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CANADIAN PACIFIC RAILWAY LTD/CN

Form 10-K

February 15, 2019

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark one)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES AND EXCHANGE ACT OF 1934

For fiscal year ended December 31, 2018

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 **98-0355078**
(State or Other Jurisdiction (IRS Employer
of Incorporation or Organization) Identification
No.)

7550 Ogden Dale Road S.E., **T2C 4X9**
Calgary, Alberta, Canada
(Address of Principal Executive Offices) (Zip Code)

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

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

Title of Each Class **Name of Each Exchange on which Registered**

Common Shares, **New York Stock Exchange**
without par value

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act.

Yes No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§232.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

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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 June 30, 2018, the last business day of the registrant's most recently completed second fiscal quarter, the aggregate market value of the voting stock held by non-affiliates of the registrant, in U.S. dollars, was \$26,091,991,353, based on the closing sales price per share as reported by the New York Stock Exchange on such date.

As of the close of business on February 13, 2019, there were 140,041,483 shares of the registrant's Common Stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Not applicable.

EXPLANATORY NOTE

Canadian Pacific Railway Limited ("CPRL"), a corporation incorporated under the *Canada Business Corporations Act*, qualifies as a foreign private issuer in the U.S. for purposes of *the Securities Exchange Act of 1934*, as amended (the "Exchange Act"). Although as a foreign private issuer the Company is no longer required to do so, the Company currently continues to file annual reports on Form 10-K, quarterly reports on Form 10-Q, and current reports on Form 8-K with the Securities and Exchange Commission ("SEC") instead of filing the reporting forms available to foreign private issuers.

CPRL prepares and files a management information circular and related material under Canadian requirements. As the Company's management information circular is not filed pursuant to Regulation 14A, the Company may not incorporate by reference information required by Part III of this Form 10-K from its management information circular. Accordingly, in reliance upon and as permitted by Instruction G(3) to Form 10-K, the Company will be filing an amendment to this Form 10-K containing the Part III information no later than 120 days after the end of the fiscal year covered by this Form 10-K. All references to our websites contained herein do not constitute incorporation by reference of information contained on such websites and such information should not be considered part of this document.

CANADIAN PACIFIC RAILWAY LIMITED

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PART I

ITEM 1. BUSINESS

Company Overview

Canadian Pacific Railway Limited (“CPRL”), together with its subsidiaries (“CP” or the “Company”), owns and operates a transcontinental freight railway in Canada and the United States (“U.S.”). CP provides rail and intermodal transportation services over a network of approximately 12,500 miles, serving the principal business centres of Canada from Montreal, Quebec, to Vancouver, British Columbia (“B.C.”), and the U.S. Northeast and Midwest regions. CP’s railway network feeds directly into the U.S. heartland from the East and West coasts. Agreements with other carriers extend the Company’s market reach east of Montreal in Canada, through the U.S. and into Mexico. CP transports bulk commodities, merchandise freight and intermodal traffic. For additional information regarding CP’s network and geographical locations, refer to Item 2. Properties.

CPRL was incorporated on June 22, 2001, under the *Canada Business Corporations Act* and controls and owns all of the Common Shares of Canadian Pacific Railway Company (“CPRC”), which was incorporated in 1881 by Letters Patent pursuant to an Act of the Parliament of Canada. CPRL’s registered, executive and corporate head office is located at 7550 Ogden Dale Road S.E., Calgary, Alberta T2C 4X9. CPRL’s Common Shares (the “Common Share”) are listed on the Toronto Stock Exchange (“TSX”) and the New York Stock Exchange (“NYSE”) under the symbol “CP”.

For purposes of this report, all references herein to “CP”, “the Company”, “we”, “our” and “us” refer to CPRL, CPRL and its subsidiaries, CPRL and one or more of its subsidiaries, or one or more of CPRL’s subsidiaries, as the context may require. All references to currency amounts included in this annual report, including the Consolidated Financial Statements, are in Canadian dollars unless specifically noted otherwise.

Strategy

CP is continuing the journey to become the best railway in North America, with a culture of responsibility and accountability focused on five key foundations:

Provide Service: Providing efficient and consistent transportation solutions for the Company’s customers. “Doing what we say we are going to do” is what drives CP in providing a reliable product with a lower cost operating model. Centralized planning aligned with local execution is bringing the Company closer to the customer and accelerating decision-making.

Control Costs: Controlling and removing unnecessary costs from the organization, eliminating bureaucracy and continuing to identify productivity enhancements are the keys to success.

Optimize Assets: Through longer and heavier trains, and improved asset utilization, the Company is moving increased volumes with fewer locomotives and cars while unlocking capacity for future growth potential.

Operate Safely: Each year, CP safely moves millions of carloads of freight across North America while ensuring the safety of our people and the communities through which we operate. Safety is never to be compromised. CP strives for continuous implementation of state-of-the-art safety technology, safety management systems, and safety culture with our employees to ensure safe, efficient operations across our network.

Develop People: CP recognizes that none of the other foundations can be achieved without its people. Every CP employee is a railroader and the Company has established a culture focused on a passion for service with integrity, in everything we do. Coaching and mentoring all employees into becoming leaders will help drive CP forward. During the turnaround, CP transformed its operations by investing in the network and executing a precision scheduled railroading model that lowers costs, optimizes assets, and provides better, more competitive service.

Today, we continue to apply our long-term strategy: leverage our lower cost base, network strengths and improved service to drive sustainable, profitable growth. While the accomplishments during the turnaround were tremendous, CP’s journey to become North America’s best-performing rail carrier is far from over. As a Company, we will remain focused on our next level of service, productivity, and innovation to continue to generate value for our customers and results for our shareholders.

Business Developments

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On October 19, 2018, CPRL announced a new normal course issuer bid ("NCIB"), commencing October 24, 2018, to purchase up to 5.68 million of Common Shares for cancellation before October 23, 2019.

Labour Disruptions - On April 18, 2018, CP received a 72-hour strike notice from the Teamsters Canada Rail Conference - Train & Engine ("TCRC"), representing approximately 3,000 conductors and locomotive engineers, and the International Brotherhood of Electrical Workers ("IBEW"), representing approximately 360 signal maintainers, of their respective plans to strike. At that time, CP commenced its work stoppage contingency plan to ensure a smooth, efficient and safe wind-down of operations.

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On April 20, 2018, CP reached an agreement with TCRC and IBEW to have the Canadian Industrial Relations Board administer a ratification vote on each of CP's final offers, which averted a potential work stoppage. The ratification votes occurred from May 18 to May 25, 2018 and both offers were voted down.

On May 26, 2018, CP received another 72-hour strike notice from TCRC and IBEW, and again CP commenced its work stoppage contingency plans. On May 29, 2018, CP reached a tentative three-year agreement with IBEW and averted strike action by its members. This agreement was ratified by the IBEW membership on June 29, 2018, with 78% of members voting for ratification.

On May 30, 2018, CP reached a tentative four-year agreement with TCRC and ended strike action which began at 22:00 Eastern Standard Time on May 29, 2018. On July 20, 2018, this agreement was also ratified. The wind-down of operations and return to full service levels following the strike notices caused disruption to the network, losses in potential revenue and costs related to labour disruptions in the second quarter.

Change in Executive Officers

On February 14, 2019, the Board of Directors appointed Mr. John Brooks to the position of Executive Vice-President and Chief Marketing Officer ("CMO") from the position of Vice-President and CMO, and Mr. Chad Rolstad to the position of Vice-President, Human Resources from the position of Assistant Vice-President, Human Resources.

On May 25, 2018, Mr. John Derry resigned from his position as Vice-President of Human Resources.

Change in Board of Directors

On December 17, 2018, CP announced that CP Board Chair, Andrew F. Reardon, will retire from CP's Board of Directors as of CP's 2019 Annual General Meeting on May 7, 2019. Isabelle Courville, a current member of the Board, has been designated by the Board as its next chair.

On September 25, 2018, the Company announced the appointment of Edward L. Monser to CP's Board of Directors effective December 17, 2018.

Operations

The Company operates in only one operating segment: rail transportation. Although the Company provides a breakdown of revenue by business line, the overall financial and operational performance of the Company is analyzed as one segment due to the integrated nature of the rail network. Additional information regarding the Company's business and operations, including revenue and financial information, and information by geographic location is presented in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations, and Item 8. Financial Statements and Supplementary Data, Note 26 Segmented and geographic information.

Lines of Business

The Company transports bulk commodities, merchandise freight and intermodal traffic. Bulk commodities, which typically move in large volumes across long distances, include Grain, Coal, Potash, and Fertilizers and sulphur. Merchandise freight consists of industrial and consumer products, such as Energy, chemicals and plastics, Metals, minerals and consumer products, Automotive and Forest products. Intermodal traffic consists largely of retail goods in overseas containers that can be transported by train, ship and truck and in domestic containers and trailers that can be moved by train and truck.

The Company's revenues are primarily derived from transporting freight. The following chart shows the Company's Freight revenue by each line of business in 2018, 2017 and 2016:

2018 Freight Revenues

2017 Freight Revenues 2016 Freight Revenues

In 2018, the Company generated Freight revenues totalling \$7,152 million (\$6,375 million in 2017 and \$6,060 million in 2016). The following charts compare the percentage of the Company's total Freight revenues derived from each of the three major business lines in 2018, 2017 and 2016:

2018 Freight Revenues 2017 Freight Revenues 2016 Freight Revenues

BULK

The Company's Bulk business represented approximately 41% of total Freight revenues in 2018.

The following charts compare the percentage of the Company's Bulk freight revenues by commodity business in 2018, 2017 and 2016:

2018 Bulk Revenues 2017 Bulk Revenues 2016 Bulk Revenues
(41% of Freight Revenues) (44% of Freight Revenues) (44% of Freight Revenues)

Grain

The Company's Grain business represented approximately 53% of Bulk revenues, which is 22% of total Freight revenues in 2018.

The following charts compare the percentage of the Company's Grain freight revenues generated from Canadian and U.S. shipments in 2018, 2017 and 2016:

2018 Grain Revenues

(53% of Bulk Revenues; 22% of Freight Revenues)

2017 Grain Revenues

(54% of Bulk Revenues; 24% of Freight Revenues)

2016 Grain Revenues

(55% of Bulk Revenues; 24% of Freight Revenues)

CP's Grain network is unique among railways in North America as it is strategically positioned in the heart of grain-producing regions of Western Canada and the Northern Plains of the U.S. Canadian grain transported by CP consists of both whole grains, such as wheat, canola, durum, pulses and soybeans, and processed products such as oils, meals and malt. This business is centred in the Canadian Prairies (Alberta, Saskatchewan and Manitoba), with grain shipped primarily west to the Port of Vancouver, and east to the Port of Thunder Bay for export. Grain is also shipped to the U.S., to eastern Canada, and to Mexico for domestic consumption.

Canadian grain includes a division of business that is regulated by the Canadian government through the *Canada Transportation Act* ("CTA"). This regulated business is subject to a maximum revenue entitlement ("MRE"). Under this regulation, railways can set their own rates for individual movements. However, the MRE governs aggregate revenue earned by the railway based on a formula that factors in the total volumes, length of haul, average revenue per ton and inflationary adjustments. The regulation applies to western Canadian export grain shipments to the ports of Vancouver and Thunder Bay.

U.S. grain transported by CP consists of both whole grains, such as wheat, corn, soybeans and durum, and processed products such as meals, oils and flour. This business is centred in the states of Minnesota, North Dakota, South Dakota and Iowa. Grain destined for domestic consumption moves east via Chicago, to the U.S. Northeast or is interchanged with other carriers to the U.S. Pacific Northwest and U.S. Southeast. In partnership with other railways, CP also moves grain to export terminals in the U.S. Pacific Northwest and the Gulf of Mexico. Export grain traffic is also shipped to ports at Superior and Duluth.

Coal

The Company's Coal business represented approximately 23% of Bulk revenues, which is 9% of total Freight revenues in 2018.

The following charts compare the percentage of the Company's Coal freight revenues generated from Canadian and U.S. shipments in 2018, 2017 and 2016:

2018 Coal Revenues

(23% of Bulk Revenues; 9% of Freight Revenues)

2017 Coal Revenues

(22% of Bulk Revenues; 10% of Freight Revenues)

2016 Coal Revenues

(22% of Bulk Revenues; 10% of Freight Revenues)

In Canada, CP handles mostly metallurgical coal destined for export for use in the steelmaking process. CP's Canadian coal traffic originates mainly from Teck Resources Limited's mines in southeastern B.C. CP moves coal west from these mines to port terminals for export to world markets (Pacific Rim, Europe and South America), and east for the U.S. Midwest markets.

In the U.S., CP moves primarily thermal coal from connecting railways, serving the thermal coal fields in the Powder River Basin in Montana and Wyoming, which is delivered to power-generating facilities in the U.S. Midwest.

Potash

The Company's Potash business represented approximately 16% of Bulk revenues, which is 7% of total Freight revenues in 2018.

The following charts compare the percentage of the Company's Potash freight revenues generated from export and domestic potash shipments in 2018, 2017 and 2016:

2018 Potash Revenues

(16% of Bulk Revenues; 7% of Freight Revenues)

2017 Potash Revenues

(15% of Bulk Revenues; 6% of Freight Revenues)

2016 Potash Revenues

(12% of Bulk Revenues; 6% of Freight Revenues)

The Company's Potash traffic moves mainly from Saskatchewan to offshore markets through the ports of Vancouver, Portland and Thunder Bay, and to markets in the U.S. All potash shipments for export beyond Canada and the U.S. are marketed by Canpotex Limited and K+S Potash Canada. Canpotex is a joint venture between Nutrien Ltd. and The Mosaic Company. Independently, these producers move domestic potash with CP primarily to the U.S. Midwest for local application.

Fertilizers and Sulphur

The Company's Fertilizers and sulphur business represented approximately 8% of Bulk revenues, which is 3% of total Freight revenues in 2018.

The following charts compare the percentage of the Company's Fertilizers and sulphur freight revenues generated from dry fertilizers, wet fertilizers and sulphur transportation in 2018, 2017 and 2016:

2018 Fertilizers & Sulphur Revenues

(8% of Bulk Revenues; 3% of Freight Revenues)

2017 Fertilizers & Sulphur Revenues

(9% of Bulk Revenues; 4% of Freight Revenues)

2016 Fertilizers & Sulphur Revenues

(11% of Bulk Revenues; 4% of Freight Revenues)

Dry fertilizers include: phosphate, urea, ammonium sulphate and nitrate. Wet fertilizers are primarily anhydrous ammonia. Roughly half of CP's fertilizer shipments originate from production facilities in Alberta, where abundant sources of natural gas and other chemicals provide feedstock for fertilizer production.

Most sulphur is produced in Alberta as a byproduct of processing sour natural gas, refining crude oil and upgrading bitumen produced in the Alberta oil sands. Sulphur is a raw material used primarily in the manufacturing of sulphuric acid, which is used most extensively in the production of phosphate fertilizers. Sulphuric acid is also a key ingredient in industrial processes ranging from smelting and nickel leaching to paper production.

MERCHANDISE

The Company's Merchandise business represented approximately 37% of total Freight revenues in 2018.

The following charts compare the percentage of the Company's Merchandise freight revenue by commodity business in 2018, 2017 and 2016:

2018 Merchandise Revenues 2017 Merchandise Revenues 2016 Merchandise Revenues

(37% of Freight Revenues)

(35% of Freight Revenues)

(34% of Freight Revenues)

Merchandise products move in trains of mixed freight and in a variety of car types. Service involves delivering products to many different customers and destinations. In addition to traditional rail service, CP moves merchandise traffic through a network of truck-rail transload facilities, expanding the reach of CP's network to non-rail served facilities.

Forest Products

The Company's Forest products business represented approximately 11% of Merchandise revenues, which is 4% of total Freight revenues in 2018.

The following charts compare the percentage of the Company's Forest products freight revenues generated from pulp and paper (wood pulp, paperboard, newsprint and paper), lumber and panel, and other shipments in 2018, 2017 and 2016:

2018 Forest Products Revenues	2017 Forest Products Revenues	2016 Forest Products Revenues
(11% of Merchandise Revenues; 4% of Freight Revenues)	(12% of Merchandise Revenues; 4% of Freight Revenues)	(13% of Merchandise Revenues; 5% of Freight Revenues)

Forest products traffic includes pulp and paper, and lumber and panel shipped from key producing areas in B.C., northern Alberta, northern Saskatchewan, Ontario and Quebec to destinations throughout North America, including Vancouver to export markets.

Energy, Chemicals and Plastics

The Company's Energy, chemicals and plastics business represented approximately 47% of Merchandise revenues, which is 17% of total Freight revenues in 2018.

The following charts compare the percentage of the Company's Energy, chemicals and plastics freight revenues generated from petroleum products, crude, chemicals, biofuels and plastics shipments in 2018, 2017 and 2016:

2018 Energy, Chemicals & Plastics Revenues	2017 Energy, Chemicals & Plastics Revenues	2016 Energy, Chemicals & Plastics Revenues
(47% of Merchandise Revenues; 17% of Freight Revenues)	(41% of Merchandise Revenues; 14% of Freight Revenues)	(42% of Merchandise Revenues; 14% of Freight Revenues)

Petroleum products consist of commodities such as liquefied petroleum gas ("LPG"), fuel oil, asphalt, gasoline, condensate (diluent) and lubricant oils. The majority of the Company's western Canadian energy traffic originates in the Alberta Industrial Heartland, Canada's largest hydrocarbon processing region, and Saskatchewan. The Bakken formation region in Saskatchewan and North Dakota is another source of condensate, LPG and other refined petroleum. Interchanges with several rail interline partners gives the Company access to refineries and export facilities in the Pacific Northwest, Northeast U.S. and the Gulf Coast, as well as the Texas and Louisiana petrochemical corridor and port connections.

Crude moves from production facilities throughout Alberta, Saskatchewan and North Dakota. CP provides efficient routes to refining markets in the Northeast U.S., the Gulf Coast and the West Coast through connections with our railway partners.

The Company's chemical traffic includes products such as ethylene glycol, caustic soda, methanol, sulphuric acid, styrene and soda ash. These shipments originate from Alberta, the U.S. Midwest, the Gulf of Mexico and eastern Canada, and move to end markets in Canada, the U.S. and overseas.

CP's biofuels traffic originates mainly from facilities in the U.S. Midwest, shipping primarily to destinations in the northeastern U.S.

The most commonly shipped plastics products are polyethylene and polypropylene. Almost half of the Company's plastics traffic originates in central and northern Alberta and moves to various North American destinations.

Metals, Minerals and Consumer Products

The Company's Metals, minerals and consumer products business represented approximately 30% of Merchandise revenues, which is 11% of total Freight revenues in 2018.

The following charts compare the percentage of the Company's Metals, minerals and consumer products freight revenues generated from frac sand, steel, aggregates (excluding frac sand), food and consumer products, and non-ferrous metals transportation in 2018, 2017 and 2016:



The majority of frac sand originates at mines located along the Company's network in Wisconsin and moves to the Permian Basin, the Bakken, Marcellus Shale and other shale formations across North America.

CP transports steel in various forms from mills in Iowa, Ontario and Saskatchewan to a variety of industrial users. The Company carries base metals such as zinc, aluminum, lead and copper. CP also moves ores from mines to smelters and refineries for processing, and the processed metal to automobile and consumer products manufacturers.

Aggregate products include coarse particulate and composite materials such as cement, limestone, gravel, clay and gypsum. Cement accounts for the majority of aggregate traffic and is shipped directly from production facilities in Alberta, Iowa and Ontario to energy and construction projects in North Dakota, Alberta, Manitoba and the U.S. Midwest.

Food and consumer products traffic consists of a diverse mix of goods, including food products, railway equipment, building materials and waste products.

Automotive

The Company's Automotive business represented approximately 12% of Merchandise revenues, which is 5% of total Freight revenues in 2018.

The following charts compare the percentage of the Company's Automotive freight revenues generated by movements of finished vehicles from Canadian, U.S., overseas, and Mexican origins, machinery, and parts and other in 2018, 2017 and 2016:

2018 Automotive Revenues (12% of Merchandise Revenues; 5% of Freight Revenues)	2017 Automotive Revenues (13% of Merchandise Revenues; 5% of Freight Revenues)	2016 Automotive Revenues (17% of Merchandise Revenues; 6% of Freight Revenues)
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CP's Automotive portfolio consists of four finished vehicle traffic components: Canadian-produced vehicles that ship to the U.S. from Ontario production facilities; U.S.-produced vehicles that ship within the U.S. as well as cross border shipments to Canadian markets; vehicles from overseas that move through the Port of Vancouver to eastern Canadian markets; and Mexican-produced vehicles that ship to the U.S. and Canada. In addition to finished vehicles, CP ships machinery, pre-owned vehicles, and automotive parts. A comprehensive network of automotive compounds is utilized to facilitate final delivery of vehicles to dealers throughout Canada and in the U.S.

Intermodal

The Company's Intermodal business represented approximately 22% of total Freight revenues in 2018.

The following charts compare the percentage of the Company's Intermodal freight revenues generated from Canada, ports, cross border transportation, other international, and U.S. in 2018, 2017 and 2016:

2018 Intermodal Revenues (22% of Freight Revenues)	2017 Intermodal Revenues (21% of Freight Revenues)	2016 Intermodal Revenues (22% of Freight Revenues)
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Domestic intermodal freight consists primarily of manufactured consumer products that are predominantly moved in 53-foot containers within North America. International intermodal freight moves in marine containers to and from ports and North American inland markets.

CP's Domestic intermodal business moves goods from a broad spectrum of industries including retail, wholesale, less-than truckload, full-truckload, food, forest products and various other commodities. Key service factors in domestic intermodal include consistent on-time delivery, the ability to provide door-to-door service and the availability of value-added services. The majority of the Company's Domestic intermodal business originates in Canada, where CP markets its services directly to retailers and manufacturers, providing complete door-to-door service and maintaining direct relationships with its customers. In the U.S., the Company's service is delivered mainly through intermodal marketing companies ("IMC").

CP's international intermodal business consists primarily of containerized traffic moving between the ports of Vancouver and Montreal and inland points across Canada and the U.S. Import traffic from the Port of Vancouver is mainly long-haul business destined for eastern Canada and the U.S. Midwest and Northeast. CP works closely with the Port of Montreal, a major year-round East Coast gateway to Europe, to serve markets primarily in the U.S. Midwest and Canada. The Company's U.S. Northeast service connects eastern Canada with the Port of New York, offering a competitive alternative to trucks.

Fuel Cost Adjustment Program

The short-term volatility in fuel prices may adversely or positively impact revenues. CP employs a fuel cost adjustment program designed to respond to fluctuations in fuel prices and help reduce volatility to changing fuel prices. Fuel surcharge revenues are earned on individual shipments and are based primarily on the price of On Highway Diesel. As such, fuel surcharge revenue is a function of freight volumes and fuel prices. Fuel surcharge revenues accounted for approximately 7% of the Company's Freight revenues in 2018. The Company is also subject to carbon taxation systems and levies in some jurisdictions in which it operates, the costs of which are passed on to the shipper. As such, fuel surcharge revenue includes carbon taxes and levy recoveries.

Non-freight Revenues

Non-freight revenues accounted for approximately 2% of the Company's Total revenues in 2018. Non-freight revenues are generated from leasing certain assets; other arrangements, including logistical services and contracts with passenger service operators; and switching fees.

Significant Customers

For each of the years ended December 31, 2018, 2017 and 2016, no customer comprised more than 10% of Total revenues or accounts receivable.

Competition

The Company is subject to competition from other railways, motor carriers, ship and barge operators, and pipelines. Price is only one factor of importance as shippers and receivers choose a transportation service provider. Service is another factor and requirement, both in terms of transit time and reliability, which vary by shipper and commodity. As a result, the Company's primary competition varies by commodity, geographic location, access to markets and mode of available transportation. CP's primary rail competitors are Canadian National Railway Company ("CN"), which operates throughout much of the Company's territory in Canada, and Burlington Northern Santa Fe, LLC, including its primary subsidiary BNSF Railway Company ("BNSF"), which operates throughout much of the Company's territory in the U.S. Midwest. Other railways also operate in parts of the Company's territory. Depending on the specific market, competing railways and motor carriers may exert pressure on price and service levels.

Seasonality

Volumes and revenues from certain goods are stronger during different periods of the year. First-quarter revenues are typically lower mainly due to winter weather conditions, closure of the Great Lakes ports and reduced transportation of retail goods. Second and third quarter revenues generally improve compared to the first quarter, as fertilizer volumes are typically highest during the second quarter and demand for construction-related goods is generally highest in the third quarter. Revenues are typically strongest in the fourth quarter, primarily as a result of the transportation of grain after the harvest, fall fertilizer programs and increased demand for retail goods moved by rail. Operating income is also affected by seasonal fluctuations. Operating income is typically lowest in the first quarter, due to lower freight revenue and higher operating costs associated with winter conditions.

Government Regulation

The Company's railway operations are subject to extensive federal laws, regulations and rules in both Canada and the U.S., which directly affect how operations and business activities are managed.

The Company's Canadian operations are subject to economic and safety regulations. Economic regulatory oversight is provided by the Canadian Transportation Agency ("the Agency") as delegated by the CTA, while safety regulatory oversight is primarily provided by Transport Canada ("TC") pursuant to the *Railway Safety Act* ("RSA"). The CTA indirectly regulates rates by providing remedies for freight rates, including ancillary charges, remedies for level of service, long-haul interswitching rates and regulated interswitching rates in Canada. The CTA also regulates the MRE for the movement of export grain, construction and abandonment of railways, commuter and passenger access, and noise and vibration-related disputes. The RSA regulates safety-related aspects of railway operations in Canada, including the delegation of inspection, investigation and enforcement powers to TC. TC is also responsible for overseeing the transportation of dangerous goods as set out under the *Transportation of Dangerous Goods Act* (Canada) ("TDG").

The Company's U.S. operations are similarly subject to economic and safety regulations. Economic regulatory oversight is provided by the Surface Transportation Board ("STB") which administers Title 49 of the United States Code and related Code of Federal Regulations. Safety regulatory oversight is exercised by the

Federal Railroad Administration (“FRA”), and the Pipelines and Hazardous Materials Safety Administration (“PHMSA”). The STB is an economic regulatory body with jurisdiction over railroad rate and service issues and proposed railroad mergers and other transactions. The FRA regulates safety-related aspects of the Company’s railway operations in the U.S. under the *Federal Railroad Safety Act*, as well as rail portions of other safety statutes. PHMSA regulates the safe transportation of all hazardous materials by rail.

Various other regulators directly and indirectly affect the Company’s operations in areas such as health, safety, security, environmental and other matters.

Regulatory Change

After the tragic accident in Lac-Mégantic, Quebec, in July 2013 involving a non-related short-line railway, the Government of Canada implemented several measures pursuant to the RSA and the TDG. These modifications implemented changes with respect to rules associated with securing unattended trains; the classification of crude being imported, handled, offered for transport or transported; and the provision of information to municipalities through which dangerous goods are transported by rail. The U.S. federal government has taken similar actions. These changes did not have a material impact on CP’s operating practices.

On June 18, 2015, “An Act to amend the *Canada Transportation Act* and the *Railway Safety Act*” received Royal Assent and is now in force. The legislation set out new minimum insurance requirements for federally regulated railways based on amounts of crude and toxic inhalation hazards (“TIH”) or poisonous inhalation hazards moved. It also imposes strict liability; limits railway liability to the minimum insurance level; mandates the creation of a fund of \$250 million paid for by a levy on crude shipments, to be utilized for damages beyond \$1 billion (in respect of CP); allows railways and insurers to have existing rights to pursue other parties (subrogation); and prevents shifting liability to shippers from railways except through written agreement. As the implementation of various aspects of the amendments by the Government of Canada is still being completed, the Company is not yet able to determine their full impact.

On May 1, 2015, the U.S. Transportation Secretary announced the final rule for a new rail tank car standard for flammable liquids and the phase-out schedule for older tank cars used to transport flammable liquids. The development of the new tank car standard was done in coordination between Transport Canada, PHMSA and the FRA. This announcement was followed by publishing the new tank car standard and phase-out schedule in Canada on May 20, 2015. Canada has since issued two protective directions to advance phase-out dates. The first, Protective Direction 38, eliminated the ability to ship crude oil in legacy U.S. Department of Transportation (“DOT”) 111 tank cars after November 1, 2016 (the phase-out date in the United States for these cars remained January 1, 2018). Protective Direction 39 was issued on September 19, 2018 and eliminated the ability to ship crude oil in unjacketed CPC 1232 tank cars after November 1, 2018, as well as certain condensates after January 1, 2019. The phase-out deadline for this car in the United States remains April 1, 2020. CP does not own any tank cars used for commercial transportation of hazardous commodities.

On October 29, 2015, the *Surface Transportation Extension Act of 2015* (“STEA”) was signed into law. The law extends, by three years, the deadline for the U.S. rail industry to implement Positive Train Control (“PTC”), a set of highly advanced technologies designed to prevent train-to-train collisions, speed-related derailments and other accidents caused by human error by determining the precise location, direction and speed of trains, warning train operators of potential problems, and taking immediate action if an operator does not respond. Legislation passed by the U.S. Congress in 2008 mandated that PTC systems be put into service by the end of 2015 on rail lines used to transport passengers or toxic-by-inhalation materials. The STEA extended the deadline to install and activate PTC to December 31, 2018, or December 31, 2020 under certain circumstances, allowing the Company additional time to ensure safe and effective implementation of PTC on its rail network.

For further details on the capital expenditures associated with compliance with the PTC regulatory mandate, refer to Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations, Liquidity and Capital Resources.

On December 4, 2015, the *Fixing America’s Surface Transportation Act* (“FAST Act”) was signed into law, representing the first long-term transportation legislation enacted in the U.S. in over a decade. The FAST Act contains key provisions on safety enhancements for tank cars moving flammable liquids in the U.S. and electronically controlled pneumatic (“ECP”) train braking. Among those key provisions, the FAST Act requires new tank cars to be equipped with thermal blankets, requires all legacy DOT-111 tank cars moving flammable liquids to

be upgraded to new retrofit standards (regardless of how many cars may be in a train) and sets minimum requirements for protection of certain valves. The FAST Act called for the U.S. Secretary of Transportation to re-evaluate its ECP final rule within one year using the results of this evaluation to determine whether ECP braking system requirements are justified. On December 4, 2017, the DOT found the ECP brake rule costs outweigh the benefits. On September 24, 2018, PHMSA officially repealed the ECP brake rule.

The *STB Reauthorization Act of 2015* was signed into law on December 18, 2015. The law requires numerous changes to the structure and composition of the STB, removing it from under the DOT and establishing the STB as an independent U.S. agency, as well as increasing STB Board membership from three to five members. Notably, the law vests in the STB certain limited enforcement powers, by authorizing it to investigate rail carrier violations on the STB Board's own initiative. The law also requires the STB to establish a voluntary binding arbitration process to resolve rail rate and practice disputes.

Finally, on May 23, 2018, the *Transportation Modernization Act* received Royal Assent. The legislation amends the CTA and the RSA, among other Acts, to (1) replace the existing 160 kilometer extended interswitching limit and the competitive line rate provisions with a new long-haul interswitching regime; (2) modify the existing Level of Service remedy for shippers by instructing the Agency to determine, upon receipt of a complaint, if a railway company is fulfilling its common carrier obligation to the "highest level of service that is reasonable in the circumstances"; (3) allow the existing Service Level Agreement arbitration remedy to include the consideration of reciprocal financial penalties; (4) increase the threshold for summary Final Offer Arbitrations from \$750,000 to \$2 million; (5) bifurcate the Volume-Related Composite Price Index ("VRCPI") component of the annual MRE determination for transportation of regulated grain, to encourage

hopper car investment by CP and CN; (6) mandate the installation of locomotive voice and video recorders ("LVVRs"), with statutory permission for random access by railway companies and Transport Canada to the LVVR data in order to proactively strengthen railway safety in Canada; and (7) compel railways to provide additional data to the federal government.

Environmental Laws and Regulations

The Company's operations and real estate assets are subject to extensive federal, provincial, state and local environmental laws and regulations governing emissions to the air, discharges to waters and the handling, storage, transportation and disposal of waste and other materials. If the Company is found to have violated such laws or regulations, it could have a material adverse effect on the Company's business or operating results. In addition, in operating a railway, it is possible that releases of hazardous materials during derailments or other accidents may occur that could cause harm to human health or to the environment. Costs of remediation, damages and changes in regulations could materially affect the Company's operating results and reputation.

The Company has implemented an Environmental Management System to facilitate the reduction of environmental risk. Specific environmental programs are in place to address areas such as air emissions, wastewater, management of vegetation, chemicals and waste, storage tanks and fueling facilities. CP has also undertaken environmental impact assessments and risk assessments to identify, prevent and mitigate environmental risks. There is continued focus on preventing spills and other incidents that have a negative impact on the environment. There is an established Strategic Emergency Response Contractor network, and spill equipment kits are located across Canada and the U.S. to ensure a rapid and efficient response in the event of an environmental incident. In addition, emergency preparedness and response plans are regularly updated and tested.

The Company has developed an environmental audit program that comprehensively, systematically and regularly assesses the Company's facilities for compliance with legal requirements and the Company's policies for conformance to accepted industry standards. Included in this is a corrective action follow-up process and semi-annual review by senior management.

CP focuses on key strategies, identifying tactics and actions to support commitments to the community. The Company's strategies include:

- protecting the environment;
- ensuring compliance with applicable environmental laws and regulations;
- promoting awareness and training;
- managing emergencies through preparedness; and
- encouraging involvement, consultation and dialogue with communities along the Company's lines.

Security

CP is subject to statutory and regulatory directives in Canada and the U.S. that address security concerns. CP plays a critical role in the North American transportation system. Rail lines, facilities and equipment, including railcars carrying hazardous materials, could be direct targets or indirect casualties of terrorist attacks. Regulations by the DOT and the Department of Homeland Security in the U.S. include speed restrictions, chain of custody and security measures, which can impact service and increase costs for the transportation of hazardous materials, especially TIH materials. Legislative changes in Canada to the TDG are expected to add new security regulatory requirements similar to those in the U.S. In addition, insurance premiums for some or all of the Company's current coverage could increase significantly, or certain coverage may not be available to the Company in the future. While CP will continue to work closely with Canadian and U.S. government agencies, future decisions by these agencies on security matters or decisions by the industry in response to security threats to the North American rail network could have a material adverse effect on the Company's business or operating results.

CP takes the following security measures:

CP employs its own police service that works closely with communities and other law enforcement and government agencies to promote railway safety and infrastructure security. As a railway law enforcement agency, CP Police Services is headquartered in Calgary, with police officers assigned to over 25 field offices responsible for railway police operations in six Canadian provinces and 14 U.S. states. CP Police Services operates on the CP rail network as well as in areas where CP has non-railway operations.

CP's Police Communication Centre ("PCC") operates 24 hours a day. PCC receives reports of emergencies, dangerous or potentially dangerous conditions, and other safety and security issues from our employees, the public, and law enforcement and other government officials. PCC ensures that proper emergency responders are notified as well as governing bodies.

CP's Security Management Plan is a comprehensive, risk-based plan modelled on and developed in conjunction with the security plan prepared by the Association of American Railroads post-September 11, 2001. Under this plan, CP routinely examines and prioritizes railway assets, physical and cyber vulnerabilities, and threats, as well as tests and revises measures to provide essential railway security. To address cyber security risks, CP implements mitigation programs that evolve with the changing technology threat environment. The Company has also worked diligently to establish backup sites to ensure a seamless transition in the event that the Company's operating systems are the target of a cyber-attack. By doing so, CP is able to maintain network fluidity.

CP security efforts consist of a wide variety of measures including employee training, engagement with our customers and training of emergency responders.

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 each of the committees of our Board of Directors, our corporate governance guidelines and our Code of Business Ethics. This Form 10-K and other SEC filings made by CP are also accessible through the SEC's website at www.sec.gov.

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

All references to our websites contained herein do not constitute incorporation by reference of information contained on such websites and such information should not be considered part of this document.

ITEM 1A. RISK FACTORS

The risks set forth in the following risk factors could have a materially adverse effect on the Company's financial condition, results of operations, and liquidity, and could cause those results to differ materially from those expressed or implied in the Company's forward-looking statements and forward-looking information (collectively, "forward-looking statements").

The information set forth in this Item 1A. Risk Factors should be read in conjunction with the rest of the information included in this report, including Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations and Item 8. Financial Statements and Supplementary Data.

As a common carrier, the Company is required by law to transport dangerous goods and hazardous materials, which could expose the Company to significant costs and claims. Railways, including CP, are legally required to transport dangerous goods and hazardous materials as part of their common carrier obligations regardless of risk or potential exposure to loss. CP transports dangerous goods and hazardous materials, including but not limited to crude oil, ethanol and TIH materials such as chlorine gas and anhydrous ammonia. A train accident involving hazardous materials could result in significant claims against CP arising from personal injury, property or natural resource damage, environmental penalties and remediation obligations. Such claims, if insured, could exceed the existing insurance coverage commercially available to CP, which could have a material adverse effect on CP's financial condition and liquidity. CP is also required to comply with rules and regulations regarding the handling of dangerous goods and hazardous materials in Canada and the U.S. Noncompliance with these rules and regulations can subject the Company to significant penalties and could factor in litigation arising out of a train accident. Changes to these rules and regulations could also increase operating costs, reduce operating efficiencies and impact service delivery.

The Company is subject to significant governmental legislation and regulation over commercial, operating and environmental matters. The Company's railway operations are subject to extensive federal laws, regulations and rules in both Canada and the U.S. Operations are subject to economic and safety regulations in Canada primarily by the Agency and Transport Canada. The Company's U.S. operations are subject to economic and safety regulation by the STB and the FRA. Various other regulators directly and indirectly affect the Company's operations in areas such as health, safety, security, environmental and other matters. Additional economic regulation of the rail industry by these regulators or the Canadian and U.S. legislatures, whether under new or existing laws, could have a significant negative impact on the Company's ability to determine prices for rail services and result in a material adverse effect in the future on the Company's financial position, results of operations, and liquidity in a particular year or quarter. This potential material adverse effect could also result in reduced capital spending on the Company's rail network or in abandonment of lines.

The Company's compliance with safety and security regulations may result in increased capital expenditures and operating costs. For example, compliance with the *Rail Safety Improvement Act of 2008* will result in additional capital expenditures associated with the statutorily mandated implementation of PTC. In addition to increased capital expenditures, implementation of such regulations may result in reduced operational efficiency and service levels, as well as increased operating expenses.

The Company's operations are subject to extensive federal, state, provincial and local environmental laws concerning, among other matters, emissions to the air, land and water and the handling of hazardous materials and wastes. Violation of these laws and regulations can result in significant fines and penalties, as well as other potential impacts on CP's operations. These laws can impose strict, and in some circumstances, joint and several liability on both current and former owners, and on operators of facilities. Such environmental liabilities may also be raised by adjacent landowners or third parties. In addition, in operating a railway, it is possible that releases of hazardous materials during derailments or other accidents may occur that could cause harm to human health or to the environment. Costs of remediation, damages and changes in regulations could materially affect the Company's operating results and reputation. The Company has been, and may in the future be, subject to allegations or findings to the effect that it has violated, or is strictly liable under, environmental laws or regulations. The Company currently has obligations at existing sites for investigation, remediation and monitoring, and will likely have obligations at other sites in the future. The actual costs associated with both current and long-term liabilities

may vary from the Company's estimates due to a number of factors including, but not limited to changes in: the content or interpretation of environmental laws and regulations; required remedial actions; technology associated with site investigation or remediation; and the involvement and financial viability of other parties that may be responsible for portions of those liabilities.

Global economic conditions could negatively affect demand for commodities and other freight transported by the Company. A decline or disruption in domestic, cross border or global economic conditions that affect the supply or demand for the commodities that CP transports may decrease CP's freight volumes and may result in a material adverse effect on CP's financial or operating results and liquidity. Economic conditions resulting in bankruptcies of one or more large customers could have a significant impact on CP's financial position, results of operations, and liquidity in a particular year or quarter.

The Company faces competition from other transportation providers and failure to compete effectively could adversely affect financial results. The Company faces significant competition for freight transportation in Canada and the U.S., including competition from other railways, pipelines, and trucking and barge companies. Competition is based mainly on quality of service, freight rates and access to markets. Other transportation modes generally use public rights-of-way that are built and maintained by government entities, while CP and other railways must use internal resources to build and maintain their rail networks. Competition with the trucking industry is generally based on freight rates, flexibility of service and transit time performance. Any future improvements or expenditures materially increasing the quality or reducing the cost of alternative modes of transportation, or legislation that eliminates or significantly reduces the burden of the size or weight limitations currently applicable to trucking carriers, could have a material adverse effect on CP's financial results.

The operations of carriers with which the Company interchanges may adversely affect operations. The Company's ability to provide rail services to customers in Canada and the U.S. also depends upon its ability to maintain cooperative relationships with connecting carriers with respect to, among other matters, revenue division, car supply and locomotive availability, data exchange and communications, reciprocal switching, interchange, and trackage rights. Deterioration in the operations or services provided by connecting carriers, or in the Company's relationship with those connecting carriers, could result in CP's inability to meet customers' demands or require the Company to use alternate train routes, which could result in significant additional costs and network inefficiencies.

The availability of qualified personnel could adversely affect the Company's operations. Changes in employee demographics, training requirements and the availability of qualified personnel, particularly locomotive engineers and trainpersons, could negatively impact the Company's ability to meet demand for rail services. Unpredictable increases in the demand for rail services may increase the risk of having insufficient numbers of trained personnel, which could have a material adverse effect on the Company's results of operations, financial condition and liquidity. In addition, changes in operations and other technology improvements may significantly impact the number of employees required to meet the demand for rail services.

Strikes or work stoppages could adversely affect the Company's operations. Class I railroads are party to collective bargaining agreements with various labour unions. The majority of CP's employees belong to labour unions and are subject to these agreements. Disputes with regard to the terms of these agreements or the Company's potential inability to negotiate acceptable contracts with these unions could result in, among other things, strikes, work stoppages, slowdowns or lockouts, which could cause a significant disruption of the Company's operations and have a material adverse effect on the Company's results of operations, financial condition and liquidity. Additionally, future national labour agreements, or provisions of labour agreements related to health care, could significantly increase the Company's costs for health and welfare benefits, which could have a material adverse impact on its financial condition and liquidity.

The Company may be subject to various claims and lawsuits that could result in significant expenditures. By the nature of its operation, the Company is exposed to the potential for a variety of litigation and other claims, including personal injury claims, labour and employment disputes, commercial and contract disputes, environmental liability, freight claims and property damage claims. In respect of workers' claims in Canada related to occupational health and safety, the *Workers' Compensation Act* (Canada) covers those matters. In the U.S., the *Federal Employers' Liability Act* ("FELA") is applicable to railroad employees. A provision for a litigation matter or other claim will be accrued according to applicable accounting standards and any such accrual will be based on an ongoing assessment of the strengths and weaknesses of the litigation or claim, its likelihood of success together with an evaluation of the damages or other monetary relief sought. Any material changes to litigation trends, a catastrophic rail accident or series of accidents involving freight loss, property damage, personal injury, environmental liability or other significant matters could have a material adverse effect on the Company's results of operations, financial position and liquidity, in each case, to the extent not covered by insurance.

The Company may be affected by acts of terrorism, war, or risk of war. CP plays a critical role in the North American transportation system and therefore could become the target for acts of terrorism or war. CP is also involved in the transportation of hazardous materials, which could result in CP's equipment or infrastructure being direct targets or indirect casualties of terrorist attacks. Acts of terrorism, or other similar events, any government response thereto, and war or risk of war could cause significant business interruption to CP and may adversely affect the Company's results of operations, financial condition and liquidity.

Severe weather or natural disasters could result in significant business interruptions and costs to the Company. CP is exposed to severe weather conditions and natural disasters including earthquakes, floods, fires, avalanches, mudslides, extreme temperatures and significant precipitation that may cause business interruptions that can adversely affect the Company's entire rail network. This could result in increased costs, increased liabilities and decreased revenues, which could have a material adverse effect on the Company's results of operations, financial condition, and liquidity. Insurance maintained by the Company to protect against loss of business and other related consequences resulting from these natural occurrences is subject to coverage limitations, depending on the nature of the risk insured. This insurance may not be sufficient to cover all of the Company's damages or damages to others, and this insurance may not continue to be available at commercially reasonable rates. Even with insurance, if any natural occurrence leads to a catastrophic interruption of services, the Company may not be able to restore services without a significant interruption in operations.

The state of capital markets could adversely affect the Company's liquidity. Weakness in the capital and credit markets could negatively impact the Company's access to capital. From time to time, the Company relies on the capital markets to provide some of its capital requirements, including the issuance of long-term debt instruments and commercial paper. Significant instability or disruptions of the capital markets and the credit markets, or deterioration of the Company's financial condition due to internal or external factors could restrict or eliminate the Company's access to, and/or significantly increase the cost of, various financing sources, including bank credit facilities and issuance of corporate bonds. Instability or disruptions of the capital markets and deterioration of the Company's financial condition, alone or in combination, could also result in a reduction in the Company's credit rating to below investment grade, which could also further prohibit or restrict the Company from accessing external sources of short-term and long-term debt financing, and/or significantly increase the associated costs.

Disruptions within the supply chain could negatively affect the Company's operational efficiencies and increase costs. The North American transportation system is integrated. CP's operations and service may be negatively impacted by service disruptions of other transportation links, such as ports, handling facilities, customer facilities and other railways. A prolonged service disruption at one of these entities could have a material adverse effect on the Company's results of operations, financial condition and liquidity.

The Company may be affected by fluctuating fuel prices. Fuel expense constitutes a significant portion of the Company's operating costs. Fuel prices can be subject to dramatic fluctuations, and significant price increases could have a material adverse effect on the Company's results of operations. The Company currently employs a fuel cost adjustment program to help reduce volatility in changing fuel prices, but the Company cannot be certain that it will always be able to fully mitigate rising or elevated fuel costs through this program. Factors affecting fuel prices include: worldwide oil demand, international politics, weather, refinery capacity, supplier and upstream outages, unplanned infrastructure failures, and labour and political instability.

The Company is dependent on certain key suppliers of core railway equipment and materials that could result in increased price volatility or significant shortages of materials, which could adversely affect results of operations, financial condition and liquidity. Due to the complexity and specialized nature of core railway equipment and infrastructure (including rolling stock equipment, locomotives, rail and ties), there can be a limited number of suppliers of rail equipment and materials available. Should these specialized suppliers cease production or experience capacity or supply shortages, this concentration of suppliers could result in CP experiencing cost increases or difficulty in obtaining rail equipment and materials, which could have a material adverse effect on the Company's results of operations, financial condition and liquidity. Additionally, CP's operations are dependent on the availability of diesel fuel. A significant fuel supply shortage arising from production decreases, increased demand in existing or emerging foreign markets, disruption of oil imports, disruption of domestic refinery production, damage to refinery or pipeline infrastructure, political unrest, war or other factors could have a material adverse effect on the Company's results of operations, financial position and liquidity in a particular year or quarter.

The Company may be directly and indirectly affected by the impacts of global climate change. There is potential for significant impacts to CP's infrastructure due to changes in global weather patterns. Increasing frequency, intensity and duration of extreme weather events such as flooding, storms and forest fires may result in substantial costs to respond during the event, to recover from the event and possibly to modify existing or future infrastructure requirements to prevent recurrence. The Company is currently subject to emerging regulatory programs that place a price on carbon emissions associated with railway operations in Canada. Government bodies at the provincial and federal level are imposing carbon taxation systems and cap and trade market mechanisms in the Canadian jurisdictions in which CP operates. As a significant consumer of diesel fuel, an escalating price on carbon emissions will lead to a corresponding

increase of the Company's business costs. Programs that place a price on carbon emissions or other government restrictions on certain market sectors may further impact current and potential customers including thermal coal and petroleum crude oil sectors.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

Network Geography

The Company's network extends from the Port of Vancouver on Canada's Pacific Coast to the Port of Montreal in eastern Canada, and to the U.S. industrial centres of Chicago, Illinois; Detroit, Michigan; Buffalo and Albany, New York; Kansas City, Missouri; and Minneapolis, Minnesota.

The Company's network is composed of three primary corridors: Western, Central and Eastern.

The Western Corridor: Vancouver to Thunder Bay

Overview – The Western Corridor links Vancouver with Thunder Bay, which is the Western Canadian terminus of the Company's Eastern Corridor. With service through Calgary, the Western Corridor is an important part of the Company's routes between Vancouver and the U.S. Midwest, and between Vancouver and eastern Canada. The Western Corridor provides access to the Port of Thunder Bay, Canada's primary Great Lakes bulk terminal.

Products – The Western Corridor is the Company's primary route for bulk and resource products traffic from western Canada to the Port of Vancouver for export. CP also handles significant volumes of international intermodal containers and domestic general merchandise traffic.

Feeder Lines – CP supports its Western Corridor with four significant feeder lines: the "Coal Route", which links southeastern B.C. coal deposits to the Western Corridor and to coal terminals at the Port of Vancouver; the "Edmonton-Calgary Route", which provides rail access to Alberta's Industrial Heartland (north of Edmonton, Alberta) in addition to the petrochemical facilities in central Alberta; the "Pacific CanAm Route", which connects Calgary and Medicine Hat in Alberta with Pacific Northwest rail routes at Kingsgate, B.C. via the Crowsnest Pass in Alberta; and the "North Main Line Route" that provides rail service to customers between Portage la Prairie, Manitoba, and Wetaskiwin, Alberta, including intermediate points Yorkton and Saskatoon in Saskatchewan. This line is an important collector of Canadian grain and fertilizer, serving the potash mines located east and west of Saskatoon and many high-throughput grain elevators and processing facilities. In addition, this line provides direct access to refining and upgrading facilities at Lloydminster, Alberta, and western Canada's largest pipeline terminal at Hardisty, Alberta.

Connections – The Company's Western Corridor connects with the Union Pacific Railroad ("UP") at Kingsgate and with BNSF at Coutts, Alberta, and at New Westminster and Huntingdon in B.C. This corridor also connects with CN at many locations including Thunder Bay, Winnipeg, Manitoba, Regina and Saskatoon in Saskatchewan, Red Deer, Camrose, Calgary and Edmonton in Alberta, Kamloops and several locations in the Greater Vancouver area in B.C.

Yards and Repair Facilities – CP supports rail operations on the Western Corridor with main rail yards at Vancouver, Calgary, Edmonton, Moose Jaw in Saskatchewan, Winnipeg and Thunder Bay. The Company has locomotive and railcar repair facilities at Golden, Vancouver, Calgary, Moose Jaw and Winnipeg. CP also has major intermodal terminals at Vancouver, Calgary, Edmonton, Regina and Winnipeg.

The Central Corridor: Moose Jaw and Winnipeg to Chicago and Kansas City

Overview – The Central Corridor connects with the Western Corridor at Moose Jaw and Winnipeg. By running south to Chicago and Kansas City, through the Twin Cities of Minneapolis and St. Paul, Minnesota, and through Milwaukee, Wisconsin, CP provides a direct, single-carrier route between western Canada

and the U.S. Midwest, providing access to Great Lakes and Mississippi River ports. From La Crosse, Wisconsin, the Central Corridor continues south towards Kansas City via the Quad Cities (Davenport and Bettendorf in Iowa, and Rock Island and Moline in Illinois), providing an efficient route for traffic destined for southern U.S. and Mexican markets. CP's Kansas City line also has a direct connection into Chicago and by extension to points east on CP's network such as Toronto, Ontario and the Port of Montreal in Quebec.

Products – Traffic transported on the Central Corridor includes intermodal containers from the Port of Vancouver, fertilizers, chemicals, crude, frac sand, automotive, grain and other agricultural products.

Feeder Lines – The Company has operating rights over BNSF tracks between Minneapolis and St. Paul along with connectivity to the twin ports of Duluth, Minnesota and Superior, Wisconsin. CP maintains its own yard facilities that provide an outlet for grain from the U.S. Midwest to the grain terminals at these ports. This is a strategic entry point for large dimensional shipments that can be routed via CP's network to locations such as Alberta's Industrial Heartland to serve the needs of the oil sands and energy industry. CP's route from Winona, Minnesota, to Tracy, Minnesota, provides access to key agricultural and industrial commodities. CP's feeder line between Drake and New Town in North Dakota is geographically situated in a highly strategic region for Bakken oil production. CP also owns two significant feeder lines in North Dakota and western Minnesota operated by the Dakota Missouri Valley and Western Railroad and the Northern Plains Railroad, respectively. Both of these short lines are also active in providing service to agricultural and Bakken-oil-related customers.

Connections – The Company's Central Corridor connects with all major railways at Chicago. Outside of Chicago, CP has major connections with BNSF at Minneapolis, North Dakota, and the Duluth-Superior Terminal and with UP at St. Paul and Mankato, Minnesota. CP connects with CN at Milwaukee and Chicago. At Kansas City, CP connects with Kansas City Southern ("KCS"), BNSF, Norfolk Southern Railway ("NS") and UP. CP's Central Corridor also links to several short-line railways that primarily serve grain and coal producing areas in the U.S., and extend CP's market reach in the rich agricultural areas of the U.S. Midwest.

Yards and Repair Facilities – The Company supports rail operations on the Central Corridor with main rail yards in Chicago, Milwaukee, St. Paul and Glenwood in Minnesota, and Mason City and Davenport (Nahant yard) in Iowa. In addition, CP has a major locomotive repair facility at St. Paul and car repair facilities at St. Paul and Chicago. CP shares a yard with KCS in Kansas City. CP owns 49% of the Indiana Harbor Belt Railroad, a switching railway serving Greater Chicago and northwest Indiana. CP is also part owner of the Belt Railway Company of Chicago, which is the largest intermediate switching terminal railroad in the U.S. CP has major intermodal terminals in Minneapolis and Chicago as well as a dried distillers' grains transload facility that complements the service offering in Chicago.

The Eastern Corridor: Thunder Bay to Montreal, Detroit and Albany

Overview – The Eastern Corridor extends from Thunder Bay through to its eastern terminus at Montreal and from Toronto to Chicago via Windsor, Ontario and Detroit or Buffalo. The Company's Eastern Corridor provides shippers direct rail service from Toronto and Montreal to Calgary and Vancouver via the Company's Western Corridor and to the U.S. via the Central Corridor. This is a key element of the Company's transcontinental intermodal service. The corridor also supports the Company's market position at the Port of Montreal by providing one of the shortest rail routes for European cargo destined to the U.S. Midwest, using the CP-owned route between Montreal and Detroit, coupled with a trackage rights arrangement on NS tracks between Detroit and Chicago.

Products – Major traffic categories transported in the Eastern Corridor include Forest products, chemicals and plastics, crude, ethanol, Metals, minerals and consumer products, intermodal containers, automotive products and general merchandise.

Feeder Lines – A major feeder line serves the steel industry at Hamilton, Ontario and provides connections with both CSX Corporation ("CSX") and NS at Buffalo. The Delaware & Hudson Railway Company, Inc. ("D&H") feeder line extends from Montreal to Albany.

Connections – The Eastern Corridor connects with a number of short-line railways including routes from Montreal to Quebec City, Quebec and Montreal to Saint John, New Brunswick, and Searsport, Maine. Connections are also made with PanAm Southern at Mechanicville, New York, for service to the Boston and New England areas, and the Vermont Railway at Whitehall, New York. Through haulage arrangements, CP has service to Fresh Pond, New York, to connect with New York & Atlantic Railway as well as direct access to the Bronx and Queens. CP can also access Philadelphia as well as a number of short-lines in Pennsylvania. Connections are also made with CN at a number of locations, including Sudbury, North Bay, Windsor, London, Hamilton and Toronto in Ontario, and Montreal in Quebec. CP also connects in New York with the two eastern class 1 carriers; NS and CSX at Buffalo, NS at Schenectady and CSX at Albany.

Yards and Repair Facilities – CP supports its rail operations in the Eastern Corridor with major rail yards at Sudbury, Toronto, London and Montreal. The Company has locomotive repair facilities at Montreal and Toronto and car repair facilities at Thunder Bay, Toronto and Montreal. The Company's largest intermodal facility is located in the northern Toronto suburb of Vaughan and serves the Greater Toronto and southwestern Ontario areas. CP also operates intermodal terminals at Montreal and Detroit. CP also has transload facilities in Agincourt and Hamilton, Ontario to meet a variety of commodity needs in the area.

Right-of-Way

The Company's rail network is standard gauge, which is used by all major railways in Canada, the U.S. and Mexico. Continuous welded rail is used on the core main line network.

CP uses different train control systems on portions of the Company's owned track, depending on the volume of rail traffic. Remotely controlled centralized traffic control signals are used in various corridors to authorize the movement of trains. CP is currently implementing PTC on 2,117 miles of its U.S. network.

In other corridors, train movements are directed by written instructions transmitted electronically and by radio from rail traffic controllers to train crews. In some specific areas of intermediate traffic density, CP uses an automatic block signalling system in conjunction with written instructions from rail traffic controllers.

Track and Infrastructure

CP operates on a network of approximately 12,500 miles of track and has access to 2,200 miles under trackage rights. The Company's owned track miles includes leases with wholly owned subsidiaries where the term of the lease exceeds 99 years. CP's track network represents the size of the Company's operations that connects markets, customers and other railways. Of the total mileage operated, approximately 5,400 miles are located in western Canada, 2,300 miles in eastern Canada, 4,400 miles in the U.S. Midwest and 400 miles in the U.S. Northeast. CP's network accesses the U.S. markets directly through three wholly owned subsidiaries: Soo Line Railroad Company ("Soo Line"), a Class I railway operating in the U.S. Midwest; the Dakota, Minnesota and Eastern Railroad ("DM&E"), a wholly owned subsidiary of the Soo Line, which operates in the U.S. Midwest; and the D&H, which operates between eastern Canada and the U.S. Northeast.

At December 31, 2018, the breakdown of CP operated track miles is as follows:

	Total
First main track	12,469
Second and other main track	1,114
Passing sidings and yard track	4,260
Industrial and way track	781
Total track miles	18,624

Rail Facilities

CP operates numerous facilities including: terminals for intermodal, transload, automotive and other freight; classification rail yards for train-building and switching, storage-in-transit and other activities; offices to administer and manage operations; dispatch centres to direct traffic on the rail network; crew quarters to house train crews along the rail line; shops and other facilities for fuelling; maintenance and repairs of locomotives; and facilities for maintenance of freight cars and other equipment. Typically in all of our major yards, CP Police Services has offices to ensure the safety and security of the yards and operations.

The following table includes the major yards, terminals and transload facilities on CP's network:

Major Classification Yards	Major Intermodal Terminals	Transload Facilities
Vancouver, British Columbia	Vancouver, British Columbia	Vancouver, British Columbia
Calgary, Alberta	Calgary, Alberta	Toronto, Ontario
Edmonton, Alberta	Edmonton, Alberta	Hamilton, Ontario
Moose Jaw, Saskatchewan	Regina, Saskatchewan	Lachine, Quebec
Winnipeg, Manitoba	Winnipeg, Manitoba	
Toronto, Ontario	Vaughan, Ontario	
Montreal, Quebec	Montreal, Quebec	
Chicago, Illinois	Chicago, Illinois	
St. Paul, Minnesota	St. Paul, Minnesota	

Equipment

CP's equipment includes: owned and leased locomotives and railcars; heavy maintenance equipment and machinery; other equipment and tools in our shops, offices and facilities; and vehicles for maintenance, transportation of crews, and other activities.

The Company's locomotive fleet is composed of largely high-adhesion alternating current locomotives that are more fuel efficient and reliable and have superior hauling capacity, compared with standard direct current locomotives. As of December 31, 2018, the Company had 243 locomotives in storage. As a result, the Company does not foresee the need to acquire new locomotives for the next several years. As of December 31, 2018, CP owned or leased the following locomotive units:

Locomotives	Owned	Leased	Total	Average Age (in years)
Road freight				
High-adhesion alternating current	784	34	818	13
Standard direct current	249	—	249	31
Road switcher	342	—	342	26
Yard switcher	14	—	14	36
Total locomotives	1,389	34	1,423	20

CP owns and leases a fleet of 35,805 freight cars. Owned freight cars include units acquired by CP, equipment leased to third parties, and held under capital leases. Leased freight cars include all units under a short-term or long-term operating lease or financed equipment. As of December 31, 2018, CP owned and leased the following units of freight cars:

Freight cars	Owned	Leased	Total	Average Age (in years)
Box car	2,687	126	2,813	31
Covered hopper	7,305	10,639	17,944	28
Flat car	1,439	779	2,218	24
Gondola	3,749	1,430	5,179	21
Intermodal	1,325	—	1,325	16
Multi-level autorack	2,788	567	3,355	30
Company service car	2,265	171	2,436	47
Open top hopper	312	—	312	32
Tank car	214	9	223	14
Total freight cars	22,084	13,721	35,805	28

As of December 31, 2018, CP owned and leased the following units of intermodal equipment:

Intermodal equipment	Owned	Leased	Total	Average Age (in years)
Containers	8,624	294	8,918	7
Chassis	5,774	494	6,268	13
Total intermodal equipment	14,398	788	15,186	9

Headquarters Office Building

CP owns and operates a multi-building campus in Calgary encompassing the head office building, a data centre, training facility and other office and operational buildings.

The Company's main dispatch centre is located in Calgary, and is the primary dispatching facility in Canada. Rail traffic controllers coordinate and dispatch crews, and manage the day-to-day locomotive management along the network, 24 hours a day, and seven days a week. The operations centre has a complete backup system in the event of any power disruption.

In addition to fully operational redundant systems, CP has a fully integrated Business Continuity Centre, should CP's operations centre be affected by any natural disaster, fire, cyber-attack or hostile threat.

CP also maintains a secondary dispatch centre located in Minneapolis, where a facility similar to the one in Calgary exists. It services the dispatching needs of

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locomotives and train crews working in the U.S.

Capital Expenditures

The Company incurs expenditures to expand and enhance its rail network, rolling stock and other infrastructure. These expenditures are aimed at improving efficiency and safety of our operations. Such investments are also an integral part of the Company's multi-year capital program and support growth initiatives. For further details, refer to Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations, Liquidity and Capital Resources.

Encumbrances

Refer to Item 8. Financial Statements and Supplementary Data, Note 17 Debt, for information on the Company's capital lease obligations and assets held as collateral under these agreements.

ITEM 3. LEGAL PROCEEDINGS

For further details, refer to Item 8. Financial Statements and Supplementary Data, Note 24 Commitments and Contingencies.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

EXECUTIVE OFFICERS OF THE REGISTRANT

Our executive officers are appointed by the Board of Directors and they hold office until their successors are appointed, subject to resignation, retirement or removal by the Board of Directors. There are no family relationships among our officers, nor any arrangement or understanding between any officer and any other person pursuant to which the officer was selected. As of the date of this filing, the executive officers' names, ages and business experience are:

Name, Age and Position

Business Experience

Keith Creel, 50 President and Chief Executive Officer	<p>Mr. Creel became President and CEO of CP on January 31, 2017. Previously, he was President and Chief Operating Officer ("COO") from February 5, 2013, to January 30, 2017.</p> <p>Prior to joining CP, Mr. Creel was Executive Vice-President and COO at CN from January 2010 to February 2013. During his time at CN, Mr. Creel held various positions including Executive Vice-President, Operations, Senior Vice-President Eastern Region, Senior Vice-President Western Region, and Vice-President of the Prairie Division.</p> <p>Mr. Creel began his railroad career at Burlington Northern Railway in 1992 as an intermodal ramp manager in Birmingham, Alabama. He also spent part of his career at Grand Trunk Western Railroad as a superintendent and general manager, and at Illinois Central Railroad as a trainmaster and director of corridor operations, prior to its merger with CN in 1999.</p> <p>Mr. Johnson has been Executive Vice-President, Operations of CP since April 20, 2016. Previous to this appointment, Mr. Johnson was CP's Senior Vice-President Operations, Southern Region from June 2013 to April 2016.</p>
Robert Johnson, 57 Executive Vice-President, Operations	<p>Prior to joining CP, Mr. Johnson's railroad career spanned 32 years with BNSF, where he held roles that progressively added to his responsibilities in operations, transportation and service excellence. His most recent position at BNSF was General Manager, Northwest Division, overseeing day-to-day operations for that region. □</p> <p>Mr. Velani has been Executive Vice-President and CFO of CP since October 17, 2017. Previous to this appointment, he was the Vice-President and CFO of CP from October 19, 2016 to October 16, 2017, Vice-President, Investor Relations from October 28, 2015 and Assistant Vice-President, Investor Relations from March 11, 2013.</p>
Nadeem Velani, 46 Executive Vice-President and Chief Financial Officer	<p>Prior to joining CP, Mr. Velani spent 15 years at CN where he worked in a variety of positions in Strategic and Financial Planning, Investor Relations, Sales and Marketing, and the Office of the President and CEO.</p> <p>Mr. Velani holds a bachelor's degree in Economics from Western University and a Masters of Business Administration degree ("MBA") in Finance/International Business from McGill University.</p>
John Brooks, 48 Executive Vice-President and Chief Marketing Officer	<p>Mr. Brooks has been Executive Vice-President and CMO of CP since February 14, 2019. Previous to this appointment, he was the Vice-President and CMO of CP from February 14, 2017 to February 13, 2019. He has worked in senior marketing roles at CP since he joined the Company in 2007, most recently as Vice-President, Marketing - Bulk and Intermodal.</p> <p>Mr. Brooks began his railroading career with UP and later helped start I&M Rail Link, LLC, which was purchased by DM&E in 2002. Mr. Brooks was Vice-President, Marketing at DM&E prior to it being acquired by CP in 2007.</p>
	<p>With more than 20 years in the railroading business, Mr. Brooks brings a breadth of experience to the CMO role that will be pivotal to CP's continued and future</p>

success. □

Mr. Clements has been Vice-President, Strategic Planning and Transportation Services of CP since 2015. Mr. Clements has responsibilities that include strategic network issues and Network Service Centre operations. In addition, he has responsibility for all of CP's facilities and Real Estate across North America.

James Clements, 49
Vice-President, Strategic
Planning and Transportation
Services

Mr. Clements has been at CP for 24 years and his previous experience covers a wide range of areas of CP's business, including car management, finance, joint facilities agreements, logistics, grain marketing and sales in both Canada and the U.S., as well as marketing and sales responsibility for various other lines of business at CP.

He has an MBA in Finance/International Business from McGill University and a Bachelor of Science in Computer Science and Mathematics from McMaster University.

Jeffrey Ellis, 51 Chief Legal Officer and Corporate Secretary	<p>Mr. Ellis has been Chief Legal Officer and Corporate Secretary of CP since November 23, 2015. Mr. Ellis is accountable for the overall strategic leadership, oversight and performance of the legal, corporate secretarial, government relations and public affairs functions of CP in Canada and the U.S.</p> <p>Prior to joining CP in 2015, Mr. Ellis was the U.S. General Counsel at BMO Financial Group. Before joining BMO in 2006, Mr. Ellis was with the law firm of Borden Ladner Gervais LLP in Toronto, Canada.□</p> <p>Mr. Ellis has Bachelor of Arts and Master of Arts from the University of Toronto, Juris Doctor and Master of Laws from Osgoode Hall Law School, and an MBA from the Richard Ivey School of Business, University of Western Ontario. Jeff is a member of the bars of New York, Illinois and Ontario.</p>
Mike Foran, 45 Vice-President, Market Strategy and Asset Management	<p>Mr. Foran has been Vice-President, Market Strategy and Asset Management of CP since February 14, 2017. His prior roles with CP include Vice-President Network Transportation from 2014 to 2017, Assistant Vice-President Network Transportation from 2013 to 2014, and General Manager – Asset Management from 2012 to 2013. In over 20 years at CP, Mr. Foran has worked in operations, business development, marketing and general management.</p>
Michael Redeker, 58 Vice-President and Chief Information Officer	<p>Mr. Foran holds an Executive MBA from the Ivey School of Business at Western University and a Bachelor of Commerce from the University of Calgary.</p> <p>Mr. Redeker has been Vice-President and Chief Information Officer ("CIO") of CP since October 15, 2012.</p> <p>Prior to joining CP, Mr. Redeker was Vice-President and CIO of Alberta Treasury Branch from May 2007 to September 2012. He also spent 11 years at IBM Canada, where he focused on delivering quality information technology services within the financial services industry.</p>
Laird Pitz, 74 Senior Vice-President and Chief Risk Officer	<p>Mr. Pitz has been Senior Vice-President and Chief Risk Officer ("CRO") of CP since October 17, 2017. Previously, he was the Vice-President and CRO of CP from October 29, 2014 to October 16, 2017 and the Vice-President, Security and Risk Management of CP from April 2014 to October 2014.</p> <p>Prior to joining CP, Mr. Pitz was retired from March 2012 to April 2014, and Vice-President, Risk Mitigation of CN from September 2003 to March 2012.</p> <p>Mr. Pitz, a Vietnam War veteran and former Federal Bureau of Investigation special agent, is a 40-year career professional who has directed strategic and operational risk mitigation, security and crisis management functions for companies operating in a wide range of fields, including defence, logistics and transportation.</p>
Chad Rolstad, 42 Vice-President, Human Resources	<p>Mr. Rolstad has been Vice-President, Human Resources of CP since February 14, 2019. Previous to this appointment, he was Assistant Vice-President, Human Resources of CP from August 1, 2018 to February 13, 2019 and Assistant Vice-President, Strategic Procurement of CP from April 10, 2017 to July 31, 2018.</p> <p>Prior to joining CP, Mr. Rolstad held various leadership positions at BNSF Railway in marketing and operations.</p> <p>Mr. Rolstad has a Bachelor of Science from the Colorado School of Mines and an MBA from Duke University.</p>

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED SHAREHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Share Information

The Common Shares are listed on the TSX and on the NYSE under the symbol "CP".

Share Capital

At February 13, 2019, the latest practicable date prior to the date of this Annual Report on Form 10-K, there were 140,041,483 Common Shares and no preferred shares issued and outstanding, which consists of 14,254 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. Each option granted can be exercised for one Common Share. At February 13, 2019, 1.7 million options were outstanding under the Company's MSOIP and stand-alone option agreements entered into with Mr. Keith Creel. There are 1.1 million options available to be issued by the Company's MSOIP in the future.

CP has a Director's Stock Option Plan ("DSOP"), under which directors are granted options to purchase the Common Shares. There are no outstanding options under the DSOP, which has 0.3 million options available to be issued in the future.

Securities Authorized for Issuance Under Equity Compensation Plans

The following table shows, as of December 31, 2018, compensation plans under which equity securities of the Corporation are authorized for issuance upon the exercise of options outstanding under the MSOIP and the DSOP. The table also shows the number of Common Shares available for issuance, including 340,000 Shares under the DSOP. On July 21, 2003, the Board suspended all further grants of options under the DSOP.

Plan Category	(a)	(b)	(c)
	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities available for future issuance under equity compensation plans (excluding securities reflected in column (a))
Equity compensation plans approved by security holders	1,533,598	\$ 176.02	1,641,047
Equity compensation plans not approved by security holders	—	—	—
Total	1,533,598	\$ 176.02	1,641,047

Stock Performance Graph

The following graph provides an indicator of cumulative total shareholder return on the Common Shares, of an assumed investment of \$100, as compared to the TSX 60 Index ("TSX 60"), the Standard & Poor's 500 Stock Index ("S&P 500"), and the peer group index (comprising CN, KCS, UP, NS and CSX) on December 31 for each of the years indicated. The values for the assumed investments depicted on the graph and in the table have been calculated assuming that any dividends are reinvested.

Issuer Purchase of Equity Securities

CP has established a share repurchase program, which is further described in the Share repurchase section in Item 8. Financial Statements and Supplementary Data, Note 20 Shareholders' Equity. During 2018, CP repurchased 4.7 million Common Shares for \$1,127 million at an average price of \$240.68. The following table presents the number of Common Shares repurchased during each month for the fourth quarter of 2018 and the average price paid by CP for the repurchase of such Common Shares.

2018	Total number of shares purchased ⁽¹⁾	Average price paid per share ⁽²⁾	Total number of shares purchased as part of publicly announced plans or programs	Maximum number of shares (or units) that may yet be purchased under the plans or programs
October 1 to October 31	399,700	\$ 259.71	399,700	5,283,240
November 1 to November 30	822,500	272.23	822,500	4,460,740
December 1 to December 31	965,000	249.10	965,000	3,495,740
Ending Balance	2,187,200	\$ 259.74	2,187,200	N/A

⁽¹⁾ Includes shares repurchased but not yet cancelled at quarter end.

⁽²⁾ Includes brokerage fees.

ITEM 6. SELECTED FINANCIAL DATA

The following table presents as of, and for the years ended, December 31, selected financial data related to the Company's financial results for the last five fiscal years. The selected financial data should be read in conjunction with Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations and Item 8. Financial Statements and Supplementary Data.

For information regarding historical exchange rates, please see Impact of FX on Earnings in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

(in millions, except per share data, percentage and ratios)	2018	2017	2016	2015	2014
Financial Performance					
Total revenues	\$7,316	\$6,554	\$6,232	\$6,712	\$6,620
Operating income ⁽¹⁾	2,831	2,519	2,411	2,618	2,202
Adjusted operating income ^{(1) (2)}	2,831	2,468	2,411	2,550	2,198
Net income	1,951	2,405	1,599	1,352	1,476
Adjusted income ⁽²⁾	2,080	1,666	1,549	1,625	1,482
Basic earnings per share ("EPS")	13.65	16.49	10.69	8.47	8.54
Diluted EPS	13.61	16.44	10.63	8.40	8.46
Adjusted diluted EPS ⁽²⁾	14.51	11.39	10.29	10.10	8.50
Dividends declared per share	2.5125	2.1875	1.8500	1.4000	1.4000
Financial Position					
Total assets	\$21,254	\$20,135	\$19,221	\$19,637	\$16,550
Total long-term debt, including current portion	8,696	8,159	8,684	8,957	5,759
Total shareholders' equity	6,636	6,437	4,626	4,796	5,610
Cash provided by operating activities	2,712	2,182	2,089	2,459	2,123
Free cash ⁽²⁾	1,289	874	1,007	1,381	969
Financial Ratios					
Return on invested capital ("ROIC") ⁽²⁾	15.3	%20.5	%14.4	%12.9	%14.4
Adjusted ROIC ⁽²⁾	16.2	%14.7	%14.0	%15.2	%14.5
Operating ratio ^{(1) (3)}	61.3	%61.6	%61.3	%61.0	%66.7
Adjusted operating ratio ^{(1) (2)}	61.3	%62.4	%61.3	%62.0	%66.7

Comparative years' figures have been restated for the retrospective adoption of Accounting Standards Update ("ASU")

(1) 2017-07, and the impact on the 2017 and 2016 comparatives are discussed further in Item 8. Financial Statements and Supplementary Data, Note 2 Accounting changes. The restatements of 2015 and 2014 comparatives resulted in a decrease in Operating income of \$70 million and \$137 million for the years ended December 31, 2015 and 2014, respectively.

(2) 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 in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

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

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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The following discussion and analysis should be read in conjunction with the Company's Consolidated Financial Statements and the related notes in Item 8. Financial Statements and Supplementary Data, and other information in this report. Except where otherwise indicated, all financial information reflected herein is expressed in Canadian dollars.

In the first quarter of 2018, the comparative figures contained in or derived from the Consolidated Statement of Income were restated to reflect the adoption of the new Accounting Standards Update ("ASU") ASU 2017-07 for presentation of Other components of net periodic benefit recovery. These changes in presentation do not result in any changes to net income or earnings per share. For further information, refer to Item 8. Financial Statements and Supplemental Data, Note 2 Accounting changes.

Executive Summary

2018 Results

Financial performance – In 2018, CP reported Diluted EPS of \$13.61, a 17% decrease from \$16.44 in 2017. The Adjusted diluted EPS increased to \$14.51, a 27% improvement compared to Adjusted diluted EPS of \$11.39 in 2017. CP's commitment to service and operational efficiency produced an Operating ratio and Adjusted operating ratio of 61.3%. Adjusted diluted EPS and Adjusted operating ratio are defined and reconciled in Non-GAAP Measures and discussed further in Results of Operations of this Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Total revenues – CP's total revenues increased by 12% to \$7,316 million in 2018 from \$6,554 million in 2017, driven primarily by an 8% volume growth as measured in revenue ton-miles ("RTM").

Operating performance – CP's average train weight increased by 3% to 9,100 tons and fuel efficiency improved by 3%, primarily as a result of improvements in operating plan efficiency. Average train speed decreased by 5% to 21.5 miles per hour and average dwell time increased by 3% to 6.8 hours in 2018 primarily from network disruptions from labour negotiations in the second quarter and harsher weather conditions in the first quarter. These metrics are discussed further in Performance Indicators of this Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

The following table compares 2018 outlook to actual results:

	Revenue growth	Adjusted diluted EPS⁽¹⁾	Capital expenditures
		Initially set as low double-digits Adjusted diluted EPS growth from full-year 2017 Adjusted diluted EPS of \$11.39.	Approximately \$1.35 billion to \$1.50 billion
Outlook	Mid-single digits	Revised at the end of the third quarter to grow in excess of 20% from the full-year 2017 Adjusted diluted EPS.	Revised at the end of the third quarter to \$1.60 billion.
Actual outcomes	Revenue growth of 12% to \$7,316 million	Adjusted diluted EPS growth of 27% to \$14.51	\$1.55 billion

⁽¹⁾ Adjusted diluted EPS is defined and reconciled in Non-GAAP Measures of this Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations. Due to reasons similar to those described in the 2019 Outlook section below, CP had not calculated an outlook for Diluted EPS in 2018.

During 2018, CP exceeded its revenue growth primarily due to sustainable volume growth, mainly attributable to increased shipments of Energy, chemicals and plastics, Intermodal, and Potash, partially offset by decreased shipments of U.S. grain. CP also exceeded its Adjusted diluted EPS outlook primarily due to volume growth and continued cost control. Capital expenditures were \$1.55 billion spent primarily on network improvements, growth initiatives and renewal of depleted assets.

2019 Outlook

With a 2019 plan that encompasses profitable sustainable growth, CP expects RTM growth to be in the mid-single digit and Adjusted diluted EPS growth to be in the double-digits. CP's expectations for Adjusted diluted EPS growth in 2019 are based on Adjusted diluted EPS of \$14.51 in 2018. CP assumes the Canadian-to-U.S. dollar exchange

rate will be approximately \$1.30 and expects an effective tax rate in the range of 25.5 to 26 percent. CP estimates other components of net periodic benefit recovery to increase by \$11 million versus 2018, and no material land sales. As CP continues to invest in service, productivity and safety, the Company plans to invest approximately \$1.6 billion in capital programs in 2019. Capital programs are defined and discussed further in Liquidity and Capital Resources of this Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Adjusted diluted EPS is defined and discussed further in Non-GAAP Measures and in Forward-Looking Statements of this Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations. Although CP has provided a forward-looking non-GAAP measure (Adjusted diluted EPS), it is not practicable to provide a reconciliation to a forward-looking reported Diluted EPS, the most comparable GAAP measure, due to unknown variables and uncertainty related to future results. These unknown variables may include unpredictable transactions of significant value. In past years, CP has recognized significant asset impairment charges and management transition recoveries or costs related to senior executives. These or other similar, large unforeseen transactions affect Diluted EPS but may be excluded from CP's Adjusted diluted EPS. Additionally, the Canadian-to-U.S. dollar exchange rate is unpredictable and can have a significant impact on CP's reported results but may be excluded from CP's Adjusted diluted EPS. In particular, CP excludes the foreign exchange ("FX") impact

of translating the Company's U.S. dollar denominated long-term debt from Adjusted diluted EPS. Please see Forward-Looking Statements of this Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations for further discussion.

Performance Indicators

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

	%			
	Change			
For the year ended December 31	2018	2017 ⁽¹⁾	2016 ⁽¹⁾	
Golden State, California Tobacco Securitization Corp. Revenue Bonds, (FGIC Insured), Series 2005				11,000
5.000% due 06/01/2045		4,000	4,072	
Golden State, California Tobacco Securitization Corp. Revenue Bonds, Series 2007				11,199
5.750% due 06/01/2047		23,585	18,814	
JPMorgan Chase Putters/Drivers Trust, California Revenue Bonds, Series 2009				
5.000% due 07/01/2037 (a)		5,000	5,467	
Lancaster Redevelopment Agency, California Tax Allocation Bonds, Series 2009				
6.875% due 08/01/2039		500	610	
Long Beach Unified School District, California General Obligation Bonds, Series 2009				
5.750% due 08/01/2033		5,000	5,747	
Long Beach, California Airport System Revenue Bonds, Series 2010				
5.000% due 06/01/2040		2,120	2,226	
Los Angeles Community College District, California General Obligation Bonds, Series 2009				
14.038% due 08/01/2033 (b)		1,000	1,349	
Los Angeles Department of Water & Power, California Revenue Bonds, Series 2005				
4.750% due 07/01/2030 (a)		6,000	6,148	
Los Angeles Department of Water & Power, California Revenue Bonds, Series 2009				
5.000% due 07/01/2039 (a)		10,000	11,258	
Los Angeles Department of Water & Power, California Revenue Bonds, Series 2012				
5.000% due 07/01/2037		2,000	2,257	
5.000% due 07/01/2043		2,115	2,363	
Los Angeles Department of Water & Power, California Revenue Bonds, Series 2014				
5.000% due 07/01/2043		3,000	3,409	
				PRINCIPAL AMOUNT (000S)
				MARKET VALUE (000S)
Los Angeles Unified School District, California General Obligation Bonds, Series 2009				
5.000% due 01/01/2034 (a)				\$ 10,000
M-S-R Energy Authority, California Revenue Bonds, Series 2009				\$ 3,825
6.500% due 11/01/2039				5,188
Malibu, California Certificates of Participation Bonds, Series 2009				576
5.000% due 07/01/2039				1,127
Manteca Financing Authority, California Revenue Bonds, Series 2009				3,323
5.750% due 12/01/2036				1,366
Montebello Unified School District, California General Obligation Bonds, (AGM Insured), Series 2008				1,902
5.000% due 08/01/2033				5,511
Peralta Community College District, California General Obligation Bonds, Series 2009				500
5.000% due 08/01/2039				3,411
Poway Unified School District, California Special Tax Bonds, Series 2005				1,458
5.125% due 09/01/2028				6,847
Regents of the University of California Medical Center Pooled Revenue Bonds, Series 2013				
5.000% due 05/15/2043				
Rocklin Unified School District Community Facilities District, California Special Tax Bonds, (NPFGC Insured), Series 2004				
5.000% due 09/01/2029				
Sacramento Municipal Utility District, California Revenue Bonds, Series 2013				
5.000% due 08/15/2037				
San Diego County, California Regional Airport Authority Revenue Bonds, Series 2013				
5.000% due 07/01/2043				
San Diego County, California Water Authority Certificates of Participation Bonds, (AGM Insured), Series 2008				
5.000% due 05/01/2038				
San Diego Public Facilities Financing Authority Sewer, California Revenue Bonds, Series 2009				

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5.250% due 05/15/2039	4,000	4,572
San Diego Regional Building Authority, California Revenue Bonds, Series 2009		
5.375% due 02/01/2036	2,200	2,428
San Francisco, California City & County Certificates of Participation Bonds, Series 2009		
5.250% due 04/01/2031	550	614
San Francisco, California City & County Redevelopment Agency Special Tax Bonds, Series 2013		
5.000% due 08/01/2028	1,505	1,650

See Accompanying Notes

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Table of Contents**Schedule of Investments PIMCO California Municipal Income Fund III (Cont.)**

	PRINCIPAL AMOUNT (000S)	MARKET VALUE (000S)
San Jose, California Hotel Tax Revenue Bonds, Series 2011		
6.500% due 05/01/2036	\$ 1,500	\$ 1,834
San Marcos Public Facilities Authority, California Tax Allocation Bonds, (FGIC Insured), Series 2003		
5.000% due 08/01/2033	12,200	12,306
San Marcos Unified School District, California General Obligation Bonds, Series 2011		
5.000% due 08/01/2038	1,000	1,100
Santa Clara County, California Financing Authority Revenue Bonds, (AMBAC Insured), Series 2007		
5.750% due 02/01/2041	500	546
Santa Cruz County, California Redevelopment Agency Tax Allocation Bonds, Series 2009		
7.000% due 09/01/2036	1,200	1,405
South Tahoe Joint Powers Financing Authority, California Revenue Bonds, Series 2003		
5.450% due 10/01/2033	4,425	4,425
Torrance, California Revenue Bonds, Series 2001		
5.500% due 06/01/2031	2,950	2,958
Washington Township Health Care District, California General Obligation Bonds, Series 2013		
5.000% due 08/01/2043	2,500	2,725
Western Municipal Water District Facilities Authority, California Revenue Bonds, Series 2009		
5.000% due 10/01/2039	2,000	2,115
Westlake Village, California Certificates of Participation Bonds, Series 2009		
5.000% due 06/01/2039	1,000	1,021
		350,965
INDIANA 2.3%		
Vigo County, Indiana Hospital Authority Revenue Bonds, Series 2007		
5.750% due 09/01/2042	5,000	5,045
NEW JERSEY 0.4%		
Tobacco Settlement Financing Corp., New Jersey Revenue Bonds, Series 2007		
4.750% due 06/01/2034	1,000	742
NEW YORK 1.5%		
New York City, New York Water & Sewer System Revenue Bonds, Series 2005		
5.000% due 06/15/2037 (a)	3,300	3,398
Total Municipal Bonds & Notes		
(Cost \$324,201)		
		360,150
	PRINCIPAL AMOUNT (000S)	MARKET VALUE (000S)
U.S. TREASURY OBLIGATIONS 0.0%		
U.S. Treasury Notes		
0.500% due 10/15/2014	\$ 100	\$ 100
Total U.S. Treasury Obligations		
(Cost \$100)		
		100

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SHORT-TERM INSTRUMENTS 7.0%		
REPURCHASE AGREEMENTS (c) 4.1%		
		9,000
SHORT-TERM NOTES 2.9%		
Federal Home Loan Bank		
0.091% due 03/13/2015	6,500	6,497
U.S. TREASURY BILLS 0.0%		
0.057% due 12/26/2014	100	100
Total Short-Term Instruments (Cost \$15,597)		15,597
Total Investments in Securities (Cost \$339,898)		375,847
Total Investments 169.7% (Cost \$339,898)		\$ 375,847
Preferred Shares (56.4%)		(125,000)
Other Assets and Liabilities, net (13.3%)		(29,432)
Net Assets Applicable to Common Shareholders 100.0%		\$ 221,415

30 PIMCO CLOSED-END FUNDS

See Accompanying Notes

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September 30, 2014

NOTES TO SCHEDULE OF INVESTMENTS (AMOUNTS IN THOUSANDS):

- (a) Residual Interest Bonds held in Trust Securities represent underlying bonds transferred to a separate securitization trust established in a tender option bond transaction in which the Fund acquired the residual interest certificates. These securities serve as collateral in a financing transaction.
- (b) Inverse Floater The interest rate shown bears an inverse relationship to the interest rate on another security or the value of an index. The interest rate disclosed reflects the rate in effect on September 30, 2014.

BORROWINGS AND OTHER FINANCING TRANSACTIONS**(c) REPURCHASE AGREEMENTS:**

Counterparty	Lending Rate	Settlement Date	Maturity Date	Principal Amount	Collateralized By	Collateral Received, at Value	Repurchase Agreements, at Value	Repurchase Agreement Proceeds to be Received ⁽¹⁾
SAL	0.010%	09/30/2014	10/01/2014	\$ 9,000	U.S. Treasury Notes 2.500% due 03/31/2015	\$ (9,187)	\$ 9,000	\$ 9,000
Total Repurchase Agreements						\$ (9,187)	\$ 9,000	\$ 9,000

⁽¹⁾ Includes accrued interest.

BORROWINGS AND OTHER FINANCING TRANSACTIONS SUMMARY

The following is a summary by counterparty of the market value of Borrowings and Other Financing Transactions and collateral (received) as of September 30, 2014:

Counterparty	Repurchase Agreement Proceeds to be Received	Payable for Reverse Repurchase Agreements	Payable for Sale-Buyback Transactions	Payable for Short Sales	Total Borrowings and Other Financing Transactions	Collateral (Received)	Net Exposure ⁽²⁾
Global/Master Repurchase Agreement							
SAL	\$ 9,000	\$ 0	\$ 0	\$ 0	\$ 9,000	\$ (9,187)	\$ (187)
Total Borrowings and Other Financing Transactions	\$ 9,000	\$ 0	\$ 0	\$ 0			

⁽²⁾ Net Exposure represents the net receivable/(payable) that would be due from/to the counterparty in the event of default. Exposure from borrowings and other financing transactions can only be netted across transactions governed under the same master agreement with the same legal entity. See Note 6, Principal Risks, in the Notes to Financial Statements for more information regarding master netting arrangements.

See Accompanying Notes

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Table of Contents**Schedule of Investments PIMCO California Municipal Income Fund III (Cont.)**

September 30, 2014

FAIR VALUE MEASUREMENTS

The following is a summary of the fair valuations according to the inputs used as of September 30, 2014 in valuing the Fund's assets and liabilities:

Category and Subcategory	Level 1	Level 2	Level 3	Fair Value at 09/30/2014
Investments in Securities, at Value				
Municipal Bonds & Notes				
California	\$ 0	\$ 350,965	\$ 0	\$ 350,965
Indiana	0	5,045	0	5,045
New Jersey	0	742	0	742
New York	0	3,398	0	3,398
U.S. Treasury Obligations	0	100	0	100
Short-Term Instruments				
Repurchase Agreements	0	9,000	0	9,000
Short-Term Notes	0	6,497	0	6,497
U.S. Treasury Bills	0	100	0	100
Total Investments	\$ 0	\$ 375,847	\$ 0	\$ 375,847

There were no significant transfers between Level 1, 2, and 3 during the period ended September 30, 2014.

32 PIMCO CLOSED-END FUNDS

See Accompanying Notes

Table of Contents**Schedule of Investments PIMCO New York Municipal Income Fund III**

September 30, 2014

	PRINCIPAL AMOUNT (000S)	MARKET VALUE (000S)
INVESTMENTS IN SECURITIES 166.8%		
MUNICIPAL BONDS & NOTES 165.5%		
DISTRICT OF COLUMBIA 0.4%		
District of Columbia Tobacco Settlement Financing Corp. Revenue Bonds, Series 2001		
6.500% due 05/15/2033	\$ 175	\$ 194
NEW YORK 161.0%		
Brooklyn Arena Local Development Corp., New York Revenue Bonds, Series 2009		
6.375% due 07/15/2043	1,000	1,133
Build NYC Resource Corp., New York Revenue Bonds, Series 2014		
5.000% due 06/01/2043	500	562
Chautauqua Industrial Development Agency, New York Revenue Bonds, Series 2009		
5.875% due 04/01/2042	1,500	1,676
Dutchess County, New York Industrial Development Agency Revenue Bonds, Series 2007		
5.250% due 01/01/2037	730	646
Erie County, New York Industrial Development Agency Revenue Bonds, Series 2011		
5.250% due 05/01/2025	1,000	1,182
Hudson Yards Infrastructure Corp., New York Revenue Bonds, Series 2011		
5.750% due 02/15/2047	4,000	4,616
Long Island Power Authority, New York Revenue Bonds, Series 2009		
5.750% due 04/01/2039	1,500	1,698
Metropolitan Transportation Authority, New York Revenue Bonds, Series 2009		
5.000% due 11/15/2034	500	564
Metropolitan Transportation Authority, New York Revenue Bonds, Series 2013		
5.000% due 11/15/2042	2,000	2,210
5.000% due 11/15/2043	4,000	4,418
Monroe County Industrial Development Corp., New York Revenue Bonds, (FHA Insured), Series 2010		
5.500% due 08/15/2040	1,500	1,708
Monroe County Industrial Development Corp., New York Revenue Bonds, Series 2013		
5.000% due 07/01/2043	1,750	1,963
Nassau County, New York Industrial Development Agency Revenue Bonds, Series 2007		
6.700% due 01/01/2043	500	365
New York City, New York General Obligation Bonds, Series 2013		
5.000% due 08/01/2031	2,590	2,991
	PRINCIPAL AMOUNT (000S)	MARKET VALUE (000S)
New York City, New York Industrial Development Agency Revenue Bonds, (AGC Insured), Series 2009		
6.500% due 01/01/2046	\$ 600	\$ 697
7.000% due 03/01/2049	2,200	2,661
New York City, New York Transitional Finance Authority Future Tax Secured Revenue Bonds, Series 2013		
5.000% due 11/01/2042	2,000	2,253
New York City, New York Trust for Cultural Resources Revenue Bonds, Series 2014		
5.000% due 08/01/2043	2,000	2,229
New York City, New York Water & Sewer System Revenue Bonds, Series 2007		
4.750% due 06/15/2035 (a)	5,000	5,368
New York City, New York Water & Sewer System Revenue Bonds, Series 2009		

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5.000% due 06/15/2039	1,500	1,675
New York City, New York Water & Sewer System Revenue Bonds, Series 2012		
5.000% due 06/15/2047	2,500	2,752
New York Counties Tobacco Trust Revenue Bonds, Series 2001		
5.750% due 06/01/2043	2,000	2,000
New York Liberty Development Corp. Revenue Bonds, Series 2007		
5.500% due 10/01/2037	2,400	2,930
New York Liberty Development Corp. Revenue Bonds, Series 2010		
5.125% due 01/15/2044	2,000	2,204
6.375% due 07/15/2049	1,050	1,178
New York Liberty Development Corp. Revenue Bonds, Series 2011		
5.750% due 11/15/2051	4,000	4,642
New York State Dormitory Authority Revenue Bonds, Series 2009		
5.000% due 03/15/2038	1,000	1,119
5.500% due 03/01/2039	1,200	1,330
New York State Dormitory Authority Revenue Bonds, Series 2010		
5.500% due 07/01/2040	500	562
New York State Dormitory Authority Revenue Bonds, Series 2011		
6.000% due 07/01/2040	250	287
New York State Dormitory Authority Revenue Bonds, Series 2012		
5.000% due 05/15/2026	1,225	1,443
5.000% due 12/15/2027	2,000	2,375
5.000% due 07/01/2042	850	946
New York State Dormitory Authority Revenue Bonds, Series 2013		
5.000% due 02/15/2029	750	872

See Accompanying Notes

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Table of Contents**Schedule of Investments PIMCO New York Municipal Income Fund III (Cont.)**

	PRINCIPAL AMOUNT (000S)	MARKET VALUE (000S)
New York State Environmental Facilities Corp. Revenue Bonds, Series 2007		
4.750% due 06/15/2032	\$ 750	\$ 811
New York State Thruway Authority Revenue Bonds, Series 2012		
5.000% due 01/01/2042	1,600	1,739
New York State Urban Development Corp. Revenue Bonds, Series 2005		
5.000% due 03/15/2035	2,400	2,446
New York State Urban Development Corp. Revenue Bonds, Series 2009		
5.000% due 03/15/2036 (a)	2,200	2,464
Niagara Tobacco Asset Securitization Corp., New York Revenue Bonds, Series 2014		
5.250% due 05/15/2034	500	549
5.250% due 05/15/2040	500	544
Onondaga County, New York Revenue Bonds, Series 2011		
5.000% due 12/01/2036	400	443
Port Authority of New York & New Jersey Revenue Bonds, Series 2010		
6.000% due 12/01/2036	600	702
Triborough Bridge & Tunnel Authority, New York Revenue Notes, Series 2009		
5.250% due 11/15/2034 (a)	2,000	2,267
Troy Capital Resource Corp., New York Revenue Bonds, Series 2010		
5.125% due 09/01/2040	1,400	1,526
TSASC, Inc., New York Revenue Bonds, Series 2006		
5.000% due 06/01/2026	4,000	3,910
5.000% due 06/01/2034	100	84
5.125% due 06/01/2042	500	405
Warren & Washington Counties Industrial Development Agency, New York Revenue Bonds, (AGM Insured), Series 2003		
5.000% due 12/01/2035	2,000	2,002
Westchester County Healthcare Corp., New York Revenue Bonds, Series 2010		
6.125% due 11/01/2037	600	686
Yonkers Economic Development Corp., New York Revenue Bonds, Series 2010		
6.000% due 10/15/2030	100	106
		85,939
OHIO 3.1%		
Buckeye Tobacco Settlement Financing Authority, Ohio Revenue Bonds, Series 2007		
6.500% due 06/01/2047	1,950	1,641
	PRINCIPAL AMOUNT (000S)	MARKET VALUE (000S)
U.S. VIRGIN ISLANDS 1.0%		
Virgin Islands Public Finance Authority, U.S. Virgin Islands Revenue Bonds, Series 2009		
6.000% due 10/01/2039	\$ 500	\$ 556
Total Municipal Bonds & Notes		
(Cost \$81,071)		
		88,330
SHORT-TERM INSTRUMENTS 1.3%		
SHORT-TERM NOTES 1.3%		
Federal Home Loan Bank		

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0.091% due 03/13/2015

700

700

Total Short-Term Instruments (Cost \$700)		700
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Total Investments in Securities (Cost \$81,771)		89,030
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Total Investments 166.8% (Cost \$81,771)	\$	89,030
Preferred Shares (60.0%)		(32,000)
Other Assets and Liabilities, net (6.8%)		(3,661)

Net Assets 100%	\$	53,369
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34 PIMCO CLOSED-END FUNDS

See Accompanying Notes

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NOTES TO SCHEDULE OF INVESTMENTS:

(a) Residual Interest Bonds held in Trust Securities represent underlying bonds transferred to a separate securitization trust established in a tender option bond transaction in which the Fund acquired the residual interest certificates. These securities serve as collateral in a financing transaction.

FAIR VALUE MEASUREMENTS

The following is a summary of the fair valuations according to the inputs used as of September 30, 2014 in valuing the Fund's assets and liabilities:

Category and Subcategory	Level 1	Level 2	Level 3	Fair Value at 09/30/2014
Investments in Securities, at Value				
Municipal Bonds & Notes				
District of Columbia	\$ 0	\$ 194	\$ 0	\$ 194
New York	0	85,939	0	85,939
Ohio	0	1,641	0	1,641
U.S. Virgin Islands	0	556	0	556
Short-Term Instruments				
Short-Term Notes	0	700	0	700
Total Investments	\$ 0	\$ 89,030	\$ 0	\$ 89,030

There were no significant transfers between Level 1, 2, and 3 during the period ended September 30, 2014.

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Notes to Financial Statements

1. ORGANIZATION

PIMCO Municipal Income Fund III, PIMCO California Municipal Income Fund III and PIMCO New York Municipal Fund III, (each a Fund and collectively the Funds) were organized as Massachusetts business trusts on August 20, 2002 as closed-end management investment companies registered under the Investment Company Act of 1940, as amended (the Act) and the rules and regulations thereunder. PIMCO Municipal Income Fund III is classified and managed as a diversified Fund, and PIMCO California Municipal Income Fund III and PIMCO New York Municipal Fund III are classified and managed as non-diversified funds. Pacific Investment Management Company LLC (PIMCO or the Manager) serves as the Funds investment manager.

Prior to the close of business on September 5, 2014, Allianz Global Investors Fund Management LLC (AGIFM) and PIMCO served as the Funds investment manager and sub-adviser, respectively. Effective at the close of business on September 5, 2014, each Fund entered into a new investment management agreement (the Agreement) with PIMCO, pursuant to which PIMCO replaced AGIFM as the investment manager to the Funds. Under the Agreement, PIMCO continues to provide the day-to-day portfolio management services it provided to each Fund as its sub-adviser and also assumed responsibility for providing the supervisory and administrative services previously provided by AGIFM to each Fund as its investment manager. The same investment professionals that were responsible for managing each Fund s portfolio prior to the transition continue to do so following the transition. PIMCO personnel have replaced AGIFM personnel as Fund officers and in other roles to provide and oversee the administrative, accounting/financial reporting, compliance, legal, marketing, transfer agency, shareholder servicing and other services required for the daily operations of each Fund. Please see Fees and Expenses below for additional information.

Each Fund has authorized an unlimited number of Common Shares at a par value of \$0.00001 per share.

2. SIGNIFICANT ACCOUNTING POLICIES

The following is a summary of significant accounting policies consistently followed by each Fund in the preparation of its financial statements in conformity with accounting principles generally accepted in the United States of America (U.S. GAAP). The preparation of financial statements in accordance with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of increases and decreases in net assets from operations during the reporting period. Actual results could differ from those estimates.

(a) **Securities Transactions and Investment Income** Securities transactions are recorded as of the trade date for financial reporting purposes. Securities purchased or sold on a when-issued or delayed-delivery basis may be settled 15 days or more after the trade date. Realized gains and losses from securities sold are recorded on the identified cost basis. Dividend income is recorded on the ex-dividend date, except certain dividends from foreign securities where the ex-dividend date may have passed, which are recorded as soon as the Fund is informed of the ex-dividend date. Interest income, adjusted for the accretion of discounts and amortization of premiums, is recorded on the accrual basis from settlement date. Tax liabilities realized as a result of such security sales are reflected as a component of net realized gain/loss on investments on the Statements of Operations.

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Debt obligations may be placed on non-accrual status and related interest income may be reduced by ceasing current accruals and writing off interest receivable when the collection of all or a portion of interest has become doubtful based on consistently applied procedures. A debt obligation is removed from non-accrual status when the issuer resumes interest payments or when collectability of interest is probable.

(b) **Distributions Common Shares** The Funds intend to declare distributions from net investment income to common shareholders monthly. Distributions of net realized gains, if any, are paid at least annually.

Income distributions and capital gain distributions are determined in accordance with income tax regulations which may differ from U.S. GAAP. Differences between tax regulations and U.S. GAAP may cause timing differences between income and capital gain recognition. Examples of events that give rise to timing differences include wash sales, straddles and capital loss carryforwards. Further, the character of investment income and capital gains may be different for certain transactions under the two methods of accounting. Examples of characterization differences include the treatment of paydowns on mortgage-backed securities, swaps, foreign currency transactions and contingent debt instruments. As a result, income distributions and capital gain distributions declared during a fiscal period may differ significantly from the net investment income (loss) and realized gains (losses) reported on each Fund's annual financial statements presented under U.S. GAAP.

Distributions classified as a tax basis return of capital, if any, are reflected on the accompanying Statements of Changes in Net Assets and have been recorded to paid in capital. In addition, other amounts have been reclassified between undistributed net investment income, accumulated undistributed net realized gains or losses and/or paid in capital to more appropriately conform financial accounting to tax characterizations of distributions.

(c) **New Accounting Pronouncements** In June 2013, the Financial Accounting Standards Board (FASB) issued an Accounting Standards Update (ASU) providing updated guidance for assessing whether an entity is an investment company and for the measurement of noncontrolling ownership interests in other investment companies. This update is effective prospectively during interim or annual periods beginning on or after December 15, 2013. At this time, management is evaluating the ASU to determine whether it will impact the financial statements.

In June 2014, the FASB issued an ASU that expands secured borrowing accounting for certain repurchase agreements. The ASU also sets forth additional disclosure requirements for certain transactions accounted for as sales, in order to provide financial statement users with information to compare to similar transactions accounted for as secured borrowings. The ASU is effective prospectively during interim or annual periods beginning after December 15, 2014. At this time, management is evaluating the implications of these changes on the financial statements.

3. INVESTMENT VALUATION AND FAIR VALUE MEASUREMENTS

(a) **Investment Valuation Policies** The Net Asset Value (NAV) of a Fund's shares is valued as of the close of regular trading (normally 4:00 p.m., Eastern time) (the NYSE Close) on each day that the New York Stock Exchange (NYSE) is open (each a Business Day). Information that becomes

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Notes to Financial Statements (Cont.)

known to a Fund or its agents after the NAV has been calculated on a particular day will not generally be used to retroactively adjust the price of a security or the NAV determined earlier that day.

For purposes of calculating the NAV, portfolio securities and other financial derivative instruments are valued on each Business Day using valuation methods as adopted by the Board of Trustees (the Board) of each Fund. The Board has formed a Valuation Committee, whose function is to monitor the valuation of portfolio securities and other financial derivative instruments and, as required by the Funds' valuation policies, determine in good faith the fair value of the Funds' portfolio holdings after consideration of all relevant factors, including recommendations provided by the Manager. The Board has delegated responsibility for applying the valuation methods to the Manager. The Manager monitors the continual appropriateness of methods applied and determines if adjustments should be made in light of market factor changes and events affecting issuers.

Where market quotes are readily available, fair market value is generally determined on the basis of official closing prices or the last reported sales prices, or if no sales are reported, based on quotes obtained from a quotation reporting system, established market makers, or pricing services. Where market quotes are not readily available, portfolio securities and other financial derivative instruments are valued at fair value, as determined in good faith by the Board, its Valuation Committee, or the Manager pursuant to instructions from the Board or its Valuation Committee. Market quotes are considered not readily available in circumstances where there is an absence of current or reliable market-based data (e.g., trade information, bid/ask information, or broker quotes), including where events occur after the close of the relevant market, but prior to the NYSE Close, that materially affect the values of a Fund's securities or financial derivative instruments. In addition, market quotes are considered not readily available when, due to extraordinary circumstances, the exchanges or markets on which securities trade do not open for trading for the entire day and no other market prices are available. The Board has delegated to the Manager the responsibility for monitoring significant events that may materially affect the values of a Fund's securities or financial derivative instruments and for determining whether the value of the applicable securities or financial derivative instruments should be re-evaluated in light of such significant events.

The Board has adopted methods for valuing securities and other financial derivative instruments that may require fair valuation under particular circumstances. The Manager monitors the continual appropriateness of fair valuation methods applied and determines if adjustments should be made in light of market changes, events affecting the issuer, or other factors. If the Manager determines that a fair valuation method may no longer be appropriate, another valuation method may be selected, or the Valuation Committee may take any appropriate action in accordance with procedures set forth by the Board. The Board reviews the appropriateness of the valuation methods from time to time, and these methods may be amended or supplemented from time to time by the Valuation Committee.

In circumstances in which daily market quotes are not readily available, investments may be valued pursuant to guidelines established by the Board. In the event that the security or asset cannot be valued pursuant to the established guidelines, the value of the security or other financial derivative instrument will be determined in good faith by the Valuation Committee of the Board, generally based upon recommendations provided by PIMCO. These methods may require subjective determinations about the value of a security. While each Fund's policy is intended to result in a

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calculation of a Fund's NAV that fairly reflects security values as of the time of pricing, the Funds cannot guarantee that values determined by the Board or persons acting at their direction would accurately reflect the price that a Fund could obtain for a security if it were to dispose of that security as of the time of pricing (for instance, in a forced or distressed sale). The prices used by a Fund may differ from the value that would be realized if the securities were sold.

(b) **Fair Value Hierarchy** U.S. GAAP describes fair market value as the price that a Fund would receive to sell an asset or pay to transfer a liability in an orderly transaction between market participants at the measurement date. It establishes a fair value hierarchy that prioritizes inputs to valuation methods and requires disclosure of the fair value hierarchy, separately for each major category of assets and liabilities, that segregates fair value measurements into levels (Level 1, 2, and 3). The inputs or methodology used for valuing securities are not necessarily an indication of the risk associated with investing in those securities. Levels 1, 2, and 3 of the fair value hierarchy are defined as follows:

- ⁿ Level 1 Inputs using (unadjusted) quoted prices in active markets or exchanges for identical assets and liabilities.
- ⁿ Level 2 Significant other observable inputs, which may include, but are not limited to, quoted prices for similar assets or liabilities in markets that are active, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the assets or liabilities (such as interest rates, yield curves, volatilities, prepayment speeds, loss severities, credit risks and default rates) or other market corroborated inputs.
- ⁿ Level 3 Significant unobservable inputs based on the best information available in the circumstances, to the extent observable inputs are not available, which may include assumptions made by the Board or persons acting at their direction that are used in determining the fair value of investments.

In accordance with the requirements of U.S. GAAP, the amounts of transfers between Levels 1 and 2 and transfers in and out of Level 3, if material, are disclosed in the Notes to Schedule of Investments for each respective Fund.

For fair valuations using significant unobservable inputs, U.S. GAAP requires a reconciliation of the beginning to ending balances for reported fair values that presents changes attributable to total realized and unrealized gains or losses, purchases and sales, and transfers in or out of the Level 3 category during the period. The end of period timing recognition is used for the transfers between Levels of the Fund's assets and liabilities. Additionally, U.S. GAAP requires quantitative information regarding the significant unobservable inputs used in the determination of fair value of assets or liabilities categorized as Level 3 in the fair value hierarchy. In accordance with the requirements of U.S. GAAP, a fair value hierarchy, and if material, a Level 3 reconciliation and details of significant unobservable inputs, have been included in the Notes to Schedule of Investments for each respective Fund.

(c) **Valuation Techniques and the Fair Value Hierarchy Level 1 and Level 2 trading assets and trading liabilities, at fair market value** The valuation methods (or techniques) and significant inputs used in determining the fair market values of

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Notes to Financial Statements (Cont.)

portfolio securities or financial derivative instruments categorized as Level 1 and Level 2 of the fair value hierarchy are as follows:

Fixed income securities including corporate, convertible and municipal bonds and notes, U.S. government agencies, U.S. treasury obligations, sovereign issues, bank loans, convertible preferred securities and non-U.S. bonds are normally valued by pricing service providers that use broker-dealer quotations, reported trades or valuation estimates from their internal pricing models. The service providers' internal models use inputs that are observable such as issuer details, interest rates, yield curves, prepayment speeds, credit risks/spreads, default rates and quoted prices for similar assets. Securities that use similar valuation techniques and inputs as described above are categorized as Level 2 of the fair value hierarchy.

Short-term investments having a maturity of 60 days or less and repurchase agreements are generally valued at amortized cost which approximates fair market value. These investments are categorized as Level 2 of the fair value hierarchy.

4. SECURITIES AND OTHER INVESTMENTS

(a) Investments in Securities

U.S. Government Agencies or Government-Sponsored Enterprises Certain Funds may invest in securities of U.S. Government agencies or government-sponsored enterprises. U.S. Government securities are obligations of and, in certain cases, guaranteed by, the U.S. Government, its agencies or instrumentalities. Some U.S. Government securities, such as Treasury bills, notes and bonds, and securities guaranteed by the Government National Mortgage Association (GNMA or Ginnie Mae), are supported by the full faith and credit of the U.S. Government; others, such as those of the Federal Home Loan Banks, are supported by the right of the issuer to borrow from the U.S. Department of the Treasury (the U.S. Treasury); and others, such as those of the Federal National Mortgage Association (FNMA or Fannie Mae), are supported by the discretionary authority of the U.S. Government to purchase the agency's obligations. U.S. Government securities may include zero coupon securities. Zero coupon securities do not distribute interest on a current basis and tend to be subject to a greater risk than interest paying securities.

Government-related guarantors (i.e., not backed by the full faith and credit of the U.S. Government) include FNMA and the Federal Home Loan Mortgage Corporation (FHLMC or Freddie Mac). FNMA is a government-sponsored corporation. FNMA purchases conventional (i.e., not insured or guaranteed by any government agency) residential mortgages from a list of approved seller/servicers which include state and federally chartered savings and loan associations, mutual savings banks, commercial banks and credit unions and mortgage bankers. Pass-through securities issued by FNMA are guaranteed as to timely payment of principal and interest by FNMA, but are not backed by the full faith and credit of the U.S. Government. FHLMC issues Participation Certificates (PCs), which are pass-through securities, each representing an undivided interest in a pool of residential mortgages. FHLMC guarantees the timely payment of interest and ultimate collection of principal, but PCs are not backed by the full faith and credit of the U.S. Government.

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5. BORROWINGS AND OTHER FINANCING TRANSACTIONS

The following disclosures contain information on a Fund's ability to lend or borrow cash or securities to the extent permitted under the Act, which may be viewed as borrowing or financing transactions by a Fund. The location and fair value amounts of these instruments are described below. For a detailed description of credit and counterparty risks that can be associated with borrowings and other financing transactions, please see Note 6, Principal Risks.

(a) **Repurchase Agreements** Certain Funds may engage in repurchase agreements. Under the terms of a typical repurchase agreement, a Fund takes possession of an underlying debt obligation (collateral) subject to an obligation of the seller to repurchase, and a Fund to resell, the obligation at an agreed-upon price and time. The underlying securities for all repurchase agreements are held in safekeeping at the Fund's custodian or designated subcustodians under tri-party repurchase agreements. The market value of the collateral must be equal to or exceed the total amount of the repurchase obligations, including interest. Repurchase agreements, including accrued interest, are included on the Statements of Assets and Liabilities. Interest earned is recorded as a component of interest income on the Statements of Operations. In periods of increased demand for collateral, a Fund may pay a fee for receipt of collateral, which may result in interest expense to the Fund.

(b) **Tender Option Bond Transactions/Residual Interest Bonds** The Funds may leverage their assets through the use of tender option bond transactions. In a tender option bond transaction, a Fund sell a fixed-rate municipal bond (a Fixed Rate Bond) to a broker who places the Fixed Rate Bond in a special purpose trust (a Trust) from which floating rate bonds (Floating Rate Notes) and residual interest bonds (RIBs or Inverse Floaters) are issued. The Fund simultaneously with selling the Fixed Rate Bond, or within a short period of time, purchases the Inverse Floaters issued by the Trust from the broker. The Floating Rate Notes are sold to third-party investors. The cash received by the Trust from the sale of the Floating Rate Notes, less transaction expenses, is paid to the Fund that contributed the Fixed Rate Bond to the Trust. The Fund may then invest this cash in additional securities, generating leverage for the Fund.

The Inverse Floaters held by a Fund provide the Fund with the right to: (1) cause the holders of the Floating Rate Notes to tender their notes at par, and (2) cause the broker to transfer the Fixed-Rate Bond held by the Trust to the Fund, thereby collapsing the Trust. The Trust may also be collapsed without the consent of a Fund, as the RIB holder, upon the occurrence of certain termination events as defined in the Trust agreements. Such termination events may include the bankruptcy or default of the municipal bond, a substantial downgrade in credit quality of the municipal bond, the inability of the Trust to obtain renewal of the liquidity support agreement, a substantial decline in market value of the Fixed Rate Bond or a judgment or ruling that interest on the Fixed Rate Bond is subject to federal income taxation. Upon the occurrence of a termination event, the Trust would generally be liquidated in full with the proceeds typically applied first to any accrued fees owed to the trustee, remarketing agent and liquidity provider, and then to the holders of the Floating Rate Notes up to par plus accrued interest owed on the Floating Rate Notes, with the balance paid out to the RIB holder.

The Funds account for the transactions described above as secured borrowings by including the Fixed Rate Bonds in their Schedules of Investments, and account for the Floating Rate Notes as a liability

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Notes to Financial Statements (Cont.)

under the caption "Payable for Floating Rate Notes issued" in the Funds' Statements of Assets and Liabilities.

The Funds may also invest in Inverse Floaters without transferring a fixed rate municipal bond into a Trust, which are not accounted for as secured borrowings.

The interest rates payable on the Inverse Floaters purchased by a Fund bear an inverse relationship to the interest rate on another security or the value of an index. The Inverse Floaters are created by dividing the income stream provided by the Fixed Rate Bond to create two securities, the Floating Rate Notes, which are short-term securities and the Inverse Floaters, which are long-term securities. The interest rate on the Floating Rate Notes is reset by an index or auction process typically every 7 to 35 days. After income is paid on the Floating Rate Notes at current rates, the residual income from the underlying bond(s) goes to the Inverse Floater. Therefore, rising short-term rates result in lower income for the Inverse Floater, and vice versa. The Inverse Floater may be more volatile and less liquid than other municipal bonds of comparable maturity. In most circumstances the Inverse Floater holder bears substantially all of the underlying Fixed Rate Bond's downside investment risk and also benefits disproportionately from any potential appreciation of the underlying Fixed Rate Bond's value. Investments in Inverse Floaters typically will involve greater risk than investments in Fixed Rate Bonds.

PIMCO Municipal Income Fund III, PIMCO California Municipal Income Fund III, and PIMCO New York Municipal Income Fund III had average leverage outstanding from the use of tender option bond transactions during the period ended September 30, 2014 of (in thousands) \$28,421, \$33,634, and \$4,933 at weighted average interest rates of 0.72%, 0.66%, and 0.64%, respectively.

6. PRINCIPAL RISKS

In the normal course of business the Funds trade financial instruments and enter into financial transactions where risk of potential loss exists due to such things as changes in the market (market risk) or failure or inability of the other party to a transaction to perform (credit and counterparty risk). See below for a detailed description of select principal risks. For a more comprehensive list of potential risks the Funds may be subject to, please see the Important Information About the Funds.

Market Risks A Fund's investments in financial derivatives and other financial instruments expose the Fund to various risks such as, but not limited to, interest rate risk.

Interest rate risk is the risk that fixed income securities will decline in value because of changes in interest rates. As nominal interest rates rise, the value of certain fixed income securities held by a Fund is likely to decrease. Interest rate changes can be sudden and unpredictable, and a Fund may lose money if these changes are not anticipated by Fund management. A nominal interest rate can be described as the sum of a real interest rate and an expected inflation rate. Fixed income securities with longer durations tend to be more sensitive to changes in interest rates, usually making them more volatile than securities with shorter durations. Duration is useful primarily as a measure of the sensitivity of a

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security's market price to interest rate (i.e. yield) movements. At present, the U.S. is experiencing historically low interest rates. This, combined with recent economic recovery and the Federal Reserve Board's tapering of its quantitative easing program, could potentially increase the

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probability of an upward interest rate environment in the near future. Further, while U.S. bond markets have steadily grown over the past three decades, dealer market making ability has remained relatively stagnant. Given the importance of intermediary market making in creating a robust and active market, fixed income securities may face increased volatility and liquidity risks. All of these factors, collectively and/or individually, could cause a Fund to lose value.

The market values of securities may decline due to general market conditions which are not specifically related to a particular company, such as real or perceived adverse economic conditions, changes in the general outlook for corporate earnings, changes in interest or currency rates or adverse investor sentiment generally. They may also decline due to factors which affect a particular industry or industries, such as labor shortages or increased production costs and competitive conditions within an industry. Equity securities and equity related investments generally have greater market price volatility than fixed income securities.

Credit and Counterparty Risks A Fund will be exposed to credit risk to parties with whom it trades and will also bear the risk of settlement default. A Fund minimizes concentrations of credit risk by undertaking transactions with a large number of counterparties on recognized and reputable exchanges. A Fund could lose money if the issuer or guarantor of a fixed income security, or the counterparty to a financial derivatives contract, repurchase agreement or a loan of portfolio securities, is unable or unwilling to make timely principal and/or interest payments, or to otherwise honor its obligations. Securities are subject to varying degrees of credit risk, which are often reflected in credit ratings.

Similar to credit risk, a Fund may be exposed to counterparty risk, or the risk that an institution or other entity with which the Fund has unsettled or open transactions will default. Financial assets, which potentially expose a Fund to counterparty risk, consist principally of cash due from counterparties and investments. PIMCO, as the Manager minimizes counterparty risks to the Funds by performing extensive reviews of each counterparty and obtaining approval from the PIMCO Counterparty Risk Committee prior to entering into transactions with a third-party. Furthermore, to the extent that unpaid amounts owed to a Fund exceed a predetermined threshold agreed to with the counterparty, such counterparty shall advance collateral to the Fund in the form of cash or cash equivalents equal in value to the unpaid amount owed to the Fund. A Fund may invest such collateral in securities or other instruments and will typically pay interest to the counterparty on the collateral received. If the unpaid amount owed to a Fund subsequently decreases, the Fund would be required to return to the counterparty all or a portion of the collateral previously advanced to the Fund.

All transactions in listed securities are settled/paid for upon delivery using approved counterparties. The risk of default is considered minimal, as delivery of securities sold is only made once a Fund has received payment. Payment is made on a purchase once the securities have been delivered by the counterparty. The trade will fail if either party fails to meet its obligation.

Master Netting Arrangements The Funds are subject to various netting arrangements with select counterparties (Master Agreements). Master Agreements govern the terms of certain transactions, and reduce the counterparty risk associated with relevant transactions by specifying credit protection mechanisms and providing standardization that improves legal certainty. Since different types of

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Notes to Financial Statements (Cont.)

transactions have different mechanics and are sometimes traded out of different legal entities of a particular organization, each type of transaction may be covered by a different Master Agreement, resulting in the need for multiple agreements with a single counterparty. As the Master Agreements are specific to unique operations of different asset types, they allow the Fund to close out and net its total exposure to a counterparty in the event of a default with respect to all the transactions governed under a single agreement with a counterparty.

Master Agreements can also help limit counterparty risk by specifying collateral posting arrangements at pre-arranged exposure levels. Under the Master Agreements, collateral is routinely transferred if the total net exposure to certain transactions (net of existing collateral already in place) governed under the relevant Master Agreement with a counterparty in a given account exceeds a specified threshold, which typically ranges from zero to \$250,000 depending on the counterparty and the type of Master Agreement. United States Treasury Bills and U.S. dollar cash are generally the preferred forms of collateral, although other forms of AAA rated paper or sovereign securities may be used. Securities and cash pledged as collateral are reflected as assets in the Statement of Assets and Liabilities as either a component of Investments at value (securities) or Deposits due from Counterparties (cash). Cash collateral received is not typically held in a segregated account and as such is reflected as a liability in the Statement of Assets and Liabilities as Deposits due to Counterparties. The market value of any securities received as collateral is not reflected as a component of net asset value. The Fund's overall exposure to counterparty risk can change substantially within a short period, as it is affected by each transaction subject to the relevant Master Agreement.

Master Repurchase Agreements and Global Master Repurchase Agreements (individually and collectively Master Repo Agreements) govern repurchase, reverse repurchase, and sale-buyback transactions between the Funds and select counterparties. Master Repo Agreements maintain provisions for, among other things, initiation, income payments, events of default, and maintenance of collateral. The market value of transactions under the Master Repo Agreement, collateral pledged or received, and the net exposure by counterparty as of period end are disclosed in the Notes to Schedule of Investments.

7. FEES AND EXPENSES

Management Fee Effective at the close of business on September 5, 2014, each Fund entered into an Investment Management Agreement with PIMCO (previously defined as the Agreement). Pursuant to the Agreement, subject to the supervision of the Board, PIMCO is responsible for providing to each Fund investment guidance and policy direction in connection with the management of the Fund, including oral and written research, analysis, advice, and statistical and economic data and information. In addition, pursuant to the Agreement and subject to the general supervision of the Board, PIMCO, at its expense, will provide or cause to be furnished most other supervisory and administrative services the Funds require, including but not limited to, expenses of most third-party services providers (e.g., audit, custodial, legal, transfer agency, printing) and other expenses, such as those associated with insurance, proxy solicitations and mailings for shareholder meetings, New York Stock Exchange listing and related fees, tax services, valuation services and other services the Funds require for their daily operations.

Pursuant to the Agreement, PIMCO receives an annual fee, payable monthly, at an annual rate of 0.705% of PIMCO Municipal Income Fund III's average daily net assets, inclusive of net assets

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attributable to any preferred shares that were outstanding, 0.715% of PIMCO California Municipal Income Fund III's average daily net assets, inclusive of net assets attributable to any preferred shares that were outstanding and 0.860% of PIMCO New York Municipal Fund III's average daily net assets, inclusive of net assets attributable to any preferred shares that were outstanding. Management fees paid to PIMCO subsequent to the close of business on September 5, 2014 to September 30, 2014 for PIMCO Municipal Income Fund III, PIMCO California Municipal Income Fund III and PIMCO New York Municipal Fund III were \$260,217, \$169,186 and \$50,108, respectively.

Prior to the close of business on September 5, 2014, AGIFM served as the investment manager to each Fund and received annual fees, payable monthly, at an annual rate of 0.650% of each Fund's average daily net assets, inclusive of net assets attributable to any preferred shares that were outstanding. Prior to the close of business on September 5, 2014, AGIFM retained PIMCO as sub-adviser to manage the Funds' investments. AGIFM, and not the Funds, paid a portion of the fees it received as investment manager to PIMCO in return for its services. Management fees paid to AGIFM from October 1, 2013 to the close of business on September 5, 2014 for PIMCO Municipal Income Fund III, PIMCO California Municipal Income Fund III and PIMCO New York Municipal Fund III were \$3,123,854, \$2,021,855 and \$495,708, respectively.

Fund Expenses Each Fund bears other expenses, which may vary and affect the total level of expenses paid by shareholders, such as (i) salaries and other compensation or expenses, including travel expenses of any of the Fund's executive officers and employees, if any, who are not officers, directors, shareholders, members, partners or employees of PIMCO or its subsidiaries or affiliates; (ii) taxes and governmental fees, if any, levied against the Fund; (iii) brokerage fees and commissions and other portfolio transaction expenses incurred by or for the Fund (including, without limitation, fees and expenses of outside legal counsel or third-party consultants retained in connection with reviewing, negotiating and structuring specialized loan and other investments made by the Fund, subject to specific or general authorization by the Fund's Board); (iv) expenses of the Fund's securities lending (if any), including any securities lending agent fees, as governed by a separate securities lending agreement; (v) costs, including interest expense, of borrowing money or engaging in other types of leverage financing, including, without limitation, through the use by the Fund of reverse repurchase agreements, tender option bonds, bank borrowings and credit facilities; (vi) costs, including dividend and/or interest expenses and other costs (including, without limitation, offering and related legal costs, fees to brokers, fees to auction agents, fees to transfer agents, fees to ratings agencies and fees to auditors associated with satisfying ratings agency requirements for preferred shares or other securities issued by the Fund and other related requirements in the Fund's organizational documents) associated with the Fund's issuance, offering, redemption and maintenance of preferred shares, commercial paper or other senior securities for the purpose of incurring leverage; (vii) fees and expenses of any underlying funds or other pooled investment vehicles in which the Fund invests; (viii) dividend and interest expenses on short positions taken by the Fund; (ix) fees and expenses, including travel expenses, and fees and expenses of legal counsel retained for their benefit, of Trustees who are not officers, employees, partners, shareholders or members of PIMCO or its subsidiaries or affiliates; (x) extraordinary expenses, including extraordinary legal expenses, as may arise, including expenses incurred in connection with litigation, proceedings, other claims, and the legal obligations of the Fund to indemnify its Trustees, officers, employees, shareholders, distributors, and agents with respect thereto; (xi) organizational and offering expenses

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Notes to Financial Statements (Cont.)

of the Fund, including with respect to share offerings, such as rights offerings and shelf offerings, following the Fund's initial offering, and expenses associated with tender offers and other share repurchases and redemptions; and (xii) expenses of the Fund which are capitalized in accordance with generally accepted accounting principles.

Prior to the close of business on September 5, 2014, in addition to the management fee paid to AGIFM, as described above, each Fund directly had borne expenses for other administrative services and costs, including expenses associated with various third-party service providers, such as audit, custodial, legal, transfer agency, printing and other services the Funds require. Effective beginning at the close of business on September 5, 2014, PIMCO (and not the Funds) bears such expenses with respect to each Fund pursuant to its management fee arrangements under the Agreement described above under Management Fee.

Each of the Independent Trustees of the Funds also serves as a trustee of a number of other closed-end funds for which PIMCO serves as investment manager (together with the Funds, the PIMCO Closed-End Funds), as well as PIMCO Managed Accounts Trust, an open-end investment company with multiple series for which PIMCO serves as investment manager (PMAT) and, together with the PIMCO Closed-End Funds, the PIMCO-Managed Funds). In addition, each of the Independent Trustees also serves as a trustee of certain investment companies (together, the Allianz-Managed Funds), for which AGIFM serves as investment adviser.

Prior to the close of business on September 5, 2014, including during the period of this report, each of the PIMCO-Managed Funds and Allianz-Managed Funds held joint meetings of their Boards of Trustees whenever possible, and each Trustee, other than any Trustee who was a director, officer, partner or employee of PIMCO, AGIFM or any entity controlling, controlled by or under common control with PIMCO or AGIFM, received annual compensation of \$250,000 for service on the Boards of all of the PIMCO-Managed Funds and Allianz-Managed Funds, payable quarterly. The Independent Chairman of the Boards received an additional \$75,000 per year, payable quarterly. The Audit Oversight Committee Chairman received an additional \$50,000 annually, payable quarterly. Trustees were also reimbursed for meeting-related expenses.

During periods prior to September 5, 2014, each Trustee's compensation and other costs in connection with joint meetings were allocated among the PIMCO-Managed Funds and Allianz-Managed Funds, as applicable, on the basis of fixed percentages as between such groups of Funds. Trustee compensation and other costs were then further allocated pro rata among the individual funds within each grouping based on the complexity of issues relating to each such fund and relative time spent by the Trustees in addressing them, and on each such fund's relative net assets.

Subsequent to September 5, 2014, in connection with the new investment management agreement between the PIMCO-Managed Funds and PIMCO and the termination of the investment management agreement between the PIMCO-Managed Funds and AGIFM, each of the PIMCO-Managed Funds began holding, and are expected to continue to hold, joint meetings of their Boards of Trustees whenever possible, but will generally no longer hold joint meetings with the Allianz-Managed Funds. Under the new Board structure, each Independent Trustee currently receives annual compensation of \$225,000 for his or her service on the Boards of the PIMCO-Managed Funds, payable quarterly. The Independent Chairman of the Boards receives an additional \$75,000 per year,

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payable quarterly. The Audit Oversight Committee Chairman receives an additional \$50,000 annually, payable quarterly. Trustees are also reimbursed for meeting-related expenses.

Each Trustee's compensation for his or her service as a Trustee on the Boards of the PIMCO-Managed Funds and other costs in connection with joint meetings of such Funds are allocated among the PIMCO-Managed Funds, as applicable, on the basis of fixed percentages as between PMAT and the PIMCO Closed-End Funds. Trustee compensation and other costs will then be further allocated pro rata among the individual funds within each grouping based on each such fund's relative net assets.

8. RELATED PARTY TRANSACTIONS

The Manager is a related party. Fees payable to this party are disclosed in Note 7, and the accrued related party fee amounts are disclosed on the Statements of Assets and Liabilities.

Certain Funds are permitted to purchase or sell securities from or to certain related affiliated funds under specified conditions outlined in procedures adopted by the Board. The procedures have been designed to ensure that any purchase or sale of securities by the Funds from or to another fund or portfolio that are, or could be, considered an affiliate by virtue of having a common investment adviser (or affiliated investment advisers), common Trustees and/or common officers complies with Rule 17a-7 of the Act. Further, as defined under the procedures, each transaction is effected at the current market price. During the period ended September 30, 2014, the Funds below engaged in purchases and sales of securities pursuant to Rule 17a-7 of the Act (amounts in thousands):

Fund Name	Purchases	Sales
PIMCO Municipal Income Fund III	\$ 17,837	\$ 0
PIMCO California Municipal Income Fund III	1,727	0
PIMCO New York Municipal Income Fund III	5,549	0

9. GUARANTEES AND INDEMNIFICATIONS

Under each Fund's organizational documents, each Trustee or officer of a Fund is indemnified, to the extent permitted by the Act, against certain liabilities that may arise out of performance of their duties to the Funds. Additionally, in the normal course of business, the Funds enter into contracts that contain a variety of indemnification clauses. The Funds' maximum exposure under these arrangements is unknown as this would involve future claims that may be made against the Funds that have not yet occurred. However, the Funds have not had prior claims or losses pursuant to these contracts.

10. PURCHASES AND SALES OF SECURITIES

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The length of time a Fund has held a particular security is not generally a consideration in investment decisions. A change in the securities held by a Fund is known as portfolio turnover. Each Fund may engage in frequent and active trading of portfolio securities to achieve its investment objective, particularly during periods of volatile market movements. High portfolio turnover involves correspondingly greater expenses to a Fund, including brokerage commissions or dealer mark-ups and other transaction costs on the sale of securities and reinvestments in other securities. Such sales may also result in realization of taxable capital gains, including short-term capital gains (which are generally taxed at ordinary income tax rates). The trading costs and tax effects associated with

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portfolio turnover may adversely affect a Fund's performance. The portfolio turnover rates are reported in the Financial Highlights.

Purchases and sales of securities (excluding short-term investments) for the period ended September 30, 2014, were as follows (amounts in thousands):

Fund Name	U.S. Government/Agency		All Other	
	Purchases	Sales	Purchases	Sales
PIMCO Municipal Income Fund III	\$ 0	\$ 400	\$ 77,382	\$ 91,210
PIMCO California Municipal Income Fund III	0	0	38,372	37,505
PIMCO New York Municipal Income Fund III	0	0	22,528	19,247

11. AUCTION-RATE PREFERRED SHARES

Each Fund's series has a liquidation preference of \$25,000 per share plus any accumulated, unpaid dividends. Dividends are accumulated daily at an annual rate that is typically re-set every seven days. Distributions of net realized capital gains, if any, are paid annually.

For the year ended September 30, 2014, the annualized dividend rates ranged from:

	Shares Issued and Outstanding	High	Low	As of September 30, 2014
PIMCO Municipal Income Fund III				
Series A	1,512	0.232%	0.066%	0.088%
Series B	1,512	0.230%	0.066%	0.133%
Series C	1,512	0.197%	0.066%	0.088%
Series D	1,512	0.232%	0.066%	0.088%
Series E	1,512	0.232%	0.066%	0.088%
PIMCO California Municipal Income Fund III				
Series A	2,500	0.230%	0.066%	0.133%
Series B	2,500	0.232%	0.066%	0.088%
PIMCO New York Municipal Income Fund III				
Series A	1,280	0.232%	0.066%	0.088%

Each Fund is subject to certain limitations and restrictions while Preferred Shares are outstanding. Failure to comply with these limitations and restrictions could preclude a Fund from declaring or paying any dividends or distributions to common shareholders or repurchasing common shares and/or could trigger the mandatory redemption of Preferred Shares at their liquidation preference plus any accumulated, unpaid dividends.

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September 30, 2014

Preferred shareholders of a Fund, who are entitled to one vote per share, generally vote together with the common shareholders of such Fund, but vote separately as a class to elect two Trustees of the Fund and on certain matters adversely affecting the rights of the Preferred Shares.

Since mid-February 2008, holders of auction rate preferred shares (ARPS) issued by the Funds have been directly impacted by a lack of liquidity, which has similarly affected ARPS holders in many of the nation's closed-end funds. Since then, regularly scheduled auctions for ARPS issued by the Funds have consistently failed because of insufficient demand (bids to buy shares) to meet the supply (shares offered for sale) at each auction. In a failed auction, ARPS holders cannot sell all, and may not be able to sell any, of their shares tendered for sale. While repeated auction failures have affected the liquidity for ARPS, they do not constitute a default or automatically alter the credit quality of the ARPS, and ARPS holders have continued to receive dividends at the defined maximum rate, equal to the higher of the 30-day AA Composite Commercial Paper Rate multiplied by 110% or the Taxable Equivalent of the Short-Term Municipal Obligations Rate defined as 90% of the quotient of (A) the per annum rate expressed on an interest equivalent basis equal to the S&P Municipal Bond 7-day High Grade Rate Index divided by (B) 1.00 minus the Marginal Tax Rate (expressed as a decimal) multiplied by 110% (which is a function of short-term interest rates and typically higher than the rate that would have otherwise been set through a successful auction). If the Funds' ARPS auctions continue to fail and the maximum rate payable on the ARPS rises as a result of changes in short-term interest rates, returns for the Funds' common shareholders could be adversely affected.

12. REGULATORY AND LITIGATION MATTERS

The Funds are not engaged in any material litigation or arbitration proceedings and are not aware of any material litigation or claim pending or threatened by or against them.

13. FEDERAL INCOME TAX MATTERS

Each Fund intends to qualify as a regulated investment company under Subchapter M of the Internal Revenue Code (the Code) and distribute all of its taxable income and net realized gains, if applicable, to shareholders. Accordingly, no provision for Federal income taxes has been made.

In accordance with U.S. GAAP, the Manager has reviewed the Funds' tax positions for all open tax years. As of September 30, 2014, the Funds have recorded no liability for net unrecognized tax benefits relating to uncertain income tax positions they have taken or expect to take in future tax returns.

Each Fund files U.S. tax returns. While the statute of limitations remains open to examine the Funds' U.S. tax returns filed for the fiscal years from 2011-2013, no examinations are in progress or anticipated at this time. No Fund is aware of any tax positions for which it is reasonably possible that the total amounts of unrecognized tax benefits will significantly change in the next twelve months.

Table of Contents**Notes to Financial Statements (Cont.)**

As of September 30, 2014, the components of distributable earnings are as follows (amounts in thousands):

	Undistributed Tax Exempt Income	Undistributed Ordinary Income	Undistributed Long-Term Capital Gains	Net Tax Basis Unrealized Appreciation/ (Depreciation) ⁽¹⁾	Other Book- to-Tax Accounting Differences ⁽²⁾	Accumulated Capital Losses ⁽³⁾	Qualified Post- October Loss Deferral Capital ⁽⁴⁾	Qualified Late-Year Loss Deferral Ordinary ⁽⁵⁾
PIMCO Municipal								
Income Fund III	\$ 0	\$	\$	\$ 59,267	\$	\$ (141,724)	\$ (1,592)	
PIMCO California								
Municipal Income Fund III	6,342			35,947		(110,843)	(695)	
PIMCO New York								
Municipal Income Fund III	1,386			7,259		(31,052)	(30)	

(1) Adjusted for open wash sale loss deferrals and inverse floaters.

(2) Represents differences in income tax regulations and financial accounting principles generally accepted in the United States of America.

(3) Capital losses available to offset future net capital gains expire in varying amounts in the years shown below.

(4) Capital losses realized during the period November 1, 2013 through September 30, 2014, which the Fund elected to defer to the following taxable year pursuant to income tax regulations.

(5) Specified losses realized during the period November 1, 2013 through September 30, 2014 and Ordinary losses realized during the period January 1, 2014 through September 30, 2014, which the Fund elected to defer to the following taxable year pursuant to income tax regulations.

As of September 30, 2014, the Fund had accumulated capital losses expiring in the following years (amounts in thousands). The Fund will resume capital gain distributions in the future to the extent gains are realized in excess of accumulated capital losses.

	Expiration of Accumulated Capital Losses			
	9/30/2016	9/30/2017	9/30/2018	9/30/2019
PIMCO Municipal Income Fund III	\$ 2,478	\$ 11,389	\$ 116,860	\$ 695
PIMCO California Municipal Income Fund III	1,377	9,243	89,815	
PIMCO New York Municipal Income Fund III	426	3,264	26,936	

Under the Regulated Investment Company Modernization Act of 2010, a fund is permitted to carry forward any new capital losses for an unlimited period. Additionally, such capital losses that are carried forward will retain their character as either short-term or long-term capital losses rather than being considered all short-term under previous law. As of September 30, 2014, the Fund had the following post-effective capital losses with no expiration:

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	Short-Term	Long-Term
PIMCO Municipal Income Fund III	\$ 6,699	\$ 3,603
PIMCO California Municipal Income Fund III	8,837	1,571
PIMCO New York Municipal Income Fund III	426	

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September 30, 2014

As of September 30, 2014, the aggregate cost and the net unrealized appreciation/(depreciation) of investments for federal income tax purposes (in thousands):

	Federal Tax Cost	Unrealized Appreciation	Unrealized (Depreciation)	Net Unrealized Appreciation/ (Depreciation) ⁽⁶⁾
PIMCO Municipal Income Fund III	\$ 474,251	\$ 64,851	\$ (5,584)	\$ 59,267
PIMCO California Municipal Income Fund III	306,103	38,872	(2,925)	35,947
PIMCO New York Municipal Income Fund III	76,818	7,697	(438)	7,259

⁽⁶⁾ Primary differences, if any, between book and tax net unrealized appreciation/(depreciation) on investments are attributable to Inverse Floater transactions and/or open wash sale loss deferrals.

For the fiscal years ended September 30, 2014 and September 30, 2013, respectively, the Funds made the following tax basis distributions (amounts in thousands):

	September 30, 2014 Long-Term				September 30, 2013			
	Tax-Exempt Income Distributions	Ordinary Income Distributions ⁽⁷⁾	Capital Gain Distributions	Return of Capital ⁽⁸⁾	Tax-Exempt Income Distributions	Ordinary Income Distributions ⁽⁷⁾	Long-Term Capital Gain Distributions	Return of Capital ⁽⁸⁾
PIMCO Municipal								
Income Fund III	\$ 25,767	\$ 274	\$	\$	\$ 27,213	\$ 418	\$	\$
PIMCO California								
Municipal Income								
Fund III	15,884	148			14,229	1,862		
PIMCO New York								
Municipal Income								
Fund III	3,553	43			3,524	93		

⁽⁷⁾ Includes short-term capital gains, if any, distributed.

⁽⁸⁾ A portion of the distributions made represents a tax return of capital. Return of capital distributions have been reclassified from undistributed net investment income to paid-in capital to more appropriately conform financial accounting to tax accounting.

14. SUBSEQUENT EVENTS

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In preparing these financial statements, the Funds' management has evaluated events and transactions for potential recognition or disclosure through the date the financial statements were issued.

On October 1, 2014, the following distributions were declared to common shareholders payable November 3, 2014 to shareholders of record on October 14, 2014.

PIMCO Municipal Income Fund III	\$	0.0623 per common share
PIMCO California Municipal Income Fund III	\$	0.06 per common share
PIMCO New York Municipal Income Fund III	\$	0.0525 per common share

On November 3, 2014, the following distributions were declared to common shareholders payable December 1, 2014 to shareholders of record on November 13, 2014.

PIMCO Municipal Income Fund III	\$	0.0623 per common share
PIMCO California Municipal Income Fund III	\$	0.06 per common share
PIMCO New York Municipal Income Fund III	\$	0.0525 per common share

There were no other subsequent events identified that require recognition or disclosure.

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Report of Independent Registered Public Accounting Firm

To the Shareholders and Board of Trustees of

PIMCO Municipal Income Fund III,

PIMCO California Municipal Income Fund III and

PIMCO New York Municipal Income Fund III

In our opinion, the accompanying statements of assets and liabilities, including the schedules of investments, and the related statements of operations and of changes in net assets and the financial highlights present fairly, in all material respects, the financial position of PIMCO Municipal Income Fund III, PIMCO California Municipal Income Fund III and PIMCO New York Municipal Income Fund III (collectively hereafter referred to as the Funds) at September 30, 2014, the results of each of their operations for the year then ended, the changes in each of their net assets for each of the two years in the period then ended and the financial highlights for each of the five years in the period then ended, in conformity with accounting principles generally accepted in the United States of America. These financial statements and financial highlights (hereafter referred to as financial statements) are the responsibility of the Funds management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these financial statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits, which included confirmation of securities at September 30, 2014 by correspondence with the custodian and brokers, provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

Kansas City, Missouri

November 21, 2014

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Glossary: (abbreviations that may be used in the preceding statements)

(Unaudited)

Counterparty Abbreviations:

SAL Citigroup Global Markets, Inc.

Currency Abbreviations:

USD (or \$) United States Dollar

Municipal Bond or Agency Abbreviations:

AGC Assured Guaranty Corp.

FHA Federal Housing Administration

AGM Assured Guaranty Municipal

IBC Insured Bond Certificate

AMBAC American Municipal Bond Assurance Corp.

NPFGC National Public Finance Guarantee Corp.

FGIC Financial Guaranty Insurance Co.

Other Abbreviations:

BABs Build America Bonds

M-S-R Mechanical Systems Review

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Table of Contents**Shareholder Meeting Results****Annual Shareholder Meeting Results**

The Funds held their joint annual meetings of shareholders on December 18, 2013. Common and Preferred shareholders voted as indicated below:

	Affirmative	Withheld Authority
PIMCO Municipal Income Fund III		
Re-election of Bradford K. Gallagher Class II to serve until the annual meeting for the 2016-2017 fiscal year	26,890,883	1,643,174
Re-election of James A. Jacobson* Class II to serve until the annual meeting for the 2016-2017 fiscal year	5,952	114
PIMCO California Municipal Income Fund III		
Re-election of Bradford K. Gallagher Class II to serve until the annual meeting for the 2016-2017 fiscal year	19,320,395	904,854
Re-election of James A. Jacobson* Class II to serve until the annual meeting for the 2016-2017 fiscal year	3,635	143
PIMCO New York Municipal Income Fund III		
Re-election of Bradford K. Gallagher Class II to serve until the annual meeting for the 2016-2017 fiscal year	4,664,131	123,602
Re-election of James A. Jacobson* Class II to serve until the annual meeting for the 2016-2017 fiscal year	1,149	

The other members of the Boards of Trustees at the time of the meeting, namely, Ms. Deborah A. DeCotis and Messrs. Hans W. Kertess, William B. Ogden, IV, John C. Maney and Alan Rappaport*, continued to serve as Trustees.

* Preferred Shares Trustee
Interested Trustee

Special Shareholder Meeting Results

The Funds held a special meeting of shareholders on June 9, 2014 to vote on the approval of the new investment management agreement between the Funds and PIMCO, as discussed in the Notes to Financial Statements. The special meeting was convened as scheduled on June 9, 2014. However, because sufficient votes in favor of the proposal had not been received for any Fund at the time of the special meeting, the shareholders of each Fund present voted to adjourn the special meeting to July 10, 2014 to permit further solicitation of proxies. On July 10, 2014 the special meeting was reconvened, and common and preferred shareholders of each Fund voted as indicated below:

	For	Against	Abstain
Approval of an Investment Management Agreement between PIMCO Municipal Income Fund III and Pacific Investment Management Company LLC	15,228,626	655,595	2,051,931

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(Unaudited)

	For	Against	Abstain
PIMCO California Municipal Income Fund III			
Approval of an Investment Management Agreement between PIMCO California Municipal Income Fund III and Pacific Investment Management Company LLC	10,160,589	396,105	1,563,361
PIMCO New York Municipal Income Fund III			
Approval of an Investment Management Agreement between PIMCO New York Municipal Income Fund III and Pacific Investment Management Company LLC	2,483,549	102,581	445,730

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Changes to Boards of Trustees

(Unaudited)

Effective at close of business on September 5, 2014, Craig A. Dawson became a Class III Trustee of each of PIMCO Municipal Income Fund III, PIMCO California Municipal Income Fund III and PIMCO New York Municipal Income Fund III.

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Table of Contents**Dividend Reinvestment Plan**

(Unaudited)

Each Fund has adopted a Dividend Reinvestment Plan (the Plan) which allows common shareholders to reinvest Fund distributions in additional common shares of the Fund. American Stock Transfer & Trust Company, LLC (the Plan Agent) serves as agent for common shareholders in administering the Plan. It is important to note that participation in the Plan and automatic reinvestment of Fund distributions does not ensure a profit, nor does it protect against losses in a declining market.

Automatic enrollment/voluntary participation Under the Plan, common shareholders whose shares are registered with the Plan Agent (registered shareholders) are automatically enrolled as participants in the Plan and will have all Fund distributions of income, capital gains and returns of capital (together, distributions) reinvested by the Plan Agent in additional common shares of the Fund, unless the shareholder elects to receive cash. Registered shareholders who elect not to participate in the Plan will receive all distributions in cash paid by check and mailed directly to the shareholder of record (or if the shares are held in street or other nominee name, to the nominee) by the Plan Agent. Participation in the Plan is voluntary. Participants may terminate or resume their enrollment in the Plan at any time without penalty by notifying the Plan Agent online at www.amstock.com, by calling (844) 33PIMCO (844-337-4626), by writing to the Plan Agent, American Stock Transfer & Trust Company, LLC, at P.O. Box 922, Wall Street Station, New York, NY 10269-0560, or, as applicable, by completing and returning the transaction form attached to a Plan statement. A proper notification will be effective immediately and apply to the Fund's next distribution if received by the Plan Agent at least three (3) days prior to the record date for the distribution; otherwise, a notification will be effective shortly following the Fund's next distribution and will apply to the Fund's next succeeding distribution thereafter. If you withdraw from the Plan and so request, the Plan Agent will arrange for the sale of your shares and send you the proceeds, minus a transaction fee and brokerage commissions.

How shares are purchased under the Plan For each Fund distribution, the Plan Agent will acquire common shares for participants either (i) through receipt of newly issued common shares from the Fund (newly issued shares) or (ii) by purchasing common shares of the Fund on the open market (open market purchases). If, on a distribution payment date, the net asset value per common shares of the Fund (NAV) is equal to or less than the market price per common shares plus estimated brokerage commissions (often referred to as a market premium), the Plan Agent will invest the distribution amount on behalf of participants in newly issued shares at a price equal to the greater of (i) NAV or (ii) 95% of the market price per common share on the payment date. If the NAV is greater than the market price per common shares plus estimated brokerage commissions (often referred to as a market discount) on a distribution payment date, the Plan agent will instead attempt to invest the distribution amount through open market purchases. If the Plan Agent is unable to invest the full distribution amount in open market purchases, or if the market discount shifts to a market premium during the purchase period, the Plan Agent will invest any un-invested portion of the distribution in newly issued shares at a price equal to the greater of (i) NAV or (ii) 95% of the market price per share as of the last business day immediately prior to the purchase date (which, in either case, may be a price greater or lesser than the NAV per common shares on the distribution payment date). No interest will be paid on distributions awaiting reinvestment. Under the Plan, the market price of common shares on a particular date is the last sales price on the exchange where the shares are listed on that date or, if there is no sale on the exchange on that date, the mean between the closing bid and asked quotations for the shares on the exchange on that date.

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Dividend Reinvestment Plan (Cont.)

(Unaudited)

The NAV per common share on a particular date is the amount calculated on that date (normally at the close of regular trading on the New York Stock Exchange) in accordance with the Fund's then current policies.

Fees and expenses No brokerage charges are imposed on reinvestments in newly issued shares under the Plan. However, all participants will pay a pro rata share of brokerage commissions incurred by the Plan Agent when it makes open market purchases. There are currently no direct service charges imposed on participants in the Plan, although the Funds reserve the right to amend the Plan to include such charges. The Plan Agent imposes a transaction fee (in addition to brokerage commissions that are incurred) if it arranges for the sale of your common shares held under the Plan.

Shares held through nominees In the case of a registered shareholder such as a broker, bank or other nominee (together, a nominee) that holds common shares for others who are the beneficial owners, the Plan Agent will administer the Plan on the basis of the number of common shares certified by the nominee/record shareholder as representing the total amount registered in such shareholder's name and held for the account of beneficial owners who are to participate in the Plan. If your common shares are held through a nominee and are not registered with the Plan Agent, neither you nor the nominee will be participants in or have distributions reinvested under the Plan. If you are a beneficial owner of common shares and wish to participate in the Plan, and your nominee is unable or unwilling to become a registered shareholder and a Plan participant on your behalf, you may request that your nominee arrange to have all or a portion of your shares re-registered with the Plan Agent in your name so that you may be enrolled as a participant in the Plan. Please contact your nominee for details or for other possible alternatives. Participants whose shares are registered with the Plan Agent in the name of one nominee firm may not be able to transfer the shares to another firm and continue to participate in the Plan.

Tax consequences Automatically reinvested dividends and distributions are taxed in the same manner as cash dividends and distributions i.e., automatic reinvestment in additional shares does not relieve shareholders of, or defer the need to pay, any income tax that may be payable (or that is required to be withheld) on Fund dividends and distributions. The Fund and the Plan Agent reserve the right to amend or terminate the Plan. Additional information about the Plan, as well as a copy of the full Plan itself, may be obtained from the Plan Agent, American Stock Transfer & Trust Company, LLC, at P.O. Box 922, Wall Street Station, New York, NY 10269-0560; telephone number: (844) 33-PIMCO (844-337-4626); website: www.amstock.com.

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(Unaudited)

The chart below identifies Trustees and Officers of the Funds. Unless otherwise indicated, the address of all persons below is c/o Pacific Investment Management Company LLC, 1633 Broadway, New York, New York 10019.

Trustees

Name, Year of Birth, and Position(s) Held with the Funds	Term of Office and Length of Time Served	Principal Occupation(s) During the Past 5 Years	Number of Portfolios in Fund Complex Overseen by Trustee	Other Directorships Held by Trustee During the Past 5 Years
Independent Trustees Hans W. Kertess 1939 <i>Chairman of the Board, Trustee</i>	Trustee since 2003, expected to stand for re-election at the annual meeting of shareholders for the 2015-2016 fiscal year.	President, H. Kertess & Co., a financial advisory company. Formerly, Managing Director, Royal Bank of Canada Capital Markets.	65	None
Deborah A. DeCotis 1952 <i>Trustee</i>	Trustee since 2011, expected to stand for re-election at the annual meeting of shareholders for the 2014-2015 fiscal year.	Advisory Director, Morgan Stanley & Co., Inc. (since 1996); Co-Chair Special Projects Committee, Memorial Sloan Kettering (since 2005); Member, Circle Financial Group (since 2010); Trustee, Stanford University (since 2010); and Member, Council on Foreign Relations (since 2013). Formerly, Director, Helena Rubenstein Foundation (1997-2012).	83	None
Bradford K. Gallagher 1944 <i>Trustee</i>	Trustee since 2010, expected to stand for re-election at the annual meeting of shareholders for the 2016-2017 fiscal year.	Retired. Chairman and Trustee, Atlantic Maritime Heritage Foundation (since 2007); Founder, Spyglass Investments LLC, a private investment vehicle (since 2001); and Founder, President and CEO, Cypress Holding Company and Cypress Tree Investment Management Company (since 1995). Formerly, Chairman and Trustee, The Common Fund (2005-2014); and Partner, New Technology Ventures Capital Management LLC, a venture capital fund (2011-2013).	65	Formerly, Chairman and Trustee of Grail Advisors ETF Trust (2009-2010) and Trustee of Nicholas-Applegate Institutional Funds (2007-2010)
James A. Jacobson 1945 <i>Trustee</i>	Trustee since 2009, expected to stand for re-election at the annual meeting of shareholders for the 2016-2017 fiscal year.	Retired. Formerly, Vice Chairman and Managing Director, Spear, Leeds & Kellogg Specialists, LLC, a specialist firm on the New York Stock Exchange.	65	Trustee, Alpine Mutual Funds Complex consisting of 17 funds
William B. Ogden, IV	Trustee since 2006, expected to stand for re-election at the annual	Asset Management Industry Consultant. Formerly, Managing	65	None

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meeting of shareholders for the
2015-2016 fiscal year.

Director, Investment Banking
Division of Citigroup Global
Markets Inc.

Trustee

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Table of Contents**Management of the Funds (Cont.)**

Name, Year of Birth, and Position(s) Held with the Funds	Term of Office and Length of Time Served	Principal Occupation(s) During the Past 5 Years	Number of Portfolios in Fund Complex Overseen by Trustee	Other Directorships Held by Trustee During the Past 5 Years
Alan Rappaport 1953 <i>Trustee</i>	Trustee since 2010, expected to stand for re-election at the annual meeting of shareholders for the 2015-2016 fiscal year.	Advisory Director (formerly Vice Chairman) (since 2009), Roundtable Investment Partners; Chairman (formerly President), Private Bank of Bank of America; Vice Chairman, US Trust (2001-2008); Adjunct Professor, New York University Stern School of Business (since 2011); Lecturer, Stanford University Graduate School of Business (since 2013); Trustee, American Museum of Natural History (since 2005) and Trustee, NYU Langone Medical Center (since 2007).	65	None
Interested Trustees Craig A. Dawson* 1968 <i>Trustee</i>	Trustee since 2014, expected to stand for election at the annual meeting of shareholders for the 2014-2015 fiscal year.	Managing Director and Head of Strategic Business Management, PIMCO (since 2014). Director of a number of PIMCO's European investment vehicles and affiliates (since 2008). Formerly, head of PIMCO's Munich office and head of European product management for PIMCO.	25	None
John C. Maney** 1959 <i>Trustee</i>	Trustee since 2006, expected to stand for re-election at the annual meeting of shareholders for the 2014-2015 fiscal year.	Member of the Management Board and a Managing Director of Allianz Global Investors Fund Management LLC; Managing Director of Allianz Asset Management of America L.P. (since January 2005) and a member of the Management Board and Chief Operating Officer of Allianz Asset Management of America L.P. (since November 2006).	83	None

* Mr. Dawson is an interested person of each Fund, as defined in Section 2(a)(19) of the 1940 Act, due to his affiliation with PIMCO and its affiliates. Mr. Dawson's address is 650 Newport Center Drive, Newport Beach, CA 92660

** Mr. Maney is an interested person of each Fund, as defined in Section 2(a)(19) of the 1940 Act, due to his affiliation with Allianz Asset Management of America L.P. and its affiliates. Mr. Maney's address is 680 Newport Center Drive, Suite 250, Newport Beach, CA 92660

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(Unaudited)

Officers

Name, Address and Year of Birth	Position(s) Held with Fund	Term of Office and Length of Time Served	Principal Occupation(s) During the Past 5 Years
Peter G. Strelow ¹ 1970	President, Principal Executive Officer	Since 2014	Managing Director, PIMCO. President and Principal Executive Officer, PIMCO-Managed Funds. Senior Vice President, PIMCO Funds, PIMCO Variable Insurance Trust and PIMCO ETF Trust. President, PIMCO Equity Series and PIMCO Equity Series VIT.
Youse Guia ¹ 1972	Chief Compliance Officer	Since 2014	Senior Vice President and Deputy Chief Compliance Officer, PIMCO. Chief Compliance Officer, PIMCO-Managed Funds. Formerly, Head of Compliance, Allianz Global Investors U.S. Holdings LLC and Chief Compliance Officer of the Allianz Funds, Allianz Multi-Strategy Trust, Allianz Global Investors Sponsored Closed-End Funds, Premier Multi-Series VIT and The Korea Fund, Inc.
Joshua D. Ratner 1976	Vice President, Secretary and Chief Legal Officer	Since 2014	Senior Vice President and Senior Counsel, PIMCO. Chief Legal Officer, PIMCO Investments LLC. Vice President, Secretary and Chief Legal Officer, PIMCO-Managed Funds. Vice President Senior Counsel, Secretary, PIMCO Funds, PIMCO Variable Insurance Trust, PIMCO ETF Trust, PIMCO Equity Series and PIMCO Equity Series VIT.
Eric D. Johnson 1970	Vice President	Since 2014	Executive Vice President, PIMCO. Vice President, PIMCO-Managed Funds, PIMCO Funds, PIMCO Variable Insurance Trust, PIMCO ETF Trust, PIMCO Equity Series and PIMCO Equity Series VIT.
William G. Galipeau ¹ 1974	Treasurer, Principal Financial & Accounting Officer	Since 2014	Senior Vice President, PIMCO. Treasurer and Principal Financial & Accounting Officer, PIMCO-Managed Funds. Vice President, PIMCO Funds, PIMCO Variable Insurance Trust, PIMCO ETF Trust, PIMCO Equity Series and PIMCO Equity Series VIT. Formerly, Vice President, Fidelity Investments.
Erik C. Brown ¹ 1967	Vice President	Since 2014	Senior Vice President, PIMCO. Vice President, PIMCO-Managed Funds. Assistant Treasurer, PIMCO Funds, PIMCO Variable Insurance Trust, PIMCO ETF Trust, PIMCO Equity Series and PIMCO Equity Series VIT.
Trent W. Walker ¹ 1974	Assistant Treasurer	Since 2014	Senior Vice President, PIMCO. Assistant Treasurer, PIMCO-Managed Funds. Treasurer, PIMCO Funds, PIMCO Variable Insurance Trust, PIMCO ETF Trust, PIMCO Equity Series and PIMCO Equity Series VIT.
Stacie D. Anctil ¹ 1969	Assistant Treasurer	Since 2014	Senior Vice President, PIMCO. Assistant Treasurer, PIMCO-Managed Funds, PIMCO Funds, PIMCO Variable Insurance Trust, PIMCO ETF Trust, PIMCO Equity Series and PIMCO Equity Series VIT.
Ryan Leshaw ¹ 1980	Assistant Secretary	Since 2014	Vice President and Counsel, PIMCO. Assistant Secretary, PIMCO-Managed Funds, PIMCO Funds, PIMCO Variable Insurance Trust, PIMCO ETF Trust, PIMCO Equity Series and PIMCO Equity Series VIT. Formerly, Associate, Willkie Farr & Gallagher LLP.

¹ The address of these officers is Pacific Investment Management Company LLC, 650 Newport Center Drive, Newport Beach, California 92660.

AGIFM personnel served as Fund officers through the close of business on September 5, 2014, but were replaced with the PIMCO personnel listed above effective as of the close of business on September 5, 2014, in connection with the transition to PIMCO as the Funds' investment manager.

Table of Contents**Matters Relating to the Trustees – Consideration of the Investment Management and Portfolio Management Agreements**

As discussed in Notes 1 and 7 in the Notes to Financial Statements, an Investment Management Agreement between each Fund and PIMCO (the New Agreement) became effective at the close of business on September 5, 2014, and at that time PIMCO replaced AGIFM as the investment manager of each Fund and ceased serving as each Fund's sub-adviser. Prior thereto, each Fund had in place an Investment Management Agreement with AGIFM (the Advisory Agreements) and Portfolio Management Agreement between AGIFM and PIMCO (the Sub-Advisory Agreements, and, together with the Advisory Agreements, the Previous Agreements), which terminated at the close of business on September 5, 2014. However, the terms of the Previous Agreements would have terminated before the New Agreement took effect, and, therefore, the Trustees were asked to approve the continuance of the Previous Agreements for an additional term which would expire upon the effectiveness of the New Agreement or, in the event the New Agreement had not been approved by shareholders of a Fund, for an additional one-year period. The Investment Company Act of 1940, as amended, required that both the full Board of Trustees of each Fund (the Board or the Trustees) and a majority of the non-interested Trustees (the Independent Trustees), voting separately, approve each Previous Agreement. Accordingly, the Trustees met in person on June 23-24, 2014 (the contract review meeting) for the specific purpose of considering whether to approve the continuation of the Previous Agreements. The Independent Trustees were assisted in their evaluation of the Previous Agreements by independent legal counsel, from whom they received separate legal advice and with whom they met separately from Fund management during the contract review meeting.

In connection with their deliberations regarding the continuation of the Previous Agreements, the Trustees, including the Independent Trustees, considered such information and factors as they believed, in light of the legal advice furnished to them and their own business judgment, to be relevant. As described below, the Trustees considered the nature, quality, and extent of the various investment management, administrative and other services performed by AGIFM or PIMCO under the applicable Previous Agreement.

In connection with their contract review meeting, the Trustees relied upon materials provided by AGIFM and PIMCO for the contract review meeting or for prior meetings which included, among other items: (i) information provided by Lipper Inc. (Lipper), an independent third party, on the total return investment performance (based on net assets) of the Funds for various time periods, the investment performance of a group of funds with investment classifications/objectives comparable to those of the Funds identified by Lipper (the Lipper performance universe) and the performance of an applicable benchmark index, (ii) information provided by Lipper on the Funds' management fees and other expenses and the management fees and other expenses of comparable funds identified by Lipper, (iii) information regarding the investment performance and fees for other funds managed by PIMCO with similar investment strategies to those of the Funds, (iv) the estimated profitability to AGIFM from its relationship with the Funds for the one-year period ended December 31, 2013, (v) descriptions of various functions performed by AGIFM and PIMCO for the Funds, such as portfolio management, compliance monitoring and portfolio trading practices, and (vi) information regarding the overall organization of AGIFM and PIMCO, including information regarding senior management, portfolio managers and other personnel who provided investment management, administrative and other services to the Funds.

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The Trustees' conclusions as to the continuation of the Previous Agreements were based on a comprehensive consideration of all information provided to the Trustees and were not the result of any single factor. Some of the factors that figured particularly in the Trustees' deliberations are described below, although individual Trustees may have evaluated the information presented differently from one another, attributing different weights to various factors.

Fund-specific performance results for the Funds reviewed by the Trustees are discussed below. The comparative performance information was prepared and provided by Lipper and was not independently verified by the Trustees. The Trustees reviewed, among other information, comparative information showing performance of each Fund against its respective Lipper performance universe for the one-year, three-year, five-year and ten-year periods ended December 31, 2013.

In addition, it was noted that the Trustees considered matters bearing on the Funds and their advisory arrangements at their meetings throughout the year, including a review of performance data at each regular meeting.

As part of their review, the Trustees examined AGIFM's and PIMCO's abilities to provide high-quality investment management and other services to the Funds. Among other information, the Trustees considered the investment philosophy and research and decision-making processes of PIMCO; the experience of key advisory personnel of PIMCO responsible for portfolio management of the Funds; the ability of AGIFM and PIMCO to attract and retain capable personnel; and the capability of the senior management and staff of AGIFM and PIMCO. In addition, the Trustees reviewed the quality of AGIFM's and PIMCO's services with respect to regulatory compliance and compliance with the investment policies of the Funds; the nature and quality of certain administrative services AGIFM was responsible for providing to the Funds; and conditions that might have affected the AGIFM's or PIMCO's ability to provide high-quality services to the Funds in the future under the Previous Agreements, including each organization's respective financial condition and operational stability. Based on the foregoing, the Trustees concluded that PIMCO's investment process, research capabilities and philosophy were well suited to each Fund given its investment objective and policies, and that AGIFM and PIMCO would be able to continue to meet any reasonably foreseeable obligations under the Previous Agreements.

In assessing the reasonableness of each Fund's fees under the Previous Agreements, the Trustees considered, among other information, the Fund's management fee and its total expense ratio as a percentage of average net assets attributable to common shares and as a percentage of total managed assets (including assets attributable to common shares and leverage outstanding combined), and the management fee and total expense ratios of a peer expense group of funds based on information provided by Lipper. The Fund-specific fee and expense results discussed below were prepared and provided by Lipper and were not independently verified by the Trustees.

The Trustees specifically took note of how each Fund compared to its Lipper peers as to performance, management fee expense and total net expenses. The Trustees noted that while the Funds were not charged a separate administration fee (recognizing that their management fees included a component for administrative services), it was not clear in all cases whether the peer funds in the Lipper category were separately charged such a fee by their investment managers, so that the total expense ratio (rather than any individual expense component) represented the most relevant comparison. It was noted that the total expense ratio comparisons reflect the effect of expense waivers/reimbursements (although none existed for the Funds).

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Matters Relating to the Trustees Consideration of the Investment Management and Portfolio Management Agreement(Cont.)

PIMCO California Municipal Income Fund III

With respect to the Fund's common share total return performance (based on net asset value) relative to its respective Lipper performance universe, the Trustees noted that the Fund had fourth quintile performance for the one-year period ended December 31, 2013, first quintile performance for the three-year and five-year periods ended December 31, 2013 and fifth quintile performance for the ten-year period ended December 31, 2013.

The Trustees noted that the expense group for the Fund provided by Lipper consisted of a total of seven closed-end funds, including the Fund. The Trustees also noted that the average net assets of the common shares of the funds in the group ranged from \$33.1 million to \$481.0 million, and that two of the funds in the group were larger in asset size than the Fund. The Trustees noted that the Fund's management fee was above the median management fee of the other funds in its expense group provided by Lipper calculated both on common share assets and on common share and leveraged assets combined. With respect to the Fund's total expense ratio (excluding interest expense) calculated on average net assets, the Trustees noted that the Fund's estimated total expense ratio was above the median total expense ratio of the group of funds presented for comparison.

PIMCO Municipal Income Fund III

With respect to the Fund's common share total return performance (based on net asset value) relative to its respective Lipper performance universe, the Trustees noted that the Fund had fifth quintile performance for the one-year period ended December 31, 2013, first quintile performance for the three-year and five-year periods ended December 31, 2013 and fifth quintile performance for the ten-year period ended December 31, 2013.

The Trustees noted that the expense group for the Fund provided by Lipper consisted of a total of nine closed-end funds, including the Fund. The Trustees also noted that the average net assets of the common shares of the funds in the group ranged from \$277.2 million to \$710.0 million, and that seven of the funds in the group were larger in asset size than the Fund. The Trustees noted that the Fund's management fee was above the median management fee of the other funds in its expense group provided by Lipper calculated both on common share assets and on common share and leveraged assets combined. With respect to the Fund's total expense ratio (excluding interest expense) calculated on average net assets, the Trustees noted that the Fund's estimated total expense ratio was above the median total expense ratio of the group of funds presented for comparison.

PIMCO New York Municipal Income Fund III

With respect to the Fund's common share total return performance (based on net asset value) relative to its respective Lipper performance universe, the Trustees noted that the Fund had third quintile performance for the one-year period ended December 31, 2013, first quintile performance for the three-year period ended December 31, 2013, second quintile performance for the five-year period ended December 31, 2013 and fifth quintile performance for the ten-year period ended December 31, 2013.

The Trustees noted that the expense group for the Fund provided by Lipper consisted of a total of six closed-end funds, including the Fund. The Trustees also noted that the average net assets of the common shares of the funds in the group ranged from \$52.4 million to \$275.7 million, and that five

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(Unaudited)

of the funds in the group were larger in asset size than the Fund. The Trustees noted that the Fund's management fee was above the median management fee of the other funds in its expense group provided by Lipper calculated both on common share assets and on common share and leveraged assets combined. With respect to the Fund's total expense ratio (excluding interest expense) calculated on average net assets, the Trustees noted that the Fund's estimated total expense ratio was above the median total expense ratio of the group of funds presented for comparison.

In addition to their review of Fund performance based on net asset value, the Trustees also considered the market value performance of each Fund's common shares and related share price premium and/or discount information based on the materials provided by Lipper and management.

The Trustees also considered the management fees charged by PIMCO to other funds with similar strategies to those of the Funds, including open-end funds advised by PIMCO. The Trustees noted that the management fees paid by the Funds are generally higher than the fees paid by the open-end funds offered for comparison, but were advised by PIMCO that there are additional portfolio management challenges in managing closed-end funds such as the Funds, such as those associated with the use of leverage and attempting to meet a regular dividend. The Trustees were advised that PIMCO does not manage any institutional or separate accounts which have an investment strategy or return profile bearing any reasonable similarity to the Funds.

The Trustees also took into account that the Funds have preferred shares outstanding, which increased the amount of management fees payable by the Funds under the Previous Agreements (because each Fund's fees were calculated based on the Fund's net assets, including any assets attributable to preferred shares outstanding). The Trustees took into account that AGIFM and PIMCO had a financial incentive for the Funds to have preferred shares outstanding, which may create a conflict of interest between AGIFM and PIMCO, on the one hand, and the Funds common shareholders, on the other. In this regard, the Trustees considered information provided by AGIFM and PIMCO and related presentations as to why the Funds' use of leverage continues to be appropriate and in the best interests of the Funds under current market conditions. The Trustees also considered PIMCO's representation that it will use leverage for the Funds solely as it determines to be in the best interests of the Funds from an investment perspective and without regard to the level of compensation AGIFM or PIMCO receive.

Based on a profitability analysis provided by AGIFM, the Trustees also considered the estimated profitability to AGIFM from its relationship with each Fund and determined that such profitability did not appear to be excessive.

The Trustees also took into account that, as closed-end investment companies, the Funds do not currently intend to raise additional assets, so the assets of the Funds will grow (if at all) principally through the investment performance of each Fund. Therefore, the Trustees did not consider potential economies of scale as a principal factor in assessing the fee rates payable under the Previous Agreements.

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Matters Relating to the Trustees Consideration of the Investment Management and Portfolio Management Agreement(Cont.)

(Unaudited)

Additionally, the Trustees considered so-called "fall-out benefits" to AGIFM and PIMCO, such as reputational value derived from serving as investment manager and sub-adviser to the Funds and research, statistical and quotation services AGIFM and PIMCO may receive from broker-dealers executing the Funds' portfolio transactions on an agency basis.

After reviewing these and other factors described herein, the Trustees concluded, with respect to each Fund, within the context of their overall conclusions regarding the Previous Agreements and based on the information provided and related representations made by management, that they were satisfied with AGIFM's and PIMCO's responses and efforts relating to the investment performance of such Fund. The Trustees also concluded that the fees payable under each Previous Agreement represented reasonable compensation in light of the nature, extent and quality of services provided by AGIFM or PIMCO, as the case may be. Based on their evaluation of factors that they deemed to be material, including those factors described above, the Trustees, including the Independent Trustees, unanimously concluded that the continuation of the Previous Agreements was in the best interests of each Fund and its shareholders, and should be approved.

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Privacy Policy

(Unaudited)

The Funds¹ consider customer privacy to be a fundamental aspect of their relationships with shareholders and are committed to maintaining the confidentiality, integrity and security of their current, prospective and former shareholders' non-public personal information. The Funds have developed policies that are designed to protect this confidentiality, while allowing shareholder needs to be served.

Obtaining Personal Information

In the course of providing shareholders with products and services, the Funds and certain service providers to the Funds, such as the Funds investment adviser ("Adviser"), may obtain non-public personal information about shareholders, which may come from sources such as account applications and other forms, from other written, electronic or verbal correspondence, from shareholder transactions, from a shareholder's brokerage or financial advisory firm, financial advisor or consultant, and/or from information captured on applicable websites.

Respecting Your Privacy

As a matter of policy, the Funds do not disclose any non-public personal information provided by shareholders or gathered by the Funds to non-affiliated third parties, except as required or permitted by law or as necessary for such third parties to perform their agreements with respect to the Funds. As is common in the industry, non-affiliated companies may from time to time be used to provide certain services, such as preparing and mailing prospectuses, reports, account statements and other information, conducting research on shareholder satisfaction and gathering shareholder proxies. The Funds or their affiliates may also retain non-affiliated companies to market Fund shares or products which use Fund shares and enter into joint marketing arrangements with them and other companies. These companies may have access to a shareholder's personal and account information, but are permitted to use this information solely to provide the specific service or as otherwise permitted by law. In most cases, the shareholders will be clients of a third party, but the Funds may also provide a shareholder's personal and account information to the shareholder's respective brokerage or financial advisory firm and/or financial advisor or consultant.

Sharing Information with Third Parties

The Funds reserve the right to disclose or report personal or account information to non-affiliated third parties in limited circumstances where the Funds believe in good faith that disclosure is required under law, to cooperate with regulators or law enforcement authorities, to protect their rights or property, or upon reasonable request by any fund advised by PIMCO in which a shareholder has invested. In addition, the Funds may disclose information about a shareholder or a shareholder's accounts to a non-affiliated third party at the shareholder's request or with the consent of the shareholder.

Sharing Information with Affiliates

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The Funds may share shareholder information with their affiliates in connection with servicing shareholders' accounts, and subject to applicable law may provide shareholders with information

¹ When distributing this Policy, a Fund may combine the distribution with any similar distribution of its investment adviser's privacy policy. The distributed, combined policy may be written in the first person (i.e., by using "we" instead of "the Funds").

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Privacy Policy (Cont.)

(Unaudited)

about products and services that the Funds or their Advisers or its affiliates (Service Affiliates) believe may be of interest to such shareholders. The information that the Funds may share may include, for example, a shareholder s participation in the Funds or in other investment programs sponsored by a Service Affiliate, a shareholder s ownership of certain types of accounts (such as IRAs), information about the Funds experiences or transactions with a shareholder, information captured on applicable websites, or other data about a shareholder s accounts, subject to applicable law. The Funds Service Affiliates, in turn, are not permitted to share shareholder information with non-affiliated entities, except as required or permitted by law.

Procedures to Safeguard Private Information

The Funds take seriously the obligation to safeguard shareholder non-public personal information. In addition to this policy, the Funds have implemented procedures that are designed to restrict access to a shareholder s non-public personal information to internal personnel who need to know that information to perform their jobs, such as servicing shareholder accounts or notifying shareholders of new products or services. Physical, electronic and procedural safeguards are in place to guard a shareholder s non-public personal information.

Information Collected from Websites

Websites maintained by the Funds or their service providers may use a variety of technologies to collect information that help the Funds and their service providers understand how the website is used. Information collected from your web browser (including small files stored on your device that are commonly referred to as cookies) allow the websites to recognize your web browser and help to personalize and improve your user experience and enhance navigation of the website. In addition, the Funds or their Service Affiliates may use third parties to place advertisements for the Funds on other websites, including banner advertisements. Such third parties may collect anonymous information through the use of cookies or action tags (such as web beacons). The information these third parties collect is generally limited to technical and web navigation information, such as your IP address, web pages visited and browser type, and does not include personally identifiable information such as name, address, phone number or email address.

You can change your cookie preferences by changing the setting on your web browser to delete or reject cookies. If you delete or reject cookies, some website pages may not function properly.

Changes to the Privacy Policy

From time to time, the Funds may update or revise this privacy policy. If there are changes to the terms of this privacy policy, documents containing the revised policy on the relevant website will be updated.

Effective as of September 5, 2014.

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General Information

Investment Manager

Pacific Investment Management Company LLC

650 Newport Center Drive

Newport Beach, CA 92660

Custodian

State Street Bank & Trust Co.

225 Franklin Street

Boston, MA 02110

Transfer Agent, Dividend Paying Agent and Registrar

American Stock Transfer & Trust Company, LLC

6201 15th Avenue

Brooklyn, NY 11219

Legal Counsel

Ropes & Gray LLP

Prudential Tower

800 Boylston Street

Boston, MA 02199

Independent Registered Public Accounting Firm

PricewaterhouseCoopers LLP

1100 Walnut Street, Suite 1300

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Kansas City, MO 64106

This report is submitted for the general information of the shareholders of PIMCO Municipal Income Fund III, PIMCO California Municipal Income Fund III and PIMCO New York Municipal Income Fund III.

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To get future shareholder reports online and to eliminate mailings, go to: pimco.com/edelivery

pimco.com/investments

CEF3008AR_093014

Table of Contents**Item 2. Code of Ethics.**

As of the end of the period covered by this report, the Registrant has adopted a code of ethics (the Code) that applies to the Registrant's principal executive officer and principal financial & accounting officer. The Registrant did not grant any waivers, including implicit waivers, from any provisions of the Code to the principal executive officer or principal financial & accounting officer during the period covered by this report.

A copy of the Code is included as an exhibit to this report.

Item 3. Audit Committee Financial Expert.

(a) The Board of Trustees has determined that James A. Jacobson, who serves on the Board's audit committee, qualifies as an audit committee financial expert as such term is defined in the instructions to this Item 3. The Board has also determined that Mr. Jacobson is independent as such term is interpreted under this Item 3.

Item 4. Principal Accountant Fees and Services.

(a) Fiscal Year Ended	Audit Fees
September 30, 2014	\$ 49,440
September 30, 2013	\$ 45,000
(b) Fiscal Year Ended	Audit-Related Fees
September 30, 2014	\$ 8,584
September 30, 2013	\$ 8,333
(c) Fiscal Year Ended	Tax Fees
September 30, 2014	\$ 11,450
September 30, 2013	\$ 10,800
(d) Fiscal Year Ended	All Other Fees ⁽¹⁾
September 30, 2014	
September 30, 2013	

Audit Fees represents fees billed for each of the last two fiscal years for professional services rendered for the audit and review of the Registrant's annual financial statements for those fiscal years or services that are normally provided by the accountant in connection with statutory or regulatory filings or engagements for those fiscal years.

Audit-Related Fees represents fees billed for each of the last two fiscal years for assurance and related services that are reasonably related to the performance of the audit or review of financial statements, but not reported under Audit Fees above, and that include accounting consultations, agreed-upon procedure reports (inclusive of annual review of basic maintenance testing associated with the Preferred Shares), attestation reports and comfort letters for those fiscal years.

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Tax Fees represents fees billed for each of the last two fiscal years for professional services related to tax compliance, tax advice and tax planning, including services relating to the filing or amendment of federal, state or local income tax returns, regulated investment company qualification reviews, and tax distribution and analysis reviews.

All Other Fees represents fees, if any, billed for other products and services rendered by the principal accountant to the Registrant other than those reported above under **Audit Fees**, **Audit-Related Fees** and **Tax Fees** for the last two fiscal years.

⁽¹⁾There were no **All Other Fees** for the last two fiscal years.

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(e) Pre-approval policies and procedures

(1) The Registrant's Audit Committee has adopted pre-approval policies and procedures (the Procedures) to govern the Audit Committee's pre-approval of (i) all audit services and permissible non-audit services to be provided to the Registrant by its independent accountant, and (ii) all permissible non-audit services to be provided by such independent accountant to the Registrant's investment adviser and to any entity controlling, controlled by, or under common control with the investment adviser that provides ongoing services to the Registrant (collectively, the Service Affiliates) if the services provided directly relate to the Registrant's operations and financial reporting. In accordance with the Procedures, the Audit Committee is responsible for the engagement of the independent accountant to certify the Registrant's financial statements for each fiscal year. With respect to the pre-approval of non-audit services provided to the Registrant and its Service Affiliates, the Procedures provide that the Audit Committee may annually pre-approve a list of types or categories of non-audit services that may be provided to the Registrant or its Service Affiliates, or the Audit Committee may pre-approve such services on a project-by-project basis as they arise. Unless a type of service has received general pre-approval, it will require specific pre-approval by the Audit Committee if it is to be provided by the independent accountant. The Procedures also permit the Audit Committee to delegate authority to one or more of its members to pre-approve any proposed non-audit services that have not been previously pre-approved by the Committee, subject to the ratification by the full Audit Committee no later than its next scheduled meeting.

(2) With respect to the services described in paragraphs (b) through (d) of this Item 4, no amount was approved by the Audit Committee pursuant to paragraph (c)(7)(i)(C) of Rule 2-01 of Regulation S-X.

f) Not applicable.

g)

Entity	Aggregate Non-Audit Fees Billed to Entity September 30, 2014
PIMCO Municipal Income Fund III	\$ 20,034
Pacific Investment Management Company LLC (PIMCO)	6,692,504
Allianz Global Investors Fund Management LLC	137,840
Total	\$ 6,850,378

The aggregate non-audit fees billed by the Auditor for services rendered to the Registrant, and rendered to the Adviser, for the fiscal period ended September 30, 2013 was \$7,487,883.

h) The Registrant's Audit Committee has considered whether the provision of non-audit services that were rendered to the Registrant's investment adviser, and any entity controlling, controlled by, or under common control with the investment adviser that provides ongoing services to the Registrant which were not pre-approved (not requiring pre-approval) is compatible with maintaining the principal accountant's independence.

Item 5. Audit Committee of Listed Registrants.

The Registrant has a separately-designated standing audit committee established in accordance with Section 3(a)(58)(A) of the Securities Exchange Act of 1934, as amended. The audit committee is comprised of:

Deborah A. DeCotis;

Bradford K. Gallagher;

James A. Jacobson;

Hans W. Kertess;

William B. Ogden, IV;

Alan Rappaport;

Item 6. Schedule of Investments.

The Schedule of Investments is included as part of the reports to shareholders under Item 1.

Table of Contents**Item 7. Disclosure of Proxy Voting Policies and Procedures for Closed-End Management Investment Companies.**

PIMCO has adopted written proxy voting policies and procedures (Proxy Policy) as required by Rule 206(4)-6 under the Investment Advisers Act of 1940, as amended (the Advisers Act). In addition to covering the voting of equity securities, the Proxy Policy also applies generally to voting and/or consent rights of fixed income securities, including but not limited to, plans of reorganization, and waivers and consents under applicable indentures. The Proxy Policy does not apply, however, to consent rights that primarily entail decisions to buy or sell investments, such as tender or exchange offers, conversions, put options, redemption and Dutch auctions. The Proxy Policy is designed and implemented in a manner reasonably expected to ensure that voting and consent rights (collectively, proxies) are exercised in the best interests of accounts.

With respect to the voting of proxies relating to equity securities, PIMCO has selected an unaffiliated third party proxy research and voting service (Proxy Voting Service), to assist it in researching and voting proxies. With respect to each proxy received, the Proxy Voting Service researches the financial implications of the proposals and provides a recommendation to PIMCO as to how to vote on each proposal based on the Proxy Voting Service s research of the individual facts and circumstances and the Proxy Voting Service s application of its research findings to a set of guidelines that have been approved by PIMCO. Upon the recommendation of the applicable portfolio managers, PIMCO may determine to override any recommendation made by the Proxy Voting Service. In the event that the Proxy Voting Service does not provide a recommendation with respect to a proposal, PIMCO may determine to vote on the proposals directly.

With respect to the voting of proxies relating to fixed income securities, PIMCO s fixed income credit research group (the Credit Research Group) is responsible for researching and issuing recommendations for voting proxies. With respect to each proxy received, the Credit Research Group researches the financial implications of the proxy proposal and makes voting recommendations specific for each account that holds the related fixed income security. PIMCO considers each proposal regarding a fixed income security on a case-by-case basis taking into consideration any relevant contractual obligations as well as other relevant facts and circumstances at the time of the vote. Upon the recommendation of the applicable portfolio managers, PIMCO may determine to override any recommendation made by the Credit Research Group. In the event that the Credit Research Group does not provide a recommendation with respect to a proposal, PIMCO may determine to vote the proposal directly.

PIMCO may determine not to vote a proxy for an equity or fixed income security if: (1) the effect on the applicable account s economic interests or the value of the portfolio holding is insignificant in relation to the account s portfolio; (2) the cost of voting the proxy outweighs the possible benefit to the applicable account, including, without limitation, situations where a jurisdiction imposes share blocking restrictions which may affect the ability of the portfolio managers to effect trades in the related security; or (3) PIMCO otherwise has determined that it is consistent with its fiduciary obligations not to vote the proxy.

In the event that the Proxy Voting Service or the Credit Research Group, as applicable, does not provide a recommendation or the portfolio managers of a client account propose to override a recommendation by the Proxy Voting Service, or the Credit Research Group, as applicable, PIMCO will review the proxy to determine whether there is a material conflict between PIMCO and the applicable account or among PIMCO-advised accounts. If no material conflict exists, the proxy will be voted according to the portfolio managers recommendation. If a material conflict does exist, PIMCO will seek to resolve the conflict in good faith and in the best interests of the applicable client account, as provided by the Proxy Policy. The Proxy Policy permits PIMCO to seek to resolve material conflicts of interest by pursuing any one of several courses of action. With respect to material conflicts of interest between PIMCO and a client account, the Proxy Policy permits PIMCO to either: (i) convene a committee to assess and resolve the conflict (the Proxy Conflicts Committee); or (ii) vote in accordance with protocols previously established

by the Proxy Policy, the Proxy Conflicts Committee and/or other relevant procedures approved by PIMCO's Legal and Compliance department with respect to specific types of conflicts. With respect to material conflicts of interest between one or more PIMCO-advised accounts, the Proxy Policy permits PIMCO to: (i) designate a PIMCO portfolio manager who is not subject to the conflict to determine how to vote the proxy if the conflict exists between two accounts with at least one portfolio manager in common; or (ii) permit the respective portfolio managers to vote the proxies in accordance with each client account's best interests if the conflict exists between client accounts managed by different portfolio managers.

PIMCO will supervise and periodically review its proxy voting activities and the implementation of the Proxy Policy.

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(a)(1)

As of November 25, 2014, the following individual has primary responsibility for the day-to-day implementation of PIMCO Municipal Income Fund III (the Fund):

Joe Deane

Mr. Deane has been the portfolio manager for the Fund since July 21, 2011. Mr. Deane is an executive vice president in the New York office and head of municipal bond portfolio management. Prior to joining PIMCO in 2011, he was co-head of the tax-exempt department at Western Asset (WAMCO). Mr. Deane was previously a managing director and head of tax-exempt investments from 1993-2005 at Smith Barney/Citigroup Asset Management. Earlier in his career, he held senior portfolio management positions with Shearson and E.F. Hutton. Morningstar named him Fixed-Income Manager of the Year in 1996 and a finalist in 1995 and 2007. He has 44 years of investment experience and holds a bachelor's degree from Iona College.

(a)(2)

The following summarizes information regarding each of the accounts, excluding the Fund, managed by the Portfolio Manager as of September 30, 2014, including accounts managed by a team, committee, or other group that includes the Portfolio Manager. Unless mentioned otherwise, the advisory fee charged for managing each of the accounts listed below is not based on performance.

PM	Registered Investment Companies		Other Pooled Investment Vehicles		Other Accounts	
	#	AUM(\$million)	#	AUM(\$million)	#	AUM(\$million)
Joe Deane	20	4,725.31	3	6,926.21	11	1,110.71

From time to time, potential and actual conflicts of interest may arise between a portfolio manager's management of investments of a Fund, on the one hand, and the management of other accounts, on the other. Potential and actual conflicts of interest may also arise as a result of PIMCO's other business activities and PIMCO's possession of material non-public information about a particular issuer. Other accounts managed by a portfolio manager might have similar investment objectives or strategies as a Fund, or otherwise hold, purchase, or sell securities that are eligible to be held, purchased or sold by the Funds. The other accounts might also have different investment objectives or strategies than a Fund.

Knowledge and Timing of Fund Trades. A potential conflict of interest may arise as a result of the portfolio manager's day-to-day management of a Fund. Because of their positions with a Fund, the portfolio managers know the size, timing and possible market impact of a Fund's trades. It is theoretically possible that the portfolio managers could use this information to the advantage of other accounts they manage and to the possible detriment of a Fund.

Investment Opportunities. A potential conflict of interest may arise as a result of the portfolio manager's management of a number of accounts with varying investment guidelines. Often, an investment opportunity may be suitable for both a Fund and other accounts managed by the portfolio manager, but may not be available in sufficient quantities for both the Fund and the other accounts to participate fully. Similarly, there may be limited opportunity to sell an

investment held by a Fund and another account. PIMCO has adopted policies and procedures reasonably designed to allocate investment opportunities on a fair and equitable basis over time.

Under PIMCO's allocation procedures, investment opportunities are allocated among various investment strategies based on individual account investment guidelines and PIMCO's investment outlook. PIMCO has also adopted additional procedures to complement the general trade allocation policy that are designed to address potential conflicts of interest due to the side-by-side management of a Fund, certain pooled investment vehicles and other accounts, including investment opportunity allocation issues.

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Conflicts potentially limiting a Fund's investment opportunities may also arise when the Fund and other PIMCO clients invest in different parts of an issuer's capital structure, such as when the Fund owns senior debt obligations of an issuer and other clients own junior tranches of the same issuer. In such circumstances, decisions over whether to trigger an event of default, over the terms of any workout, or how to exit an investment may result in conflicts of interest. In order to minimize such conflicts, a portfolio manager may avoid certain investment opportunities that would potentially give rise to conflicts with other PIMCO clients or PIMCO may enact internal procedures designed to minimize such conflicts, which could have the effect of limiting a Fund's investment opportunities. Additionally, if PIMCO acquires material non-public confidential information in connection with its business activities for other clients, a portfolio manager may be restricted from purchasing securities or selling securities for a Fund. When making investment decisions where a conflict of interest may arise, PIMCO will endeavor to act in a fair and equitable manner as between a Fund and other clients; however, in certain instances the resolution of the conflict may result in PIMCO acting on behalf of another client in a manner that may not be in the best interest, or may be opposed to the best interest, of a Fund.

Performance Fees. A portfolio manager may advise certain accounts with respect to which the advisory fee is based entirely or partially on performance. Performance fee arrangements may create a conflict of interest for the portfolio manager in that the portfolio manager may have an incentive to allocate the investment opportunities that he or she believes might be the most profitable to such other accounts instead of allocating them to a Fund. PIMCO has adopted policies and procedures reasonably designed to allocate investment opportunities between a Fund, certain pooled investment vehicles and other accounts on a fair and equitable basis over time.

(a)(3)

As of September 30, 2014, the following explains the compensation structure of the individual who has primary responsibility for day-to-day portfolio management of the Fund:

Portfolio Manager Compensation

PIMCO has adopted a Total Compensation Plan for its professional level employees, including its portfolio managers, that is designed to pay competitive compensation and reward performance, integrity and teamwork consistent with the firm's mission statement. The Total Compensation Plan includes an incentive component that rewards high performance standards, work ethic and consistent individual and team contributions to the firm. The compensation of portfolio managers consists of a base salary and discretionary performance bonuses, and may include an equity or long term incentive component.

Certain employees of PIMCO, including portfolio managers, may elect to defer compensation through PIMCO's deferred compensation plan. PIMCO also offers its employees a non-contributory defined contribution plan through which PIMCO makes a contribution based on the employee's compensation. PIMCO's contribution rate increases at a specified compensation level, which is a level that would include portfolio managers.

Key Principles on Compensation Philosophy include:

PIMCO's pay practices are designed to attract and retain high performers.

PIMCO's pay philosophy embraces a corporate culture of pay-for-performance, a strong work ethic and meritocracy.

PIMCO's goal is to ensure key professionals are aligned to PIMCO's long-term success through equity participation.

PIMCO's Discern and Differentiate discipline is exercised where individual performance ranking is used for guidance as it relates to total compensation levels.

The Total Compensation Plan consists of three components:

Base Salary Base salary is built on core job responsibilities, market factors and internal positions/levels. Base salary levels are reviewed annually, when there is a significant change in job responsibilities or position, or a significant change in market levels. Base salary is paid in regular installments throughout the year and payment dates are in line with local practice.

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Performance Bonus Performance bonuses are designed to reward individual performance. Each professional and his or her supervisor will agree upon performance objectives to serve as a basis for evaluation throughout the year. The objectives will outline individual goals according to pre-established measures of the group or department success. Achievement against these goals as measured by the employee and supervisor will be an important, but not exclusive, element of the Compensation Committee's bonus decision process. Final award amounts are determined at the discretion of the Compensation Committee and will also consider firm performance.

Equity or Long-term Incentive Compensation Equity and Long-term incentive compensation allow key professionals to participate in the long-term growth of the firm. M Options and/or Long Term Incentive Plan (LTIP) are awarded to professionals. Employees who reach a total compensation threshold are delivered their annual compensation in a mix of cash and equity or long-term incentive awards. PIMCO incorporates a progressive allocation of deferred compensation as a percentage of total compensation, which is in line with market practices.

- i The M Unit program provides employees with the potential to acquire an equity stake in PIMCO over their careers and to better align employee incentives with the firm's long-term results. In the program, options are awarded and vest over a number of years and may convert into PIMCO equity which shares in the profit distributions of the firm. M Units are non-voting common equity of PIMCO and provide a mechanism for individuals to build a significant equity stake in PIMCO over time.
- i The LTIP award provides cash awards that appreciate or depreciate based on PIMCO's operating earnings over a rolling three-year basis. The plan provides a link between longer term company performance and participant pay, further motivating participants to make a long-term commitment to PIMCO's success.

Participation in the M Unit Option Plan and LTIP is contingent upon continued employment at PIMCO.

In addition, the following non-exclusive list of qualitative criteria may be considered when specifically determining the total compensation for portfolio managers:

3-year, 2-year and 1-year dollar-weighted and account-weighted, pre-tax investment performance as judged against the applicable benchmarks for each account managed by a portfolio manager (including the Funds) and relative to applicable industry peer groups;

Appropriate risk positioning that is consistent with PIMCO's investment philosophy and the Investment Committee/CIO approach to the generation of alpha;

Amount and nature of assets managed by the portfolio manager;

Consistency of investment performance across portfolios of similar mandate and guidelines (reward low dispersion);

Generation and contribution of investment ideas in the context of PIMCO's secular and cyclical forums, portfolio strategy meetings, Investment Committee meetings, and on a day-to-day basis;

Absence of defaults and price defaults for issues in the portfolios managed by the portfolio manager;

Contributions to asset retention, gathering and client satisfaction;

Contributions to mentoring, coaching and/or supervising; and

Personal growth and skills added.

A portfolio manager's compensation is not based directly on the performance of any Fund or any other account managed by that portfolio manager.

Profit Sharing Plan. Portfolio managers who are Managing Directors of PIMCO receive compensation from a non-qualified profit sharing plan consisting of a portion of PIMCO's net profits. Portfolio managers who are Managing Directors receive an amount determined by the Compensation Committee, based upon an individual's overall contribution to the firm.

(a)(4)

The following summarizes the dollar range of securities of the Fund the portfolio manager beneficially owned as of September 30, 2014:

Portfolio Manager

Dollar Range of Equity Securities of the

Joe Deane

Fund Owned as of September 30, 2014
None

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Item 9. Purchases of Equity Securities by Closed-End Management Investment Company and Affiliated Purchasers.

None

Item 10. Submission of Matters to a Vote of Security Holders.

There have been no material changes to the procedures by which shareholders may recommend nominees to the Fund's Board of Trustees since the Fund last provided disclosure in response to this item.

Item 11. Controls and Procedures.

- (a) The principal executive officer and principal financial & accounting officer have concluded that the Registrant's disclosure controls and procedures (as defined in Rule 30a-3(c) under the Investment Company Act of 1940, as amended ("1940 Act")) provide reasonable assurances that material information relating to the Registrant is made known to them by the appropriate persons, based on their evaluation of these controls and procedures as of a date within 90 days of the filing of this report.

- (b) There were no changes in the Registrant's internal control over financial reporting (as defined in Rule 30a-3(d) under the 1940 Act) that occurred during the second fiscal quarter of the period covered by this report that have materially affected, or are reasonably likely to materially affect, the Registrant's internal control over financial reporting.

Item 12. Exhibits.

- (a)(1) Exhibit 99.CODE Code of Ethics pursuant to Section 406 of the Sarbanes-Oxley Act of 2002.

- (a)(2) Exhibit 99.CERT Certifications pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

- (b) Exhibit 99.906CERT Certifications pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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Signatures

Pursuant to the requirements of the Securities Exchange Act of 1934 and the Investment Company Act of 1940, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

PIMCO Municipal Income Fund III

By: /s/ PETER G. STRELOW

Peter G. Strelow
President, Principal Executive Officer

Date: November 25, 2014

Pursuant to the requirements of the Securities Exchange Act of 1934 and the Investment Company Act of 1940, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

By: /s/ PETER G. STRELOW

Peter G. Strelow
President, Principal Executive Officer

Date: November 25, 2014

By: /s/ WILLIAM G. GALIPEAU

William G. Galipeau
Treasurer, Principal Financial & Accounting Officer

Date: November 25, 2014