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Transcript

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Webcast

Corporate Participants:

John Brooks – Executive Vice-President and Chief Marketing Officer, Canadian Pacific

Other Participants:

Konark Gupta – Analyst, Scotia Capital, Inc.

QUESTION AND ANSWER SECTION

Konark Gupta
Analyst, Scotia Capital
Welcome, everyone from their break. So, just to remind, if people who have joined just now, this is Scotiabank's Third Annual Transportation & Industrials Conference. So, next up, we have with us Canadian Pacific Railway's Executive Vice President and Chief Marketing Officer, John Brooks. John, welcome and thanks for joining us this year and congrats to the entire CP team for being recognized as a sustainability leader in North America by Dow Jones Index. But before we get into our fireside chat, do you have any opening remarks for us?

John Brooks
EVP and CMO, Canadian Pacific
Yeah. No. Absolutely, Konark, and thanks for having me this morning and thanks for calling out the sustainability. That's something we worked hard at. I think we've, as I was saying to you earlier, we've done a good job in that space and now we've really taken the opportunity to project it and this is a really tremendous recognition for the CP family.

I do want to provide some opening remarks, talk a little bit about the quarter, what's unfolding and some specifics on our lines of business. And then we can get into some questions. But let me start by saying and acknowledging, we've got the best team of railroaders at CP in the industry. I am incredibly proud to come to work every day with these team members with the CP family particularly in the volatile year of 2020 that we've all faced. They've shown their daily resilience and commitment to delivering to our customers, to their families and frankly to the global economy. As we all have, we've managed ups and downs through this and I don't think we're through with it quite yet. But we haven't lost sight of our values at CP and the foundations that have got us where we are today and those are really the things that set us apart.

Just a couple of comments. I'm so pleased so far with how the fourth quarter has unfolded. We knew the quarter was going to be, what I would say, more front-end loaded. But we're ahead of expectations so far. October was extremely strong, just about across all of our lines of business. We set all time world records in grain and domestic intermodal that really helped to drive those volumes.

Credit goes to our operating team, and our grain customers, and the supply chain. We moved over 3 million metric tons of grain in October and it was the first time we've moved that much grain in our 139-year history.

As I look at the quarter so far, we're up about – RTMs are up about 5% quarter-to-date. Again, this is ahead of where I had projected at this point in the quarter. Now, we expect the pace to probably moderate just a little bit. As you think back the last year, we had a fairly late Canadian grain harvest. So, we'll begin pushing up against some of those comps. And then also as a reminder, we moved 36,000 carloads of crude. So, we'll push up against some of that also.

What we've seen as volume has picked up, I can tell you the CP team has remained very disciplined in terms of how we bring back costs, cost control, how we optimize our assets. Our October operating ratio was exceptional I can tell you. And I think we're really in a good position to finish out the year and carry this momentum into 2021, Konark.

Maybe just a couple comments on the lines of business, and I know we'll probably get into this a little deeper. But specifically, our bulk, our merchandise, our auto and intermodal. If you think about it, our bulk franchise continues to be a tremendous source of strength for our franchise particularly during these challenging times. Grain, on both sides of the border, I expect to continue to be strong to finish out the year and into 2021. The Canadian grain harvest, I think, went exceptionally smooth. And currently, we're moving about 6,000-plus cars a week which has got us on a record pace in Canadian grain.

On the US side, we're seeing strong volumes continue to the US P&W. And currently, our RTMs quarter-to-date are up about 34% in this space year-over-year.

Looking ahead in potash and coal, Canpotex and Teck are performing well, both are sold out basically for the rest of the year. So, it's really about execution with those two key partners and their supply chains, and I expect us to finish strong in both of those spaces, close out the year. Our potash RTMs are up about 33% quarter-to-date. So, very optimistic in the bulk space.

In the merchandise space, as I look down the lines of business, RTMs are up in just about every area except crude and frac which you would expect. Again, a lot of momentum in the forest products, energy chemical, plastics, excluding the crude, as we continue to see I think tailwinds in the spaces of home improvement, benefits from our CMQ acquisition, and then also the ongoing production and ramp-up of essential goods as we all fight this pandemic.

Maybe some last comments, automotive and intermodal, again, bright spots for CP. Our automotive business, we've brought Glovis on board. They've come on with a very strong start, Konark. Our automotive volumes quarter-to-date are up about 50%, 55%, 56%. Domestic intermodal delivered a record October in terms of volumes for us and we don't see that pace stopping. Frankly, consumer demand remains high across North America in this space. We're well-positioned to serve it. And I don't know about you but I still go to the store and there's a lot of restocking in inventories that need to be filled.

And then maybe last on the international side of our business. I'm extremely excited to report that we're going to start up the Maersk import business early. We hadn't anticipated that business coming online until March of next year. We're actually going to have our first vessel or ship arrive into Vancouver the first week in December. So, we're going to get a nice little boost from that business coming on early and we're quite excited about that.

Let me just finish by saying I'm optimistic that the CP team is going to deliver for the third straight year the best volumes in the industry and I truly believe this is based on our unique franchise. It's how we sell and market in the marketplace and I think these strengths set us up well for 2021 Konark and beyond.

<Q – Konark Gupta>: Perfect. No. That's great color, John. Really appreciate giving us insights into Q4 trends and, clearly, as you called out, bulk, potash, coal, grain, auto and domestic intermodal. All those commodities are doing pretty good except for, obviously, the obvious ones like crude by rail and frac sand.

But anything into the end of the year, John, where you anticipate any potential for positive surprises. I mean, I know frac sand, we heard about natural gas drilling has picked up a little bit, so, that might be an

upside probably. How about that for you guys down in the US? And then how about crude by rail? Any early sort of kick from the crude prices that went up recently?

<A – John Brooks>: Yeah. I do think there are some additional upsides here, the back half of the quarter. You mentioned crude by rail. So with the Alberta government's recent announcement in shutting down the production curtailments, we've definitely seen an uptick in terms of activity. Sequentially, October to November we're going to see a nice bump and I think we'll see a further bump as we move into December. I would say definitely the phones by the crude guys, are ringing far more than they were just two, three months ago. So, we'll see how that plays out.

It's funny that you bring up frac sand. I was on a call with the team yesterday and it looks like we're going to add five or six additional trains into our December forecast as we've seen a little bit of spike in that area. That's encouraging. I'm not quite holding my breath there yet, but certainly encouraging to finish out the year.

And I'd also say, potash is going to finish strong. We've had a pretty decent October but we've had a little bit of a slow start with some supply chain challenges in the first few weeks. And so, this back half of the quarter is going to be, I think, we'll see a pretty nice ramp-up of potash to close out the year also.

<Q – Konark Gupta>: Right. And how about intermodal? We kind of have heard about a lot of traffic jam, call it, container jam at the US West Coast ports. We heard about that in Vancouver as well. Obviously, some east ports are trying to kind of ease the congestion on the west side. What's happening there on the intermodal side and like how much – do you see that as a constraint, call it, or do you see it as an upside opportunity? I mean how do you think about that whole import situation into the US?

<A – John Brooks>: Yeah. I'm quite bullish on our international intermodal right now. As I mentioned, we're excited. The Maersk business is going to come on early for us. So that will come into Vancouver into the Vanterm Terminal that first week in December. So, that's going to get us a nice early lift in that business and allow us to ramp up as we move into 2021.

I would say there has been a lot of hard work between the CP operating team, our commercial team and the Vancouver terminals to make sure we don't run into the levels of congestions and concern that maybe the US railroads and ports have faced. I think we feel pleased. We're certainly pleased with our level of capacity to handle that business consistently.

I was on the phone yesterday with one of our major steamship line customers. He was telling me, in China alone, this customer is short 50,000 boxes to fill demand. There's a lot of pent-up opportunity still to play out and I think, again, that bodes well for not only our international business but all that business turns in usually to domestic intermodal business. So, I think for both spaces we see – again, we're all going to have to watch this pandemic situation and the surge and what adjustments we're going to have to make.

But if consumer demand continues at the pace that we're seeing it, it's going to be a challenge I think for a lot of these companies to continue to restock and get inventories up and that bodes well for a lot of transportation needs.

<Q – Konark Gupta>: Right. Right. Makes sense. Thank you. So, maybe just as we think about the trends finishing up Q4, heading into 2021, obviously general expectations I see around are around mid-single

digit RTM growth for you guys next year. How do you feel about that first of all? And then, secondly, would you expect some of the recent commodity strength like grain, coal, auto, intermodal to be in the driver's seat next year given the recent momentum, or do you see any upside potential in some of the lagging commodities next year?

<A – John Brooks>: Yeah. I guess let me start by saying this, we'll provide some further guidance certainly as we come into January and our Q4 earnings. That being said, I am bullish and quite excited about what 2021 will deliver. And certainly, there is an element that I can't control and relative to this pandemic and what transpires.

The good thing is we've controlled our story pretty well for the last three years and that's with our self-help. A lot of the initiatives that we've brought on are unique. They're opportunities that have created long-term, I think, sticky partnerships with our customers, and a fairly big chunk of those, Konark, have yet to be on-boarded or fully ramped up.

So, as I look to 2021, yeah, mid-single-digits, by far isn't unreasonable at all because I'm excited about the pipeline of opportunities that we have out there. And specifically, you start going down the list, you got this certainly the Maersk opportunity. We've had a lot of success in autos that we haven't begun to see the full ramp-up. I'll remind you we've got the Alberta Heartland. We've got the new Inter Pipeline polypropylene facility that will come online next year. We've got our DRU project in Hardisty that is going to come on next year.

I only think we continue to gain momentum in the grain space. We've got a number of new elevators that will come online and also be expanded up to our 8,500-foot model for next year. And look, we get lost sometimes in some of these bulk commodities like potash. We expect the export, the world growth in potash to continue to be at that 2.5% range annually. We think Canpotex is well-served to win their share and we're going to do our part to make sure they're successful.

So, I am pretty excited about what 2021 looks like. I think you got some wild cards out there that if they turn the right way, could even add a better tailwind as you start thinking about, again, crude by rail. I think we've been trying to be very conservative in our views around what that could look like. But based on the amount of phones ringing right now, there could be some upside in that space. And then as you mentioned, we'll see how the frac sand plays out. But we're well positioned to service that business if in fact that does turn back on.

<Q – Konark Gupta>: Right. Okay. That's great to hear, John. Thank you. So, maybe we can dig into some of the growth elements you've talked about for 2021, perhaps starting with the Maersk contract. So, as I understand, you recently announced these two contracts with Maersk. One is for the intermodal. That's into Vancouver and Montréal. I think that's the most simplest contract to understand.

The other one is a bit of a difficult one perhaps for some people that maybe a little bit unique. Can you explain the transload piece of that agreement with Maersk? Why would Maersk be involved in building a transload facility with you guys? And are you leveraging your new transload facility in Montréal as well to serve the intermodal piece?

<A – John Brooks>: Yeah. So, it's a great question, Konark. It is a nothing short of maybe transformational project for CP, but also the intermodal world. There hasn't been a new transload

facility built in Vancouver, well, I had the team digging back trying to figure out when the last one was built. It's been a long time.

So, this is a much-needed capacity that hasn't been available until we made our land available. I go back to our Investor Day, and we spoke extensively about why our growth story is going to be unique, and a lot of it had to do with our land capacity that we had over and above our capacity to move freight just simply on our railroad. So, we've taken that land capacity in Vancouver, matched it now with a company in Maersk that's a global leader in the international and steamship line space, and their desire to be more integrated within their customer supply chain. So, this definitely checks their box.

But you think about growth in e-commerce, the growth in not only the retail, but the e-tail sector, and I think this transload space allows Maersk to bring in import goods, turn their empty boxes much quicker back to Asia or whatever country they need to return them to, it allows them to fill their boxes right at our terminal with exports whether it be plastics, lumber bulk or send them back empty. We'll have the scale to be able to rail directly off the port into the terminal, into the transload both directions.

Great environmental opportunity in terms of carbon emissions and taking trucks off the road, and that'll be 100% rail move into the future. It allows CP and Maersk to partner with a whole different world of customers that neither of us are doing business with and loading 53-foot containers at the transload, shipping them out either to distribution centers or directly to stores across both Canada and the US. I think you can tell by my enthusiasm, I think this is a long-term partnership with Maersk we are extremely excited about.

<Q – Konark Gupta>: Right. No, absolutely, I can see that, John. Thank you. Perhaps on the ports then. Obviously, Vancouver you were able to leverage this land you have. We kind of saw the Canadian ports have been quite successful in taking market share away from US ports over the last many years on the west side. Now, Canadian railroads, all of a sudden they are starting to focus on the East Coast, right. Do you think the eastern strategy can be as successful as it was on the west? And why is there sort of a rush to the east now? I mean like is it because are we expecting a shift from volumes from west to the east or are we assuming that the eastern ports are underserved at this point and they will gain market share from the US East Coast ports?

<A – John Brooks>: Yeah. So, a lot there and I think the answer maybe is yes in a lot of different pieces of those questions, Konark. But let me give you my take. Number one, we targeted the Port of Saint. John as part of our CMQ acquisition as sort of the next stepping stone in extending our reach to the Atlantic Coast.

Let's face it, our competitor has a good network. They've been in that marketplace for a long time. But the reality is those shippers haven't had a competitive alternative for 25-plus years. Not only will they have a competitive alternative, they have a better alternative. It's a 200-plus shorter mile route out of Port of Saint John. We're going to be in Toronto in 24 hour – or Montréal in 24 hours, Toronto in 48, and we'll hit the Chicago market in 72 hours. We do think it is a tremendous opportunity in really three buckets as I talk to my team about them, Konark.

One is the opportunity to do, I think, similar to what you're alluding to shift share, say, out of the US, out of the – likely, out of California ports up into Vancouver. I think there's a tremendous opportunity for us to work on share out of the Port of New York or the Port of New Jersey and shift that up into and take

advantage of some of the cost advantages out of Canada at the Port of Saint John. That's number one. I think number two, I already spoke to. I think there's some customers that are eager for a competitive alternative to Halifax. I think that presents a pretty good opportunity for us.

And then, three, maybe to your last point, shift between West to East. A lot of talk in the marketplace on near-shoring and what that could mean, more goods being produced in Southeast Asia, India, South America, Mexico and we think Port of Saint John sets us up, if in fact, and I think it's early in the innings to see how that's going to play out. If it does play out, I think we believe Port of Saint John sets us up well. And I'll tell you we have strong support from the Maritime Provinces. We have strong support obviously from Saint John. We fully expect to expand that port up to the capabilities of 800,000 TEUs annually. I fully expect in 2021 we're going to have a major steamship line calling Port of Saint John.

<Q – Konark Gupta>: Okay. That sounds like a pretty exciting opportunity for sure. We look forward to that. Maybe then talking about pricing, given what we are seeing right now in terms of demand/supply situation in the entire freight industry, be it air cargo, road transportation, rail transportation, there's a lot of constraints in supply chain here. How are you kind of looking at the contract renewals these days from railroad perspective? Are shippers looking to secure capacity early on? Are they willing to pay up to get that capacity? How are we thinking about that?

<A – John Brooks>: Yeah. I don't know if we've seen, Konark, to that extent in terms of shippers looking to secure that capacity early on. As I look at really the last year, I haven't seen a whole lot of – pricing has been pretty stable for us. It hasn't – there hasn't been any meaningful change, and it has almost been very different line of business by lane, by customer, as you look across our renewals and our portfolio.

That being said, I do think there's ongoing opportunity. I am optimistic that this volume surge that I think a lot of the rails and trucking industry is facing, as long as we continue to navigate out of this pandemic, is going to provide further upside in the pricing environment as we move into 2021. We're using a number of mechanisms to pull levers where we've put on some surcharges in our domestic intermodal space to capture some pricing opportunity in this peak season.

Customers have enjoyed pretty low fuel surcharges. I think, collectively, customers and transportation providers are going to see I think a period of low inflation that will provide some benefits. So, generally, I'm optimistic as I look on the pricing side moving into 2021.

<Q – Konark Gupta>: Okay. No. That's great color. Perhaps talking about maybe two of your commodities, potash and coal. I wanted to understand pretty quickly if – we once had BHP, Jansen as a potential, like where are we on that? Do you think that's a possibility again now where potash is heading? And secondly, on coal, we recently had about Teck signing a contract with Westshore. I don't know if you guys have signed anything formally yet from April 2021? How are things progressing on that front and any opportunities on coal side that you want to flag?

<A – John Brooks>: Maybe I'll take the coal one first. I'll just generally say, discussions with Teck are constructive. They're ongoing. We are keenly focused with them on finishing out a big 2020 and getting 2020 off to a strong start. So, more to come on that. We have signaled about a 1% EPS headwind as a relation to that shift in that business. Frankly, if you look at the benefit of maybe taking more than we

had thought to Westshore, combined with a low shipment volume in 2020, we actually see 2021 relatively flat. We've eaten up that 1%. So, more to come on the Teck file.

The potash side and the Jansen mine, it's been on again, off again for a long time. I would just say this, we continue to stay close with that group and, certainly, CP will be a primary part of the transportation provider if in fact that project comes to fruition.

<Q – Konark Gupta>: Right. Thanks for that. And then perhaps lastly before I let you go for your meetings. On your CMQ and land strategies. So, I think Keith had been pretty vocal about CMQ and strategic opportunities there clearly so there's a lot of growth coming in. And then with respect to your land strategy as well, how do you – like where are the new opportunities for utilizing the kind of excess land you have all across Canada? We have seen transload obviously lately, we have seen auto ports, auto compounds, what are the incremental opportunities from here for you guys? Thank you.

<A – John Brooks>: Yeah. So, again, we – in your point in Keith's comments around CMQ, we remain very bullish on those opportunities. Not only the international intermodal that I spoke to. I can tell you last week we just fired up our domestic intermodal product. So, we moved some of our first loads in and out of the Maritimes last week quite successful. Customers are very pleased where – deployed our capital into that property to where we have the service product available. So, whether it be domestic intermodal, automotive, energy chemicals, plastics, forest products, we still see a pretty good tailwind from the CMQ opportunity into the future.

The land piece, Konark, is very exciting because it is the basics and foundation of our playbooks that we laid out as you recall back at our Investor Day and that hasn't changed. I think I said we've got over 1,000 acres of untapped opportunity in our major terminals in these major metropolitan areas that you just can't go out and get.

This give us a unique selling tool that, frankly, the industry and our competitor can't replicate. So, I look at Edmonton as ripe ground, I look at the Chicago market, I look at Eastern Canada as all tremendous opportunities for our land opportunities.

<Q – Konark Gupta>: Right. That's great color, John. Thanks so much. I appreciate the time. Thanks for joining again, and best of luck for the rest of the day.

<A – John Brooks>: All right. Stay safe. Thanks, Konark.