48 million for the same period in 2012. Free cash flow does not have any standardized meaning prescribed by GAAP and may, therefore, 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 after the payment of capital expenditures and dividends. The Company defines free cash flow as the sum of net cash provided by operating activities, adjusted for changes in cash and cash equivalents resulting from foreign exchange fluctuations; and net cash provided by (used in) investing activities, adjusted for changes in restricted cash and cash equivalents, if any, the impact of major acquisitions, if any; and the payment of dividends, calculated as follows:

	Three months ended March 31	
In millions	**2013**	2012
Net cash provided by operating activities	**$ 321**	$ 125
Net cash provided by (used in) investing activities	**(161)**	89
Net cash provided before financing activities	**160**	214
Adjustments:		
Dividends paid	**(183)**	(165)
Change in restricted cash and cash equivalents	**(9)**	-
Effect of foreign exchange fluctuations on US dollar-denominated cash and cash equivalents	**12**	(1)
Free cash flow	**$ (20)**	$ 48

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,	**2013**	2012
Debt-to-total capitalization ratio (1)	**40.0%**	38.2%
Add: Present value of operating lease commitments (2)	**1.8%**	1.7%
Adjusted debt-to-total capitalization ratio	**41.8%**	39.9%

Adjusted debt-to-adjusted EBITDA

$ in millions, unless otherwise indicated — *Twelve months ended March 31,*	**2013**	2012
Debt	**$ 7,411**	$ 6,787
Add: Present value of operating lease commitments (2)	**567**	526
Adjusted debt	**7,978**	7,313
Operating income	**3,672**	3,444
Add: Depreciation and amortization	**929**	896
EBITDA (excluding Other income)	**4,601**	4,340
Add: Deemed interest on operating leases	**29**	29
Adjusted EBITDA	**$ 4,630**	$ 4,369
Adjusted debt-to-adjusted EBITDA	**1.72 times**	1.67 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.