Transcript

Wolfe Research Global Transportation Conference

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Corporate Participants

Keith Edward Creel
President & Chief Executive Officer, Canadian Pacific Railway Ltd.

Other Participants

Scott H. Group
Senior Analyst, Wolfe Research, LLC

QUESTION AND ANSWER SECTION

Keith Edward Creel
President & Chief Executive Officer, Canadian Pacific Railway Ltd.

[Abrupt Start]

...in this quarter, it's pretty strong, they were about up 13% of [indiscernible] basis year-over-year, which is not completely surprised driven a lot by the bulk. We certainly expect to that, the surprise has been energy stat. The frac sand is obviously moving quite a bit more than the we had anticipated and maybe actually this quarter the [indiscernible] we're at pretty exceedingly all time high, which we hit back in 2014. The underlying fundamental today I think is good. That frac sand is going to Eagle Ford and the Permian Basin and areas as long as they're extracting crude from the ground, sand is required. We're in a pretty good position over the cost producers that the benefit from that underlying strength and that piece of the energy segment. The crude itself also first quarter and the second quarter a bit of a surprise, but at the same time, we've been burned to learn over the last several years with crude, so we remain optimistic.

It's a bit too early to know if that's going to sustain itself, but in fact, the last couple of weeks it has fallen off, so I think it's more appropriate to be cautious in that regard. To suggest though, the 13% up RTM growth, again, I'll remind everyone, last year was our lowest quarter, second quarter was a sort of the trough. And 2016, to be able to sustain that through the quarter, I'd like to say that, but the reality is, the comps do get a little bit tougher in June. So obviously we're extremely pleased with what we've done so far, but we have to remain a bit cautious as we look forward.

Scott H. Group
Senior Analyst, Wolfe Research, LLC

Q

Okay. That makes sense. So up 13%, maybe expect some deceleration in June, but I think the kind of – the official guidance was mid-single digit, is it – should we be thinking more like high-single digit, low-double digit now for the full quarter?

Keith Edward Creel
President & Chief Executive Officer, Canadian Pacific Railway Ltd.

A

What – again, I got to be a bit cautious than optimistic, but the numbers pretty much speak for themselves. So we're pretty good position. I'd say it's probably more likely a higher number than the lower number obviously, but again we got to play the whole quarter out. But overall, underlying, the fundamentals are pretty strong.

Scott H. Group
Senior Analyst, Wolfe Research, LLC

Q

And how should we think about incremental margins or just operating ratio in an environment, where RTMs are growing double digits?

Keith Edward Creel
President & Chief Executive Officer, Canadian Pacific Railway Ltd.

A

You know what, we proved that with this operating model, we're set up to effectively drive the improvement in the operating ratio. We said at the beginning of the year, a point to two points overall for the year, we're going to stick to that. So we got a little bit of headwind with fuel surcharge. Obviously, we're charging more than for fuel given the fuel prices going up and that's all at the 100% operating ratios, that's a little bit of the offset, but we still feel very strong on the basis of just operational synergies. The fundamental is improving the operating ratio, somewhere between a point, two points for the year, and obviously pretty significant improvement quarter-over-quarter of the revenue growth we've achieved so far in the second quarter this year.

Scott H. Group
Senior Analyst, Wolfe Research, LLC

Q

Okay. And then just last one kind of just on the earnings framework. The guidance for the year was, or is high single-digit earnings growth that didn't include buyback second quarter off to a better start, that's something you're kind of ready to revisit now, is that more of a – we'll, kind of give an update on the call in July?

Keith Edward Creel
President & Chief Executive Officer, Canadian Pacific Railway Ltd.

A

It's something we're obviously aware of, obviously in a better position than we had anticipated but again I will remind everyone this is a four-quarter game. I was talking to Maeghan this morning, and I said, you know what Atlanta Falcons have won the Super Bowl at half time and they didn't, and so, we're not going to make that mistake but at the same time again the underlying fundamentals are strong. So, I would certainly – I still feel extremely confident about the guidance that we provided.

We get to the end of the second quarter and things look like we might be able to sustain some of the trends that we're seeing today and enjoying today then we'll revisit it at the end of the quarter.

Scott H. Group
Senior Analyst, Wolfe Research, LLC

Q

Okay, great. So, I want to talk about and then we'll get a question from Barry in a sec, I want to just talk about this transition from a focus on margin improvement to one on revenue growth. And I want to understand how you actually go about doing it and how long it's going to take it and what should be the metric that we judge you on? Should it be, you should be growing volumes faster than CN within a year, within two years, is it volume faster than the other rails, and don't look at just versus CN? How should we judge you on what you want to do? And I guess, how do you go about it, and then how should we judge you on?

Keith Edward Creel
President & Chief Executive Officer, Canadian Pacific Railway Ltd.

A

All right. So, I would say number one, this is not a CP-CN story. This is about CP and it's about focusing on the strength of our networks. We spent the last four years fixing the engine, we've created an operating model but we are actually leveraging the strengths of the network which are the shorter lengths of haul on our key markets as opposed to worrying about the weaknesses of the network, which in the past that's what our predecessors did. So that's what we're doing. We've got our marketing team realigned now, we've got a Chief Marketing Officer that's got laser-focus, interacting with our customers, we've built the bench on the intermodal side, we've got I think best-in-class extremely talented individual and Jonathan Wahba, leading the Intermodal piece of the railway as well as the bulk side. He's got deep, deep knowledge of the trucking industry, deep knowledge of the railroad industry. To be able to connect the dots there is critically important.

So, as we're seeing we actually – we're the only railroad that drove intermodal growth in 2016, we're seeing that underlying strength to continue and domestic again to the strength of our network and more so to the point of taking trucks off the highway and put them on the back of the railroad, which is straight accretive. It's – we've got trains that are running out there, the margins are good, even though there's some competitive challenge there with the trucks. When you're adding additional cars to a train that already exist and the operating cost is there, it's pretty powerful from the operating leverage standpoint, from an earnings growth standpoint.

So, you'll continue to see growth on our intermodal product overall. We're doing some things to enhance the network to make us more attractive as we also deal with our international intermodal customers as we go forward some things to increase revenue streams. We're taking a look at investing in some transfer facilities, transload facilities we had not had in the past, more specifically Vancouver, which is a key metropolitan area, it's certainly an area where there is a lot of congestion of the trucks. So if we can take rail and take trucks off the road and we can turn boxes at the port that's pretty powerful given the importance of the footprint of Vancouver in that international space.

So things like that we're doing – willing to do to drive the top line. The bulk side is the bulk side, I can't control commodity prices. So, success there is out of my control. We think we're going to do better with what we have, we're going to continue to drive margin improvements, operational synergies on bulk side but there is not a lot we can do that and then the other place to look for success is going to be on a merchandise business as we have become more reliable, this railway in the past, it was no secret especially in Canada, if you ran a production line, if you ran a product from say, Edmonton to Vancouver, and depending upon that product getting there to keep the production line running, this company was not trusted. We've created an opportunity now, trust with our customers that they will entrust us with moving freight in those key lines to move their production line. So if you are a car owner and I remind you again that over 50% of the cars in the rail industry, in our railway we don't own, so that said 50% is owned by car owners. If I can help them save money by turning their assets faster, so they have less ownership cost. That's what selling service is. It's not necessarily the rate. We have to be competitive with our rates, but at the same time there is tremendous value and capital avoidance in saving bottom line cost for a service provider and helping them grow their business. So in turn we grow ours as well. So again, international, domestic combined, intermodal growth expect to see that. That's going to be a success area. We get outpace the economy and then, on the merchandise side, you will start to see that become a bigger piece of our overall business portfolio.

Scott H. Group
Senior Analyst, Wolfe Research, LLC

Q

So if I'm hearing you, in your mind the benchmark should just be volume or the goal is volume growth in excess of GDP?

Keith Edward Creel
President & Chief Executive Officer, Canadian Pacific Railway Ltd.

A

That's correct. Absolutely.

Scott H. Group
Senior Analyst, Wolfe Research, LLC

Q

Okay. Barry had a question.

Analyst Question

Q

Yeah. Hi Keith, just wanted to follow up on revenue side as well with a couple more questions. So let's take an intermodal move where you are identifying an opportunity to take trucks off the highway. I know it'll vary by customer, but what sort of the average length of the selling cycle. You go and meet with them and how long does it take you to actually get the business and hit the revenue line if you're successful.

And secondly, any – just anecdotal or recent wins that you had that you could talk about it just as an example of some early success? Thanks.

Keith Edward Creel
President & Chief Executive Officer, Canadian Pacific Railway Ltd.

A

Yeah. I would say, the barrier to change on intermodal side to sales cycle, when we're talking about taking the trucks off the highway to the rail, it's not very long. So it's a short cycle and it's something - that is the specific area we're seeing tremendous success in. Our product going cross borders, so trans-border or cross-border domestics, Montreal, Toronto, down Chicago, frankly, a year-and-a-half ago, we didn't compete in that marketplace.

So we've got an ability now with our double-stack synergies. We're running our train now via the CSX railroad to Buffalo into the Toronto into the Montreal market. It's reliable service. There is plenty of room for growth. So that's exactly been an area of opportunity that we seized on a converted specific to the intermodal space. And that's what drove our growth overall last year versus the industry when other people were contracting, we were able to take strikes and value for the marketplace on the basis of that. You will continue to see more of that, there is a lot more trucks that are moving across that border, that once they get a reliable ride in the railway, there is an opportunity for the truck to win as well as the railways to win.

Scott H. Group
Senior Analyst, Wolfe Research, LLC

Q

Good. So just sticking on this theme now, so, you are transitioning want to grow faster than the economy. We know that CN wants to do you the same, you were there, obviously, a good competitor. How does it work when both rails want to gain share? I know you said it's not CP versus CN, but certainly on some of the business, it is CP versus CN. And just struggling with the idea of, how can it work or what's the impact if both of the rails want to gain share and we'll ask the same thing to CN next?

Keith Edward Creel
President & Chief Executive Officer, Canadian Pacific Railway Ltd.

A

Well, I would suggest that it's happening now, both railways are outpacing the industry. So it's – there is an opportunity for both railways to do well. Obviously CN has different reach than CP does, they go to places we don't go to, but in the marketplaces again that we serve, if a customer has its freight on the most efficient supply chain, so to speak and then create that opportunity, then we should do well in that marketplace, but likewise again the places that CN's franchise and network is superior to the CP, then they should do well in that marketplace. So in that space there is a lot of grain to move, there is lumber to move, there is potash to move, there is coal to move, there is intermodal to move, the growth in the western ports, service reliability standpoint, via CP, via CN, getting into the Midwest of the U.S.A.

The reliability there and the cost and advantages of the Canadian ports, have over the U.S. West Coast ports remains another area. So again we're doing it today. And I've always said, I said when I worked at the other rail and I'll say it now, there is enough opportunity in business in Canada, and enough goods in trade going across the border as the both railways can remain responsible, they can maintain price, they can sell service, you get the best two run railways in North America with the lowest cost and the best service. It's a pretty competitive environment out there, yes, but that's the pretty compelling market opportunity and pretty compelling value for our customers.

Scott H. Group
Senior Analyst, Wolfe Research, LLC

Q

Okay. And then I want to ask you from the other perspective of, yes, maybe it's a competitive market, but on the other hand you guys are both seeing really good volume growth, right now. Is this the kind of environment where we can start to expect an acceleration in pricing trends, which have been stable, but maybe not stellar. Can we start to see a reacceleration of pricing just given how good the volumes are right now?

Keith Edward Creel
President & Chief Executive Officer, Canadian Pacific Railway Ltd.

A

Yeah. I would say, essentially, it's still a pretty competitive marketplace out there. Historically the Canadian rails have been the 3% – in its strong market 3% to 4% versus now we're 2.5% to 3%. So I think today reflects the competitive marketplace that's out there, some of the excess capacity that is still yet to be taken up, but as we go forward and you talk about trucking capacity being taken up you talk about the new regulations that are coming into place. Is that going to be a huge tailwind, no; but is that going to increase the underlying fundamentals of soaking up demand? I think, yes. You'll start to see spot rates that are improving, that are increasing. So, I think it's still a couple of quarters out before we get to that 3% to 4%, but I do see line of sight to it given the macroeconomic strength that we're seeing.

Scott H. Group
Senior Analyst, Wolfe Research, LLC

Q

Okay. And then given the volume strength that we're seeing, do we need to start thinking about adding head count back or are we starting to do that yet?

Keith Edward Creel
President & Chief Executive Officer, Canadian Pacific Railway Ltd.

A

No, not at CP. Obviously, there is still tremendous amount of synergies from the operational side. Train length is, we're probably 7,300 or 7,400 feet. If you think about a railroad that we've built, they can run 10,000 or 11,000 foot trains. At CP, 100% of our high horsepower fleet or mainline locomotives are DP equipped. For those that who don't know what DP is, distributed power, it allows you to run longer, heavier trains. So, effectively we can optimize the network. We can use the length of the sidings that we invested in. There is still tremendous amount of our railroad that we have not even converted, but as we go forward, our objective this year is to increasing train length, increasing train weight. It's actually to absorb the mid-single-digit RTM growth that we've guided to without adding any additional headcounts. So, there is still synergies there for us.

Scott H. Group
Senior Analyst, Wolfe Research, LLC

Q

So, relative to RTMs tracking up those double-digits right now, how much your trains starts up in the quarter?

Keith Edward Creel
President & Chief Executive Officer, Canadian Pacific Railway Ltd.

A

RTM sort of tells you the leverage about 3%.

Scott H. Group
Senior Analyst, Wolfe Research, LLC

Q

Train starts up about 3%?

Keith Edward Creel
President & Chief Executive Officer, Canadian Pacific Railway Ltd.

A

Overall, no. The head count look – if you look at the train miles and look more trains miles and train starts, the train miles affectively is about 3% versus the 13%. So that sort of tells you the power of the leverage.

Scott H. Group
Senior Analyst, Wolfe Research, LLC

Q

Okay. Great. So, why don't you just go through some of the individual commodity segments and get your take. So, coal volumes really strong up in the net 20% quarter-to-date range, how much of a benefit do you think your coal franchises are seeing from some of the outages we saw in Australia and the strength in met spot prices in the first quarter and second quarter. Do you think that we should be expecting a slowdown in coal in the back half just as met spot prices have come down a lot?

Keith Edward Creel
President & Chief Executive Officer, Canadian Pacific Railway Ltd.

A

I think, by and large Teck being a low cost producer, which were certainly probably a part of that partnership with Teck. They've done well when the price is down, they've done well when the price is up. So, I think the spot market sort of started to shift demand up a bit, but they stuck to their guidance 27 million metric tonnes, 28 million metric tonnes which is up about a 1 million metric tonnes versus last year.

We're certainly on track to be able to do that. So, I don't see a lot of change with Teck at this point.

Scott H. Group
Senior Analyst, Wolfe Research, LLC

Q

Okay, good. On the grain side, so I think mid-teens volume growth rate now. Can you just give us a sense, how much is Canadian grain up, how much is U.S. grain up, how do you think about a better South American harvest and what that could mean for grain in the second half of the year?

Keith Edward Creel
President & Chief Executive Officer, Canadian Pacific Railway Ltd.

A

Yeah. I think both sides on Canadian and U.S. have been very strong, I'd say pretty even. As we go forward, the underlying fundamentals in Canada remain strong. Obviously, there is some uncertainty, because we don't know what the harvest is going to do as of yet, but to your point about Brazil and to your point about some of the crops that we're seeing in South America, could that become a headwind from the run rates that we've enjoyed, I would say yes.

It's obviously something that we're very cognizant of, but we'll truly know the impact of that until later in the crop year. So far I think the underlying volumes are still there, the demand is still there. We're still moving a lot of grain out of the U.S. franchise, but to expect that it might slow down given the excess supply on the marketplace, I think that's probably a reasonable expectation.

Scott H. Group
Senior Analyst, Wolfe Research, LLC

Q

Now, this time a year ago, you started to get or I guess maybe in the second quarter call last July, you started to get very bullish on grain and it got better, but probably didn't get it as good as you were thinking in the back half last year. In retrospect with some of that any market share shift and do you see an opportunity if it was to gain any of that market share back?

Keith Edward Creel
President & Chief Executive Officer, Canadian Pacific Railway Ltd.

A

Yeah. No. No, not market shifts. I mean, in Canada, if you understand the dynamic again is it 51%, 49% or 49.5% and 50.5%, it is what it is. The railroads are going to be as long as we both compete to provide service from out catchment areas, we're going to be about 50% rough numbers. So, from market share standpoint, no. For us from where we were going to, our network we were challenged. We were challenged with tremendous amount of rain in the fourth quarter last year, which slowed the supply chain down where we were challenged with quite a bit of mother nature challenges with avalanches, with mud slides in the first quarter, but we've sort of captured that. We're regaining that. April actually was a record month for us, tremendous month for us. Supply chain is working well. We've invested and partnered with our grain partners on the South Shore, we're setting records in unloads, we're setting records in loads. Thunder Bay has opened again. So, that's working well and turning well for us. So, nothing on the market share loss. Underlying fundamentals are strong and as long as there's grain to move the supply chain is much more efficient than it was in the past and I think that's when you see we start talking about people that have been very critical of the Canadian grain supply chain as the railroads are related to it in Canada given us accolades and actually saying that service is pretty good. We, both railroads, have made monumental change to that supply chain, which is sustainable through the investment the way we operate the railway.

Scott H. Group
Senior Analyst, Wolfe Research, LLC

Q

I think we have one over there from Paul.

Analyst Question

Q

Hi. Just two quick ones. The first is why are train miles more important and train starts in your mind where you're evaluating the network? And then second, you're clearly targeting growth in Intermodal, how do you think about the market size and your potential to grow there?

Keith Edward Creel

President & Chief Executive Officer, Canadian Pacific Railway Ltd.

A

Okay. With the train starts, I mean, think of it this way, if I'm running a bunch of inefficient short trains or if I'm not getting trains over the railway, then you're going to see train starts go up, so it's not really good proxy. The train miles is what we get paid by and that's what we pay by essentially, so that's what our track from a productivity standpoint. So if I've got a bunch of short trains out there, train miles are going to be up. If I've got more efficient longer trains, which is what we're doing and we should see train miles going down. So if you take on tonnage RTM growth and you can control the train miles and keep them low, while you expand with RTM growth and don't make one-for-one, that's natural productivity synergy.

What was second question, I apologize?

Analyst Question - [Question Inaudible]

Q

Keith Edward Creel

President & Chief Executive Officer, Canadian Pacific Railway Ltd.

A

As far as opportunity?

Analyst Question

Q

Yeah

Keith Edward Creel

President & Chief Executive Officer, Canadian Pacific Railway Ltd.

A

Yeah. There is domestic side, there is still a tremendous amount of trucks that are going across Canada and again thousands and thousands of trucks that go across that border, so there is still big opportunity in the domestic side. The international space is the international space, our particular network, we are going to have some benefits going forward that to me are meaningful. Hapag Lloyd has made a decision to land the largest ship that's ever landed in Canada, which Hapag is our – sort of our anchor customer in international Intermodal, in Vancouver as of a couple of weeks ago. So that ship, which is normally 8,500 TEUs, is now 13,000 TEUs, so that's going to serve our franchise well, so we expect natural growth as we get in the fall on the international side, even partnering with our international customers, our business overall year-over-year is down in international, but if you take out Yang Ming, which is the contract that we lost the CN, we're actually up, so that's a positive thing on international as well for us and it bodes well for our franchise.

Scott H. Group

Senior Analyst, Wolfe Research, LLC

Q

When does the new Hapag Lloyd business start?

Keith Edward Creel
President & Chief Executive Officer, Canadian Pacific Railway Ltd.

A

It actually started two weeks ago, there is obviously with any new service, there is going to be wrinkles to iron out but the first ship landed two weeks ago.

Scott H. Group
Senior Analyst, Wolfe Research, LLC

Q

And are there any large international contracts coming up for bid over the next 12 months that we should be aware of?

Keith Edward Creel
President & Chief Executive Officer, Canadian Pacific Railway Ltd.

A

Not for CP, no.

Scott H. Group
Senior Analyst, Wolfe Research, LLC

Q

Okay, okay. So, you talked about potash hitting potentially a new all-time high for you. Can you just give run through the mix of where that's going to and what is it, white sand or brown sand and how you think about all of the new brown sand that's coming online in the Permian for trucks?

Keith Edward Creel
President & Chief Executive Officer, Canadian Pacific Railway Ltd.

A

Okay, you said potash, but ...

Scott H. Group
Senior Analyst, Wolfe Research, LLC

Q

Did I say potash? Sorry, sand.

Keith Edward Creel
President & Chief Executive Officer, Canadian Pacific Railway Ltd.

A

Yeah. So, the sand for us predominantly white sand, it's high grade silica sand, it's desired or preferred, I would say, it's coming out of Wisconsin, in or around Portage, sort of East of St. Paul across the border, take it down to Kansas City, and again Eagle Ford and Permian, and we've got some long-term contracts. When I say long-term, two years to three years contracts and commitments, again partner with very steep, strong, sand players that are low cost producers that we think the underlying demand is going to stay there.

Scott H. Group
Senior Analyst, Wolfe Research, LLC

Q

And do you have a sense of – is it more of growing into Eagle Ford or Permian?

Keith Edward Creel
President & Chief Executive Officer, Canadian Pacific Railway Ltd.
A

I don't know the mix, I don't know if it's 50-50, but we're certainly above the markets.

Scott H. Group
Senior Analyst, Wolfe Research, LLC
Q

Okay, all right. So, now I'll ask about potash, just give us a sense on, the market feels good right now, how you're thinking about the back half of the year, what's the size of K+S this year and how big you think that can get next year?

Keith Edward Creel
President & Chief Executive Officer, Canadian Pacific Railway Ltd.
A

Yeah. So, essentially the market's extremely strong now at 17% to 18%. But again last year, Canpotex, they got the contracts a little bit late, so they started shipping late. So, we'll get to a point where we lap that, the back half, but the other fundamental that wasn't there to your point is K+S, as they came online and we had a grand opening there about three weeks ago. We should get the first product out of K+S this month, in the month of May. In the June, the first unit train, probably July. They're going to ramp up and move about 500,000 metric tonnes, which is about 5,000 carloads in 2017 next year with the nameplate capacity on the facility of about 2 million metric tonnes, which stay expect to ship next year.

Scott H. Group
Senior Analyst, Wolfe Research, LLC
Q

Okay. And then, just lastly on the commodity side for me, crude by rail, you said stronger than expected to begin the quarter, slowing a little bit in the last couple of weeks. What's driving that better than worse and then what's the opportunity in the back half of the year, with some new production coming on line in Canada?

Keith Edward Creel
President & Chief Executive Officer, Canadian Pacific Railway Ltd.
A

Yeah. You just answered the question, it's production. So whenever the production exceeds the pipeline take away capacity, that's what drive some shifts to crude by rail, it's obviously not the economics, it's not the cost of the oil it’s the spread. So Western Canada Select discount to WTI is a key thing to watch, whenever that opens up and it's based again and there is oversupply to the pipeline. So right now, some of the capacity is down in the pipeline, there is available space for the oil to move, as we get into the third quarter and fourth quarter though, there is a couple of projects, more or so the fourth quarter that are coming online that should again allow that pipe to exceed the takeaway capacity and you'll start to see more shift to the rail.

Scott H. Group
Senior Analyst, Wolfe Research, LLC
Q

And any early sense on that, on how much of that you guys can see your share of that incremental?

Keith Edward Creel
President & Chief Executive Officer, Canadian Pacific Railway Ltd.
A

Again we're being cautious, I'd say no. We got it, to about 20,000 carloads for the year is what we expected, we’ve moved 17,000 so far, so that's certainly has exceeded expectations, but at the same time any dramatic increase we're being very cautious, before we adjust anything, that put us wait and see and if there is upside, we're going to be well positioned with assets, and with our franchise to generate a share of that.

Scott H. Group
Senior Analyst, Wolfe Research, LLC

Q

Okay. We saw a legislation come out of Canada last week, what are your kind of initial takes on what's good in the bill, what's bad in the bill, and then is this a bill that we should all expect is going to become a law?

Keith Edward Creel
President & Chief Executive Officer, Canadian Pacific Railway Ltd.

A

I would say that at CP our view is that the Canadian government has taken a fair approach level – a level set approach to modernization of the act. Obviously, the devil is in the detail, the bill is going through now, definitely will become part of law. Exactly what the law says, we're not exactly sure, but that's sort of categorized that there are things that I love, there are things that I like, there are things that I will accept at CP. So, the things that I love the LVVR, for those of you that may not know what that is, locomotive video and voice recording. It's something that I've been a very vocal proponent of, and effectively taking cameras and equipping our locomotives to make sure that the right behavior is occurring in that locomotive. To me it provides a quantum leap for safety, which is going to help service, which is going to help cost, but importantly protect people, both employees that operate the railway as well as the communities we operate in and through. So, the government is creating a path to be able to implement that technology was huge. So, that's one of the things that I love. The things that I like, although the MRE position remains. Obviously, I wanted the MRE to disappear in the competitive mode ...

Scott H. Group
Senior Analyst, Wolfe Research, LLC

Q

And the grain cap?

Keith Edward Creel
President & Chief Executive Officer, Canadian Pacific Railway Ltd.

A

Yeah, the grain cap. I wanted that to disappear obviously. It has not. But the things that I do like about it is there is now some bifurcation when it comes to the way the index is worked the cost side. As I said before, if we were to invest in fleet, or likewise CN was to invest in the fleet and both railways been a bit from the cost to doing that. As far as the inability to charge or recover those costs within the MRE, within the maximum revenue entitlement. With this legislation change, they bifurcated, so there will be two indexes, a CP index, and a CN index. And obviously, CP were in a very unique position, I think it's position of strength for our franchise and for our customers given that our fleet right now is in the worst shape in Canada.

CP in the past, for whatever reason maybe lack of resources, lack of desire to not invest in the grain fleet, so about a third of our fleet is owned by the Canadian government and its low cap cars. So we're talking about 263 versus 286 which is the modern day car. They are not very reliable, the maintenance costs are expensive.

Our customers don't necessarily like them, so now that this bifurcation has occurred, we've got an opportunity to take a case to our board that allows us to buy more modern cars, 286 cars that will allow us. If you look at just our standalone fleet alone, same number of cars we can effectively pick up about 20% more grain carried in the same number of cars without adding additional operating cost of sales perhaps a little bit more fuel. So from a synergy standpoint, from service to liability standpoint, providing value to our customers as well as margins at bottom-line, we're super excited about that piece.

Now the part I don't like, I'll just have to accept or say is this extended long haul switching. They've replaced the extended interswitching with this long haul haulage that devil is in the detail on that. I think we got to be very careful and I've told the minister, and I'll continue to say this, unintended consequences to me to allow the U.S. railroad to come into the backyard of Canada and to take potential business away without an opportunity to reciprocate that, could lead to a point where some certain lines if that were to be exercised then we were to lose any significant market share, maybe it says we can't invest in that line at the end of the day because we're not making enough money to maintain it. This is a capital intensive industry. You got to have a business in order to maintain and sustain the line. So I think, we got to be very careful about the unintended consequences, but at the same time some of the things that I do, I think are much more fair. In the past, we had a situation with extended interswitching. If you were there, you had an opportunity to take advantage of it. Now, at least with what's been proposed, the shipper has to apply for it. It's got to be approved by the government, it's more compensatory, costing is opposed to the past, the zone interswitch, we didn't even cover our cost.

So there are some things in there that I think, will make it a little bit more attractive and the reality is that, I looked at our network, with the extended interswitching as it was, if I overlay the new application of legislation. We had 90% of our traffic that could be touched with extended interswitching of what is up open now. So we're talking about 10% more, as far as I'm concerned of another railroad coming in my backyard, when I'm a low cost carrier and I provide great service and take my business, I'll stand for that competition. So again, I don't like it. I think, we've got to pay attention on unattended consequences, but overall, I think, it was pretty balanced.

Scott H. Group
Senior Analyst, Wolfe Research, LLC

Q

And just to follow up on the switching. The way I thought about it is, it exists in Canada, you and CN have the best margins of any rail. So it can't be that big of a deal and if the new one is done, on a case-by-case basis with effectively market pricing and it sounds bad, but probably not that big of a deal.

Keith Edward Creel
President & Chief Executive Officer, Canadian Pacific Railway Ltd.

A

Yeah. I would agree. As far as we do our jobs to maintain a low cost service, provide a good service, customers aren't going to have a chance and no reason to switch in the first place in reality competition coming in, for them to be able to make a buck in an environment like that. That's going to be huge headwind for them, that's for sure.

Scott H. Group
Senior Analyst, Wolfe Research, LLC

Q

Okay. And then last one from me and then we get to wrap it up. I asked you some the call in April about opportunities to work with CSX, just around some of the issues in Chicago, I think, you said that, yes, there could be opportunities that your largest interchange partner. Can you help us think about what that potential could be from a – what could you do to work together and what could be the margin or cost saving opportunity ultimately be?

Keith Edward Creel
President & Chief Executive Officer, Canadian Pacific Railway Ltd.

A

I don't – I can't put a number on it yet, Scott, because we're early into the game, but I can say this, there are opportunities from an operational play as well as the revenue play, obviously if I can partner with and from a marketing alliance standpoint extend the reach of my network for my customers and give them better service doing it, then that's pretty compelling value proposition. And if it makes sense for our shareholders, then we're obviously going to look at it.

So, we've had some discussions with CSX operationally as well as commercially in those regards and we'll continue to have those discussions. Chicago specific, we interchanged rough numbers about 400 cars a day with the CSX. I think there is an opportunity for at least 25% of those cars not to go into the belt railway, and I mean that's a train a day, and if we can take a train and create an ability to extend the cars past Chicago deep into the CSX network to improve service for our joint customers and they can do likewise then I think that's pretty compelling opportunity in the marketplace that we'll be able to realize as we go forward.

Scott H. Group
Senior Analyst, Wolfe Research, LLC

Q

I want to ask one more just quick one, because you've now – you've worked at a few railroads in your career, precision railroading, it's in Canada now being implemented in the East. Is there anything that says that can't be done in the West?

Keith Edward Creel
President & Chief Executive Officer, Canadian Pacific Railway Ltd.

A

Precision railroading is about the process and the people and execution of the process, it's not complicated. I mean, Hunter has written books about it, it's pretty simple. We got to have a discipline and execute it, that's a bottom line and it's about having the right people to be able to do it. So, to me any railroad if they believe it and their investors too, that they have a discipline to execute it and they got the right people to execute it, you can replicate it. It's – I mean it's happened a couple of times now, three times, four times now. So, it is what it is, it's the same gauge, it's the same technology, the difference is the operating model and the ability to execute it with the people that you develop and lead day-to-day in the rail.

Scott H. Group
Senior Analyst, Wolfe Research, LLC

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Okay, great. We're going to wrap it there. Thanks so much, Keith.

Keith Edward Creel
President & Chief Executive Officer, Canadian Pacific Railway Ltd.

Thank you.