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Transcript

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Corporate Participants:

Keith Creel – President and Chief Executive Officer, Canadian Pacific

Chris De Bruyn – Director Investor Relations and Treasury, Canadian Pacific

Other Participants:

Brandon Oglenski – Analyst, Barclays

QUESTION AND ANSWER SECTION

Brandon Oglenski

Analyst, Barclays

All right, good afternoon, everyone. I'm Brandon Oglenski, transportation and airline analyst here at Barclays. And next up today we have Canadian Pacific Railway, and I'm really honored to have Keith Creel on stage with me here, CEO of the company. And Keith, your rise to fame has been pretty awesome, going through Burlington first, and then Canadian National and now runs CP. So I know we're going to dig into a lot of that. But if first we can just get the audience response questions. Question number one, do you currently own CP? Yes, overweight; two, market weight; three, underweight; four, no. Keith, I know your answer to this one. Question number two can change some hearts here. What's your general bias towards CP right now: positive, negative, or neutral? All right. And then question number three, in your opinion through cycle EPS growth for CP will be above peers, in line with peers, or below peers? All right. Well, Keith, thank you again for coming down. We really appreciate having you here. I definitely want to keep this long term in nature. But I got to ask for everyone in the room, because I think folks are pretty concerned about what the slowdown in China means, and if it's prolonged, how could that impact the supply chain. Been asking every company, are you hearing anything from your customers? Is there an inventory issue? Is there something you need to start planning for in the network?

Keith Creel

President and CEO, Canadian Pacific

Yeah. I think our customers are probably as puzzled as we are. I don't think there's an accurate answer, because we just don't know yet. We're paying attention obviously to intermodal space, international intermodal, but with that being said, our business, because of a contract win with Yang Ming coming online is still up double digits. So we look at blank sailings; we only know of one so far, but do we expect that more may come? I think that's a reasonable expectation. But at this point, that space, and then the other thing that I see is a bit of a headwind that we are paying attention to is Canpotex. Obviously we've moved a lot of potash, and I think that this issue certainly has pushed that decision back a bit, but we're optimistic that that will get resolved and we're just taking a wait-and-see approach like everyone else, and in spite of that, it's created some choppiness obviously, some uncertainty. We're getting to a place so that uncertainty seems to be certain. Certainly was last year, we see that in this year, and that's why we think about our business. Some have accused us of being conservative in our guidance, I think it's prudent. I think that there's so many moving needles that seem to be moving on us consistently, that we feel confident talking about what we see line of sight to and what we feel convicted and confidence in, and in times like this, it pays – that strategy pays well for our shareholder, as well as for our planning processes.

<Q – Brandon Oglenski>: One I guess maybe more specific to that, if Canpotex becomes an issue longer term throughout 2020, does that jeopardize the outlook that your teams put together?

<A – Keith Creel>: Just depends where it's at. I would say, with all the other puts and takes and the other opportunities, we set in our guidance high-single-digit, low-single – double-digit EPS potential. I think we're covered in that range even if it does. So, if it doesn't, is there upside? Yeah, that's why we put the guidance we've put out there. But in spite of it, unless that just completely goes away

altogether, which we know is not going to happen, because at least India and some of the other potash has been settled, I don't think it prevents us from getting to within the range that we've guided to.

<Q – Brandon Oglenski>: Okay. We can definitely take questions from the audience, too, if there's any. So just let us know. But I guess I want to ask something much more longer term in nature, because I want to come back to your, I think, 2018 Analyst Meeting, the last time we were up in Calgary. I think the theme was constructive tension, if I get that right.

<A – Keith Creel>: Yeah.

<Q – Brandon Oglenski>: And I can honestly say, I think you're one of the only CEOs I know that could name his entire team just by looking out in the audience. And there must have been 40 or 50 folks you called out, pretty impressive by my book. How important is the culture at CP? And is there a culture at CP? It seems to be quite positive.

<A – Keith Creel>: Yeah. Well, listen, I think about this, the operating model, the physical network, the geographic footprint, all that matters, but it's not any good unless you convert it. When you're talking about a railroad that – the culture that was at CP before allowed the lack of performance to exist; they didn't know what they didn't know. They didn't hold people accountable to what the potential could be. They essentially – and this is the way human nature works. If you make excuses and let people off the hook instead of finding solutions, that's what you're going to get. And that's what was there. We took an operating model that's very powerful and applied it to a company footprint with people that wanted to be led. There was a tremendous amount of pride that has always existed at Canadian Pacific. And if you understand the history of the company, it's a company that helped create a country. So there was pride there that's unlike, I think, any Canadian company, pride that I didn't experience at my competitor. It was very unique and I sensed it early. And when they were given the right leadership, it's an operating company, you run it as an operating company, because that's the majority of your employees, and give them direction and show them how to do something they've never done. It's powerful. So the culture, to me, is the fuel in the engine. And if you don't have the right culture, and we started with operations, it's a culture of accountability is what it is. And it's accountability to each other. It's accountability to our customers. It's accountability to our shareholders. It's all three. Those are your three constituents, and you've got to serve all of them. And we understand, and I learned this from my mentor years ago, if you don't do your job, number one job of leader is to produce results. That's what we get paid to do. And if I don't do it, somebody else should do it for me. I'm not entitled to a job. But the team that we've put together, and this is permeating to the entire company, there are people that are there because they want to be there; there are people that are there because they get that. They understand that they're not entitled to be there, they've got to produce. And if you take that mindset and people understand that constructive tension, I might like you and you might – we might be able to have friendship, but your job comes first. And you've got to produce and you play a role and you play a part. And when we do that collectively together, we succeed. And if you can articulate that vision and create a healthy culture, not a destructive but a constructive, that's why that word is important, it's not produce results at all costs, because that's when you get into the things that don't lead to right business decisions and business practices. So you create the right culture, you'll overlay it with values but that is that's what we evolved in 2019. I said, okay, listen, all of you get it. How do we continue to convert the employees within the company? And all 13,000 of us get it, because it's like a city, 13,000 people. You're going to have dysfunctions. So the least dysfunctional we can become, the better we can lead, the better individually

we'll become, the better long term the company becomes. So that's why we invest so heavily. That's to me, I think about following what will go down as I think the best railroader ever in history in Hunter Harrison. What did I learn from I, I learned how to run the railway right. But my legacy is, to honor his, is to not only do that, but to pour into people so it's sustainable, so that we can continue to create the success and it's not a flash in the pan, it's the right way to run the business, and whether I'm there or not there, short term, long term, the company should improve. That's the legacy of a leader, and that's exactly what we're doing fundamentally.

<Q – Brandon Oglenski>: It's so hard for us as analysts to measure that on the Excel sheet, but...

<A – Keith Creel>: Yeah. But I would agree, you can't put it on an Excel sheet, but there's – I don't think there's anybody in this room that when you're in the right culture, when you go to a place where you know that there are high expectations, you've got to produce. But if you do it, you're going to be treated fairly, you're going to create some success that's bigger than you, that's energizing, that gives you more than what money does, and money's nice, too. You're going to make money at the same time. You can't just go anywhere and create that experience. This is a special unique team that we've put together that's – they're experienced in that, where they've never experienced it before, success breeds success, they're winners. And the more we share that with our employee base, you couple that with pride, and it's pretty powerful and unique in this industry.

<Q – Brandon Oglenski>: Well, and I asked your closest competitor here on stage earlier today, if along these lines, because they've had some success over there, too I'm sure you had a small part to play at that previously. But the idea that the railroading business shouldn't be looked at as just an economy business, this actually should be a growth business this cycle, is that true?

<A – Keith Creel>: I would say yes, especially it's a journey. When I think about where we're at, and I think about when I took over as the CEO, when I came – if I back up to 2013, I had a mandate to help fix the engine, to implement PSR, to teach and lead change in the company, so we can provide a great service, do it safely, and make money doing it. That created a whole lot of capacity. Then I had a mandate to grow. So as I grow, what we've done the last three years that are allowing us, we had the best revenue growth last year, or best – on an RTM basis, revenues, earnings the year before, two consecutive years we've led the industry. Last year was a down year. We were marginally up but we were up, and that was important. And we're going to do the same thing again this year. And it's because of unique solutions that we're creating with our physical footprint, we've got capacity at inland terminals. We've built an automotive compound in Vancouver that came as a result of, okay, how do we take what we've created and monetize it and drive growth that's counter to what – just what the economy will give you. So if you innovate and you think about this, and then I think about now, what's going to fuel – we've got this automotive compound done, are we finished there? No. We're building one in Chicago now. We're going to come online second half of this year with a facility, smaller scale, but still a facility located next door to the largest consumer of vehicles, OEM vehicles in North America called O'Hare Airport. It's literally next door; you can see it from O'Hare. So it's compelling. So those kind of solutions, if you sprinkle them across the railroad, you go to Montréal, we're building a transload facility right now, which is going to bring additional revenue to the railway, serving a market that, quite frankly, the truck and we partner with TYT, which is a respected transload operator, we built a building, we use our physical footprint, they come and they operate it. They bring that expertise and it complements the railway. Those kind of things are going to continue to allow this railroad several years

out, gives me strong convictions that we'll be able to be counter to what the economy gives us, which is going to be GDP plus, which is going to be different than, I think, what other railroads have been able to realize and experience yet.

<Q – Brandon Oglenski>: And how much of this is born out of the, I guess, integral management of operations and marketing and planning? Is that an important aspect here?

<A – Keith Creel>: I think it's critical. If the right hand doesn't know what the left's doing, and if the marketing team commits what the operating team can't produce, or they oversubscribe because the market wants it, they think they can make money doing it, and then the operating teams can't figure it out, that will destroy value. That's not the way this operating model works. It has to be in lockstep. So when you talk about sustainable, profitable growth, it means the assets, be it people, be it locomotives, be it track, you're not doing a customer any good if you promise them the moon and the sun and the stars, and essentially you lose your credibility. You have to create truck-like reliability, I guess is the best way to put it, and enjoy the margins that we enjoy and the cost advantage we enjoy on the rail network. So they have to be together. And if you disconnect them, that's something I learned a long time ago when I worked with Hunter in my previous life, I never really understood on the operating side when I had operations. Wait a minute, I won't – and as the CEO, he said no, you're not ready yet, number one, and I wasn't. But now that I'm doing it, the power – and I talked about this in an investor meeting a minute ago, I have operating sessions with my operating team fourth quarter every year. We go through, okay, this is what we've done, this is what we've done well. What are your initiatives for next year? And it's as much about teaching and learning at the same time. So when I participate for three days, and we whiteboard things and we talk about the nuts and the bolts and where we have capacity, where we don't have capacity, where we need to hire, where we don't need to hire, what are the productivity opportunities, when you can take that knowledge and help teach, so they execute it, and then I can overlay that in partnership with my marketing team, because we're – I'm not doing that by myself. Mike Foran, who is the glue that connects the two with our assets, whether it's sizing people, locomotives or cars, and also track capacity, he's in the middle of those meetings, too. So when you can parlay that and you connect the two in the middle, you've got a great product that doesn't destroy the value of your existing product and it's compelling when you go to customers, because they can say, okay, this is what we need you to do. All right? Well, that's how Vancouver came about. What's the challenge with Vancouver? Well, Annacis Island is locked out we can't really – not good service, there's no more capacity and it's really expensive. Do you have a way to fix this? Well, let's look at it. Well, I got a whole lot of land, well, what if we were to build an automotive compound? What would that do? Those kind of solutions, when you get to a customer, when you can help them make money and save money at the same time and grow their business and you can benefit? That's how you create stickiness and that's how you do something that's innovative, and it's not just give me what GDP gives me. You're going out creating solutions yourself. You got to think entrepreneurial and you got to have the knowledge to make sure you don't overstep your commitments, because when you do, if you destroy customers' trust, they don't forget easily, and it creates – to me it's value-destroying, it's not value-creating.

<Q – Brandon Oglenski>: How do you incent the team around this one?

<A – Keith Creel>: We have a very unique commission program, where they actually can earn commissions on additional new revenue, and there's profitability thresholds in it. There's pricing in it so

it's got to be quality revenue. It's not just revenue for revenue. So I'm not going to put an edict out says, grow revenue 20% and you get X number of commission dollars. You've got to get your base budget and new revenue above and beyond that's qualified, quality revenue. We have a little internal team, two or three guys and gals that go through and look at all these opportunities, then they qualify what's called a SIP payment which is a bonus. It's essentially a commission above and beyond their base salary. And we implemented that 2014, 2015, and just last week, once a year, we bring all of the marketing and sales together. We had a three-day session last Monday, Tuesday, and Wednesday that I participated in with the marketing team. And I'm telling you, that group, looking across the room, and I've seen this over the last six years because that was our sixth one. And I participated in all six. The players that are in there, there are A-players. They're people that want to work in an environment where they can be pushed and challenged, and they're given support from senior leadership. They've got a physical plant. They've got a product to sell. It's just a pretty motivating place to be in. And at the same time, back to what I said earlier with the culture, they can make money doing it. It's pretty special. So that's it. You've got to pay them well, but also you got to have accountability, that constructive tension. They don't have a seat at the table if they don't bring their base budget to the table. It's the same standard of culture in the marketing team as it is in the operating team. We all have a role to play, we have to play it, produce results, it's not at all costs, do it the right way, you stay, we all succeed. If you don't, you're not a bad person, you're just a bad fit. You don't fit this culture. And you either self-select, which a lot of people have, or we have to make the tough decisions as leaders.

<Q – Brandon Oglenski>: Well, I guess along these lines, you guys have talked about end market opportunities in autos, grain. I mean, it runs the gauntlet at your company right now. What is most exciting for you? And of course, got to bring up crude, too, because that seems to be maybe a bit different this time, maybe.

<A – Keith Creel>: I don't know if I'm – crude's a tough one, right. We've had a unfortunate past couple of weeks with a couple of crude derailment we had in February and one we had in December. Obviously it created a lot of concern, and we had to respond to with – we had a minister of slow order that came out last week, or I guess all these issues we've had, these challenges, this choppiness, I guess Friday was a week ago where we had a derailment, crude derailment, we had the government come out with a minister order, slowed all the trains down. We had already taken steps ourselves as soon as it happened to slow our crude trains down until we better understood what was going on, and we had time now to go through data to set with Transport Canada and the experts and they came out with a revised order, which we put back in place, I guess it was two days ago. So we're beyond that on the crude side. The thing that excites me in crude is the DRU, and we talked about that a little bit on our last investor call, but that's – going forward, that's going to be online in the second quarter next year. So it's an 18 – maybe 24-month process to build it. It's going to be in Hardisty, which we originate. We single-line serve it. Right now, we run three typical crude trains a day, which is, for those of you that don't understand, it's 70% bitumen and it's 30% diluent, so that it's – it has enough viscosity to move through the pipeline to get into the railcar, and then it's offloaded the same way when it gets to the refineries. This new product is going to take that diluent out, and you're going to have 100% bitumen, so 30% more product per car. And it creates a pipeline competitive product, and then the exciting benefit is it's non-hazardous. It's not a hazmat shipment. It goes in, it cools off, it sets up, and then it has to be steamed and heated at the receiving end to offload it again. So if you have an unfortunate accident, the environmental exposure is not even remotely close to what crude is today. And the other huge piece

beyond the safety piece is it's ratable, and it's going to become part of our revenue pipeline in perpetuity as long as we use fossil fuels. Crude has always been, and we've said this, it's been a temporary lack of capacity takeaway alternative to the pipe once the pipe gets built whenever that is. Regular crude as we ship today is going to go away; this will not. So when it comes online, it's 100,000 barrels a day capacity, which effectively equates to two trains a day. The per car revenue is not the same as a regular crude move today, but the risk is not remotely same either. And then the other positive is the length of haul is going to be longer. So most of the proponents of the crude we take today is hauled to Emerson in partnership with Burlington Northern, it goes to the BN, so it's a shorter-haul move versus the new stuff, the 10-year deal that's going to come on line with the DRU that's going to be to Kansas City. But the length of haul is going to be greater than it is today.

<Q – Brandon Oglenski>: How significant could this business get to?

<A – Keith Creel>: You know what, it's CAD \$100 million rough number a year revenue stream today. I think I'm an optimist. The potential is there to double that. Obviously they've got to get the contracts, the capacity is 100,000 barrels a day, it's scalable up to, I believe, six. Now you got to have a business case to do it. So I don't want to get ahead of ourselves, but I truly think that once this starts to move as more oil companies see the benefit of diversifying their supply chains. They're going to have some – I think going through a DRU, they're going to have some going in the pipeline and some is going to be coming off the water. I mean, it's – I think it becomes part of a long-term recipe for success that all the oil companies are going to have to follow to be able to compete.

<Q – Brandon Oglenski>: What about the other business opportunities in the network? You spoke a lot about developing real estate like you did in Vancouver and Chicago for your autos business. What else is coming down the pipe for CP?

<A – Keith Creel>: Which group? I mean, I can...

<Q – Brandon Oglenski>: What excites you the most?

<A – Keith Creel>: All right, let's go to, I think a game changer for this franchise that we're just now starting to see some of the benefit of is grain. Grain is a large portion of our revenue. We're known as the grain railroad. We're revolutionizing that supply chain. So you hear us talk about 8,500-foot grain trains. Well, the 8,500-foot grain train goes back to four years ago, when we're looking at our fleet which was the worst fleet in the industry. Low capacity cars mixed with high capacity cars, so we're having to move more trains to move this equal amount of grain that our competitor was moving with high capacity cars, plus they're not reliable in their high cost because they're so old. So we said, okay, what's state-of-the-art? Well, state-of-the-art is a company, it's located in Hamilton, Ontario. They build a shorter rail car that handles more capacity. So that's what I call, right now, that's the best in the business. So we've created a business case, said, okay, if we can work with the government to make sure we get the benefit, our shareholders get the benefit, which is what the legislation did last year, what would it look like in a perfect world? Well, it's going to look like incremental cars that had no more locomotives, you've got an 8,500-foot train that if you compare the two and you can launch them and land them, and that's why we've gone and said, okay, we're going to create market dynamics and rate incentives. We're going to do away with the 56 car block incentive when we get this done, and we're going to go to, okay, if you can do 134 cars, which is 8,500 feet rough numbers, you can launch it and land it, we're going to let you share in the synergies, because we're going to be able to move more grain,

you're going to get it at a lower cost. So that's what's driving investment on the book ends. But the grain companies right now in our network, we've got 15% that are capable to launch an 8,500-foot train, we've got a plan going this year, by the end of this next crop year, we'll be at 30% and it's going to continue. So once that gets to fruition, we've got 2,000 of those cars now, we're going – two more years we'll be up to 6,000, I think the end of this year we'll be around 3,200. Once that gets done and that creates that perfect 134-car grain train versus today's model that's 112, which is a mix of low capacity and high capacity, it's 40% on that one train. Now that's euphoria. They won't all be 40%, but that's how much more grain you can move with the same crew expense. Incremental fuel, incremental wear and tear, and obviously you've got to pay for the investment. But that's a needle mover, that's compelling for this company.

<Q – Brandon Oglenski>: I think a fair concern for investors though, I mean, because your competitor's relatively successful too, doesn't this become potentially a market share game then in the grain business, or is this a growth opportunity specific to CP?

<A – Keith Creel>: I think it's more unique to CP because of our cars, like we're in a unique position. We were disadvantaged for so long, and now we're going to have the best fleet. My competitor's fleet, it's going to be a long time before they can replicate and justify turning those assets over because they have so much life left in their existing assets. So I think as long as we drive the right investments and we're doing that and we got the right place to launch them and land them, I think there's space for both of us to win. I think we're going to be early adapters, and I think we're benefiting. Right now, if I look at the crop year-to-date, there are a lot of reasons that are going on, but our network, we're 52%, 53% this year, but the reality of it is, I don't care how much they talk about it or we talk about it. You want a diverse supply chain. All the grain that's produced in Canada, they need both railroads to do well, and it's not about one's going to go to 60%, one's going to 40%. This is just the way the elevators are built and the way they continue to be built. It's going to be 51%, 52% on one railroad; 48%, 49% on the other, which networks, how is the moisture in the ground, where does it grow, where does it not grow. I just think both railroads go up, both railroads do well, yields are improving every year. I think this year, 73 million metric tons is what the forecast is for the crop year that we're moving now. And if you go back 10 years ago, that might have – I mean, that was 20% less. So, as they get better, they being the farmers, yields continue to grow, you got two railroads that are going to benefit in that space.

<Q – Brandon Oglenski>: Can we get question number four here on the screen? In your opinion, for the audience, what should CP do with excess cash, bolt-on M&A, larger M&A, share repurchases, dividends, debt pay down, or investment? And Keith, I'm going to ask it because you've mentioned that publicly, share repurchases are the highest there. But you've said before in the past that as CEO of CP, you'd like to drive an agenda of M&A in the industry. Is that a mischaracterization, or...

<A – Keith Creel>: Yeah, you know what, that is a bit of mischaracterization. I wouldn't like to drive I just feel it's inevitable at some point. It's a natural evolution if capacity is going to be limited. And it is. It's limited when you have two separate networks. When you create one bigger network, you create more capacity. And for the railroads to handle the growth that's going to come and it depends upon rail networks, we have to have more capacity. So that's the thesis. Eventually you get to a place to create that capacity without an ability to build more railroads that you got to have a better running network. Now what's happened, which I think prolongs that, which I'm extremely encouraged for our customers and for our shareholders and for the industry overall, is this rapid adoption of precision scheduled

railroading. Because once you get beyond people being afraid of it, change is never easy. They're going to see and experience better service than you've ever saw or experienced. Those car owners, those customers that are scared of it now are going to be thanking you one day when they own less of those CAD \$100,000 tank cars or CAD \$100,000 hopper cars, and they're getting a better service. So the industry is going through an evolution that I think is going to create tremendous pressure or capacities that will push that dialogue back. But it doesn't solve it forever. So, to me, I would have thought two years ago, it was a five-year discussion. Now I think it's a 5 to 10-year discussion.

<Q – Brandon Oglenski>: Okay. Question number five, in your opinion, what multiple of 2020 earnings you're in should CP trade? And I ask that because you do have a fairly decent valuation now at least relative to the industry. So, if you are looking to do something, maybe now is not the worst time, but – and then question number six, what do you see is the most significant share price headwind for CP going forward: core growth, margin performance, capital deployment, or execution on strategy, or growth? Well, Keith, I guess, as we look at this – and the last one I want to ask and we are almost out of time, but there's definitely a divergence. I think I asked this on your earnings call, too. With some of your former colleagues even running the other North American railroads with CapEx going a lot lower, some US carriers relative to where CP is reinvesting in the business, but clearly, they don't also have a track record of driving a lot of core growth. So do you view your capital profile as the right way, and I guess how do you approach that reinvestment?

<A – Keith Creel>: Well, to me, the first call has always and will always be, can we invest the money back into the business to grow the business and drive earnings. That's, to me, what we're paid to do. And that's why we bought the CMQ. I mean, that feeds that thesis, how can we extend our reach and could I give it back to the shareholder, could they do something with it? Yes. But if I can keep it and do more with it, I think that's what the shareholder would want us to do. So that's what we're going to call on first. And then I think about our capital envelope, I don't get wrapped up in percentages. I know that ours is high if you want to look at comparing us to the other railroads, but I would remind you, we're at a different place in the journey. We have already optimized, we have already created surplus assets. We're using locomotives for the last three years and the next two that we created six years ago. So us being able to take this capital holiday that PSR will get them naturally in a healthy way. It's not the same opportunity. So I look at how do I grow? I look at what do I do to become more productive. We're spending a CAD \$0.5 billion on these hopper cars. That's going to be paying dividends and driving earnings for decades. That's the right thing to do. That in and of itself though is unique and special. And that's a big chunk of cash every year, it's CAD \$100-sum million. So, when that finishes, and that's going to happen in the end of 2021, a little bit in 2022, you'll see that come out. You'll see our normal CAD \$1.6 billion be a CAD \$1.5 billion or CAD \$1.45 billion, and then that's going to create a whole lot of cash flow valuation. And if I don't have a more compelling need internally to grow at that time, I'm going to give it back to the shareholders. We're going to continue modest dividend increases, because we also have shareholders, a large book of our shares are on the Canadian side and they prefer so we think we have a responsibility to balance with some dividend, give back, but also similar cash retirements or share retirements as we've done in the past.

<Q – Brandon Oglenski>: Well, unfortunately we're out of time, Keith, but I really appreciate you coming down. Thank you.

<A – Keith Creel>: Okay. Thank you.